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OVERVIEW OF CREDIT DELIVERY CHANNELS IN NIGERIA

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ABSTRACT

In most developing countries Nigeria inclusive, financial services such as bank loans, insurance, and pension funds are inaccessible by the poor. When credit is available, it is often limited to either community savings groups or informal money-lenders who charge very high interest rates which most of our local entrepreneurs could not afford, and this reflects the lack of a formal market .The mobilisation of savings at local level has been an important element for community development around the world for a long time. At the traditional schemes, individual have been utilising loans through moneylenders, community savings, and the mobilisation of local resources through concerted actions.

This paper attempts to give an overview of the credit delivery channels in Nigeria so that the participants of this seminar would appreciate the diversity and complexity of the channels as well as some basic limitations surrounding the channels. The paper contends that in order to enable the beneficiaries of micro finance schemes to fully appreciate the utility of the facility, the monetary authority (CBN) must continue to appraise the credit delivery channels and formulate policies that would facilitate the delivery of the facilities to the rural communities.

Introduction

The mobilisation of savings at local level has been an important element for community development around the world for a long time. From the traditional setup, individual loans through moneylenders, community savings, and the mobilisation of local resources through concerted actions, communities have been looking for ways to secure funds to cover their daily needs.

The 2005 United Nations International Year of Microcredit was instrumental in informing people and advocating for microfinance. Mainstream banks such as Citigroup, Deutsche Bank, Credit Suisse and ICICI have now found out that the poor, like everyone else, attach great value to being able to save and to protect themselves against unexpected expenses. Historically, microfinance has focused on other sectors, such as trade or small scale producers. However, as questions about financing small-scale business arose, finance has received more attention in recent years within the economy.

Although, the focus of this paper is on the overview of credit delivery channels in Nigeria, it may not be out of point to begin the discussion by raising and answering some questions on microfinance and drawing distinction on vital issues.

To most, microfinance means providing very poor families with very small loans (microcredit) to help them engage in productive activities or grows their tiny businesses. Over time, microfinance has come to include a broader range of services (credit, savings, insurance, etc.) as we have come to realize that the poor and the very poor who lack access to traditional formal financial institutions require a variety of financial products.

Microcredit came to prominence in the 1980s, although early experiments date back 30 years in Bangladesh, Brazil and a few other countries. The important difference of microcredit was that it avoided the pitfalls of an earlier generation of targeted development lending, by insisting on repayment, by charging interest rates that could cover the costs of credit delivery, and by focusing on client groups whose alternative source of credit was the informal sector. Emphasis shifted from rapid disbursement of subsidized loans to prop up targeted sectors towards the building up of local, sustainable institutions to serve the poor. Microcredit has largely been a private (non-profit) sector initiative that avoided becoming overtly political, and as a consequence, has outperformed virtually all other forms of development lending.

Traditionally, microfinance was focused on providing a very standardized credit product. The poor, just like anyone else, need a diverse range of financial instruments to be able to build assets, stabilize consumption and protect themselves against risks. Thus, we see a broadening of the concept of microfinance--our current challenge is to find efficient and reliable ways of providing a richer menu of microfinance products through the most appropriate credit delivery channels that suit the peculiarities of our local communities.

What is the difference between microfinance and micro credit ?

Microfinance refers to loans, savings, insurance, transfer services and other financial products targeted at low-income clients. Microcredit refers to a small loan to a client made by a bank or other institution. Microcredit can be offered, often without collateral, to an individual or through group lending.

Who are the clients of microfinance?

The typical microfinance clients are low-income persons that do not have access to formal financial institutions. Microfinance clients are typically self-employed, often household-based entrepreneurs. In rural areas, they are usually small farmers and others who are engaged in small income-generating activities such as food processing and petty trade. In urban areas, microfinance activities are more diverse and include shopkeepers, service providers, artisans, street vendors, etc. Microfinance clients are poor and vulnerable non-poor who have a relatively stable source of income.

Access to conventional formal financial institutions for many reasons, is directly related to income: the poorer you are the less likely that you have access. On the other hand, the chances are that, the poorer you are, the more expensive or onerous informal financial arrangements. Moreover, informal arrangements may not suitably meet certain financial service needs or may exclude you anyway. Individuals in this excluded and under-served market segment are the clients of microfinance.

As we broaden the notion of the types of services microfinance encompasses, the potential market of microfinance clients also expands. For instance, microcredit might have a far more limited market scope than, say, a more diversified range of financial services which includes various types of savings products, payment and remittance services, and various insurance products. For example, a lot of poor farmers may not really wish to borrow, but rather, would like a safer place to save the proceeds from their harvest as these are consumed over several months by the requirements of daily living.

How does microfinance help the poor?

Experience shows that microfinance can help the poor to increase income, build viable businesses, and reduce their vulnerability to external shocks. It can also be a powerful instrument for self-empowerment by enabling the poor, especially women, to become economic agents of change.

Poverty is multi-dimensional. By providing access to financial services, microfinance plays an important role in the fight against the many aspects of poverty. For instance, income generation from a business helps not only the business activity expand but also contributes to household income and its attendant benefits on food security, children's education, etc. Moreover, for women, who, in many contexts, are secluded from public space, transacting with formal institutions can also build confidence and empowerment.

Recent research has revealed the extent to which individuals around the poverty line are vulnerable to shocks such as illness of a wage earner, weather, theft, or other such events. These shocks produce a huge claim on the limited financial resources of the family unit, and, absent effective financial services, can drive a family so much deeper into poverty that it can take years to recover.

Microfinance increasingly refers to a host of financial services savings, loans, insurance, remittances from abroad, and other products. It is hard to imagine that there would be any family in the world today for which some type of formal financial service couldn't be designed and made useful.

Microcredit is only useful in certain situations, and with certain types of clients. As we are finding out, a great number of poor, and especially extremely poor, clients exclude themselves from microcredit as it is currently designed. Extremely poor people who do not have any stable income such as the very destitute and the homeless should not be microfinance clients, as they will only be pushed further into debt and poverty by loans that they cannot repay. As currently designed, microcredit requires sustained, regular, and often significant payments from poor families. At some level, the very cause of poverty is the lack of a sustained, regular, and significant income. Even though a family may have a significant income for extended periods, it may also face months of no income, thereby reducing its ability to enter into the type of commitment demanded today by most MFIs. Some people are just too poor, or have incomes that are too undependable to enter into today's loan products. These extremely poor people at the bottom percentiles of those living below the poverty line need safety net programs that can help them with basic needs; some of these are working to incorporate plans to help “graduate” recipients to microfinance programs.

Often time's governments and aid agencies wish to use microfinance as a tool to compensate for some other social problem such as flooding, relocation of refugees from civil strife, recent graduates from vocational training, and redundant workers who have been laid off. Since microcredit has been sold as a poverty reduction tool, it is often expected to respond to these situations where whole classes of individuals have been "made poor

Microcredit serves best those who have identified an economic opportunity and who are in a position to capitalize on that opportunity if they are provided with a small amount of ready cash. Thus, those poor who work in stable or growing economies, who have demonstrated an ability to undertake the proposed activities in an entrepreneurial manner, and who have demonstrated a commitment to repay their debts (instead of feeling that the credit represents some form of social re-vindication), are the best candidates for microcredit. The universe of potential clients expands exponentially however, once we take into account the broader concept of "microfinance".

What is the government's role in supporting microfinance?

Governments have a complicated role when it comes to microfinance. Until recently, governments generally felt that it was their responsibility to generate development finance', including credit programs for the disadvantaged. Twenty years of insightful critique of rural credit programs revealed that governments do a very bad job of lending to the poor. Short term political gain is just too tempting for politically controlled lending organizations; they disburse too quickly (and thoughtlessly) and they collect too sporadically (unwillingness to be tough on defaulters). In urban areas, governments never really got into the act, and subsidized micro enterprise credit is still relatively rare when compared to its rural counterpart.

Now that microfinance has become quite popular, governments are tempted to use savings banks, development banks, postal savings banks, and agricultural banks to move microcredit. This is not generally a good idea, unless the government has a clear acceptance of the need to avoid the pitfalls of the past and a clear means to do so. Many governments have set up apex facilities that channel funds from multilateral agencies to MFIs.

Finally, governments can also get involved in microfinance by concerning themselves with the regulatory framework that impinges on the ability of a wide range of financial actors to offer financial services to the very poor.

Credit Delivery Channels

There are a number of new credit delivery channels that banks have used to reach the beneficiaries of their financial services, and most bank managers are busy trying to determine which ones to embrace to be able to reach their customers more easily. If the history of ATMs is a good predictor for the evolution of other banking credit delivery channels, banks will profit from devoting more resources to understanding emerging technologiesand deploying them quickly. Let's review some of the key credit delivery channels banks are using and talking about in Nigeria today:

1. **BRANCHES:** Many customers continue to flockand probably always willto this traditional banking delivery channel. Only a few banks nationwide have rid themselves of bricks and mortar.

2. **ATMS:** ATMs have evolved as the primary delivery channel for cash withdrawals. They are continuously being enhanced with foreign language, touch-screen, advanced transaction, video conferencing, and related capabilities. This channel is likely to continue to be an important one for most banks. However, the common person would find this channel very difficult to use because they are largely concentrated in the cities.

3. **PHONE BANKING:** With low set-up costs for banks, phone banking is another delivery channel that's taken hold recently. Telecommunication companies and call centers now offer sophisticated voice response and video telephone services, which increase functionality for bankers who prefer to contact their banks from home.

4. **KIOSKS:** Video kiosks give customers a direct connection to the most appropriate service agents. Although currently most don't link directly to a customer's records, this functionality is expected in the near future. At that time, banking kiosks will become enhanced ATMs.

5. **PC BANKING THROUGH PERSONAL FINANCIAL SOFTWARE:** Quicken, Microsoft Money, Managing Your Money, and related programs are a familiar delivery channel to many customers. These personal financial software companies offer direct links to many large banks. Some banks reject this delivery channel because they believe customers will transfer their loyalty to the software company, not the bank.

6. **PC BANKING THROUGH PROPRIETARY SOFTWARE:** PC, or dial-up banking, is sometimes offered through a bank's proprietary software system. Such systems are generally considered more secure than "open" systems. Their primary drawback is that they require the bank and/or its technology provider to issue and maintain the software program and its upgrades.

7. **INTERNET BANKING:** Today, talking about Internet banking seems to be the rage. Analysts predict it will grow by roughly 150% annually over the next four years. However, fewer than 75 banks currently offer true Internet banking. Most analysts agree that Internet banking will surpass PC banking within the

next year or twoand that by 2020, there will be twice as many Internet bankers as people using dial-up programs.

8. **COMMERCIAL ONLINE SERVICE BANKING:** Online services such as America Online are becoming an increasingly important delivery channel for some banks. Some computer users prefer commercial online services because they find them easier to use and because they think they're more secure than direct Internet connections.

9. **INTERACTIVE TV:** TV banking is currently being sampled in various test markets. According to Frost and Sullivan, today's $545 million interactive TV market is primarily pay-per-view services. Some analysts believe it will grow to compete with the Internet (both for functionality and market share) with. If interactive TV takes off with added functionality, TV banking is likely to be an important delivery channel.

10. **SMART CARDS / E-CASH:** Although they won't offer all the functionality of the delivery channels outlined above, experts believe smart cards and e-cash will replace cash for certain purchases. Business Communications Co. predicts that the number of smart cards in use will grow from height to height. If this happens, banks will want to be positioned to deliver money through these innovative channels.

When the future is highly uncertain, and the risk of being unprepared for the future is large, smart businesses find ways to prepare for any future they can anticipate. Banks who choose not to be early adopters must position themselves so they can deploy new technologies quickly enough that they won't lose their existing customers. A bank management should not build its company's architecture for today's delivery channel; instead, rather, it should make it flexible enough to incorporate tomorrow's. It should explore all the delivery channels its customers might demand in the futureand build a system that will allow the bank to deploy those channels quickly, effectively, and securely for the mutual benefit.

FACTORS ACTING AS BARRIERS AND LIMITATIONS TO CREDIT DELIVERY

What are the factors, which act as barriers to credit access by small, marginal and tenant entrepreneurs? These have been well documented in literature and it is not my intention to go through them in an exhaustive way but merely to recount some of them. From the borrower's side, the main factors relate to loan sanctions, including frequency of visits to the branch coupled with procedural and documentation complexities.

a) From the bank's side, the transaction costs inherent in servicing small loans to a large number of borrowers and the perceived risk cost in the absence of appropriate risk mitigation measures, continues to act as a barrier.

b) From the institutional side, poor health of the cooperatives which have the penetrative reach and which could cater effectively to small and marginal farmers has been a inhibiting factor.

c) At the bank level, particularly amongst branch managers located in some rural areas and resource poor areas, inappropriate attitudinal orientation has been reported. This has hindered access and we need to find ways and means around it.

There are, however, challenges that we're grappling with in the roll out of co-operatives.

d) Training and skills development is inadequate in areas. There is a need for the training of people to manage co-operatives and the acquiring of skills necessary to provide the services that their businesses offer.

e) The management of interpersonal relationships is an issue that must be addressed because it has been the cause of co-operatives collapsing because of the dynamics between individuals. Poor administration skills must also be attended to because we want to invest very significantly in training programmes to sustain the co-operative movement.

f) Again the challenge is the ability to provide sound business plans. On the other hand, financial institutions have not quite bought into the support of co-operatives, as we would like them to. Thus it becomes very important for financial institutions to support this sector in business. If we want to meet the objectives of achieving broad-based black economic empowerment (BBBEE), creating jobs and growing the economy, then things have to change.

g) On the other hand, the outstanding loans of the cooperatives have grown at much faster rate as compared to their loan advances during both pre- and post economic reform periods. The slower growth in institutional finance through credit cooperatives during the decade of 1999-2007 is mainly due to adverse environment created by the financial sector reforms. Due to unfavourable policy framework, much of the deposits of the credit cooperatives are going into investments, instead of advancing loans to the farming sector. As a result, the C-D ratios of these credit cooperatives have been adversely affected.

h) In fact, as far as the rural credit delivery system is concerned, the focus should be on strategies that are required for tackling issues such as sustainability and viability, operational efficiency, recovery performance, small farmer coverage and balanced sectoral development

INNOVATIONS IN CREDIT DELIVERY CHANNELS

(a) MFIs

Let us now turn our attention to some of the innovations with regard to delivery channels. Of these, MFIs are one. MFIs have emerged as an important innovative channel for lending to the poor. Basically, MFIs are an extremely heterogeneous group, divisible into two broad categories. The MFI channel has potential, provided it can overcome certain limitations regarding rate of interest, high transaction cost, paucity of owned funds and improvement in its governance structures.

(b) Financial deepening through Post Offices

Another channel, which is being tested in India on a pilot basis, involves Post Offices. As you are aware with large network of post office outlets in the country with relatively good accounting systems and cash transfer facilities, the system would work better in the country.

(c) Farmers' Clubs

In the line of innovations, Farmers' Club are important. The club represents a grass root organization built through peoples' participation and aimed at disseminating farmer related information, facilitating the adoption of financial products of the banking system by farmers. The linkage between the rural branches of banks and Farmer Clubs and their beneficial impact is now being increasingly recognized and adopted by commercial banks on a larger scale.

(d) Village Development Boards (VDBs)

A corpus fund account could be opened whereby loans are extended to the VDB. All the VDBs are expected to open their Corpus Fund Account so that they are financed by major banks. This can enable them to also finance their members who are largely small-scale entrepreneurs. The innovation is still in its early stage and its performance is being tracked. We can borrow a leaf from India on this issue.

Cost of credit delivery

The cost of credit varies from loan to loan. The cost of mortgages works out cheaper than that of consumer loans. Once the cost of credit delivery -- including the transaction cost, terms and conditions of credit, risk premium, return on capital -- are outlined, credit based on the PLR cannot vary much from bank to bank.

Industry experts feel that while a broad guideline will be outlined by the RBI covering all different loan segments, deciding the spreads over the PLR will be left to the discretion of the respective banks within a broad band suggested by the regulator.

With the wide array of electronic delivery channels available, customer service has not been compromised as banks move towards a five-day work week early this year. Banking today has changed dramatically with sophisticated technologies impacting every aspects of banking in unprecedented ways. Speed, reliability and availability of multiple delivery channels have become important prerequisites for banks to remain relevant. Recognising this, banks in Malaysia for instance, have been investing substantially in innovative electronic delivery channels to improve consumers' accessibility to banking products and services. Switching to electronic channels, in particular internet banking, to perform banking transactions will further empower consumers as they now have greater ability to control their own transactions. When banks move to a 5-day work week, banking hours on weekdays were extended. Certain banks operated their branches beyond the recommended banking hours to meet the increasing needs of their customers, this increases the delivery cost.

The way forward

Having analysed and reviewed important issues upon which the microfinance and the credit delivery channels revolve, we can now conclude by presenting some body of suggestions which we believe would enhance improvement in credit delivery channels:

a) From charity to business

An increasing number of new microfinance institutions are not charities or NGOs created to serve the poor, but existing institutions seeking new clients amongst the low-income populations, previously seen as un-bankable and not creditworthy. The microfinance sector can become more diverse, with the entrance of several private commercial banks, finance companies, insurance companies, and many NGOs that have become regulated MFIs.

Other necessary changes include modifications to the banking regulations to better fit the needs of microfinance, such as replacing collateral requirements by a need to demonstrate client creditworthiness, and by simplifying reporting requirements.

b) Increased competition

The increasing number of MFIs and other institutions providing microfinance is stimulating competition and leading to innovation, which increases the number of clients. While some MFIs complain that their best clients are now moving to formal banks that also provide microfinance,

c) Diversification

In areas where group loans have been maximised, there is a growing trend towards individual loans to allow for more and faster borrowing. Instead of group peer pressure, a client's creditworthiness is built up over time, with lenders progressively loaning larger amounts over longer periods. Expanding lending to include savings schemes and micro-insurance allows smaller MFIs to take deposits, build capitalisation, and lower costs, as well increasing the potential to access more finance from larger institutions interested in microfinance

D) Strategic partnerships to develop scalable solutions

Given increasing competition and a need to build new markets and expand a client base, some MFIs have sought strategic alliances with NGOs and other financial intermediaries. These offer complementary skills to reach new markets and their support can result in lower running costs for the MFIs.

e) Consistent Regulatory and Supervision

The Central Bank of Nigeria must continue to provide consistent regulatory environment for licensing and supervision of Intermediaries involved in rural finance and build adequate capacity for off- and on-site Supervision.

f) Open and Liberal Financial Markets

Create open and liberal financial markets (open access and exit, no price regulations), where by journalist would have access to all information on credit delivery for the purpose of dissemination to the various information to prospective beneficiary.

g) Transparency and Clarity

The Central Bank of Nigeria should ensure consistency, transparency and clarity of respective legal and regulatory framework.

h) Fixed and Movable Collateral

Government should facilitate use of fixed and movable collateral by beneficiaries.

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REDUCING POVERTY THROUGH BETTER CREDIT DELIVERY: THE ASIAN EXPERIENCE

BY

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1. Introduction

Over 500 million of the world's populations live under very poor conditions but they are economically active. They lack access to basic necessities of life: food, shelter and primary health care. They earn their livelihoods by being self employed as micro entrepreneurs or by working in micro enterprises (very small businesses which may employ up to 5 people). These micro entrepreneurs make a wide range of goods in small workshops; engage in small trading and retail activities; make pots, pans and furniture, or sell fruits and vegetables. Yet, these poor households often fail to secure the capital they need and miss the opportunities for growth because they do not have access to financial resources loans or safe places to hold savings.

More than 80 per cent of all households in developing countries do not have access to institutional banking services. This is because they do not have collateral to secure loans from formal financial institutions. Besides, the technical backstopping needed for creativity and enhanced productivity is absent. Since there are a few financial institutions to serve them, these poor enterprises and households rely largely on informal sources such as family, friends, suppliers or moneylenders for their financial needs.

1.1 Microfinance and Access to Financial services

The world of microfinance has dramatically changed over the past decade from a subsidy oriented focus to a focus on sustainability; from a project approach to a focus on building sustainable microfinance institutions; from a perception of poor people as beneficiaries to treatment of people as partners; from providing credit only to providing a range of financial services. In addition, Microfinance institutions are expanding their client base from subsistence enterprises only, to a broader clientele and small businesses. Nowadays, there is a growing consensus that "in order to achieve its full potential of reaching a large number of the poor, microfinance should become an integral part of the financial sector. Microfinance has emerged as a growing industry to provide financial services to very poor people.

Access to financial services enables the poor to increase their household incomes, build assets and reduce their vulnerability to crises that they face in their daily lives. Financial services can put power into the hands of poor households, allowing them to progress from hand-to-mouth survival to planning the future, acquiring physical and financial assets and investing in sustainable livelihood initiatives. When such resources are effectively utilized, they lead to expansion of business activities, enhanced productivity and employment of additional labor as a result of business expansion.

Access to financial services also translates into better nutrition, improved health and long-term plans for their future and those of their children. One of the most important roles of access to credit is that it enables the poor to diversify their incomes. Most poor households do not have one source of income or livelihood. Instead, they pursue a mix of activities depending on the season, prices, their health and other contingencies. All these are critical factors with strong impact on the attainment of the Millennium Development Goals (MDGs).

Financial services can play a critical role in reducing poverty. The ability of the poor to borrow a small amount of money to take advantage of a business opportunity not only impacts positively on the eradication of poverty but also tends to swell the ranks of micro-entrepreneurs. In Nigeria, micro-enterprises constitute a very substantial segment of the industrial structure. Providing access to flexible, convenient and affordable financial services to micro-enterprises therefore remain one of the most viable policy options for job creation and poverty reduction for the country. Moreso, micro-enterprises are a subset of the small and medium enterprise sector which the National Economic Empowerment and Development Strategy (NEEDS) recognizes as one of the key activities that will drive growth in the private sector.

In Asia, the microfinance revolution has changed attitudes towards helping the poor in many countries and in some has provided substantial flows of credit, often to very low-income groups or households who would normally be excluded by conventional financial institutions

2.0. The challenge

In September 2005 the World Summit, the 60th high-level plenary meeting of the United Nations General Assembly gathered 151 Heads of State from all over the world at the UN Headquarters. The Summit was the first opportunity for the world leaders to review progress in reaching the targets of the Millennium Development Goals, whose primary aim is to eradicate extreme poverty by the year 2015. Microfinance was prominent on the agenda of this historic gathering. The most significant recognition of its importance was made in the 2005 World Summit Outcome Document adopted by the gathering, which states: "We recognize the need for access to financial services, in particular for the poor, including microfinance and micro credit". Beyond the outcome document, Heads of State from Africa, Asia, Latin America and Europe called specific attention to the critical need for access to financial services in their statements to the Assembly.

Some of the findings of the recent research undertaken by CGAP, the global resource center for microfinance, supported by a syndicate of 30 multilateral, bilateral and private donors indicate that following the high level of commitment expressed by the meeting and the various strategies adopted by focal national institutions, people have become increasingly aware of the potentials of microfinance all over the world. There is a vast potential market for retail financial services among low-income clients and a growing number of commercial banks have successfully entered this market by down-scaling their operations. New policy frameworks have been developed by several countries to provide the strategic growth paths that are critical for the growth of microfinance intermediation.

However, as Kofi Annan (the former UN Secretary General) states: "the stark reality is that most poor people in the world still lack access to sustainable financial services, whether savings, credit or insurance. The great challenge before us is to address the constraints that exclude people from full participation in the financial sector. Together, we can and must build inclusive financial sectors that help people improve their lives". This challenge confronts us with the question why so many bankable people are still not banked.

3.0 Key Principles of Microfinance

The questions raised by the growing demand and the insufficiency in the administration of credit to the unbanked population was a key item in the agenda of the Group of Eight leaders of industrialized nations, (including USA, Britain and Germany) in their meeting of 10th June 2004. Among others, the meeting considered and ratified the key principles of Microfinance that was developed and endorsed by CGAP. The adherence to these principles has helped successful institutions to promote access to financial services and enhance institutional practices for efficient microfinance delivery. They include:

- Microfinance is a specialized field that combines banking with social goals. This requires that the capacity of microfinance operators needs to be built at all levels. Most investments in the sector both public and private should focus on this capacity building initiative.

- National governments play an important role in setting a supportive policy environment that stimulates the development of financial services while protecting poor people's savings. The key things that a government can do for microfinance include, to maintain macroeconomic stability, avoid interest-rate caps and refrain from distorting the market with unsustainable subsidized, high delinquency loan programme. Governments can also support financial services for the poor by improving the business environment for entrepreneurs, clamping down on corruption and improving access to markets and infrastructure.

- An overwhelming number of people in developing nations lack access to basic financial services. This is due mostly to lack of strong retail financial intermediaries. Just like everyone else, poor people need a wide range of financial services that are convenient, flexible and reasonably priced.

- Access to sustainable financial services enables the poor to increase incomes, build assets and reduce their vulnerability to external shocks. Microfinance allows poor household to move from everyday survival to planning for the future, investing in better nutrition, improved living conditions, and children's health and education. In order to achieve its full potential of reaching a large number of the poor, microfinance should therefore, become an integral part of the financial sector.

- Building financial systems for the poor, means building strong domestic financial intermediaries that can provide financial services to the poor on a permanent basis. Such institutions should be able to mobilize and recycle domestic savings, extend credit and provide a range of services.

- Achieving financial sustainability means reducing transaction costs, offering better products and services that meet client needs and finding new ways to reach the unbanked poor. Donors should use appropriate grant loan and equity instruments on a temporary basis to build the institutional capacity of financial providers. Donor funding must seek to integrate financial services for the poor into local financial markets.

- It costs much more to make many small loans than a few large loans. Unless micro lenders can charge interest rates that are well above average bank loan rates, they cannot cover their costs. Their growth and sustainability will be limited by the scarce and uncertain supply of subsidized funding. When governments regulate interest rates, they usually set them at levels too low to permit sustainable micro credit administration

4.0 Some features of Microfinance in Asia

Asia is the most developed continent of the world in terms of volume of MFI activities. This conclusion is based on an analysis of over 1500 institutions from 85 developing countries. Comparing MFIs in Asia with those in Africa and Latin America in the 1990's, it was noted that Asia accounted for the majority of MFIs, retained the highest volume of savings and credit, and served more members than any other continent. This generalization of course covers up the wide disparities within the region. For example, East Asia is particularly well served by MFIs. The largest number of members served and the largest distribution of loans and mobilization of savings in terms of GNP is found in Bangladesh, Indonesia, Thailand and Vietnam. In contrast, the two most populated countries in Asia, India and the PRC have very low outreach despite a high concentration of the regions poor. Countries such as Afghanistan, Myanmar and Pakistan also have a low outreach due to a variety of factors.

Despite these disparities within the region, it is noted that overall, MFIs have flourished in Asia and that compared to other regions, they exhibit good outreach and high repayment rates. The table below shows the most recent data from the Micro Banking Bulletin which gives only data on the limited number of MFIs who choose to report to the Bulletin and they represent the best performance. Asian MFIs demonstrate relatively good outreach. They account for the largest number of borrowers (70 per cent of which are women) and are second only to African MFIs in terms of number of voluntary savers. In terms of impact, size of loans and deposits are often taken as simple indicators of impact on the poor. By these criteria, Asian MFIs have one of the lowest Loan and Savings Balance per Borrower, even after adjusting for GNP per capita, suggesting that they are effectively reaching the poor.

Table 1:
Outreach Indicators by Region

	Number of Active Borrowers	Average Loan Balance per Borrower (US$)	Number of Voluntary Savers	Average Saving Balance per Saver (US$)
Africa	21,974	228	27,082	105
Asia	32,915	195	18,374	39
Eastern Europe/Central Asia	6,040	590	0	N/a
Latin America	13,755	581	2,422	741
Middle East/North Africa	13,463	286	0	N/a

Source: Microbanking Bulletin Issue Number 9, July 2003.

5.0 The Asian Microfinance Industry

The modern Microfinance industry which originated from the small-scale experimental efforts in the 1970's to provide collateral-free loans to the poor people has grown significantly over the last three decades. According to the data collected by the Micro credit Summit Campaign, by the end of December 2005, globally, 3,133 micro credit institutions had 113.26 million clients with current loans. Of these institutions, 1652 were in the Asian and pacific region. The region's institutions reached about 97 million clients with a current loan and some 64 million of these clients have been classified as poorest women. These data refer only to microcredit clients. Data available from other sources indicate that many poor people have been able to use deposit facilities that microfinance institutions (MFIs) and variety of other financial institutions offer. For example, in addition to MFIs involved in financial intermediation, savings banks, post offices, cooperatives and commercial banks in many developing countries have opened their deposit facilities to an increasing number of poor people during the last two decades.

The Government Savings Bank of Thailand and the National Savings Bank of Sri Lanka provide deposit facilities to many poor and low income house holds. Pakistan's Post Office has 12, 343 field offices making over 4 million savings accounts and 70 per cent of these accounts hold savings below Rs 10,000 (about $165). In some countries, even non-governmental organizations (NGOs) are offering deposit services.

5.1 The Changing Concept of Microfinance in Asia

At the early stages of the Microfinance industry, it was noted by CGAP that the concept of Microfinance was easily understood as a credit methodology that employs effective collateral substitute to deliver and recover short term, working capital loans to micro entrepreneurs or potential entrepreneurs. This narrow definition has undergone a transformation over the years. Today, it encompasses a broad spectrum of financial services that include not only microcredit but also savings, insurance, payment services, and money transfer.

In recent years, the target groups on microfinance have expanded to include low income men, women, youths, children, and the poorest of the poor. The inclusion of the poorest of the poor in the target group seems to have been influenced by the work of the advocacy groups such as the Microcredit Summit Campaign and the encouraging results shown by pioneering MFIs such as the Grameen Bank, BRAC, and ASA in Bangladesh. These perspectives have essentially broadened the potential market for the service providers.

Microfinance was perceived as a separate segment of the broader financial system. However, an increasing number of promoters, practitioners, academics, and policy makers tend to believe that if Microfinance were to achieve its full potential, it must be integrated into the broader financial system. In recognition that no real or imaginary walls should exist between microfinance and the broader financial system compels industry players to consider microfinance as the lower end of the broader financial system rather than an isolated marginal sector that used to be served only by narrowly focused niche market MFIs.

5.2 Institutional Growth and expansion

The dramatic growth reported by a number of flagship MFIs in the region provides evidence of the dynamism in the microfinance industry. The Association of Social Advancement in Bangladesh, better known in its acronym ASA, had over 5.5 million active borrowers at the end of August 2007, as against 1.1 million at the end of 1999. ASA also had about $54.3 million outstanding deposits in 1.4 million accounts it had at the end of 1999. Building Resources across Communities (BRAC), also in Bangladesh had 4.55 million active borrowers at the end of 2006 as against 2.6 million it had at the end of 1999. In India, because of their rapid growth during the last decade, self help groups now provide credit to over 11 million poor women. Niche-market MFIs such as Spandana, Share Microfin Ltd and SKS microfinance have also scaled up their micro-credit outreach dramatically in recent years.

The number of active borrowers of Spandana has increased from a mere 1,695 at the end of March 2000 to 972,212 at the end of March 2007. The gross loan portfolios increased from $104,648 to about $89.8 million equivalent in the same period. In Indonesia, unit desa of the Bank Rakyat Indonesia (BRI) now reach more than 15 million poor and low-income households with deposit services. BRI units had 30.9 million savings accounts and 3.46 million active borrowers at the end of 2006. It is important to examine the various perspectives in this growth and the mitigating factors in Asia

5.3 THE INSTITUTIONAL LANDSCAPE

With the wide acceptance of the new perspectives of microfinance, the institutional composition of the industry, scope of services, and target market segments have changed. About two decades ago, the institutional landscape of microfinance in most countries was relatively barren with little or no involvement of former financial institutions except in Bangladesh and Indonesia. Grameen Bank was a major source of formal microcredit in Bangladesh while BRI unit deserts were a major source of both formal microcredit and deposit services in Indonesia. In addition a state owned pawning company, Perum Pegadaian, also played a major role in serving the poor with microcredit in Indonesia.

In Sri-Lanka, cooperative rural banks were an important source of credit for many low income households; they were also providing deposit services to many villagers. In countries such as Cambodia, Nepal, and Philippine, NGOs were the major service providers. Many promoters and practitioners believed that only institutions with a social mission can provide financial services to the poor. The commercial banks, particularly those in the private sector, shunned serving the poor and low income households in virtually all countries. In countries such as India, Pakistan and many others, formal sources of finance for the poor were rare. In the Lao Peoples Democratic Republic, hardly any formal public or private institutions providing financial services to low income people existed. In most countries, even public sector financial institutions with a social mandate to serve the poor and the low income households seldom served their target claims. Credit provided by these institutions in particular flowed to the non-poor.

The Microfinance institutional landscape in most countries in Asia is today more fertile and diverse. The diversity has resulted from a number of very interesting developments in the industry. These developments have increased the potential access of the poor to financial resources including micro credit. The increase in funding sources is gradually impacting on the level of interest rates administered by the institutions. The market is becoming more competitive.

- **Transformation of NGO**

  A number of NGOs have transformed themselves into regulated financial institutions. ACLEDA Bank in Cambodia is a case in point. More than 14 other NGOs in Cambodia have become licensed regulated financial institutions. Mongolia's Xac Bank and Nepal's Nirdham Bank, India's share Microfin Ltd, Spandana and SKS Microfinance, and the

Philippines Opportunity Microfinance Banks are some examples of regulated MFIs established through the transformation of NGOs.

- **Increase in Microfinance Banks**

The entry of new Microfinance banks into the industry has made the landscape diverse. In Pakistan, six national level microfinance banks have entered into the industry since 2000. In the Philippines, the diversity has increased partially because of the increased role of rural banks and cooperatives in microfinance. According to the Bangko Sentral ng Pilipinas (Central Bank of Philippines), a total of 550 branches of 223 thrift, rural, and cooperative rural banks are significantly involved in microfinance in addition to about 4000 savings and credit cooperatives and over 200 NGOs, in 2005, two pioneer Microfinance NGOs established Microfinance thrift banksDungganon Bank by the Negroes Women for Tomorrows Foundation and Kauswagan by TSKI.

- **Whole scale Commercial Banks**

A number of commercial banks are providing wholesale financing facilities to smaller microfinance rural banks and other MFIs. This has led to a tremendous increase in the retail outlets for credit funds to the poor communities. The traditional fear of incurring unsustainable administrative costs by the commercial Banks was removed through this development.

- **The Cooperatives**

Institutional diversity has been enhanced by the increased role of Cooperatives. The Cooperatives are playing a significant role in countries such as Philippines, Sri-Lanka and Vietnam. According to the Asian Confederation of Credit Unions, cooperatives in the region reach over 3 million poor claims, in addition to the non-poor.

- **Down Scaling Private Sector Commercial Banks**

The entry of conventional private sector commercial banks into the microfinance market is further enhancing institutional diversity. In a number of countries, domestic private sector commercial banks have begun to penetrate the market by down scaling their services. India appears to be at the forefront of this development. The ICICI Bank, the second largest commercial bank in India is expanding its financial services to poor household through multi-pronged approach directly providing credit facilities to self help groups, and providing wholesale credit facilities to microfinance NGOs and non-bank finance companies to fund their lending operations to the poor. ICICI claims that it now serves over 2 million poor claims. In addition many other private and state owned commercial banks such as the Syndicate Bank, Yes Bank, Canara Bank and Indian Bank have entered this market.

- **Non Financial Institutions**

Another source of institutional diversity is the entry of non financial companies. Telecommunication companies in a number of countries have entered the market in various ways. Globe telecom and Smart telecom in the Philippines have been offering cell phone based money transfer and payment services. Successful cell phone based microfinance programmes are found in India as well.

The entry of telecommunication firms into microfinance has also brought other non-financial institutions like gas stations, pharmacies, grocery stores and fast food outlets into the microfinance institutional landscape as agents or sales outlets. In the Philippines, Globe telecomm is also working with a number of rural banks to facilitate loan disbursement and recovery through cell phones. Other countries such as Pakistan and Sri-Lanka have begun the same process.

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5.4 THE NEW MICROFINANCE MODELS

- **The change in credit focus**

Although cross country experience varies substantially, the credit focused, single dimension characteristic of the microfinance industry has changed significantly in recent years. With the maturity of the pioneering institutions and institutional diversity in the market operations, the credit products and services that the industry offers have become much broader and more demand driven. This change is best reflected in the operation of the Grameen Bank.

In August 2002, Grameen Bank discarded its twenty year old model of micro credit based on the groups' liability system. This was a very strategic shift in operational model because group liability system was the hallmark of Grameen Bank. Since dropping that system, each member's loan is secured against his/her ward. The new approach offer flexible loan arrangement for terms of three months to three years and the variable repayment schedule to avoid seasonal difficulties.

Many other MFIs in Bangladesh and other countries now offer loans with different maturities and repayment schedules. MFIs also provide credit for a wide range of purposes including consumption smoothing, housing, emergencies, health, education and meeting expenses related to many life cycle events

- **Expansion in the scope of services**

Beyond the focus on credit, many MFIs and other financial institutions serving the poor now pay more attention than before to deposit services. In the 1980s, the addition to state owned savings bank and post office, only BRI unit's deserts in Indonesia and cooperatives emphasized deposit services for the poor. Most practitioners and policy makers shared the view that the poor have neither the willingness nor the capacity to save in financial assets. Three empirical evidences challenges this view. While BRI units continue their impressive work on deposit mobilization, the industry currently includes a number of other institutions providing deposit services on a large scale.

- **The Grameen Model**

The transformation of Grameen Bank into a true financial intermediary is undoubtedly the most remarkable change in the regions Microfinance industry in recent years. The Grameen Bank now offers a savings facility that enables members to deposit and withdraw at will. In addition, the bank has introduced a contractual savings account called the Grameen Pensions Scheme with five or ten year terms for members. These deposit services have become remarkably popular among low income households and the bank has been able to mobilize a vast amount of resources within a short period. Behind these sources are large pent-up demands for reliable deposit services, the banks vast network of branches and trustworthiness. At the end of September 2007, the outstanding deposits amounted to about $697million, consisting of $401million of members deposits and $296million non-members deposit. The ratio of outstanding deposits to loans outstanding was 139 per cent. The Grameen Bank has thus become a financial institution providing deposits to millions of poor households, in addition to credible credit facilities.

- **ASA and Other Models**

ASA in Bangladesh has also increased its depositor outreach in 2006. At the end of 2006, ASA had over 6.4million savings accounts in its books compared to some 4.1 at the end of 2005. A number of other MFIs in Bangladesh have also increased their deposit services in recent years. A case in point is the Themgamara Mohima Sabuj Sangha (TMSS). The MFI began to offer deposit services only in 2005, but had 570,000 savings accounts at the end of June 2007, with a total outstanding deposit amount of $3,3million.

Other MFI with impressive records in deposit mobilization include Khan Bank and Xac Bank in Mongolia, First Microfinance bank in Pakistan and ACLEDA Bank in Cambodia. The number of depositor at ACLEDA Bank increased from 19,070 to 92, 413 between the end of 2002 and 2005. At the end of 2006 it had 141,368 depositors. The total deposit volume at ACLEDA Bank increased from $5.7million at the end of 2002 to $61.9million at the end of 2005 to $121.1million at the end of 2006.

The microfinance-oriented rural banks in the Philippines have also substantially increased their deposit services to low income households in recent years. In most cases, the menu of deposit products has also become increasingly diversified because of the demand driven approaches of these institutions. While the bulk of the deposit amounts in most cases come from the non-poor, most of the accounts are held by the poor. In effect, these institutions are effectively intermediating local capital to serve a broad range of claims including the poor.

- **Money Transfer Services**

Some MFIs also provide payment and money transfer services to poor households. The First Microfinance Bank in Pakistan began to provide domestic money transfer services a few years ago and has been able to expand this operation substantially in recent years.

ACLEDA Bank has dramatically increased the number and volume of domestic money transfers. In 2001, the domestic money transferred amounted to only $7.0million in 886 transactions, in 2005, the amount increased to $286.7million dollars in 98,171 transactions. Adhikar, a small NGO/MFI based in the Indian state of Orissa, provides money transfer services to migrant workers in competition with post office.

- **Micro Insurance services**

An increasing number of institutions are also providing micro insurance services on their own or as agents of established mainstream insurance companies. Early this year, Opportunity International Company established a micro insurance company in the Philippines. While Center for Agriculture and Rural Development (CARD) mutual benefit association in the Philippines began its micro insurance operations a few years ago and has been expanding its client base in this significantly induced largely unserved market.

Micro insurance services have begun to expand in Bangladesh, Cambodia, India, and Sri-Lanka as well. And the mainstream insurance companies have begun to penetrate this market. The entry of mainstream micro insurance companies into the micro insurance market is a change with far reaching implications for access to sustainable micro insurance services for the poor.

- **Competition in the Microfinance Market**

The competition and improvements in efficiency in microfinance markets in Bangladesh, Cambodia, southern states of India and Mongolia have already brought benefits to the to the clients in terms of more flexible and higher quality services, better products and lower prices. In Cambodia, ACLEDA bank and AMRET reduced their interest rates on loans several times during the last 4 years. A number of major MFIs in India have also reduced their interest rates partly because of competition and scale economies.

According to Sanjay Sinha, the founder and Chief Executive of Micro-credit Ratings International, the effective interest rates paid by microcredit\clients in India have declined to among the lowest in the world. In Bangladesh, ASA and BRAC reduced their flat interest rate from 15 per cent per year to 12.5 per cent per year in January 2007. ASA also reduced the compulsory deposit required to borrow from 10 per cent to 5 per cent of the loan amount. These reductions in effective prices resulting from the increasing maturity of the industry have benefited millions of poor people in the region.

- **Diversification in Source of Funds**

The microfinance industry has also significantly diversified its sources of funds. The structure of liabilities of many MFIs has changed. The amount of commercial and semi commercial funds into the microfinance industry has increased significantly during the last decade, particularly during the last 5years. Many microfinance investment vehicles (MIVs) have emerged in recent years. A CGAP survey counted 74 MIVs at the end of 2006. Equity investments in MFIs have increased with the increased importance of regulated institutions. A significant part of the equity has come from foreign sources, including foreign social investors. Private equity funds are also increasing their microfinance equity investments. Structured finance has also made its inroads into the industry.

With these developments, the industry's dependency on donor grants and concessional funding appears to have declined in recent years, although cross-country experience on this seems to differ significantly. The increased deposit mobilization from the public, emergence of commercial and semi commercial microfinance investment funds and lenders, wholesale credit facilities from established commercial banks, and increased retained earnings of MFIs have contributed to this trend.

Domestic private sector commercial banks have also been increasing their finance for microfinance. Such financing from domestic banks has reached quite significant levels in India. In the Philippines, rural banks finance their loan portfolio from commercial debt and public deposits. In a number of other countries in the region, debt financing by commercial banks are increasing rapidly. According to a recent study, the volume of international private lending for the global microfinance industry has exploded in the last 3years. In 2005 alone, outstanding loans doubled to nearly $1billion. BRAC in Bangladesh, for example, completed a large securitization deal with a consortium of commercial banks and other financial institutions in 2006 to fund its operations. Multilateral and other public sector international financial institutions have also increased their funding for microfinance substantially in the last five years. A 2006 survey by the CGAP found 19 development finance institutions with a combined portfolio of about $2.5 billion in microfinance.

- **Entry of philanthropic support organizations**

The entry of high profile philanthropic institutions to support microfinance development in Asia was a remarkable boost to the national agenda. Such institutions include the Bill and Melinda Gates Foundation, Michael and Susan Dell Foundation, eBay Foundation and google.org. These big players greatly enhanced the scaling up of the services on a sustainable basis than many smaller private foundations that were previously providing support.

- **Microfinance Support Service Organizations**

Compared to two decades ago, a wide range of support service organizations for microfinance have emerged. These include both domestic and foreign institutions. Some of these are driven by social objectives to help developing country institutions expand their financial services to the poor and excluded socioeconomic groups. However, some others operate for profit. Such organizations include microfinance rating agencies and consulting firms, technical assistance providers and training centers. Many flagship

MFIs in Asia have achieved their remarkable growth little assistance from these organizations.

- **The Macro policy Environment**

In general, the macro level policy environment has been very supportive in most countries in Asia, although cross-country differences exist. Among the large countries, the governments of India and Pakistan have made effort to change the macro policy environment for the improvement of the market in various ways. In both, banks have been encouraged to offer no frill basic banking accounts to bring the unbanked to the banks. Both have facilitated partnerships between the banks and non-banking institutions to expand the outreach of different financial services for the low income people.

The government of India has made micro insurance mandatory for mainstream insurance companies, catalyzing the market and triggering supply-led initiatives. In both countries, efforts are underway to promote pro-poor banking technology such as biometric Automated Teller Machines (ATMs). While these developments may seem minor, such measures are likely to significantly impact on the market in the medium to long term.

The government of the People's Republic of China (PRC), following its traditional approach to development issues, has begun to gradually liberalize the microfinance market and create legal space for institutional diversity. Also, the government has allowed for limited foreign private and social investments in microfinance. As a result, in November this year, the first wholly foreign invested microcredit company was established in Nanchang City in southwestern Sichuan Province. Many foreign investors including Grameen Trust, Accion International and Catalysts Microfinance Investors are keen to enter the microfinance market in the PRC to establish robust MFIs. With this perspective, it is clear that the more liberal policy environments will most likely catalyze one of the largest undeserved and unserved microfinance markets in the region and also globally, significantly, reinforcing the dramatic structural changes in the regions microfinance industry that the developments in the Indian market have begun to unleash.

CONCLUSION

Modern microfinance in Asia has evolved over the last three decades to become an industry of relatively significant scale. The evolution began with the initial experimental efforts and programs in the 1970s, focused primarily on providing short term microcredit to narrowly defined target groups consisting largely of poor women.

In Asia, the Micro finance revolution has changed attitudes towards helping the poor in many countries and in some has provided substantial flows of credit, often to very low-income groups or households who would normally be excluded by conventional financial institutions.

From being a niche market operation undertaken by socially oriented, noncommercial institutions, Asia is increasingly becoming a more commercial financial service market with flagship MFIs leading the revolution to better access to new products and financial services including money transfer services and the installation of ATMs. This has made Asia the most advanced continent in Microfinance administration.

A small core group of highly commercial and professional market oriented institutions have emerged. They have broken away from their peers and moved forward to consolidate their position as robust institutions. In most cases, the institutions in this core group report much better profitability in terms of ROAs and ROEs than the conventional financial institutions. And they account for much of the total outreach. They are the market leaders and the trend setters.

The region's microfinance industry may be better described as one in transition. While the achievements to date are very encouraging, the current state of affairs in the microfinance market presents both challenges and opportunities for the interested in sustainable development of financial services for the poor and low-income people and for their small and microenterprises.

The industry barely scratches the surface of its huge potential market. This is particularly true for large countries such as India, Pakistan, and the PRC. A more commercial industry must be built to reduce this wide demand-supply gap for sustainable financial services for the poor through innovative approaches.

The governments are partnering with the private sector in an effort to create an enabling environment for the promotion of sustainable microfinance industry and building strong retail capacity within a competitive framework. It is important that the development community should also cooperate and closely work together with a firm commitment to build inclusive financial systems that will accelerate the progress made in poverty reduction initiatives.

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THE ROLE OF MICROFINANCE INSTITUTIONS IN THE ECONOMIC DEVELOPMENT OF NIGERIA

By
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INTRODUCTION

In the past two decades creating access to financial services for owners of micro and small businesses has become a thriving industry. The fabricators on the streets of Nairobi; street traders of Lagos and farmers in Ethiopia and food vendors in Las Paz are increasingly turning to microfinance institutions for financial services of various types and sizes. In response to these demands, institutions have emerged and developed across developing countries.

Lending to micro-enterprises is no longer just a nice thing to but is equally profitable. For good and for bad, microfinance has left the domain of charity. Microfinance has been acknowledged as an important instrument for meaningful development. Strategy for delivering financial services to the poor has become a feature of major development policies and initiatives of international development agencies. National and regional governments incorporate financial intermediation that benefits the poor into their development agenda. Regulatory agencies in most countries have formulated policies, regulatory and supervisory guidelines for microfinance practice ostensibly to expand access to financial services to the poor or owners of microenterprises.[2] Agencies and institutions, which provide support services to the emerging industry, have also emerged. As commercial funds gradually replace grants, investment companies and banks are springing up to provide portfolio refinancing debt and equity funds to microfinance institutions and banks.

Microfinance is usually conceived of as the provision of small units of financial services to low-income clients who are usually excluded from mainstream financial systems. It is a form of financial intermediation, which primarily focuses on alleviating poverty through provision of financial services to the poor or owners of microenterprises. Service users include artisans, smallholder farmers, food processors, petty traders and other persons who operate micro-enterprises.

In practice, microfinance means more than delivery of small units of financial services. It goes beyond disbursement and collection of loans. It also refers to the flexible structures and processes by which affordable financial services are delivered to the owners of micro-enterprises on a sustainable basis. At the onset of what is now termed *microfinance revolution,*[3] credit was the dominant financial service. Working capital loan was in most cases the only product delivered to clients. This explains the appellation microcredit. Over the years the scope of financial services has been expanded to include savings, consumer's loans, micro-leasing, micro-insurance, money transfers and micro-investment services.

It is important to make some clarifications about microfinance practice. First, despite its poverty alleviation appellation, microfinance is not charity. It is simply the provision opportunity for poor persons to access financial services on affordable terms. Second, microfinance in spite of the current emphasis is not a new creation especially for us in Africa. We have always had our esusu and adashi in communities across Nigeria.

Modern microfinance practice has moved towards commercialization and promotion of innovations. This is largely in response to the fact that owners of microenterprises like other economic actors need a wide range of financial services that are flexible, dependable and reasonably priced. For instance, the poor need financial services to build up assets, meet consumption needs, hedge against business risks and other emergencies.

Microfinance recognizes the peculiar challenges of owners of micro and small enterprises especially in accessing financial services. In service delivery design it takes into account the inability of the poor to provide tangible collateral required by formal financial institutions.

HISTORY OF MICROFINANCE

The rise of microfinance practice was prompted by the apparent failure of conventional development paradigms and approaches to achieve meaningful development, which is poverty alleviation. Growth-led development perspective, which gained currency in 1950s and 1960s with its resurgence in the last decade, has always yielded fantastic

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[2] The Nigerian Microfinance Policy, Regulatory and Supervisory Framework was launched on December 15, 2005.
[3] A term made popular by Marguerite S. Robinson

statistics with discouraging impact on the lives of the people. For instance, while growth rates were rising, the number of persons in poverty was also on the increase. Microfinance therefore seeks to provide low-income people with capital for income generating activities. Microfinance is premised on the fact of economic relations, that the poor remain poor because they are deprived of access to life transforming opportunities such as affordable financial services. As a development strategy, microfinance believes in the ability of the poor to meaningfully improve their conditions of living, if they can access financial support on affordable terms.

While microfinance practice, especially community based savings or 'contribution' schemes is not new in most communities, modern microfinance or what has become known as 'microfinance revolution' on the other hand, it is a creation of deliberate efforts at addressing poverty. The current form of practice grew out of development support agencies and governments desiring to improve productivity and conditions of living of farmers. This was the era, when national development enterprise equated poverty with rural areas. It was reasoned that rural dwellers or farmers were poor because they lack access to funds. Banks' unwillingness to support small farmers has always been there. Small loans were disbursed to farmers in farmers' cooperative societies. The rates of repayment were for several reasons very poor. This is understandable. The intention and approaches of loan givers tilted more towards charity.

The experiment of Muhammad Yunus the 2006 Nobel Peace Prize winner for his work in credit-for-poor and other initiatives across the world have taken microfinance from the realm of charity. Microfinance banks and institutions today are not in business for charity. However, intention of poverty reduction of early experiment with microfinance remains. The underlying reason for poverty lending or microfinance, is simple, that is, the poor or owners of small businesses remained poor because they lacked access to affordable institutional credit. We know that it will be easier for the proverbial head of camel to pass through the eye of a needle than an asset-less person to obtain loans from commercial banks. This illustrates one of the most profound ironies of economic relations and transactions. Those desperately need financial support to grow are denied only for the reason of their poverty. Today microfinance has become a common feature of financial landscapes in developing countries.

In Nigeria, modern microfinance began as the visionaries worked initiated non-profit institutions to address poverty. In Akure, Chief Bisi Ogunleye started a pro-women initiative- Country Women Association of Nigeria (COWAN) while Late Venerable David Ogbonna ran the Nsukka United Self-Help Organization (NUSHO) in the early 1980s. LAPO, which I founded, began credit plus programmes in late 1980s it is important to note that early funding for these institutions was provided by the Ford Foundation.

In 2000, actions towards the commercialization of microfinance in Nigeria began with the Central Bank of Nigeria led process, which culminated in the launching of the National Microfinance policy and regulatory framework with extensive supervisory guidelines

ELEMENTS AND PRINCIPLES OF MICROFINANCE

Over the years, certain features have been identified with micro-finance practice. These include:

- **Collateral Substitution**

  A distinguishing feature of classical microfinance practice is its disregard for tangible collateral requirement. Conventional banking practice places primacy on provision of collateral as condition precedent for credit. Tangible assets are pledged as security for credit facilities. This requirement is premised on the reasoning that a credible threat of loss of pledged assets serves as enough motivation for loan repayment. It is a ready means of transferring risk from the lender to the borrower.

  Exclusion of the poor and owners of microenterprises from institutional financial services is attributable to collateral requirement. Collateral requirement is often cited as the reason for the rise of modern microfinance. Microfinance begins with the recognition that poor or owners of micro-enterprises do not exercise command over assets as titled land and stocks often demanded by conventional banks. Collateral requirement is akin to demanding from someone what he or she does not have. Micro-finance as a development tool represents an approach which believes in the people (what they are) rather solely in collateral (what they have). Microfinance as a development approach believes that the poor are capable of improving their condition if they have access to financial services on affordable conditions, and that they remain poor because they are excluded from institutional credit. Pledged collateral is unnecessary as motivation to meet repayment obligation can be created by other means as peer group guarantees, effective loan utilization monitoring and client friendly practices as prompt approval of larger subsequent loans and convenience of access. Clients in most cases have adequate knowledge of members of their credit group; their character and debt absorptive capacity.

[4] Institutions established on the assumption that the only sure way to provide microfinance sustainably on a massive scale is to be profit driven.

This knowledge becomes useful in participatory loan appraisal. Assurance of continuous access to affordable services has proven to be a strong motivation for prompt repayment. It is important to note that increasing commercialization of microfinance practice is leaning towards collateral requirement. This development is partly due to a number of factors as relative larger sizes of units of services. Commercial Microfinance entities[4] tend to provide services of relatively larger sizes than those provided by not-for- profit microfinance institutions.

Another factor is the emphasis on individual service delivery methodology. The comfort usually provided by peer support and pressure within a credit group is absent. In group methodology, members play vital role in client selection and screening. Members provide useful and complete information on potential borrowers' character and absorptive capacity. Information asymmetry is possible in dealing with individual who wants to borrow. Credit discipline is more difficult to cultivate and enforced when borrowers are acting alone. This pose credit threat to credit discipline hence a resort to demand for collateral.

- **Small units of services**

Usually, financial services are often directed at owners of micro and small enterprises. Services are therefore structured to reflect the absorptive and debt capacity of the service users. Fund absorptive capacity of micro-enterprises is low. A loan size of 10,000 naira could be all a client needs to make a difference in her business volume and profitability. Sizes and frequency of savings are determined by the ability of the clients. There is not doubt about the ability of the poor to save; the size of amount they save is limited. Similarly. Low-income people have relatively smaller amount to invest. This has implication for the level of transactional cost. Delivery methodology as group formation is adopted to mitigate cost.

- **Priority focus on women**

Women constitute greater proportion of client base of most microfinance providers. There are a number of explanations and opinions for this disproportionate representation of women in client base of most microfinance institutions. Many practitioners are of the opinion that female clients exhibit better credit discipline than their male counterparts therefore microfinance institutions seek them. It is also noted that women could be easily intimidated to comply with repayment undertaking. Usually excellent loan repayment performances of microfinance are cited as evidence. Comparative statistics that in most cases support this assertion are also presented. It however needs to be sufficiently demonstrated if gender has more impact on portfolio quality than factors as operational strategy, loan utilization monitoring systems staff training and motivation, More plausible reasons preponderance of women include relative higher degree of deprivation of women. There are very few societies across developing countries where women are treated as good as men. Customs, traditional practices and religion in some cases ascribe low social status to women. Women by some customs are denied rights of inheritance. They do not own land and other valuable assets acceptable as collateral security for institutional credit. Lack of access to information and command over assets constrain women access to institutional credit.

Women do not also have access to information on credit opportunities in the mainstream financial system. Frustrated at this form of exclusion and scared of the usually high rate of interest on moneylenders' funds, they turn to microfinance institutions. Another reason is the nature of business activities in which women are engaged in. Female entrepreneurs tend to undertake business activities, which are usually supported with small loans. Sizes and other features of mainstream microfinance products tend to fit into the requirement of business activities as subsistence farming, trading, food vending, tailoring, basic craft work and other economic activities in the informal sector dominated by women. Another opinion is that when a woman's income earning capacity increases, the entire household especially children benefit more than when that of a man does. This again can hardly explain directly the observed service priority to women.

- **Access to repeat loans**

Continuous provision of financial services to identified clients has become a feature of micro financing. Typically, loans of larger sizes are disbursed to clients in subsequent cycles. Small loans are disbursed at earlier cycles according to lower debt capacity of new clients. It also serves to test the credit worthiness of newer clients. Repeat loans ensure that impact of utilization of financial services is maximized. Micro-enterprises require several cycles of financial support to grow to maturity. Microfinance institutions through client surveys and product/service improvement strive to retain their clients. This makes economic sense. Older clients are cheaper to service; they require less monitoring as they present less credit risk. Also it has been proven that meaningful impact is only achievable if poor customers are exposed to services repeatedly.

- **Client centeredness**

Microfinance is not simply micro-banking. A distinctive feature of microfinance practice is that service users are not related with as faceless customers as in conventional financial institutions where their account numbers identifies customers. Beyond the demand for tangible collateral for loan, a major obstacle to credit for the poor is their inability to understand the language and nuances of formal lending. To reach the poor with financial services, the provider must seek to engage them in a creative manner. In micro financing, partnership is essential. Usually poor customers distaste being treated as the 'faceless customers' of conventional financial institutions, who are only related with by account numbers. They relish personal touch. Relationship must be beyond collection of loans and deposits. The microfinance banker must demonstrate interest in their businesses and even in the welfare and education of their children. Also the microfinance banker must be able to relate effortlessly with poor customers. She must not in language, dressing and general carriage intimidate her customers. In training and orientation, the microfinance banker must be equipped to meet the challenges of being a “banker for the poor”.

Clients are assisted to address a range of challenges beyond the need for financial services. As a poverty alleviation strategy, microfinance institutions provide non-financial services as enterprises development, extension support and healthcare. Micro-business management training could be integrated into pre-loan training for potential clients. In some cases separate institutions are established or networked with to provide extra-financial services to clients. Most non-profit microfinance institutions provide institutional structures for clients' participation in governance inform of representation on the governing boards.

- **Group Delivery Methodology**

The rising trend of provision of financial services to individuals has not diminished the predominance of group delivery methodology in microfinance. Potential clients are assisted to organize into credit and savings groups. Membership of these groups is self-selecting with members sufficiently familiar with each other. For convenience and peer support, groups are usually formed along commonality of business activities and location of residences and businesses. Service delivery to members could be done jointly whereby borrowers collectively access, utilize and repay loans. On the other hand, individual acting in a group takes individual responsibility for the utilization and repayment of his or her credit facility. Group methodology is adopted to achieve operational objectives.

First, it is cost reduction strategy. Contact with borrowers for the purpose pre-loan training, loan appraisal, and monitoring is cheaper. Several visits to clients' individual homes are reduced to few visits to group meetings. Secondly, group lending aids credit discipline. Despite the rising controversy over the necessity of group pressure it is obvious that small group exerts considerable pressure on its members for whatever purpose. Repayment enforcement is more effective with less rancour by group members themselves. Finally, group approach builds solidarity among borrowers. It provides for beneficial interaction among borrowers and the lending institution. Emerging needs and views of borrowers are articulated at group meetings. Lending institutions could deliver into non-financial services as management development and health awareness through clients' groups.

- **Door-step service delivery**

Unlike the practice in the conventional financial sector, microfinance service providers take financial services to customers in their homes, business and meeting locations. The microfinance banker must be prepared to “take” banking to the clients rather than wait for them in exquisitely furnished branch offices. While exotic furnishing and designer wears might impress yuppies-customers of commercial banks, they are intimidating or nauseating to the poor customers of microfinance banks and institutions. Often than not, they are more comfortable with the sometimes dusty or oily business environment for their financial transactions. Branches and credit group locations are located near their dwelling places and business. These combine to reduce service access cost for borrowers and enhance their convenience.

The Consultative Group to assist the poor CGAP a consortium of public and private development agencies dedicated to expanding access to financial services for the poor in 2004 endorsed what it called principles of microfinance. Some of the principles can be summarized as follows:

- **The poor need a variety of financial services, not just loans**

Early attempts at providing financial services to the poor or owners of microenterprises emphasized credit, this in part, earned the practice its early microcredit appellation. This was understandable. Exclusion from mainstream financial institutions was seen mainly in terms of deprivation of affordable credit facilities. Interventions were therefore directed at providing loans. Organizational structures and procedures of early microfinance institutions were designed for credit delivery. Maturity, innovation and competition have altered the mono-service nature of the practice. Like other users of financial services the poor require a range of financial services. The poor have various priorities and needs, which should be met by variety of products. Savings, which R.C. Vogal tagged, the "forgotten half" of microfinance is considered as ultimate risk management tool and hedge against vulnerability. Microfinance institutions provide institutionalized arrangement for more secure savings than informal savings groups or deposits under a mattress. Today most institutions, even in regions as East Africa and Latin America without history of traditional savings schemes provide a wide range of savings products.

Micro-insurance has emerged to assist the poor address the problem of vulnerability. Vulnerability is the bane of persons with limited means. The poor face enormous risks. For their paper-thin economic base, fire out-breaks in the market or flood can wipe out gains of years of access to financial services. To hedge against these risks, microfinance institutions integrate responsive insurance services into their product mix. Frontiers of microfinance have also been expanded to include provision of cash transfers and micro investment.

- **Microfinance is a powerful instrument against poverty**

The search for a development strategy, which could lead to significant improvement in the socio-economic conditions of members of poor households, led to the focus on credit. The underlying assumption of credit for empowerment is that availability of capital on affordable conditions is critical to efforts at enhancing income-earning capacity of the recipient. Microfinance is foremost a poverty alleviation tool. It is assumed that the poor know what to do and have enormous potentials to enhance their conditions and that they remain poor because they operate from slim economic base. Access to sustainable financial services can result in over all improvement in the conditions of service users. With financial services the poor have been economically empowered, socially emboldened with improved to health services. They are able to start or improve their businesses thus enhancing their incomes. Increased income supports asset building and reduces vulnerability which the bane of the poor. Regular income flow enables poor households plan and take actions to mitigate external shocks. Incomes have been invested in improving nutritional status of poor households, children's education and education (Copestake et al, 2005). Collateral effect of access to capital is greater voice of women within and outside their households. With increased contribution to household budget, female members are accorded greater respect and have increased say in decision making. In a female beneficiary of SEWA Bank a pro-poor and pro-women bank in Ahmedabad, India boasted "my husband used to instruct me around and beat me up before, but when I had joined SEWA he cannot do that now" (Ehigiamusoe, 2000)

- **Microfinance means building financial systems that serve the poor**

Supporting the poor has always been on the agenda of developing agencies and governments. In addition it has always been believed that the poor have peculiar needs, which require unique delivery approach. A common operating assumption of early non-profit organizations was that 'the poor are too disadvantaged to benefit from credit schemes operated by formal institutions'. Personal and business characteristics of the poor as lack of formal education and business skills and assumed little returns on their investments were cited. It was reasoned by early interventionists that separate credit delivery structures and procedures be designed for those excluded from the formal financial markets. Targeted credit programme were established in most cases for farmers. Microfinance practice was at the fringe of the financial market. To give loans to small business person was considered good and socially-responsible people and institutions. These targeted projects had a number of limitations namely, limited out-reach thereby had marginal impact the gap between the huge demand for and little supply of financial services for the poor. Secondly, they recorded poor financial and loan recovery performances, which undermined sustainability. Two decades of lessons from scaling-up experiences, innovations and impact studies across the world have engendered paradigm shift which emphasizes and recognizes the huge demand for financial services by poor people and that meeting the demand on a sustainable basis would require mainstreaming microfinance into the entire national financial sector. A major tool for such mainstreaming is a robust national microfinance policy and regulatory framework. It recognizes that microfinance is not just a nice thing to do but it is also profitable. Free-flow of funds from the mainstream financial system is required to meet the varied financial needs of the poor.

- **Financial sustainability is necessary to reach significant numbers of poor people**

  Current attention to institutional sustainability represents an important phase in the development of microfinance. The practice has progressed from a phase when concerns were on feasibility of putting money in the hands of the low-income people. Early practitioners were pre-occupied with strategies to over-come obstacles against reaching the poor with appropriate financial services. Dominant practice issues were delivery methodology, development of targeting tools and techniques and client training. A key measure of performance was depth of outreach. Donors' interest in micro-credit as an innovative poverty reduction strategy was high. Non-profit institutions were incorporating credit component into their service mix.

  By mid-1990s, experiences from South-East Asia, Latin America and Africa had demonstrated that the poor could effectively utilize loans, repay timely and improve the living standard of their households. The desire to bring social and economic benefits of financial services to a larger number of poor households on a sustainable basis prompted attention on financial sustainability. Thus, building financially self-sufficient institutions is not an end in itself (CGAP, 2004). Financial sustainability is achieved when a service provider is able to cover its operating and financial costs with surpluses for expansion and innovations. It is only financially sustainable microfinance institutions that can access commercial funds and acquire technology to expand outreach. Attempts at achieving financial sustainability have led to adoption of cost reduction strategies and improved services at lower cost. However, the quest for financial sustainability has in some cases forced providers to be risk-averse (Oketch, 2003). Decisions on product development and location of branches for instance are influenced by profit consideration rather than immediate impact o poverty. Services are concentrated in urban informal sector as against on agricultureled rural economy, which considered riskier, becomes sustainability.

MICROFINANCE AND ECONOMIC DEVELOPMENT

The search for a development strategy which could lead to significant improvement in the economic condition of members of poor households, led to the focus on microcredit. The underlying assumption of microfinance for development is that availability of capital is critical to the effort of enhancing income earning capability of the poor. It is assumed that the poor know what to do to enhance their economic condition and that they remain poor because they operate from a slim economic base. This base, according to proponents of microfinance, can be strengthened by funds borrowed on affordable terms.

The rapid spread of microfinance in developing countries is attributed to its capacity to impact positively on poverty. Professor Muhammad Yunus of the Grameen Bank calls it "development from the bottom" Most development initiatives in agriculture, health, female empowerment enhance their impact with integration of credit programme. The improving condition of living in Bangladesh is a good example of how to develop with small loans. The South East Asian nation was in mid-1970s branded a 'basket case' by Henry Kissinger, a US Secretary of State, on accounts of the nation's hopeless development prospects. Small are effective weapons for addressing mass poverty. Impact of microfinance could be addressed at personal and household as well as national dimension. It has been demonstrated that little loans availed much.

On a general note, injection of new funds on appropriate conditions into a small businesses take them from the vicious cycle of small investment little returns small investment to the virtuous cycle of prosperity of little capital-injection of funds (credit)-greater output greater investment. With financial services, poor households have recorded improvement in access to what matter most to them that is better nutrition and education for their children and medical services. An improvement in the economic condition of the poor especially women invariably reflects in the nutritional status of members of their households. They are anxious about the future of their children. They want to put their children in school.

Microfinance has been demonstrated to have enormous capacity to boost economic development through support for micro, small and medium scale businesses. Microfinance as a strategy for economic development is driven by the emerging paradigm of "The fortune at the Bottom of the Pyramid" popularized by C. k. Parahalad. Simply put, this paradigm refers to the enormous advantage of the large number of the poor in any economy and its implications for market and over-all economic development. It advocates for the integration of the poor with their number to THE MARKET as most effective strategy to alleviate poverty without charity. In the process, the poor also make their contributions to national development. The vital link between the poor and the market or national economy is the microfinance institutions and banks. This is true of any economy including Nigeria.

- **Creating access to affordable financial services.**

  The greatest constraint of small businesses and other actors in the informal sector is constrained access to affordable institutional credit. The existence of vibrant microfinance institutions would sufficiently address this challenge. China, India and other economies of Asia owe their vibrancy to viable small-scale industries/businesses adequately supported by viable and appropriate financial arrangements. In spite of dearth of statistics on volume of services provided by Microfinance institutions (MFIs), it is evident that persons who ordinarily would not access institutional credit have done that through MFIs. For example LAPO (Lift Above Poverty Organization) made the following disbursements in the past three years: N1.1billion (2005); N2.2billion (2006); N4.8billion (2007) and projects N7.8billion for the current financial year (2008). With the numerous microfinance banks, the volume of financial services to the "bottom of the pyramid" is expected to rise sharply.

- **Reaching the underserved**

  Agriculture has under performed largely due to absence and inappropriate financial support approach. Microfinance institutions reach rural dwellers and women who ordinarily are locked out of conventional financing systems through innovation products and procedures. Therefore existence of viable microfinance banks/institutions with responsive products and services in rural communities would have impact on productivity of small-scale farmers.

- **Building economic actors**

  Beyond access to financial services, strict credit discipline of loan repayment and savings support clients to cultivate requisite discipline for business success. Economic actors hitherto outside the mainstream economy are integrated with attendant benefits for capital formation, improved productivity and over-all national economic development. In a nation as Nigeria with exceptionally enterprising people, this benefit is enormous.

- **Generating employment**

  By their large number and spread, small businesses development/ support is a potent strategy for addressing mass unemployment. Microfinance creates self-employment, which obviously is the most sustainable form of employment. Several beneficiaries start or manage their businesses no matter how small. In an economy where microfinance has been sufficiently developed, the informal sector depends mainly on microfinance institutions for financial support. Micro, small and medium enterprises are regarded as the bedrock of any economy. It is evident that Nigeria is in need of entrepreneurial spirit and development. A prime mover of this development is the existence of appropriate financing arrangement. Often, prescribed revision of course contents of our educational institutions would yield limited successes if not backed with strong financial system.

MAXIMIZING THE GAINS OF MICROFINANCE

There are enormous opportunities for microfinance development in Nigeria. Here is a nation of huge market of exceptionally enterprising people.

Microfinance exists to create a positive value for the country beyond that of corruption. The face of microfinance has taken over from the images of corruption, cyclones and poverty in Bangladesh. It is helpful to add that these benefits would not come without the existence of a microfinance sector with the following:

- **Supportive enabling policy environment;**
- **Sustainable refinancing arrangement; and**
- **Abundance of skilled operators.**
- **Regulation and supervision**

  Regulation by statutory authorities has been acknowledged as tool for developing the sector. However, the "the rush to regulate" in some countries has replaced regulation with strangulation. It is gladdening that Nigeria has joined several developing nations to formulate a microfinance framework. This is commendable, however, for desired results, key provisions of the regulatory and supervisory guidelines should be subjected to periodic review in the face of emerging challenges. This is in view of the fact that there is hardly any perfect regulatory framework especially, as the microfinance practice and sector are young and very dynamic.

- **Refinancing**

  Financing microfinance has gone through phases of funding. Donations and donor agencies dominated funding of non-profit microfinance practice of NGOs when emphasis was on feasibility of the practice. The desire to reach a large number of clients has rendered donations insufficient for implementation of massive expansion plans. This has led to the involvement of private commercial institutions. Emerging regulatory environment across developing nations has also created platform for private capitalization. In nations where microfinance has made significant contributions to national development, there exist strong and responsive refinancing institutions. This is so as there are still some concerns over the suitability of profit driven investors to support microfinance that supports the poor.

Environment across developing nations has also created platform for private capitalization. In nations where microfinance has made significant contributions to national development, there exist strong and responsive refinancing institutions. This is so as there are still some concerns over the suitability of profit driven investors to support microfinance that supports the poor.

Without any prejudice to the emerging refinancing arrangement, I wish to propose the following refinancing arrangement with the following features:

1. The establishment of a FUND provides refinancing facility to fledging MFBs and poverty-focused microfinance institutions. While these institutions are desirable for their reach to rural areas, they will certainly be disadvantaged in competing for on-lending funds with participating deposit money banks. In accessing government funds for these weak but relevant institutions will be an up-hill task.

2. Contributions to the FUND should come from sources as varied as government, development agencies, private sources and even the microfinance institutions themselves. There are still developments agencies interested in microfinance development but at a lost on how to intervene in an environment of ultra-commercialization.

3. The Management of the FUND should be as independent and professional as possible.

4. The FUND operationally to have two (2) windows for funding viz i. developing window through which funds be channeled to fledging microfinance institutions and banks ii. Commercial support window, which will support mature microfinance institutions with loans on commercial interest rates.

- **Human resources development**

  Microfinance is no miniature commercial banking. The practice requires a unique set of skills and attitude. There emphasis should be on training of operators for the sector. Attention should also be given to research and documentation. Institutions of higher learning should go beyond seeing elements of microfinance as novelty and appendix to business and banking courses. Microfinance institutions with competences should set up training and technical support centers. Skillful persons are required in critical areas as financial planning and treasury management, product development and improvement, and information management. Capacity in non-financial issues as clients' engagement is also required.

  Complementary enterprise development programmes.

  It is obvious that lack of money is not the only factor that constrains viability of micro and small businesses. Some forms of micro-business management training are required to enable maximum utilization of borrowed funds to ensure impact and excellent repayment performance. For efficiency, such capacity enhancing interventions do not need to be elaborate; rather it should be incorporated into the financial service delivery procedures.

- **Awareness creation on microfinance**

  Microfinance practice is new. There are a lot of myths and misconceptions that need to be addressed for the development of the sector. One is that microfinance has been highly romanticized as instant and only cure for poverty. There is need for massive awareness creation of microfinance: what is, what it is not, its gains and development potentials. The efforts of the Central Bank of Nigeria in this regard are highly commendable.

Concluding remarks

Microfinance has become a permanent feature of financial landscape and poverty alleviation strategies in developing countries. What began as simple act of “ it is-possible- visionaries” has blossomed into a thriving industry. Microfinance has demonstrated its capacity to engage the huge masses at the bottom of the economy for meaningful poverty alleviation without the demeaning elements of charity. However, the gains of microfinance are dependent on the presence of certain success imperatives.

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INSTITUTIONAL REFORMS FOR EFFICIENT MICRO FINANCE OPERATIONS IN NIGERIA

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INTRODUCTION

A notable development economist has aptly observed many years ago that for many people, poverty represents "only statistics". However, for another economist not yet great by the time he sought to find out what poverty actually meant, his findings on poverty and the institution he established to fight poverty on a sustainable basis made him great. Dr Muhammad Yunus, the "Banker to the poor" and the founder of Grameen Bank in Bangladesh, was led into microfinance when he realized that the enterprising poor needed only a small amount of credit for their inputs and could not secure this from the existing formal financial institutions and had to rely on numerous informal-sector exploitative arrangements. The case of Begum Sufiya, a bamboo stool maker, who earns only two cents a day and needs raw materials that cost only 22 cents is typical of the plight of the enterprising poor (Yunus, 2003). Sufiya does not have the money and had to depend on borrowings from the trader under an arrangement to sell the finished product to the trader at a predetermined price that barely covered the cost of materials. Her case is illustrative of the dadan system under which the poor in Bangladesh operated. Under the dadan system, traders advanced loans against standing crops for purchase at predetermined prices that are below the market rate. Dr Yunus was seriously worried that Begum and other poor people were living a life akin to bonded labour that would only change if they could have access to credit to buy bamboo and be free to sell their products in a free market and charge the full retail price to the consumers. Dr Yunus vividly orchestrated the challenge of microfinance when he summarized his impressions on the economic condition of the poor as follows:
" It seemed to me that the existing economic system made it absolutely certain that Sufiya's income would be kept perpetually at such a low level that she would never save a penny and would never invest in expanding her economic base". People like Sufiya "were poor because the financial institutions in the country did not help them widen their economic base". Thereafter, Dr Yunus, in 1976, lent $27 to 42 artisans like Sufiya in the Jobra area of Bangladesh to buy inputs and produce their wares and to repay "whenever it is advantageous for them to sell their products". The rest of his efforts in microfinance culminated in the formation of the Grameen Bankin 1983, which is one of the greatest microfinance institutions in the world. In 2006, Muhammad Yunus and Grameen Bank jointly won the Nobel Peace Prize for their effort in tackling poverty.

The plight of the poor in neighbouring India was not different from that in the Jobra area studied by Dr Yunus and his assistants. In India , we find the poor resorting to the informal sector with its monopolistic practices and exorbitant interest rates (in cash or kind). According to Duggal and Singhal (2002), "Interest rates in the informal market vary from 3 percent to 10 percent a month. Vegetable vendors are known to borrow at even 10 percent a day to finance their daily working capital needs". The picture is the same in many developing countries, including Nigeria. The poor lack access to financial services from the formal financial sector. But experience has shown that the poor are bankable as they can save, invest, repay loans, and have need for insurance services (Seibeil, 2000).

Microfinance is the supply of loans, savings, and other basic financial services to the poor and the providers of these financial services to the poor have included donor supported, non-profit non-governmental organizations (NGOs), cooperatives, community-based development institutions like self help groups (SHGs) and credit unions, commercial and state banks, insurance and credit card companies, wire services, post office and other points of sale. The clients of microfinance have included different categories of the poor, all of which fall into four poverty levels: destitute, extreme poor, moderate poor and vulnerable non-poor. A micro finance institution (MFI) is an organization that provides financial services to the poor.

Since the poor make up a large proportion of most developing economies, governments, social entrepreneurs and commercial banks have sought to provide for their financial needs. Government attempts in most cases in microfinance provision have failed while social entrepreneurs have mostly had only limited success. Commercial banks are only now entering microfinance and, in most cases, are seeing it as a way of discharging their corporate social responsibility. After many decades of microcredit, Nigeria is now trying to develop the microfinance industry. This is no doubt a natural consequence of the restructuring and consolidation of the Nigerian financial system, as it has become imperative to integrate all segments of the financial system.

Despite decades of public provision and direction of provision of microcredit, policy reorientation, and the entry of new players, the supply of microfinance in Nigeria is still inadequate in relation to demand. This suggests there are some inefficiency in microfinance operations in Nigeria due to some institutional inadequacies. Our task in this paper is to identify those institutional inadequacies crying for reforms. In order to undertake this task, the rest of the paper is divided into five sections. Section 2 explores the institutional environment of business and financial firms. Section 3 examines market failure in microfinance provision and in section 4 we discuss the state of microfinance across the world. In section 5, we highlight past and current efforts in microfinance within the institutional environment of business in Nigeria. Section 6 pinpoints some of the necessary institutional reforms and concludes the paper.

2. THE INSTITUTIONAL ENVIRONMENT FOR BUSINESS FIRMS

Business firms operate in an environment that is defined by a set of rules that govern the relationships between the different actors in the economy. These constitute the institutions of the economy and they may refer to the market system, the legal system, the political system, or the civil society (Nabli, 2006). Polski (2000) defines institutions in the context of the firm and the industry. In relation to a firm, institutions are the rules that govern the purpose of an organization, the way that an organization is structured, and the way that it produces and provides goods and services in markets. In the context of an industry, institutions refer to the rules that affect the way that firms organize to produce and provide goods and services and interact with others (Polski, 2000; p.15). In fact the performance of an economic system has been attributed to the quality of its institutions because these influence incentives for saving, investment, production and trade. Aspects of the institutional environment and how they affect performance of economic entities include:

- **Political governance system**, including the budgetary processes that provide for macroeconomic stability. Macroeconomic stability is critical in determining the certainty of investors' decisions. High quality political governance system also produces credible trade and exchange rate policies that do not undermine competitiveness.

- **Regulatory system.** This defines the rules and regulations governing particular businesses as well as the statutory agencies and procedures for conducting oversight and supervisory responsibilities over certain sectors. The regulatory institutions are typically agencies of government but government may sometimes find it convenient to cede regulatory power to privately managed institutions. A good regulatory system promotes fair trade and competition, supports efficient resource allocation, protects property rights and discharges its mandate without unnecessary encumbrances or corruption.

  Legal system. This comprises the totality of laws governing the conduct of political, economic, social, business and other transactions in the economy as well as the institutions that enforce and interpret the laws, resolve disputes and punish people who violate the laws. An effective legal system clearly defines and protects property rights, speedily resolves business disputes, protects lives and property and facilitates enforcement of contracts.

- **The level and development of financial markets.** The financial system is the mechanism of funds intermediation in an economy. It is supposed to be as complex as the complexity of the financial requirements of the modern economic agents, be they governments, individual consumers, or corporations. It is expected to consist of the capital market, for long-term funds, and the money market for short-term funds, and within each of these segments, numerous sub-sectors to cater for different financial needs of the economic agents. The insurance sector is also part of the financial system as well as other market mechanisms for managing risks. An efficient financial system would readily provide financing for any viable project with acceptable risk profile.

- **The educational system.** The types of institutions for producing and transferring knowledge, the ownership and organization of these institutions, and the quality of output of these institutions all have effects on the performance of businesses. Productive educational institutions supply high quality labourers with relevant skills demanded by businesses.

- **The structure of employment in the economy.** Whether employment is predominantly in the public sector or the private sector, it has consequences for the structure of and expectations concerning wages. The structure of employment also influences the choices of workers concerning further human capital investments (Nabli, 2006).

- Labour market and migration policies. The flexibility of the labour market with respect to the ease of hiring and firing, and the absence of distorting wage legislations is a major factor determining the performance of companies. Migration policies determine the extent of use of expatriate labour, and this in turn affects the ability of the private sector to access internationally competitive skills at cost-efficient wages (Nabli, 2006).

- **Structure of ownership and provision of infrastructure facilities.** Because there is an observed difference in the efficiency of infrastructure provision by the public and private sector, infrastructure quality may depend on the existing institutional arrangements regarding ownership and mode of provision. Since infrastructure services are major inputs in the production processes of businesses, poor quality infrastructure is great tax on businesses, which make them uncompetitive in both the domestic and the international markets.

Whenever, the institutional environment for business is not investment friendly, there is need for institutional reform, which simply means modifying the rules governing economic and business transactions to make them more investment friendly by attracting the optimal amount of capital into all the sectors of the economy. But we need to bear in mind, as all development economists know and as we are aptly reminded by Nabli (2006, p. 4) that "Institutional reform is deeply political-it affects the balance of power between actors in the society, and challenges the entrenched practices and economic privilege that some have enjoyed for generations". This is why successful institutional change has proved difficult across the world. Further more, he advises that there is no best way to bring about institutional reform, as some have come as a result of political or financial crisis while others have been the result of gradual reforms. The political nature of institutional reforms suggests that implementing and sustaining institutional reforms requires building coalitions within the economy of those who need high quality institutions flows. Nabli (2006, p.5) cites greater trade openness, greater openness in information, and a country's readiness to domesticate external agreements on trade and investments, as effective levers in building institutional reform coalitions. Opening economies to greater trade and competition expands the role of non-rent dependent export sectors that demand better institutions across the board. Also, greater openness and trade exposes the work force to the need for new skills and knowledge, as they become used to best practices across the world. This creates another effective coalition for reform, such that this work force begin to demand for the skills and services needed to compete in this economic setting. Greater access to information exposes the sources of economic rents in the economy and increases the pressure to dismantle them.

3. MARKET FAILURE IN RESPECT OF MICROFINANCE

The financial system in most developing countries is fairly developed, at least, in relation to the financial requirements of most of the economies, but it has largely failed to provide financial services to the poor. This failure has been attributed to massive market and regulatory failure (Easton, 2005). The size of the financial needs of the poor is typically small; they do not have adequate titles to property that can be pledged as collaterals for loans, they do not usually have steady income and their household and business transactions cannot easily be separated. The poor also typically live in geographically dispersed settlements and usually lack sophistication in business/ financial matters. All these features make serving the poor highly costly and risky and would call for highly prohibitive bank charges to cover costs. But blanket regulation of banking services provision prevents banks from charging the cost-recovery rates on microfinance. The state ownership and control of the financial sector in these countries reinforces the effects of market failure by introducing corruption, which raises the cost of every financial transaction to the poor. Easton (2005) and Prahalad (2006), list the other factors that explain why the existing financial system in developing countries have underprovided microfinance:

- Simple social prejudice, as many financial firms are not interested in serving the poor and have not explored ways of reaping economies of scale.

- Interest rate caps on lending to the poor, which undermine the profitability of lending and reduce supply of loans.

- Lack of deposit insurance protection for most financial institutions dealing with the poor so that when these institutions fail, the poor savers do not get their money.

- Inadequate supply of basic public services, which force the firms to bear the costs of providing these services, and increasing the cost of their services.

- High and volatile inflation.

- The absence of necessary legal framework for financial services.

These notwithstanding, Navajas and

Schreiner (1998), believe that commercial banks have the greatest capacity for providing microfinance due to their widespread branch network, profit motive, private governance, competent organization structure, charter and their success in deposits mobilisation. They, however, noted the problems militating against commercial banks' provision of microfinance as including:

- The high risk and the high cost of taking small deposits, especially in rural areas.
- The inability to brand the products so as to price microfinance services higher than traditional services in order to cover higher cost.
- The fear of competition from subsidized lenders.
- High start-up costs due to the need for research and development when discoveries cannot be hidden from rivals.

4. MICROFINANCE ACROSS THE WORLD

Across the globe, governments of various developing countries have sought to provide finance to the poor through the creation of agricultural development banks, special lending schemes and the support of the growth of cooperatives and other self-help groups (SHGs). Examples include the following:

- The Vietnam Bank for Agriculture and Rural Development (VBARD).
- Bank for Agriculture and Agricultural Cooperative (BAAC) in Thailand.
- Bank Rakyat Indonesia (BRI).
- Nigerian Bank for Agriculture and Cooperatives (NACB), established in 1973.

Public-sector microcredit intervention schemes, however, failed for the following reasons:

- The banks generally focused on providing credit rather than accepting deposits with adverse consequences on their self-reliance and viability.
- The banks were unable to serve small farmers and other customers in the rural areas because they restricted their loans to agricultural activities instead of covering other kinds of rural-income generating activities.
- Interest rate regulation prevented agricultural banks from covering their costs and restricted the access of the poor to financial services.
- The banks have been largely unsupervised and exempted from prudential banking regulations and effective monitoring and supervision of their activities.
- Many of the banks lack the managerial wherewithal to diversify and enhance customer services.
- Most of the microfinance lending goes to people who are not among the poor (Prahalad, 2006).

NGOs have also played prominent part in redressing the lack of access of the poor to credit through the extension of uncollateralized loans. The pioneers in this regard include:

- Opportunity International, which began lending in Columbia in 1971.
- ACCION International, which made its first micro loan in 1973.
- PRODEM, which began operations in 1987 in Bolivia and in 1992 established BancoSol, a fully regulated bank.
- Grameem Bank, established in 1983, although its founder began to extend micro loans in Bangladesh in 1976.
- K-Rep Bank (Kenya), established by Kenya Rural Enterprise Programme (K-Rep) in 1999. K-Rep began lending to micro-enterprises through NGOs in 1984.

These NGO-pioneers of microfinance introduced the innovation of group/solidarity loans, which according to the United Nations Capital Development Fund (UNCDF) (2004) have the following virtues:

- Effective character screening and verification, which is a fundamental part of credit analysis and risk in any type of financing program.
- Peer discussion and evaluation of business ideas for soundness, thus saving costly feasibility study.
- Groups serve as an outstanding method of 'guaranteeing' a loan when no collateral is available. Because a group's credit is 'frozen' until all members are current, groups exert pressure on their members to repay loans on time.
- The principles of group lending are often familiar to target clients as many cultures have a tradition of lending money to members of savers' groups.
- Groups perform many of the administrative duties in managing loans. This reduces an institution's cost of delivering credit.
- Group members tend to become interested and involved in each other's businesses over time and offer much guidance and support to fellow members.

From the literature on microfinance and our discussions so far, the critical success factors for the sustainability of MFIs include:

- Achieving adequate outreach, which means growing the MFI to reach a minimum critical size of clientele for optimum scale of operations. K-Rep bank, for instance had total loans outstanding by September 2003 of US$20 million with 42,000 active borrowers and 55,830 active savers. Grameen funds its entire loan portfolio from its deposits since 1998 when it received the last instalment of donor funds. BAAC had, by 2001, 10.43 million micro savings clients and US$3.08billion in micro account portfolio.

- Use of appropriate lending methodology. MFIs should use group lending for rural/scattered populations and individual lending for urban borrowers. The Grameen Bank does not require any collateral for its loans but each borrower must belong to a five-member group, which is not required to give any guarantee for a loan to its members. The individual borrower is solely responsible for his loan repayment. However, if any member of a group defaults in repayment the whole group is denied further credit.

- Supportive regulatory and supervisory environment. The risks in a microfinance portfolio are different from those of commercial banks. This calls for differential prudential standards for MFIs, and probably a separate agency charged with the responsibility for MFI supervision. Regulations that apply to mainstream financial institutions need to be modified to take cognizance of the special nature of microfinance portfolio and the transaction cost MFIs incur. In respect of documentation requirements, for example, the Reserve Bank of India issued instructions to all commercial banks to allow registered and unregistered SHGs to open savings accounts in their group's name.
  Strong leadership, and sound corporate governance structure. The board of an MFI must provide strong leadership and direction for the bank and must see profitability of operations as an overriding goal for the bank because it is through profitable operations that the bank grows. A good example is BancoSol's board which, according to Gonzales-Vega et al (1996), was deeply concerned with the bank's financial viability from the very beginning as reflected in the adoption of interest-rate policies that covered lending costs and a resolute attitude towards loan collection. Yet another example of a MFI with sound financial management is the K-Rep Bank which achieved an average return on equity of 7.05% over the period 2000-2003, and obtained a long-term credit rating of BBB+ from Global Credit Rating Co. and MicroRate in 2003.
- Availability of a wide product range. The financial needs of the poor are many and varied. Consequently, a viable MFI should be able to offer a cocktail of products to meet the needs of the poor. In K-Rep Bank the available products include group loans, individual loans, business loans, current accounts, group savings, involuntary savings, voluntary savings, regular savings accounts, letters of credit, foreign currency dealings and ATM services.

- Use of appropriate management information system (MIS).

- Appropriate segmentation of market/clients and deploying the right product/service to each market segment.

- Correct pricing of microfinance services. In each market segment, the interest rate that covers all costs of providing the service should be charged while aiming at minimizing the transaction and opportunity costs for clients. For example, because it costs more to provide credit in the rural areas compared to urban areas, VBARD charged rural borrowers 12% interest rate per year while urban loans attracted 8.4% under the MBP.

- The right human resources. Microfinance personnel must have the desire to help the poor and become personally involved with their economic advancement (Prahalad, 2006; p.119).

- Provision of promotional and developmental assistance to micro-entrepreneurs, in the form of enterprise promotion, human capital development, technology introduction and upgrades, quality control management and marketing (Brijmohan (2002).

- Existence of credit bureaus that would facilitate the assessment of repayment patterns and other related issues (Butler, 2002).

- Availability of technical assistance to both to the MFIs and the regulators. This, according to Navajas and Schreiner (1998) would assist an MFI in the following areas:

  - Design of a governance structure.

  - Adoption of strategic planning.

  - Design of systems for internal control.

  - Installation and customization of hardware and software to track transactions and to manage accounts.

  - Design of systems of incentive for personnel.

  - Representation and handling of donors and their representatives.

- Link to international

microfinance apex organizations, which may take different forms such as provision of technical assistance, portfolio investment, provision of funds for on-lending. International microfinance apex organizations include ACCION International, USAID, CIDA, United Nations Development Programme (UNDP) which provides technical assistance to MFIs through the United Nations Capital Development Fund (UNCDF) and the MicroStart programmes.

- A good network of apex organizations providing funding and technical assistance to MFIs.

- The right combination of channels to reach the poor. It is not only through physical branch expansion that microfinance providers can reach their clients to collect deposit or loan repayments. Particularly for dispersed settlements, they can use mobile banks. For example, the VBARD purchased 159 mobile vehicles in 1998 to enable loan officers to reach remote areas to process loan applications, disburse money, collect repayments and mobilize savings deposits.

- Availability of generous fiscal incentives. The development functions of microfinance can be rewarded by the government through generous fiscal incentives, such as exemption from corporate income tax for certain years. For example, Grameen Bank in Banladesh is exempted from payment of corporate income taxes and in return any profit it makes is transferred to a Rehabilitation Fund created to cope with disaster situations.

Big banks have entered into microfinance through various routes, including creating an entirely separate subsidiary, extending loans through a network of microfinance banks and the establishment of investment funds. The impact that big banks can make in micro finance can be illustrated with the experience of ICIC, India's second-largest private bank. While many other banks saw providing credit to poor farmers and opening costly rural branches as non-profitable, ICICI saw these reforms as an opportunity, declaring that it "wants to lend in a sustainable way to rural India" (Prahalad, 2006). ICICI outlined three strategic goals to actualize this opportunity:

- To increase banking penetration in rural areas through innovative ways of defining distribution point.
- To prepare rather than react to the increasingly important rural market.

- To support the down trodden as a good corporate citizen

ICICI believed that many of the problems/risks with microfinancing could be alleviated by the capital, expertise, scale, and reach of a major bank. ICIC got involved in the promotion of Self-Help Groups (SHGs). The SHG programme was designed to "form, train, and initiate small groups of women into formal savings, banking, and lending groups". The programme involves training the members of the SGH to:

- Learn to save.

- Learn to lend among them what they have saved.

- Learn to borrow responsibly from the bank.

One year after the formation of the SHG, the women submit a loan proposal to a bank manager, with key supporting documents such as loan agreements signed by each member of the SHG, an updated family survey, a No Due certificate that guarantees that no outstanding loans are owed by any member, and a Letter of Sanction approved by the area manager. The size of the total loan to the SHG is $5,000 with a distribution of $250 to each member. Activities that can be funded with this amount include the purchase of livestock, the leasing of land for agricultural purposes, the opening of a small teashop, candle manufacturing, and the purchase of a home. The loans are non colllateralised and the savings account of the SHG with the bank is not held as collateral against the loan, because the bank wants the group to continue their internal lending process. However, the SHG as a whole is responsible for each member's loan, which builds a strong degree of social collateral which has helped the bank achieve a repayment rate of 99.99%. The repayment terms require each member to pay $8 to the bank for 43 weeks, which gives an effective annual interest rate of 18%, higher than most loans which is around 9%, and other commercial loans at 12%. ICICI charges this rate to cover the training costs and salaries of the promoters and coordinators of the SHG who make this operation sustainable. ICIC also lends to MFIs through a network of 53 microfinance banks, which market the loans. ICICI lends to the MFIs at 9.5-11%, slightly higher than it charges its corporate clients, and the MFIs re-lend the funds at 16-30%. By 2005, ICICI had an outstanding micro loans portfolio of US$265million to 1.5 million customers through this method (Easton, 2005).

5. PAST AND CURRENT EFFORTS IN MICROFINANCE IN NIGERIA

Microfinance, in the form of microcredit, has been around in Nigeria for quite some time. Past public efforts at redressing the inadequate supply of financial services to the poor in Nigeria include the following:

- Government support to cooperatives, which began with the promulgation of the Cooperative Societies Ordinance in 1936. All types of cooperatives have regular/compulsory savings by members as one of their goals, while thrift and credit societies combine regular savings of members with lending. Even though there is a Department of Cooperatives in the Federal Ministry of Agriculture, cooperative societies are regulated and supervised by state governments.

- The establishment of the Nigerian Agricultural and Cooperative Bank (NACB) in 1973. This acted liked a development finance institution (DFI), extending loans for agricultural development to both small and large-scale farmers, and to state governments for on-lending to farmers.

- The setting up of the Agricultural Credit Guarantee Scheme Fund (ACGSF) in 1978. The ACGSF was designed to reduce risk involved in agricultural lending by banks by guaranteeing up to 75% of the principal in the case of default due to natural events beyond the control of the farmer. The Central Bank of Nigeria (CCBN) has administered it.

- The Rural Banking Programme (RBP). Under the RBP, universal banks were required to establish a specified number of branches in identified rural locations. By the time the programme was suspended in 1989, the existing old banks had established over 700 rural branches. None of the new banks established between 1986 and 1990 was allocated any rural branch to open and up till now many of them do not have any rural branches. But the old surviving banks now have a large legacy of rural branches, sometimes constituting as much as one third of their total branch network. A major set back to rural banking was the liquidation of many regional banks between 1993 and 2003, without regard to their social function in providing banking to the poor.

- The Supervised Credit Schemes of various state governments, under which funds from the state governments are given as loans to the poor for small-scale enterprises such as farming, small-scale manufacturing, etc. The loans carry highly subsidized interest rates.

- The Peoples' Bank. This was established in 1989, as a deposit taking and lending institution for the poor by the Federal Government. It operated through both urban and rural branches and was bogged down by bureaucracy of government and it did not make much impact.

- The licensing of community banks in the 1990s. These were conceived as unit branch, community-owned institutions providing non-sophisticated banking services to local residents. The incentive for their establishment given by the Federal Government was 100% matching grant for a community raising the minimum capital of N0.25 million. The minimum capital for community banks was eventually raised to N5 million and later to N20 million in 2005.

- CBN directives to commercial banks on lending to the poor, including lending a specified proportion of their rural deposits to rural enterprises.

- The various initiatives on the funding of small and medium-scale enterprises (SMEs), including SME I, SME II, NERFUND, Family Economic Advancement Programme (FEAP), SMEEIS, etc.

- The launching of the Microfinance Guideline in 2005, creating microfinance banks (MFBs) with a minimum capital of N20 million and directing community banks to convert to MFBs by December 31, 2007. So far, over 700 MFBs are in existence and many more are in advanced stages of licensing. A major fallout of the new regime of MFBs is the extension of deposit insurance to MFBs and mortgage banks, even though with lower limit of insurance cover.

- The launching of the N50 billion Microfinance Fund. This fund is taking off with the balance of SMEEIS uninvested set-aside fund and is expected to attract more funds from state governments' contribution representing 1% of annual budgets.

As it is now, there are diffused sources of microfinance in Nigeria. The universal banks are providing microfinance through their rural and urban branches, and through SMEEIS. The primary mortgage banks are also into microfinance. There is also the Nigerian Agricultural, Cooperative, and Rural Development Bank (NACRDB), and the cooperative societies (some of which have more assets that the MFBs). The MFBs and a host of other schemes managed by NGOs and state governments also provide microfinance. Universal banks are expected to be involved in microfinance either through a department of the bank, in which case it becomes a special product or through an independent subsidiary. Whatever method the universal banks choose to enter microfinance, they represent the best opportunity for meaningful impact as we have earlier observed.

Banking business in Nigeria now is conducted under a climate of improved political governance, with the government deeply committed to due processes. This minimizes arbitrariness in policies and assures a measure of policy stability and macroeconomic stability. The legal system is witnessing a bout of judicial activism with respect to constitutional matters, and it is reasonably expected that this would soon be extended to other sectors, especially in business and debt recovery cases. Security of lives and property is highly threatened and banking halls across the country have become one of the most risky places to be during the business day. In this era of knowledge workers, the educational system is not living up to expectation in producing the workers with the requisite skills needed by banks and other businesses. The quality of infrastructure provision is very poor. The financial sector is emerging from a major consolidation and there are strong forces for a second round of consolidation even as some recently consolidated banks are experiencing serious governance challenges. The oligopolistic nature of the banking system is persisting as the biggest seven banks control more than 60% of banking assets and liabilities. There is also on-going consolidation in the insurance sector. The number of supervised entities under the CBN (universal banks, MFBs, and mortgage banks), is increasing at a time of shortage of supervisory expertise. Can the CBN cope or should additional supervisory agenciesnot be created? Recall there used to be the National Board for Community Banks, charged with the oversight of community banks, and it was understood at some time that the Federal Mortgage Bank of Nigeria (FMBN) was in charge of the supervision of Primary Mortgage Institutions (PMIs).

In respect of the MFBs, there are a lot of issues to consider. Is the capital base adequate? Are the right types of entrepreneurs being attracted into the industry? Can the right governance arrangements be quickly put in place? Do we have adequate stock of human resources with the orientation for microfinance? Will the new MFBs be able to weather the infrastructure challenge?

6. POLICY RECOMMENDATIONS

Our discussion has highlighted many aspects of microfinance and some institutional impediments to effective microfinance. It now remains for us to recommend some institutional reforms that would move microfinance forward. These recommendations are informed by the great impact on economic growth that bringing the enterprising poor into the market economy could make. As Prahalad (2006) rightly observed:

"The real source of market promise is not the wealthy few in the developing world, or even the emerging middle-income consumers. It is the billions of aspiring poor who are joining the market economy for the first time".

Efficient microfinance in Nigeria would require the following institutional reforms:

1. Reform of the legal system to offer more protection to investors and creditors. As it is now, people would borrow from banks and refuse to pay and even go to court to obtain injunctions against realizing the security, which they have willingly pledged as collateral.

2. Establish a credit information exchange mechanism that would track all borrowings and repayments in the banking system no matter the size.

3. Establish a Microfinance Advisory Agency to coodinate all issues of technical assistance for MFIs, both from internal and external sources, and link MFIs to long-term social investors from abroad.

4. Create a separate regulatory and supervisory agency for MFIs and PMIs, and bring all thrift and credit societies with assets in excess of N50 million under the same supervisory umbrella as the MFBs and PMIs.

5. Re-orientate political governance towards policies that are investment-friendly through more rigorous project evaluation and improved budgetary practices. In this way, macroeconmic stability would always be a bye-product of public economic policy decisions.

6. Government should rethink its support for non-commercial microfinance, using all its public enlightenment channels to propagate the virtues of full-cost pricing of services provided by the government, which could alternatively be provided by the private sector. All such slogan as "free education" "free healthcare" "subsidized interest rate" are injurious to efficient resource allocation. The poor have proven that access is more important than cost to them when the playing field is leveled.
7. Government should liberalise the provision of all basic infrastructure like power, roads, and water supply.

8. Nigeria should move towards full external trade lliberalisation.

9. Use fiscal incentives to attract the right capital and entrepreneurs into microfinance. Commercial microfinance is no doubt a pioneer industry and entrepreneurs establishing multi-branch (state) MFBs, and are able to open, say 10 branches within one year, should enjoy income tax holiday for five years.

10. Reintroduce rural banking for all banks and require every bank to open one rural branch for every five urban branches. In India, The Reserve Bank requires banks to open one rural branch for every three urban branches opened. This is a requirement of Section 22 of Banking Regulations Act of 1949 that provides that " Private sector banks.. are required to open a minimum of 25% of their total branches in rural/semi urban areas as a condition of the license issued to them.." In the meantime, government/CBN should extend matching grants to legacy banks for their existing

rural branches.

11. Government at all levels should revitalize their social mobilization networks to nurture viable groups/associations of tradesmen, artisans, producers, and workers, to provide effective group guarantees for microfinance lending as well as imbibe the savings culture.
12. Raise the minimum capital of MFBs to N500 million after three years in order to encourage the kind of consolidation that took place in the universal banking sector in 2004/2005, as the number of MFBs would soon present supervisory nightmares.
13. Review the curricula in our educational system to emphasise self-employment and entrepreneurship and tone down wage expectations of graduates after school. This would increase the supply of entrepreneurs across the country and produce the type of workers with the temperament for microfinance industry.
14. Liberalisation of all input and output markets so that exploitative market powers that work against the poor are dismantled.

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BEYOND FINANCE: STRATEGIES FOR POVERTY REDUCTION IN NIGERIA

BY

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Introduction

An important result of the Household Survey conducted in 2004 by the National Bureau of Statistics is the poverty in Nigeria, though falling, was still as high as 54 per cent. In a land that is so blessed, there seems to be no reason why poverty should be widespread and severe. It is therefore a legitimate objective that every effort should be made not only to reduce it but to eliminate it. In this effort, much premium is placed on finance. This is understandably so since there is not much that can be achieved without finance. As Prof. Soludo, the Governor of the Central Bank of Nigeria has stated, a dream without finance to implement it remains just that a dream! Over the years a number of initiatives have been adopted to bring finance closer to the poor. In addition to the traditional credit delivery systems, there have been other initiatives. One of the latest being the Microfinance Policy of the Central Bank of Nigeria and the recent conversion of community banks to microfinance banks and the licensing of new ones. Nevertheless, finance alone is not enough. Other complementary strategies must be adopted if we are to realize the goal of poverty reduction in Nigeria. The objective of this paper therefore is to identify the non-financial constraints that the poor face in order to adjust the financial products accordingly. The rest of the paper is organized as follows. In section 2 we provide some stylized facts on poverty. Section 3 covers the role of finance in poverty reduction while section 4 deals with complementary non-financial strategies. The paper is concluded in section 5.

Some Stylized Facts on Poverty

To be able to tackle poverty, it is necessary to understand the nature of the problem and identify some of its characteristics. Generally, economists regard poverty as a situation of low income or consumption. Thus people are regarded as poor when they are unable to meet the minimum standard of living, especially in terms of nutrition or other necessities of life. More broadly, poverty refers to lack of physical necessities, assets and income. Also, poverty is strongly related to lack of basic needs and cultivable land; the poor are characterized by relatively low access to health related infrastructure; poverty is higher in rural areas than in the urban areas and that poverty in Nigeria is higher among female headed homes than in male headed households.

The role of Finance/Credit

The importance of financial intermediation in attacking poverty has long been recognized in the literature. Yet substantial challenges remain in providing affordable, useful and sustainable financial services to the poor.

We are conscious of the consequences of inadequate financial support for the health, well being and earning capacity of the poor.

The view has been expressed that lack of access to credit has kept many Nigerians in poverty. It is claimed that commercial banks are reluctant to lend to the poor because of inadequate collateral. In this regard, the ease with which a customer can access funds depends on a number of critical factors. Some of these factors are reviewed below.

- The type and size of the project. There are projects that banks are more willing to support than others.
- The credit history of the borrower. Usually, the borrower with a good repayment record is more likely to get further credit than one with a poor credit history.
- The prevailing economic conditions. Access to credit is always easier when the economy is in a boom than when it is in a recession.
- The level of competition in the industry.
- The judicial processes in credit recovery. Many borrowers have abused the judicial processes when they default to pay back the loan which they obtained. Some defaulters seek court injunctions restraining the

financial institutions or their agents from realizing the collateral asset until the substantive case had been determined.

Such borrowers may regard the loan as part of the national cake.

A quick review of the above factors will give us a sense as to why it has been difficult to expand credit in Nigeria as much as would be reasonably expected and may enable us reach an unbiased judgement on the performance of financial institutions in Nigeria.

Strategies for Poverty Reduction

The private sector must ultimately be the driver of growth, employment creation, and poverty reduction. A major impediment to growth is poor infrastructure especially low power generation and its weak distribution, inadequate water supply and inadequate means of transportation including poor access roads which combine to raise the cost of doing business in Nigeria. Therefore, any genuine effort at reducing poverty must address the issues of power and transportation. Small businesses such as carpentry, iron works, barbing and hairdressing, tailoring and so on all require reliable electricity to operate and prosper.

It is often touted that the Small and Medium Enterprises (SMEs) are the major source of growth, innovation and employment generation. In a country where that is true, a great deal of attention is paid to skills acquisition, particularly in project identification, project design and project implementation. The weakness of entrepreneurs in the identified areas informed the recent move by the CBN in setting up pilot entrepreneurship development centres in three geopolitical zones of Nigeria. The idea is to train potential entrepreneurs in the critical areas so that they can have better access to credit. It is also envisaged that both the government and other operators in the financial services industry would take a cue from the CBN's initiatives and establish similar projects across the country.

Another constraint to the development of Small and Medium Enterprises (SMEs) and therefore their access to credit is poor management practices. Many of them do not keep proper records of their transactions. This makes it difficult for banks and other financial institutions to appraise the performance of the enterprises and in that way constraining their access to credit. A training program in basic bookkeeping would tend to enhance the performance of the enterprises and provide evidence of seriousness on the part of the business owners as they would separate personal from business activities.

Another critical strategy for reducing poverty is the direct promotion of innovation in the various sectors of the economy. The development of new products and new processes is essential for the expansion of the production frontier. This is not limited to the high-tech areas of biotechnology or information and communication technology. With better training, come improvements in output. Similarly, increased technical capability contributes to better export performance. In this area, in addition to the knowledge of firms and owners, it is important that there should be support from local institutions particularly research institutes and institutions of higher learning. As Oyeyinka has observed, as firms face both domestic and external competition, the need for new sets of technical and managerial competencies arises. In emerging countries, specialized financial institutions such as venture capitals are set up to provide support to firms with new ideas.

The provision of support services can enhance the productivity of the companies and therefore the success of the poverty reduction strategies. Some of these include identification of markets and the packaging of the product. These tend to raise the profitability of loan financed projects. Many SMEs would increase output with increase in the demand for their products. This can be enhanced when government as a matter of deliberate policy encourages the citizens to patronize the products of such enterprises. For instance, the use of local textile materials, such as "adire" by our leaders encourages others to buy and the use of such products not only improves revenue but also definitely influences the access to finance. The example has also been cited of farmers who were persuaded by their political leaders to plant sugarcane but could not find a market after harvest. Similarly, good packaging increases the attractiveness of a product and therefore the volume of sales. The better packaged our products the better the prospects of higher sales and penetration into the international market.

A final critical factor that we shall consider in this paper is the role of a favourable macroeconomic and regulatory environment. In an environment of rising inflation lenders are wary. That is one reason why central banks are committed to keeping inflation low so as to encourage financial institutions to increase lending.

Conclusion

The paper reviewed the factors affecting poverty in Nigeria and pointed that there is ample room to improve our performance in reducing poverty significantly in the near term. However, a number of strategies need to be deployed in order to realize that dream. When implemented, financial services, particularly credit delivery, will be enhanced and the poor in our society can be lifted out of poverty. Essentially, we reached the conclusion that although finance is critical, the provision of finance alone will not do the magic. This calls for a coordinated, focused and increased action without which no significant progress can be made in reducing poverty in Nigeria.

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