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Mejeha, Remy O. and Nwachukwu, Ifeanyi N.

Michael Okpara University of Agriculture Umudike, Abia State, Nigeria

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MICROFINANCE INSTITUTIONS IN NIGERIA

MEJEHA, R. O. [1] **and I.N. NWACHUKWU**[2]

[1]**Dept of Agricultural Economics**
[2]**Dept. of Agribusiness and Management**
Michael Okpara University of Agriculture Umudike,
Abia State, Nigeria
Email:onyekamej@yahoo.com; ifnwachukwu@yahoo.com

MICROFINANCE INSTITUTIONS IN NIGERIA

ABSTRACT

The advocation of micro – financing was triggered by the poor performance of the conventional finance sector. The essence was to reach the overwhelming population of the poor to assist in the drive to alleviate poverty. Barely a million had been provided with some credit in Nigeria while a yawning 40 million poor people are yet to be attended to. In terms of supply, commercial and development finance institutions are in the fore front of the outfits that provide credits to the microfinance institutions. Despite their efforts, rates of interest, inequitable distribution of wealth and income and outreaching the poor constitute challenges to the operations. The establishment of microfinance institutions in Nigeria was based on weak institutional capacity, weak capital base, existence of a huge unserved market, utilization of SMEEIS fund among other things

Keywords: microfinance, financial institutions, agricultural credit and finance

BACKGROUND

The dismal performance of the conventional finance sectors triggered the advocation of micro – financing by policy makers, practitioners, and international organizations as a tool for poverty reduction. Since its emergence, the number of microfinance institutions around the world has proliferated at a fast pace after the 1970s. Today there are more than 7000 micro – lending organizations providing loans to more than 25 million poor individuals around the globe (Mohammed and Hasan, 2008). The Nigerian microfinance industry has come a long way. It boasts of the entire four well - known models in the industry. A CBN study identified, as of 2001, 160 registered Microfinance Institutions (MFIs) in Nigeria with aggregate savings worth N99.4 million and outstanding credit of N649.6 million, indicating huge business transactions in the sector (Anyanwu, 2004). With a population of about 150 million and GDP per capita of $641 (2006), two – thirds of Nigeria's people are poor. Nigeria has the third highest number of poor people in the world. Most of these people are dependent on micro and small – scale farm and off – farm enterprises for their livelihood (UNDP, 2007).

One of the challenges microfinance currently faces in Nigeria is for the MFIs to reach a greater number of the poor. The CBN survey indicated that their client base was about 600, 000 in 2001, and there were indications that they may not be above 1.5 million in

2003. The existing microfinance in Nigeria serves less than 1 million people out of 40 million potential people that need the service (CBN, 2005).

Also, the aggregate micro credit facilities in Nigeria account for about 0.2 percent of GDP and less than one percent of total credit to the economy. Another challenge is that most of microfinance funding goes to the commercial sector to the detriment of the more vital economic activities, especially agricultural and manufacturing sectors which provide the foundation for sustainable growth and development. Currently, only about 14.1 and 3.5 per cent of total MFI funding went to these sectors, respectively, while the bulk, 78.4 percent, funded commerce (Anyanwu, 2004). About 90% of Nigeria's businesses are considered microenterprises and these farm or non-farm activities serve as the main income source for the majority of the labor force. Due to the unwillingness or inability of commercial banks to provide financial services to the urban and rural poor, coupled with the unsustainability of government-sponsored development financial institutions and programs, most microentrepreneurs still access financial services from informal sources, including savings and credit associations, traders, or moneylenders. Semi-formal and formal providers of microfinance are a small but rapidly growing part of the financial sector in Nigeria with a handful of large, microcredit NGOs and locally-owned community banks providing the bulk of services.

MICROFINANCE IN NIGERIA: EVOLUTION AND CHALLENGES

Microfinance: Concept and Need

Micro financing is the provision of financial services to poor and low income households without access to formal financial institutions (Conroy, 2003). Microfinance is described also as banking for the poor. Microfinance programmes provide loans, savings and other financial services to low-income and poor people for use in small businesses. Originally based on traditional forms of community financing (a cross between finance and development assistance), microfinance is found all over the world in places such as Africa, Latin America and Asia. The microfinance movement began in earnest in the early 1980.s in places like Bangladesh and Bolivia and has, over the last 20 years, captured the interest of multilateral donor agencies and private sector bankers. (Enugu Forum, 2006).

Microfinance institutions are essentially needed to serve the poor city dwellers overcrowding in slums or squatter settlements in appalling conditions. They lack access to basic services such as education for children and health care. Their survival tool kit lacks skills that are essential to enter the employment mainstream of the economy. Many of them are women, poorly trained and playing dual roles of provider and caregiver. These poor people are more exposed to the threats of contamination, bad sanitation, and disease than the rest of the population (Otero, 1999)

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

CHARACTERISTICS OF MICROFINANCE INSTITUTIONS IN NIGERIA

Before the emergence of formal microfinance institutions, informal microfinance activities flourished all over the country. Informal microfinance is provided by traditional groups that work together for the mutual benefits of their members. These groups provide savings and credit services to their members. The informal microfinance arrangements operate under different names: .esusu. among the Yorubas of Western Nigeria, etoto. for the Igbos in the East and adashi in the North for the Hausas (CBN, 2000). The key features of these informal schemes are savings and credit components, informality of operations and higher interest rates in relation to the formal banking sector. The informal associations that operate traditional microfinance in various forms are found in all the rural communities in Nigeria (Otu *et al*, 2003). They also operate in the urban centres. However, the size of activities covered under the scheme has not been determined. The non-traditional, formalized microfinance institutions (MFIs) are operating side by side with the informal services. The financial services provided by the MFIs in Nigeria include savings, credit and insurance facilities.

Microfinance suppliers

(i) Commercial banks and Microfinance

The response of the banking system in Nigeria is changing to pay attention to microfinance seekers. The Bankers Committee has recently decided that 10 per cent of the funds accruing to the Small and Medium Industries Equity Investment (SMIEIS) should be channeled to micro enterprises through registered microfinance institutions. Under the SMIEIS arrangement, banks in Nigeria agreed to set aside 10 per cent of their pre-tax profit annually for equity investment in small and medium industries. At the end of June 2004, over N24 billion had been set aside under the scheme, while less than N10 billion had been invested. Apart from providing a large volume of resources, the fund is fairly medium to long term in nature and this has the potential of positively changing the structure of the microfinance industry in Nigeria (CBN, 2004).

(ii) Development Finance Institutions

Between 1964 and 1977, various development finance institutions (DFIs) were established at both national and state levels in the country. The national DFIs included the Nigerian Industrial Development Bank (NIDB), Nigerian Bank for Commerce and Industry (NBCI), Nigerian Agricultural and Cooperative Bank (NACB) and Federal Mortgage Bank of Nigeria (FMBN). Each institution was given the responsibility of promoting the development of a specific sector or sub-sector (CBN, 2000). The NIDB was established in 1964, from the restructuring of an existing Investment Corporation of Nigeria (ICON), and given the mandate of developing new industrial enterprises and expanding existing ones through the provision of medium and long term loans and equity participation. A decade later in 1973, the NBCI was established to provide funding to small and medium scale enterprises. Of more relevance to micro enterprises, the NACB was also established in 1973 to promote the development of the agricultural sector in which most of the operators are micro enterprises. Also the FMBN, which took over the assets and liabilities of the Nigerian Building Society (NBS), was established in 1977, with the mandate to provide funding for residential and other housing needs of individuals and corporate organizations. Two other DFIs, the Urban Development Bank and Education Bank, were established in 1992 and 1993, respectively, to cater for these two important sectors. These DFIs made varying contributions According to their sectors of responsibility. They funded various projects and enterprises, many of which are in operation today. However, with the drastic reduction in government subventions to them in the 1990s, their operations reduced drastically and by late 1990, they all ceased operating, as all of them depended mainly on government funding (Mohammed and Hasan, 2008).

The poor performance of the DFIs notwithstanding the need to channel financial resources to the productive sectors, have remained a major challenge to the government and the monetary authorities. Attempts have therefore been made to restructure the DFIs, give them commercial orientation and make sustainability the guiding principle. In December, 2007, the new government policy give licenses to 107 microfinance banks and converted 600 out of 761 community banks to microfinance banks which make the total number of microfinance banks 707 in the country (Soludo, 2008).

MICRO FINANCING: CHALLENGES

There are some challenges that militate against micro financing in Nigeria. The elaborate details are presented below:

(a) Rates of interest

According to Anyanwu (2004), the interest rates in the microfinance institutions are much higher than the prevailing rates in the banks. This ranges between 32-48%. During this period the banks are charging between 19.5% and 21.6 %. Money lenders at informal sector charge interest rates of 100% or more. Some of the clients when interviewed by MFI evaluators bitterly complained about the interest rates being too high.[8] Two reflections could be made.

First, given the fact that people borrowing at this rate indicate that they are industrious and productive. It is only that they are not given access to financial institutions, because they do not have collateral to meet the requirements of formal financial institutions and then they remain poor and liabilities to the economy instead of being assets. Second, the objective of microfinance to combat poverty might be defeated since the clients have to repay back double of what they have received at all cost.

(b) Inequitable Distribution of Wealth and Income

The conventional Micro financing in Nigeria aggravates the inequitable distribution of income and wealth in Nigeria. This is due to the fact that while interest rate on borrowing from microfinance institutions ranges from 30% to 100%, interest rates on both voluntary and mandatory savings for the clients are between 4.5% and 6% per annum.

Again, lending at this rate is taking the rewards of poor and redistributes it to the rich. The poor borrowers must pay the amount through group pressure even if it resort them to another borrowing or selling their properties. Moreover, the current micro financing in Nigeria gives loan to commerce based activity to the detriment of agriculture based which is the source of income and sustenance for the majority of poor Nigerians. In a study conducted by CBN on the major ten MFIs in Nigeria it was found that the loan disbursement goes to the trade and commerce because of its fast yield and high return.

The average loan on this sector was 78.4%. The corresponding figure on agriculture which most poor rely on for their lively hood was only 14.1%. It was only 3.5% on manufacturing and absolutely no funding is given towards housing and consumption (Folake, 2005)

(c) Outreaching the poor

According Central Bank of Nigeria's estimate the unreachable client of microfinance reaches 40 million.(CBN, 2004) Microfinance specific institutions in Nigeria have not been able to adequately address the gap in terms of credit, savings and other financial services required by the micro entrepreneurs. The existence of huge unserved market - over 80 million people (65% of Nigeria's active population). In 2005, the share of micro credit as a percentage of total credit was 0.9%, while it contributed a meager 0.2 percent of the GDP (Bamisile, 2006)

The dominant microfinance institutions are concentrated in the south and eastern part of the country to the detriment of poor majority in the predominantly Muslim north. The incidence of poverty in the three Northern regions is high compared to the three southern regions. It was 71% in North West, 72% in North East and 67% in North Central. The corresponding figure in the South is 43% in South West, 23% in South East and 35% in South South. These numbers are what led to the conclusion that very high level of poverty is essentially a Northern Phenomenon (Soludo, 2007)

According to Soludo (2008), after introducing new policy on microfinance, the new focus on small and medium-scale enterprises was borne out of the realization that the country could not go far in employment generation and poverty alleviation without these enterprises having their pride of place[12] He added that the microfinance policy, which evolved as a result of the perceived need for funding of businesses, which have no access to banks funds, will benefit only 35 per cent of the nation’s population, particularly micro and small scale entrepreneurs, due to uneven spread of the(Microfinance Banks (MFBs) across the states (Soludo, 2008)

JUSTIFICATION FOR THE ESTABLISHMENT OF MICROFINANCE BANKS

From the appraisal of existing microfinance-oriented institutions in Nigeria, the following facts have become evident:

Weak Institutional Capacity: The prolonged sub-optimal performance of many existing community banks, microfinance and development finance institutions is due to incompetent management, weak internal controls and lack of deposit insurance schemes. Other factors are poor corporate governance, lack of well defined operations and restrictive regulatory/supervisory requirements.

Weak Capital Base: The weak capital base of existing institutions, particularly the present community banks, cannot adequately provide a cushion for the risk of lending to micro entrepreneurs without collateral. This is supported by the fact that only 75 out of over 600 community banks whose financial statements of accounts were approved by the CBN in 2005 had up to N20 million shareholders’ funds unimpaired by losses. Similarly, the NACRDB, with a proposed authorized share capital of N50.0 billion, has N10.0 billion paid up capital and only N1.3 billion shareholders’ funds unimpaired by losses, as at December, 2004.

The Existence of a Huge Un-Served Market: The size of the unserved market by existing financial institutions is large. The average banking density in Nigeria is one financial institution outlet to 32,700 inhabitants. In the rural areas, it is 1:57,000, that is less than 2% of rural households have access to financial services. Furthermore, the 8 (eight) leading Micro Finance Institutions (MFIs) in Nigeria were reported to have mobilized a total savings of N222.6 million in 2004 and advanced N2.624 billion credit, with an average loan size of N8,206.90. This translates to about 320,000 membership-based customers that enjoyed one form of credit or the other from the eight NGO-MFIs. Their aggregate loans and deposits, when compared with those of community banks, represented percentages of 23.02 and 1.04, respectively. This reveals the existence of a huge gap in the provision of financial services to a large number of active but poor and low income groups. The existing formal MFIs serve less than one million out of the over 40 million people that need the services. Also, the aggregate micro credit facilities in Nigeria account for about 0.2 percent of GDP and less than one percent of total credit to the economy. The effect of not appropriately addressing this situation would further accentuate poverty and slow down growth and development.

Economic Empowerment of the Poor, Employment Generation and Poverty Reduction: The baseline economic survey of Small and Medium Industries (SMIs) in Nigeria conducted in 2004, indicated that the 6,498 industries covered currently employ a little over one million workers. Considering the fact that about 18.5 million (28% of the available work force) Nigerians are unemployed, the employment objective/role of the SMIs is far from being reached. One of the hallmarks of the National Economic Empowerment and Development Strategy (NEEDS) is the empowerment of the poor and the private sector, through the provision of needed financial services, to enable them engage or expand their present scope of economic activities and generate employment. Delivering needed services as contained in the Strategy would be remarkably enhanced through additional channels which the microfinance bank framework would provide. It would also assist the SMIs in raising their productive capacity and level of employment generation.

The Need for Increased Savings Opportunity: The total assets of the 615 community banks which rendered their reports, out of the 753 operating community banks as at end of December 2004, stood at N34.2 billion. Similarly, their total loans and advances amounted to N11.4 billion while their aggregate deposit liabilities stood at N21.4 billion for the same period. Also, as at end-December 2004, the total currency in circulation stood at N545.8billion, out of which N458.6billion or 84.12 per cent was outside the banking system. Poor people can and do save, contrary to general misconceptions. However, owing to the inadequacy of appropriate savings opportunities and products, savings have continued to grow at a very low rate, particularly in the rural areas of Nigeria. Most poor people keep their resources in kind or simply under their pillows. Such methods of keeping savings are risky, low in terms of returns, and undermine the aggregate volume of resources that could be mobilized and channeled to deficit areas of the economy. The microfinance policy would provide the needed window of opportunity and promote the development of appropriate (safe, less costly, convenient and easily accessible) savings products that would be attractive to rural clients and improve the savings level in the economy.

The Interest of Local and International Communities in Micro-financing: Many international investors have expressed interest in investing in the microfinance sector. Thus, the establishment of a microfinance framework for Nigeria would provide an opportunity for them to finance the economic activities of low income groups and the poor.

Utilization of SMEEIS Fund: As at December, 2004, only N8.5 billion (29.5%) of the N28.8 billion Small and Medium Enterprises Equity Investment Scheme (SMEEIS) fund had been utilized. Moreover, 10% of the fund meant for micro credit had not been utilized due to lack of an appropriate framework and confidence in the existing institutions that would have served the purpose. This policy provides an appropriate vehicle that would enhance the utilization of the fund (FAO, 1999; Olaitan, 2001; Yaron *et al*, 1998; Zeller and Sharma, 1998.

SUPERVISORY AND REGULATORY FRAMEWORK OF THE MICROFINANCE INSTITUTIONS

Given the importance and growth of the fledgling microfinance industry in Nigeria, it has recently caught the attention of policymakers and the donor community. Recent efforts have been devoted to improving the policy, legal and regulatory framework for microfinance. The objective of this note is to highlight strengths and weaknesses of the current system as well as recent and ongoing changes in the legal and regulatory framework for microfinance, namely:

• The drafting of a national microfinance policy, specifically the draft national microfinance policy that has been under development for the last three years. The latest draft includes the basic legal underpinnings for regulation and supervision of microfinance providers. It is now under review by the Governor and Directors of the Central Bank of Nigeria (CBN);

• Proposed changes to the Small and Medium Industries, Equity Investment Scheme (SMIEIS) Program in order to increase access to lending by farm and non-farm micro, small and medium-scale micro enterprises; and

• The introduction of measures to promote consolidation within the banking industry, including new capitalization requirements for commercial banks.

Strengths

Existence of the Community Bank Legal Form

Despite their mixed performance, the existence of the community bank as a legal form of financial intermediary represents one of the most positive attributes of the legal and regulatory framework for microfinance. With a total number of about one million clients and about one sixth of all banking counters in Nigeria, community banks enjoy many comparative advantages in microfinance operations: they are located close to their clients, they have intimate knowledge of local cultures, habits, opportunities and constraints; and they primarily concentrate on simple banking functions. Despite low levels of lending and relatively high bad debt provisions (mandated by the CBN), some well-managed community banks generate satisfactory levels of profit. Improved performance and competition is likely to lead to a much greater number of borrowers and either higher profitability, higher deposit interest rates, or lower lending interest rates (IFAD 2004).
Although there are several aspects of community bank regulation and supervision that need to be improved (discussed below), this legal form of financial intermediary holds much promise for future achievement of sustainability and scale of the microfinance industry.
Another strength of Nigeria's legal and regulatory framework for microfinance is the interest of the CBN in microfinance and its willingness to learn from and adapt international best practices to their development of an enabling legal and regulatory framework. For example, the CBN has been collaborating with the United Nations Development Program (UNDP) and USAID's Promoting Improved Sustainable MSME Services (PRISMS) program on several capacity building activities, including:

• Study tours for key CBN personnel to countries having advanced legal and regulatory frameworks for microfinance such as the Philippines, Jordan, etc.

• Attendance of selected CBN staff at advanced microfinance training programs.

• Development of courses and training-of-trainers' assistance for a series of courses aimed at increasing CBN examiners' awareness of the specialized nature of microfinance operations and risk-based supervision techniques.

Weaknesses

Inadequacies in the legal framework for secured transactions continue to provide barriers for microfinance. These include inadequate property rights for real estate and movable property, bankruptcy laws and leasing contracts. Laws are not interpreted with consistency in the courts and there is inadequate enforcement of existing laws and commercial contracts. The CBN is currently overstretched in its supervision capacity and requires capacity building assistance to deal effectively with the growing number of institutions engaging in microfinance operations.

The CBN is the sole institution for the licensing and regulation of the commercial banking sector; with regard to community banks. It has shared this responsibility in the past with the NBCB, but is now taking over as the sole regulator and supervisor. Within CBN, two departments are directly involved in rural and microfinance: the Development Finance Department (DFD) and the Other Financial Institutions Department (OFID). DFD is in charge of promoting and developing, OFID in charge of regulating and supervising community banks, other non-bank financial institutions and, in the future MFIs. Together, the two departments have taken full responsibility for rehabilitating, restructuring and retraining community banks to be more effective rural and micro financial service providers (Charitonenko, 2005; IFAD, 2004; FAO, 2004).

SUMMARY OF PROPOSED GUIDELINES FOR MICRO FINANCE INSTITUTIONS (MFIS) IN NIGERIA (PREPARED BY THE CENTRAL BANK OF NIGERIA)

1. Introduction

The guidelines are to regulate the establishment, operations and other activities of Microfinance Institutions (MFIs) that seek to take savings/deposits from members of the public and engage in microfinance intermediation services in Nigeria. A Microfinance Institution (MFI) shall be construed as any company licensed to carry on the business of providing microfinance services, such as savings, loans, domestic fund transfers and other financial support services, that micro enterprises need to conduct or expand their businesses.

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

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

2. Application for License

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

a. A non-refundable application fee of N20, 000.00 (twenty thousand naira only) in bank draft, payable to the Central Bank of Nigeria.

b. Deposit of the minimum capital of N30 million in bank draft made payable to the CBN. The capital thus deposited together with the accrued interest will be released to the promoters on the grant of the final license.

c. A copy of detailed feasibility report disclosing relevant information.

d. A copy of the draft Memorandum and Articles of Association.

e. A letter of intent to subscribe to the shares allotted to the shareholders of the proposed Microfinance Institution, signed by each subscriber.

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

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

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

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

3. Financial Requirements

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

a. Minimum paid-up capital - N30, 000,000.00

b. Non-refundable Application Fee- N20, 000.00

c. Non-refundable Licensing Fee - N50,000.00

d. Change of Name Fee - N10, 000.00

4. Directors

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

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

5. Sources of Funds

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

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

b. Deposits by customers.

c. Debenture/qualifying medium to long term loans

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

6. Publication of Audited Accounts

Every Microfinance Institution shall submit its audited financial statements and the abridged version of the accounts to the Director of Other Financial Institutions of the CBN for approval not later than four months after the end of the company's financial year. The Domestic Report on the Accounts from the External Auditors should be forwarded to the Director, Other Financial Institutions Department (OFID), not later than three months after the end of the accounting year. After approval, the MFI shall publish the accounts in at least two (2) national daily newspapers. Every published account shall disclose in detail the penalties paid as a result of the contravention of BOFIA 25, 1991 (as amended) and any policy guideline in force during the year in question and the auditor's report shall reflect such contraventions. Any Microfinance Institution that fails to comply with any of the above requirements will be liable to a fine not exceeding N20, 000.00 each day during which the offence continues.

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

a. For lateness in submitting return/furnishing any information required, the penalty shall be a fine of N2, 500.00 for each day during which such failure occurs. Persistent failure/refusal to render returns in the prescribed form may be a ground for the revocation of a MFI's license.

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

c. If any Director or Officer of an MFI fails to take all reasonable steps to ensure that proper books of accounts are kept with respect to all transactions of the company at its Head Office and/or at its branches, the CBN may impose on him a fine not exceeding N20, 000.00. If any default in this respect is caused by the willful act of any Director or Officer of the Microfinance Institution, the CBN may impose on him a fine not exceeding N100, 000.00 or cause the removal of such Director or Officer in order to protect the integrity of the financial system. In addition, the Bank may impose on the MFI such other penalties as are deemed appropriate.

8. Prudential Requirements

Every MFI shall comply with the following requirements:

Liquidity ratio

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

Capital Funds Adequacy

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

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

In addition, the MFI may be required to submit within a specified period, a recapitalization plan acceptable to the CBN.

Failure to comply with the above may constitute grounds for the revocation of the license of the MFI or such other penalties as may be deemed appropriate. MFI are enjoined to ensure that their shareholders' funds do NOT fall below the required minimum paid-up capital.

Fixed Assets/Long-terms Investments and Branch Expansion

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

• Acquisition of fixed assets

• Equity investments and investments in longer-term debentures.

• Branch expansion

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Maintenance of Capital Funds

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

• All preliminary and pre-operational expenses have been written off;

• All preliminary losses have been made for loan/assets deterioration;

• All identifiable losses have been fully provided for.

Payment of Dividend

No dividend shall be paid until:

• All accumulated losses have been fully absorbed and written off.

• All preliminary and pre-operational expenses have been written off.

• Capital Adequacy ratio has been met.

• All matured obligations have been met.

Limit of lending to Single Borrower

The maximum loan by a MFI to any person or maximum investment in any venture by a MFI shall be 5% of the MFI's shareholders' funds unimpaired by losses or as may be prescribed by the CBN from time to time. Any contravention will attract a penalty of N100, 000.00 on the Microfinance Institution and a fine of N10, 000.00 on the directors/managers who failed to comply.

Maximum Equity Investment Holding Ratio

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

Provision for Classified Assets

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

Days at risk Description Provisioning Requirement

- 1-30 days Pass and watch 20%
- 31-90 days Sub-standard and doubtful 50%
- >90 days Loss 100%

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

Limit of Investment in Fixed Assets

The maximum amount which a MFI can invest in fixed assets is 20% of its shareholders' funds unimpaired by losses. Any contravention will attract a penalty not exceeding N200, 000.00 or suspension of the license.

9. Disclosure of Interest by Directors and Officers of MFIs

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

Every Director or Officer of a MFI that holds any office or possesses any property whereby whether directly or indirectly, duties or interests might be created in conflict with his duties or interest as a Director or Officer of the MFI, shall declare at a meeting of the Board of Directors of the MFI, the fact and the nature, character and extent of such interests. Any Director or Officer that contravenes either of these regulations shall be liable to a fine of N100, 000.00 or removal from office.

10. Opening/Closing of Branches of Microfinance Institutions

Prior approval of the CBN is required for the opening and closing of branches. If in contravention, the MFI shall be made to pay a fine not exceeding N200, 000.00 and the closing/reopening of the branch as the case may be and in addition, a fine of N10, 000.00 for each day during which the offence continues.

11. Display of Interest Rates

Every MFI shall display on a daily basis in a conspicuous place at its Head Office and branches, its rates of interest. Interest rates shall be quoted on annual basis and not per month. In contravention, the Microfinance Institution shall be liable to a fine of N20, 000.00 and additional N5, 000.00 for every day during which the offence continues or such other penalties deemed appropriate.

12. Internal Controls

Every MFI shall have an Internal Audit, which should ensure that the operations of the company conform to the law as well as to its internal rules and regulations. Every fraud or attempted fraud must be promptly reported to the Director of Other Financial Institutions Department. Also a quarterly report on Frauds and Forgeries affecting the company and any default in meeting any obligation to lenders or investors shall be submitted to the Director, Other Financial Institutions Department. Where no frauds/forgeries and defaults occurred during the quarter, a Nil return shall be forwarded. The report shall be made along with the quarterly returns on assets and liabilities. Failure to comply with this requirement will attract a fine of N25, 000.00 per quarter.

13. Appointment of Chief Executive and Principal Officer

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

14. Appointment of Auditor

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

The approved auditor shall satisfy the following requirements:

a. a member of a recognized professional accountancy body in Nigeria;

b. carries on in professional practice as accountant and auditor in Nigeria;

c. No person shall be appointed as the auditor of a MFI if:

• He has interest in the MFI otherwise than a depositor

• He is a director, officer or agent of such institution

• It is a firm in which a director of the MFI has interest as partner or director

d. Any auditor who is subsequently affected by Section 14(c) above shall immediately cease to continue as auditor of the MFI.

e. If an approved auditor in the course of his duties as an auditor of a MFI is satisfied that:

• There has been contravention of BOFIA, 1991 as amended or that an offence under any other law, guidelines, circulars, etc. has been committed by the MFI or any of its officers; or

• Losses have been incurred by the MFI which substantially reduces its capital funds; or

• Any irregularity which jeopardizes the interest of depositors or creditors of the MFI or any other irregularity has occurred, or

• He is unable to confirm that the assets of the MFI cover the claims of depositors or creditors. He shall immediately report the matter to the Central Bank of Nigeria;

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

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

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

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

j. Any approved auditor who acts in contravention of the foregoing requirements or fails deliberately or negligently to comply with the requirements of this section shall be liable to a fine of a maximum of N50,000.00 or a determination of his status as an approved auditor to all financial institutions under the supervisory purview of the CBN.

15. Schemes of Arrangement

No Microfinance Institution shall enter into any "Scheme of Arrangement" with its creditors/investors without the prior approval of the CBN. Any Microfinance Institution that is unable to meet its obligations to its creditors or investors must submit its proposals to restore liquidity or viability and for eventual settlement of its outstanding obligations to the Director of the Other Financial Institutions Department for consideration and approval. Failure to comply with this will attract a penalty of N2, 500.00 for each day during which the contravention exists.

16. Restructuring and Re-Organisation of Microfinance Institution

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

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

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

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

d. for the reconstruction of the Microfinance Institution;

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

17. Prohibitions

No Microfinance Institution shall:

a. Deal in foreign currency;

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

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

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

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

18. Conditions for Revocation of License

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

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

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

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

d. Engaging in activities prejudicial to the Nigerian economy.

e. Failure to redeem matured obligations to customers.

f. Unauthorized shop closure.

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

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

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

19. Exit Conditions

The condition for exit of a licensed Microfinance Institution shall be as prescribed by the relevant sections of the Banks and Other Financial Institutions Act (BOFIA) 25 of 1991 (as amended) as applicable to deposit taking financial institutions and the Company and Allied Matters Act (CAMA) 1990.

20. General

The list of valid licenses may be published by the CBN from time to time (Anyanwu, 2004).

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