

## **ASSESSMENT OF RURAL SUSTAINABLE DEVELOPMENT BY MICROFINANCE BANKS IN NIGERIA**

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### **Abstract**

In many developing countries the rural poor are often denied access to financial support because of inadequate infrastructure and pro-urban banking systems. This may be overcome where microfinance systems are introduced. A system of microfinance usually signifies a financial arrangement designed to help the rural poor transform their economic condition. However it can also be viewed as a means to transform rural economic, environmental and social development by empowering communities to find their own solutions to their developmental needs. In order to assess the provision of microfinance systems in Nigeria, and to identify any positive effect on the socio-economic well-being of rural areas, I carried out an analysis of the pattern and the value of loans, advances and credit disbursed to people in different segments of the rural economy over a fifteen year period. The results revealed a major downward trend in the value of credits to rural people compared to the deposits mobilized from them. Hence it appears that there is a net outflow of finance from the rural poor jeopardizing the sustainable development of the rural areas. My research therefore assesses the changes needed in microfinance schemes if the rural poor are to be helped.

**Key Words:** Economy, Microfinance, Poverty, Sustainability, Well-being

### **Introduction**

The application of Microfinance systems has become a crucial factor in finance, economics and related disciplines to the extent that local and international organizations are exploring the modalities of deriving the best in the application of this concept to almost every area of socio economic needs of individuals, small and medium enterprises over the years. This development led to the declaration of year 2003 as international year of microcredit, as a result, Annan (2003) declared that 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

However, Oluymbo (2007) opined that microfinance institutions and banks are fast becoming a household name globally due to its acceptance as a means of reaching those people that were not served by the conventional big banks. It therefore means that the adoption of microfinance policy in Nigeria and other countries is part of the global financial integration in the provision of tailor made financial services to those outside the catchments of the big banks either as a result of their income, location, literacy level or discrimination. This may be the reason for a major increase in number of microfinance banks in Nigeria with more coverage area.

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Although, the Central Bank of Nigeria recognizes 744 registered microfinance banks in operation in Nigeria as at November 14, 2008 ([www.cenbank.org/Supervision/fstitutions.asp#Micro](http://www.cenbank.org/Supervision/fstitutions.asp#Micro)) the number is relatively small if compared with the 160million population figure of a country where the majority reside in the rural areas.

Despite the above, the opportunity for growth and the challenges for full development of microfinance institutions across many nations have raised some essential questions as to the perspective of this type of financial service providers by different countries and whether indeed microfinance institutions or banks can be used to cause transformation in rural areas.

The overall objective of this paper is to examine the effects of microfinance banks on rural development in Nigeria from 1992 to 2006. This will be achieved by examining how loans and advance by microfinance banks penetrate different segmented areas of the rural economy in Nigeria; identifying the relationship that exists between microfinance banks and deposit mobilizes from the rural areas. From this it is hoped to draw conclusions based on empirical analysis and to give recommendations for the successful implementation of microfinance institutions at rural areas and for rural development.

### **Review of Related Literature**

Microfinance is a term that is being used by different people, organization and government to mean different thing at different time. Karlan and Goldberg (2007), sees microfinance as the provision of small scale financial services to people who lack access to traditional banking services. The term microfinance usually implies very small loans to low-income clients for self employment, often with simultaneous collection of small amounts of savings.

Park and Ren (2001) noted that microfinance programs are united in aiming to provide financial services to individuals traditionally excluded from the banking system, especially women. Most microfinance initiatives explicitly target the poor. They overcome conventional obstacles to banking with the poor by paring down traditional branch – banking structures to reduce transaction costs, by using collateral substitutes that harness peer screening and monitoring effort via group lending contracts, and by creating dynamic incentives by increasing loan sizes over time conditional on repayment histories.

At its simplest, microfinance is an economic approach to the delivery of financial services to those that are hitherto unreachable at a fee that is affordable and economic to the users of such services. At the same time, funds from the providers of financial services are used to generate adequate returns for the users, thereby building up their enterprises and creating employment opportunities which will help to reduce the poverty level in the economy. Microfinance is a holistic approach designed to improve the lot of micro, small and medium scale entrepreneurs both in the rural and urban areas in accessing fund as at when needed from the conventional banks.

Udejaja and Ibe (2006) provided a broader definition of a microfinance institution (MFI) as an organization specifically providing financial services to the poor. The organizational form varies but may be a credit union, downscaled commercial bank, financial NGO, or credit cooperative. The formality also varies – from those formal institutions subject to both general laws and to specific banking regulation and supervision (development banks, savings and postal banks, and non-bank financial intermediaries) through the semi formal providers who are required to abide by to general and commercial laws but not regulated by under bank regulation and supervision (financial NGOs, credit unions and cooperative) to informal providers are non-registered groups such as rotating savings and credit association (ROSCAs) and self-help groups. Ownership may also vary from those which are government owned, such as the rural credit cooperatives in China; member-owned, such as the credit

unions in West Africa, socially minded shareholders, such as many transformed NGOs in Latin America; and profit-maximizing shareholders, such as the micro finance banks in Eastern Europe (ibid).

### **Features of Microfinance Banks**

The distinguishing features of microfinance -which may be termed 'sustainable finance' – are identified by ADB (2000), CBN (2005) and Karlan and Goldberg (2007) as including the following:

- i. The smallness of loans advanced to their customers
- ii. Small transactions and minimum balances (whether loans, savings or insurance)
- iii. Savings from the customers are very small
- iv. Loans are for entrepreneurial activity
- v. The absence of asset-based collateral
- vi. Group lending
- vii. Simplicity of operation
- viii. Simple application process
- ix. The extension of banking services beyond economic to social and cultural benefit.
- x. Development of good inter-personal relationship between the MFI and its customers leading to high degree of trust and openness on both parties.
- xi. Provision of services in underserved communities.

Hence they are characterized by the small scale of their operations at the individual level and the inclusion of social and environmental aspects which distinguish them from the purely financial aspects of conventional banks.

### **Financial Methods of Microfinance Bank**

The operation of microfinance systems differ from conventional banking because although MFIs operate like banks, their financing methods are deeply rooted in the philosophy of alleviating the plight of the poor and those who are prevented from accessing banking services as a result of their lack of economic power, education, financial status and lack of adequate collateral for conventional bank loan.

The financing instruments or products of Microfinance Banks include:

- i. Deposits: This is a determined savings mobilization from the grass roots. It may be a target amount of savings made on a daily, weekly or monthly basis. The majority of traders and market women/men save on special market days when their sales are expected to be higher than other, non-trading, days.
- ii. Credit: This is loan facility which is relatively small and typically used as working capital by micro and small scale enterprises (MSSE).
- iii. Collateral Substitution: Unlike the commercial banks that seek collaterals in form of fixed and financial assets, microfinance banks collateral is substituted in most cases by group guarantees, inventory/commodity collateralization and compulsory savings.
- iv. Transfer/Payment Service: This entails standing order payment and other regular payments like salaries, pension and gratuities that are either credited or debited to the member's account by the microfinance bank.

### **Rural Poverty and the Poor**

Despite urban migration on the increase, Alderman (2001) and Ravallion (2000) noted that about 75 percent of the world's poor reside in rural areas, and at current trends, the global percentage of poor people in rural areas will not fall below 50 percent before 2035. This opinion does not exonerate the developing countries because incidence of poverty is more pronounced in the rural areas than the urban centers.

A poor person is defined by the World Bank (1992) as one without job, who cannot help himself or cater for his family, who has no money, farm or business. Adolescent males and females are poor if they have no parents, no education, no good food, clothes and health. Is a person who is undernourished and ageing fast, one without self confidence, looks dirty and lives in filthy environment, one who cannot cater for his family, train his children in the school and unable to pay medical bills. This definition can be used to categorize the population of Nigeria, given that it applies to the majority of Nigerians, including the elites who live in environmentally unfriendly locations slumps areas, refuse disposal arenas etc.

Generally, poverty alleviation is a continuous process involving mixed activities of reaching the poor on timely basis. However, poverty alleviation programs in Nigeria over the years were based on institutional approach mostly sponsored by the government with little or no private sector participation. The resulting effect is lack of finance to rural resident in Nigeria as identified by Robinson (2001) and Aremu (2004)

### **Methodology**

To ensure adequate coverage of the topic, the scope is limited to only microfinance banks that were approved and render their annual returns to the Central Bank of Nigeria (CBN). This includes community banks that were hitherto approved by the former National Board for Community Banks (NBCB) that was closed and whose duties were transferred to the CBN. The choice of microfinance banks is based on the fact that they are widely located and situated in several rural communities across different geo-graphical locations in Nigeria. Moreover, they are owns by individuals in conjunction with the community in which they are located which should bring about massive rural patronage.

In addition, there is easy access to the financial statements of these banks because it is mandatory for them to submit their financial reports at regular interval and render their annual reports to the regulatory authorities. It should be noted that financial and annual reports of microfinance banks in Nigeria are made available in government publications such as the Central Bank of Nigeria Statistical Bulletins, Central Bank of Nigeria Banking Supervision Annual Reports and the Central Bank of Nigeria Annual Report & Statement of Accounts. It is from these reports that we gather our data for the period covering 1992 to 2006. Microfinance banks that are unable to meet the statutory submission of their annual reports were excluded from the research because they are deemed to be non-performing by the regulatory bodies.

We would have included year 2007 in our data, but they are not available for public usage as at the time of this research. However, this limitation of not having 2007 data does not in any way directly or indirectly affect the result of this work.

### **Techniques of Analysis**

The adoption of the appropriate technique for analysis is based on the source of the data. However, literature on microfinance impact assessment methodologies recommends mixed methods which entail the use of both qualitative and quantitative approach (Zaidi et al 2007). Bearing in the mind the economic profile of our population, the use of quantitative methods is adopted since we are using a secondary data. This in itself requires the interpretation of data derived from the financial and annual reports of microfinance banks made available to the Central Bank of Nigeria.

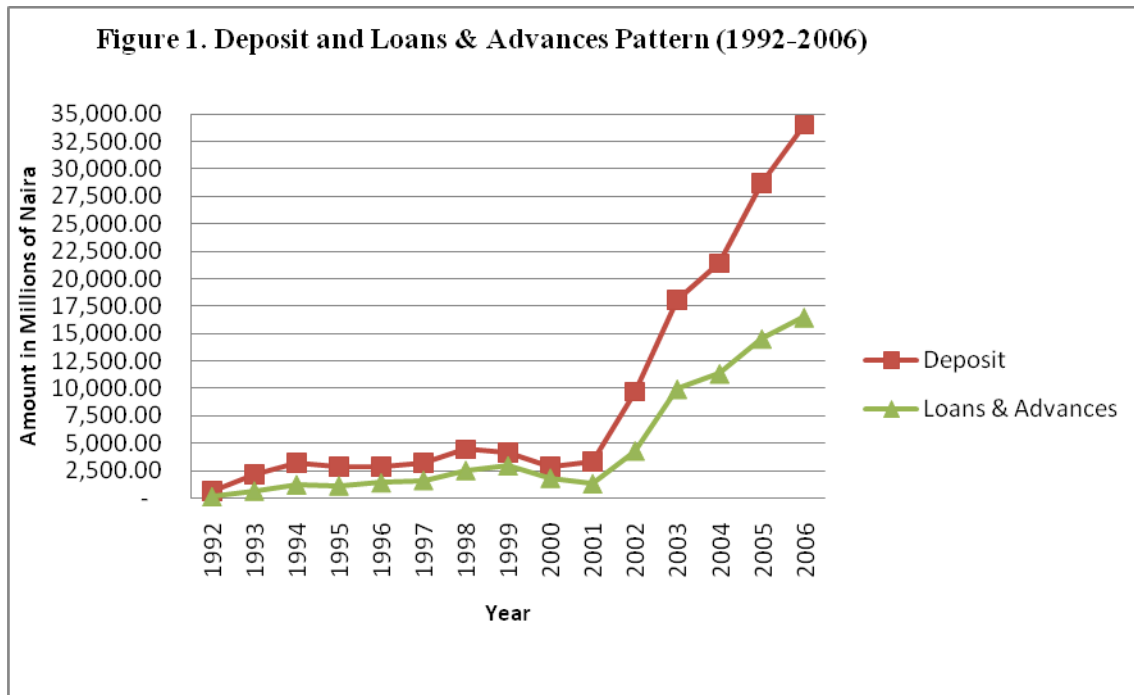
To ensure that this work makes good meaning to different categories of people that might like to consult it now or later, the researcher tries to simplify the analysis by using simple statistical tools. To this end, loans and advances data from the annual reports that have direct bearing to the issue under study were presented in tables, graphs and analyzed on

yearly basis with the individual segmented credit: Agriculture, Mining, Manufacturing, Commerce etc.

### Performance of Microfinance Banks in Rural Development

The performance of any Microfinance bank cannot be determined in isolation, but from the data gathered, we noticed a major discrepancy in the amount of deposit mobilized and loan disbursement on yearly basis. Throughout the years, the deposit was far higher than the loans. However, it is disheartened to notice that from year 2001 (figure 1) the deposit mobilization rate went so high and in some years like 2003 to 2006, it was more than double of loans and advances for the same period. The implication of this scenario is that cheap funds are sourced from the rural areas without an equivalent disbursement in forms of loans and advance to the same community were the deposits were mobilized. Perhaps these funds might have been invested by these microfinance banks outside the rural areas for better income generating ventures.

If these microfinance banks are really meant to be for the rural people, it therefore means that their loans and advances to these communities should be a reasonable proportion of the funds mobilized from them, otherwise, the rural people are been deceived in the use of their financial resources

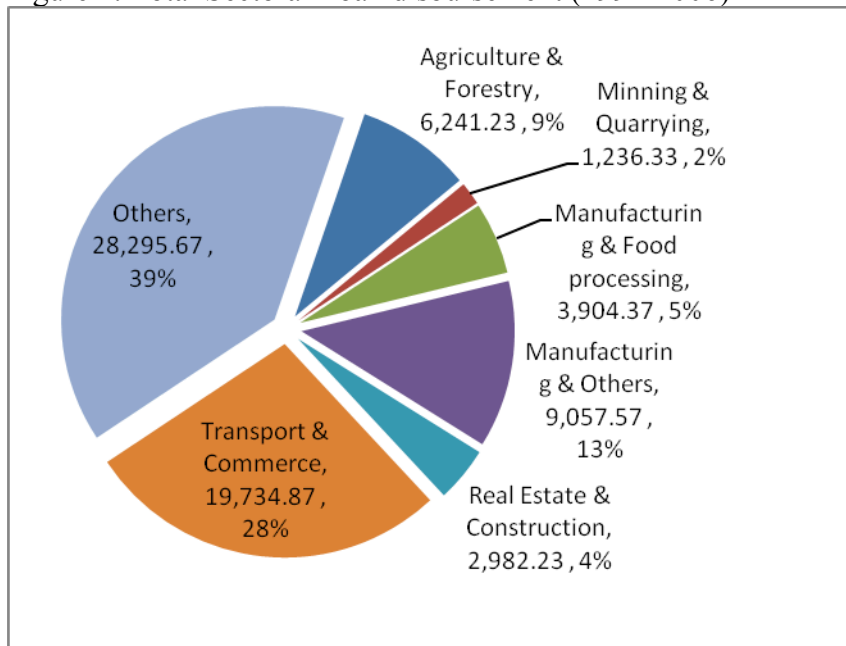


A proper review of the performances of microfinance banks toward rural development is to examine the loans disbursed to each segment of the rural communities as depict in figure 1. The amount of deposit collected by banks from 1992-2006 was higher than the loan and advances. However, the margin between the variables (deposit and loans) can be grouped into two. 1992-2001, there was a narrower margin. This could mean that the amount of loan request may probably be as high as the deposit. 2002-2006, there was a wide difference between the variables. The rate of deposit was quite high as against the loan and advances. However, the two variables can be said to be proportional in their relationship as both moved almost in the same direction.

The sharp rise in deposit from 2002 must have been triggered by the availability of funds and/or aggressive deposit mobilization pushing the deposit from ₦7,500m - ₦10,000m. It is evident therefore, that the loan and advances given by Microfinance Banks to

their various communities for the years 1992 – 2006 was not a reasonable proportion of the funds mobilized from them, showing that the rural people were being cheated in the use of their financial resources. This position is captured in percentage form in figure 2 below.

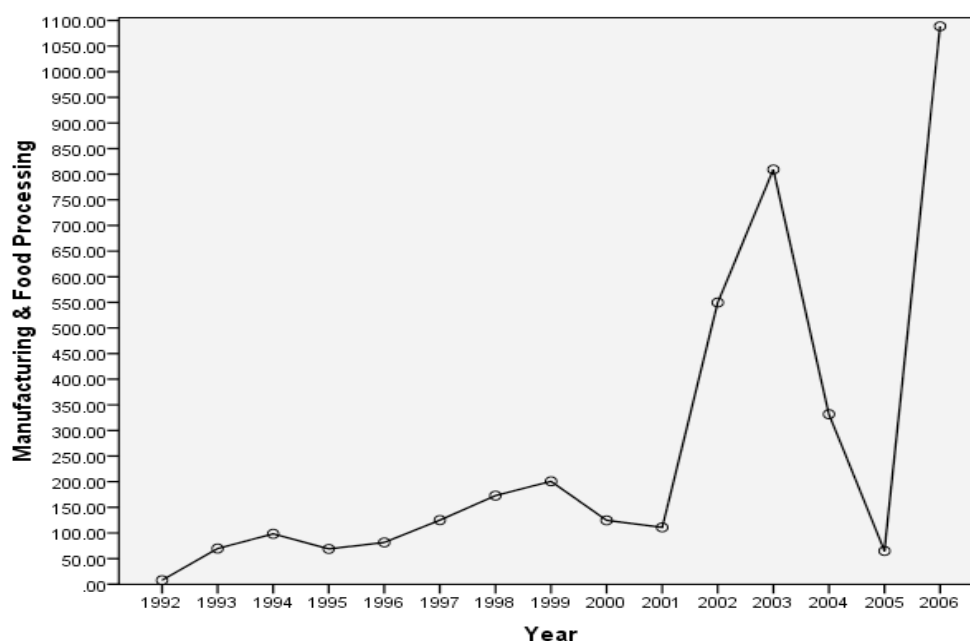
Figure 2. Total Sectoral Loan disbursement (1992-2006)



The impact of microfinance programme on rural development can be seen best based on the contribution of the bank to rural business which will eventually lead to rural development. Rural development first and foremost is about agricultural business that is made available in the community. However, while Nigerian microfinance banks gave 39 percent of their loans to “others”, only 9 percent was made available to rural people in agriculture and agricultural related businesses. This is a lopsided arrangement that do not justify the basic reasons for the establishment of microfinance banks in the rural areas of Nigeria. Furthermore, the service sector was accorded significant importance by these microfinance banks than the real productive sector. To this extent, 28 percent of the total loan disbursed for the fifteen years was for transport and commerce. The totality of their loan outside the real sector (others and transport) can therefore be put at 67 percent. This rate is dramatic and appears to show that loans are not been channeled into rural productive area of the nation.

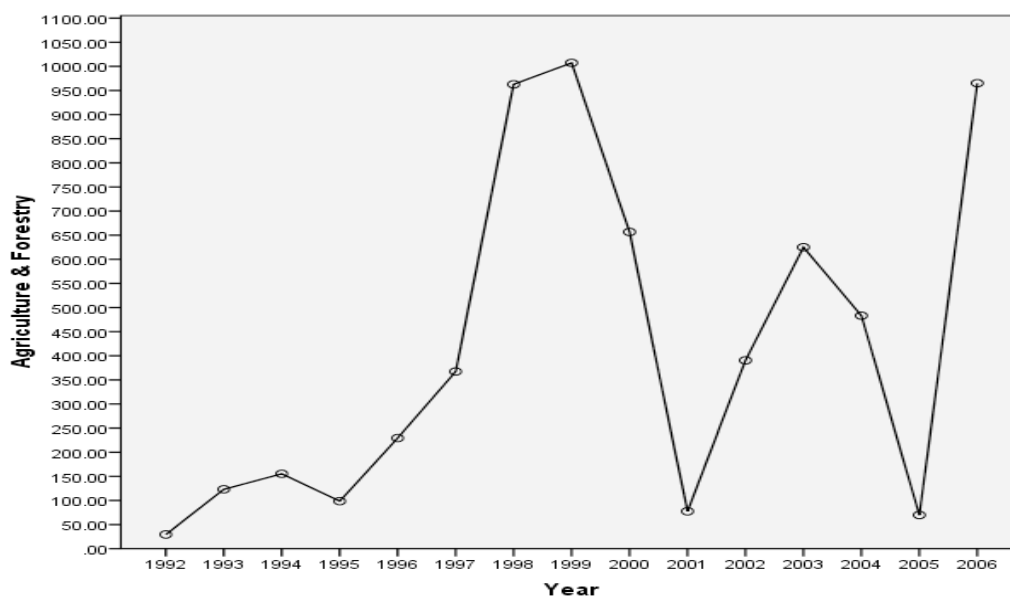
On a single sectoral basis, the loan structures are capture in figures, with figure 3 depicting the pattern of loan disbursement to microfinance bank’s clients in the manufacturing and food processing area.

Figure 3. Loans and Advances to Manufacturing and Food Processing



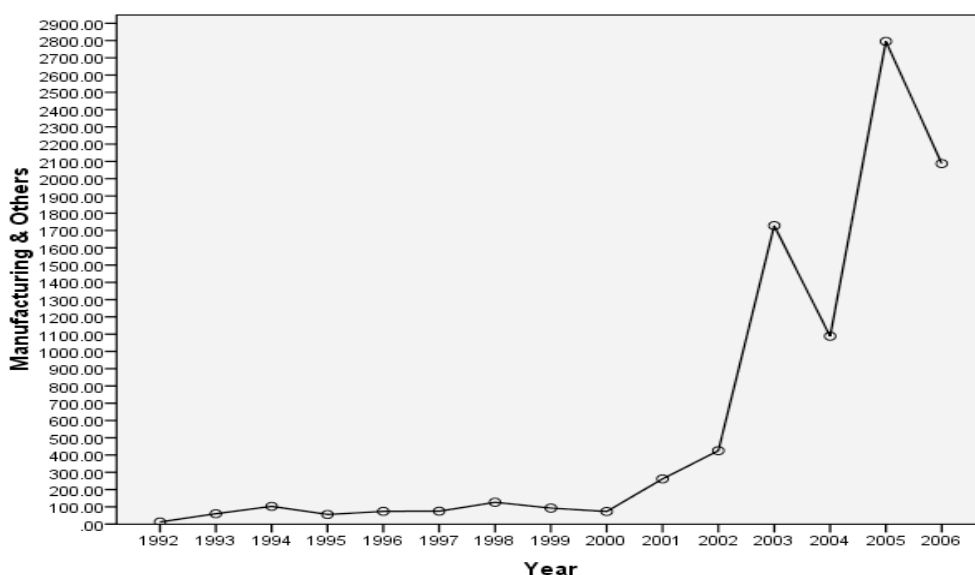
From this chart, loan disbursement to borrowers in the manufacturing & food processing sector increased at a very slow rate from nothing in 1992 to ₦75m in 1993 and a further increase in 1994, and then a decrease in 1995. There was also a minimal increase in loan disbursement from 1996 – 1999 and a fall in 2000, with a further decrease in 2001 but, there was a significant rise in loan disbursement in the year 2002 as the loan disbursement moved from about ₦75m in 2001 to about ₦575m in 2002. Also in 2003, there was a further rise in loan disbursement to the manufacturing and food processing sector while there was a drastic fall in 2004 with a decrease of about ₦275m in 2005. The fall in loan disbursement in 2005 could be as a result of the bank recapitalization which allows for banks to increase their capital base and as a result, in 2005 when the initiative was in between success and failure, banks resolved to sourcing for capital rather than loan disbursement. In 2006 however, there was a net rise in loan disbursement to this sector of the economy and this could be credited to the successful bank recapitalization exercise, affording the sector an increased loan disbursement of about ₦1,050 m (i.e. from ₦50 m in 2005 to ₦1,100 m in 2006), post-consolidation.

Figure 4. Pattern of Loan and Advances to Agriculture & Forestry



The pattern of loan and advances to the agriculture & forestry sector from the above was on a slow increase from 1992 – 1994 and a decrease in 1995. There was an increase in 1996 and a further increase in 1997 but, a significant increase occurred in 1998 where loan disbursement to this sector moved from ₦375m to ₦950m. a slight increase also occurred in 1999 while there was a major fall from ₦1000m to ₦650 m in year 2000 and a massive fall in to ₦50m in 2001. Also, there was a significant increase from ₦50 m to ₦400m in 2002 and a further increase to about ₦625 m in 2003 while; there was a fall to ₦475 m in 2004 and a drastic fall to ₦50m in 2005. Loan and advances to the agriculture & forestry sector was not stable showing inconsistent in developing the rural economy.

Figure 5. Loans and Advances to Manufacturing and Others

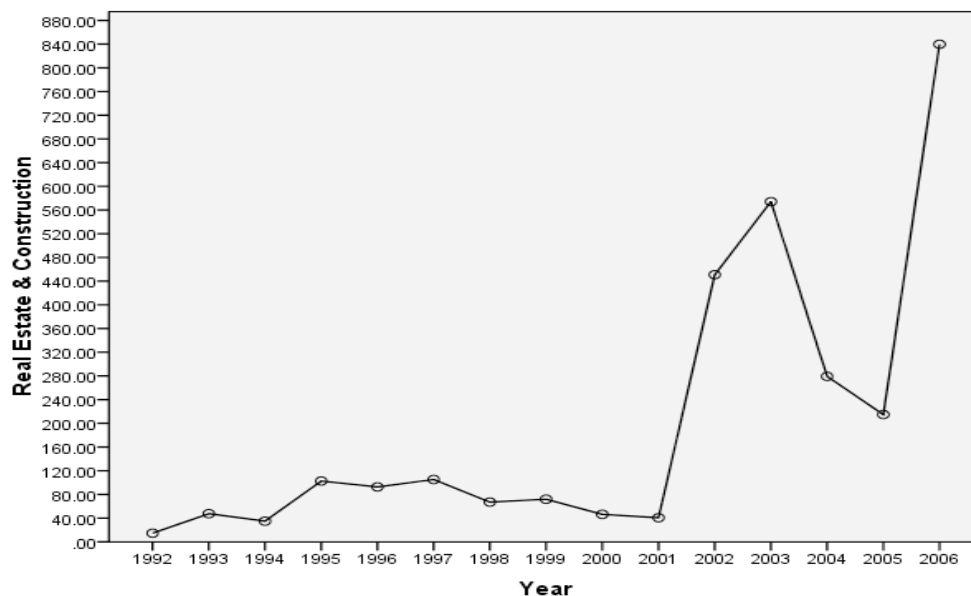


The loan and advances to the manufacturing & others sector increased slightly from nothing in 1992 to ₦50 m in 1993 and a further increase in 1994, while a slight decrease occurred in 1995. There was a narrow increase in 1996 and a further increase in 1997. In 1998 however, there was an increase in loan disbursement to the sector but a fall occurred in

1999, while there was a further fall in 2000. In 2001, there was an increase of about ₦200m and a further increase in 2002 and then, a significant increase to ₦1800m in 2003.

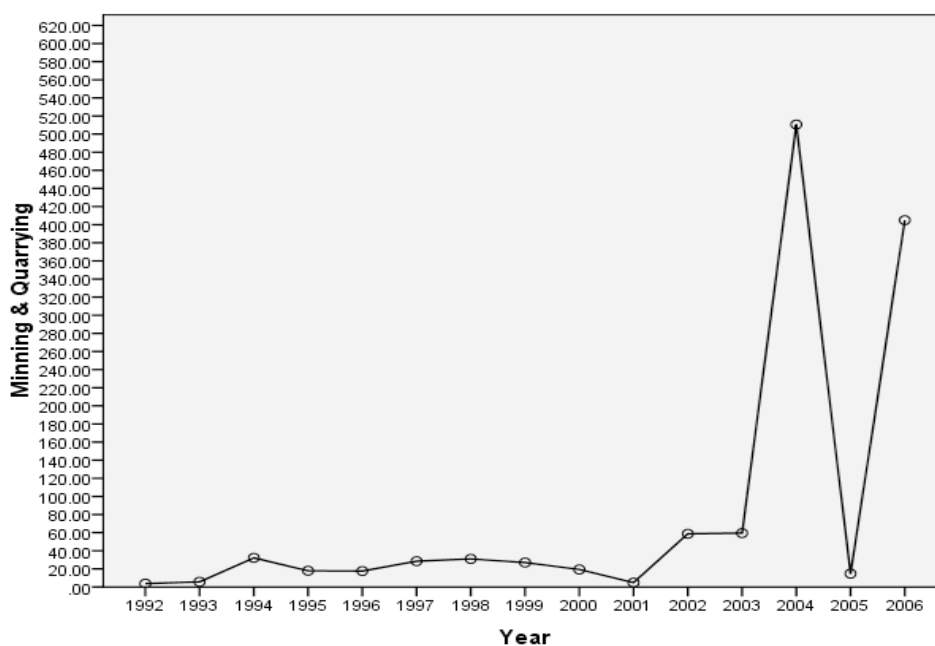
There was a fall to ₦1,100 m in 2004 and then an increase to 2,800m during the bank recapitalization exercise in 2005 and a fall to ₦2,100 m after the exercise in 2006. The fall in loan disbursement to this sector after the recapitalization exercise could be an incentive to reduce the amount of loan given to this sector of the economy, as there was a massive increase in disbursement to this sector at the peak of the consolidation exercise in 2005. On the contrary, the persistent fall in loans and advances to this sector in the face of economic challenge of persistent increase in cost of labour and other cost of production signify a lack of commitment to the manufacturing sector by the microfinance banks.

Figure 6. Loans and Advances to Real Estate and Construction



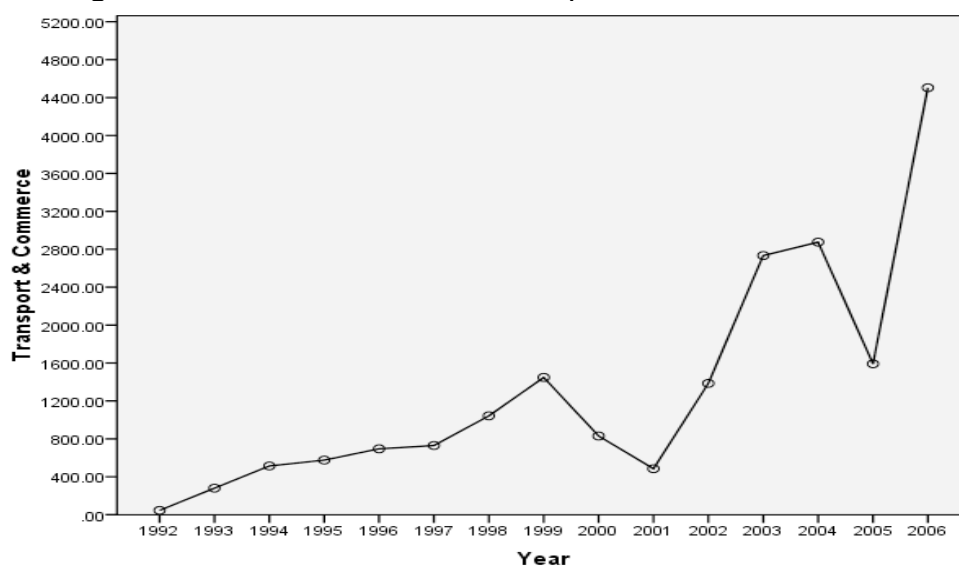
There was an increase in loan disbursement to the real estate & construction sector from about ₦20m in 1992 to ₦60m in 1993 and a fall to ₦40m in 1994, the implication is a decline in credit available to housing in the rural areas which will lead to more dilapidated houses in some communities. An increase in the amount of loan given to this sector occurred in 1995 and then a fall in 1996 while there was a slight increase in 1997. In 1998 however, loan disbursement to the sector fell from ₦120m to 60m and then a slight increase to ₦80m in 1999, and then a fall to ₦60m in 2000 and a further fall in 2001. From 1992 up to 2001, there was a galloping disbursement of loan to this sector. From 2002 however, there was an increase in the loan disbursement up to the year 2003, while a fall occurred in 2004 and a further fall in 2005 but then, there was a very high increase in loan disbursement post-consolidation era in 2006 as the disbursement moved from just 220m to about 840m showing that the bank recapitalization exercise of 2005 helped the Microfinance Banks to increase the loan and advances given to the real estate & construction sector in 2006.

Figure 7. Loans and Advances to Mining and Quarrying



The pattern of loan disbursement to the mining & quarrying sector of the rural areas was on the increase from 1992 up to 1994, and then a fall occurred in 1995. Thereafter, loan disbursement to the sector increased slowly from 1996-2000. In 2001, there was a sharp fall in the loan disbursed to the sector while there was a rise in 2002 and 2003. A significant rise from ₦80m to ₦520m occurred in 2004 while there was a drastic fall to 20m in 2005, meaning that almost nothing was disbursed as loan to this sector during the bank recapitalization exercise of 2005 but, there was a very high increase post-consolidation, as the loan disbursement to the sector moved from just ₦20m to ₦440m (an amount less than that which was disbursed in 2004) in 2006.

Figure 8. Loans and Advances to Transport and Commerce



In this chart, the loan disbursement to the transport and commerce sector was on the increase from 1992 to 1999 and then a fall in 2000, and a further fall in 2001. In the year 2002, there was an increase in loan given to the sector and a further rise in 2003. However in 2004, there was a slight increase from 2,600m - ₦2,800m in 2004 but, a fall in loan

disbursement occurred in 2005 but there was an astronomical increase from ₦1,600m - ₦4,600m in 2006, resulting in an increased loan disbursement by ₦3,000m to the sector in 2006.

### Conclusion

The totality of microfinance banks commitment to rural development can best be seen from the total loans and advances disbursed to the different segment of the rural economy for the fifteen years as revealed in table 1 below.

Table 1. Total Sectoral Loan Disbursement (1992-2006)

Sectoral	(N'm)
Transport & Commerce	19,734.87
Manufacturing & Others	9,057.57
Agriculture & Forestry	6,241.23
Manufacturing & Food processing	3,904.37
Real Estate & Construction	2,982.23
Mining and Quarrying	1,236.33
Others	28,295.67
<b>Total</b>	<b>71,452.27</b>

It is revealed from the above table that the main core area of the rural people (agriculture) was neglected for the fifteen years period because loan and advances to agriculture occupies the 4<sup>th</sup> position and less than ten percent of the total loans disbursed. From the total sum of ₦71,452.27m loan given by microfinance banks, other sectors apart from the core sectors of the economy got more funding. From the period of 1992 – 2006, only 9% was allocated to the agriculture sector which is the main sustenance of the rural economy and should be able to boast of engaging more rural people than any other sector of the economy.

It can also be observed that the basic sectors of the economy which helps in the provision of essential needs of the society was neglected for 15 years, as the agriculture & forestry sector was allocated just 9% of the total loan, while 5% was for the manufacturing & food processing sector, and just about 4% for the real estate & construction sector. This shows that Microfinance Banks have not really improved nor developed the economy of the rural people because 39.6 percent of loans given by the microfinance banks went for other areas that do not directly or indirectly affect the socio economic well being of the rural people and do not contribute to their developmental status.

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