MICROFINANCE AND POVERTY REDUCTION IN NIGERIA

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Abstract

Microfinance is a key policy strategy for poverty alleviation. Inadequate access to credit by the poor has been identified as one of the contributing factors to poverty. To redress the issue the policy of increasing access to both production and consumption credit by the poor has been articulated. For sustainable poverty alleviation the policy also emphasizes the sustain inability of the microfinance institutions (MFIS) that deliver services to the poor. It is for this reason that the government credit programmes are to be wound up and all recovered funds form such schemes will be channeled to sustainable MFIs. This paper established the factors that poverty is indeed increasing in Nigeria based on the poverty assessment study commissioned and sponsored by the World Bank in 2001. It further indicated in the introduction that the World Bank and the International Monetary Fund (IMF) group are focusing on poverty assessment study commissioned and sponsored by the World Bank in 2001. It further indicated in the introduction that the World Bank and the International Monetary Fund (IMF) group are focusing on poverty reduction as a prerequisite for debt relief. In the conclusion, the paper emphasized that indeed microfinance is strategy of poverty reduction.

Introduction

Poverty alleviation has been a key development challenge over decades. One of the identified key constraints facing the poor is lack of access to formal sector credit to enable them tae advantage of economic opportunities to increase their level of output hence, move out of poverty. This concern for the poor has been responsible for the design of various financial sector policies with conflicting prescriptions. In the case of Nigeria, the issue of the importance of improving access to the poor was identified as a key development strategy right from the 1960's. The formal banks that were inherited from the colonial government were inherited from the colonial government were judged to be serving the trade sector and neglecting the agricultural sector that was the backbone of the country's economy employing over 75% of the population especially in the rural sector.

This motivated the government to set up state-owned banks (like agricultural Development Bank) whose mandate include to provide credit to the rural sectors including agricultural credit. This was under the policy of sectoral allocation of credit and controlled interest rate which were administratively fixed by the Central Bank (Muwanga, 2000). The credit to the poor engaged in

agriculture was extended mainly in kind through the supply of productive inputs like fertilizers, high yielding seeds and tractor hire services under special bank schemes like Rural farmers scheme. The recovery performance of these credit schemes was poor partly because of the perceptions that these were government grants and also because of the lack of the linkage between production and marketing. There were however, concerns that this directed credit was not reading the poorest of the poor as it was the non-poor with good political commendations who mainly accessed this credit. This led to increase in high level of poverty which is an indicator that point to the need to improve the output of governance which is expected to impact on poverty.

At the global level, the World Bank Devoted the "World Development Report 2001/2002: Attacking Poverty" to the subject based on new evidences and a deeper understanding of the meaning and causes of poverty.

The report are argued that major reductions in world poverty are indeed possible. It shows that economic development continue to be central to success in reducing poverty but that poverty is also an outcome of economic social and political processes that interact with and reinforce each other in ways that can ease or exacerbate the state of deprivation in which poor people live.

Consequently the report concluded that to conquer poverty requires actions at the local, National and global level to expand poor people's opportunities empower them and increase their security.

Conceptual Framework

Understanding how to alleviate poverty is a central concern of development economics.

Martins (2002) indicated that there are ample evidences that policies designed to foster economic growth significantly reduce poverty, but hat polities aimed specially at alleviating poverty are also important. For example, programs that provide credit and build human capital try to eliminate the causes of poverty. Such program can have a short-run or long run perspective.

Timothy (n.d) took a short run perspective on program design for alleviating poverty, assuming that income-earning abilities are fixed. He took two disparate approaches to program design which he called the technocratic and the institutional. The technocratic approach was usually associated with economist, focusing on targeting, exploring the theoretical and empirical implications of trying to direct limited resources to people with the greatest need.

These efforts emphasize the difficulties of identifying target groups and using creative approaches to program design that substitute for detailed information required to achieve first-best results. Central to such explorations are the incentive effects of program design which underscore the need to know key behavioral parameters such as labour supply responses in order to formulate policy.

The institutional approach is more common among non-economists. For them, the question of why program for the poor do or do not work has much more to do with social institutions that with policy design. In this view antipoverty policies fail because the poor lack political power or because administrative incompetence or corruption keep governments from delivering services. Thus, improving the lives of the poor requires developing institutions, improving government performance and changing political structures and attitudes towards the poor.

The gulf between these two perspective is evident in their views of the role of Non- Governmental Organizations (NGOs), in poverty alleviation programs. The technocratic approach rarely refers to NGOs, while the institutional approach considers them vital to the attack on poverty in developing nations. The increasing concern with better targeting in poverty alleviation program stems from governments desire to minimize the cost of achieving poverty alleviation objectives. The model is a useful vehicle for clarifying thinking about a number of issues relating to poverty alleviation objectives. The model views society as composed of two groups: those who make transfer (the rich) and those who receive them (the poor). The model assumption are as follows:

i. That the rich care about consumption of the poor and not their utility.
ii. The rich control government and its goals is to design a poverty alleviation program i.e financed through taxes paid by the rich.
iii. There must be voluntary participation by the poor in poverty alleviation program i.e. the poor must be willing to take any benefits intended for them.

Review of Country Experience of Finance Program for the Poor

In order that we appreciate the successes and/or failures of those programs we are going o review it is pertinent to bring to focus the breakthrough that have made micro finance program an imperative of alleviation poverty.

The delivery of financial services to poor and low income people changed significantly during the past decade firstly, long standing and fundamental assumption about the bank ability of the poor have been overturned based on well documented experience in banking with the poor in a selection of developing countries. A small number of highly effective micro finance programes have demonstrated that low income clients can use small loans productively, repay them back fully and on time when given reason to do so, can and are willing to pay high real interest rates for their loans, and so save and often need savings services as much as or more than credit services. These findings corrects earlier notions that the poor cannot use credit effectively do not have the capacity to repay loans, cannot afford to pay high interest rates that reflect the real cost of funds and do not generate sufficient surplus funds to enable them to save.

Secondly, a shift in thinking is within the effort being made for delivering credits and savings to the poor. This is being conceptualized as extending the reach of national financial systems to include low-income customers. For example, financial sectors are being redefined to include non-bank financial institutions as well as banks. This framework differs radically from the long- standing practice of separating micro finance programs from financial sector development and including it within "project " context for social welfare services for the poor. In this view, micro-finance institutions fit within a continuum of financial and in fact represent an essential component of an integrated financial system that serves the majority of citizens. This new paradigm necessarily has far-reading implication.

a. Links between all financial institutions on the continuum become far more important.
b. The need to revise banking regulations to include non- bank financial institutions arises.
c. A new legitimacy is granted to financial institution that serve the poor and to their clients who come to represent an enormous new market for financial services rather than a hefty welfare burden.

A third breakthrough has been the development of new lending large numbers of low income borrowers and in moving micro finance institutions toward financial sustainability. These technologies are designed to deliver small loans with terms and conditions that meet the needs of poor clients to lower lenders' transaction costs and to increase revenues by using full-cost interest rates and high loan repayment rates.

A fourth important change is that micro-finance institutions are now expected to attain high levels of (if not full) financial sustainability within a reasonable period of time. The generation of credit programs were fueled by a constant supply of donor funds and paid little attention to operating costs, loan losses and the expense of auxiliary services efficiency and cost recovery were not priorities for services providers or for international donors. As a results credit programs had minimal outreach because credit funds were limited to donor funds, department rates were poor, financial intermediation was stunted because cheat credit discouraged the mobilization of local deposits and credit was concentrated in the hands of privilege and less than-credit worthy borrower who successfully pursed these subsidized loans over the past decade a handful of pioneer micro-finance institutions have demonstrated not only the bank ability of the poor but also the potential for sustainability of financial institution that serves the poor. Full financial sustainability is reached when administrative, loan loss inflation and financial costs are covered entirely by revenues.

The fifty development of significance is the new focus on mobilizing savings among the poor. Micro finance institutions increasingly are under pressure to mobilize savings and there is some contention among practitioners about the wisdom of this trend. It is clear that savings service are needed

urgently by large number of poor people around the world to prefect their in comes and to serve as an alternative of the assumption of debt. savings deposits also offer micro finance institutions a valuable source of sustainable local funds.

Experience of some Finance Models

There are basically formal and informal models of purveying micro credit to the target group.

a. **The informal Model:** The informal models s built around concept. The model works in a situation where groups whose commitment to savings and credit are weak and look up to donor sponsored credit are weak and look up to donor sponsored credit. While this works better with a group that voluntarily come together to form a revolving savings and credit association, it develops managerial problem where the groups are not cohesive and not problem where the groups are not cohesive and voluntary (Besley, 1993).

   The Grammen Bank (ii) Obtain credit (iii) Non Government organization (NGO) (iv) ESUSU.

b. The formal model: The formal micro finance model is built around formal financial institutions such as the commercial banks, rural village/community bank etc. Most of the formal institutions that purvey credit to the poor had not been successful. The reasons adduced for their failure had limited knowledge of the poor and no closer relationship between the formal institutions and the informal institution. The Grammer experience is an example of that model that have been able to transform from informal to formal model of the poor has been found to be very small compared to what the formal model can possibly attend to and also the reoccurring problem of no collateral. The formal micro credit operators have found that per-client costs are high and expensive to reach group of client physically and in part because poorly developed infrastructure increase the expense f delivering even basis need. In addition, most progrmme offering micro-finance services have a small capital and do not have access to the level of financing that would be requiring for significant scaling up. This is the reason why commercial banks and development banks could not really purvey micro-credit and could not be used as the second-best to informal lending. The case of Nigerian Agricultural and Cooperative Bank Nigeria industrial Development Bank, people were quite recent and confirmed the enormous problems of using the formal models as a strategy to alleviate poverty.

Efforts of Micro-Credit Delivery to the Poor

Nigerian Government Efforts and Problems

By the understanding of the level of poverty in Nigeria, Government attempted with several micro-credit programs to alleviate poverty programs/projects such as Agricultural Development programs (ADPs), National Directorate of employments (NDE), Better life for rural Dwellers (later named family support programs), the directorate of food, Roads and Rural Infrastructure (DERRI) were pursued during 1986 to 1999. Other institution that have also attempted purveying micro-credit were the rural banking scheme (1977 – 1990), people's Bank (1987 – 1990): Community bank (1990 to 2007 date). In addition, the central Bank of Nigeria Agricultural credit Guarantee scheme which came into existence since (1977). Although all the programs were directed at improving the productive base for sustainable growth, most of the efforts at purveying micro credit to alleviate poverty were largely irrelevant, urban structured from the stand point of the realities of who is the poor understanding the poor. The programs in terms of resource endowment were dominated by government who gave paternalistic subventions in trickles. The way the programs had functioned over the years was such that credit system was essentially directed at meeting the needs of elites whereas the program is largely for small peasant poor group. The semi-bank agencies in the system. Some of which were created precisely to redress the weakness of the existing system saddled with myriads of problems especially in adequate finding as well as lack of appropriate skills to mobilize identifying the poor and cannot therefore provide the essential remedy in a sustainable way.

The most serious problem in the agencies set to provided credit (NACB) was the fact that they lacked adequate professional staff. CBN (1986) credit study shared that some 64% of personnel of NACB were administrative staff. Lending procedure were tortuous with extremely demanding forms for completing by uniformed and illiterate farmers and the targets group who are basically seeking relatively small loans.

Bilateral/Multilateral Institutions Efforts

The world Bank Group and the International monetary fund's efforts at assisting countries to understand to understand the poverty situation in their economy assess the level and determine to reduce the level, knowing that most developing economies are held back with debt obligations, have proved quite successful in most developing countries. It has helped Nigeria to open up again discussions with our creditors and have enabled us reschedules our debt at very accommodation concessions at the pairs club group of creditors. The world Bank and the IMF determined in 1999 that nationally owned participatory poverty reduction strategies should provide the basis for all their concessional lending and debt relief under the enhanced Heavily Indebted Poor Countries (HIPC) initiative. This approach builds on the principles for the comprehensive

development papers on poverty reduction strategy by country authorities for submission to the Bank and fund boards. There are core principles underlying the development and implementation of poverty reduction strategies and these are as follows:

a) Country-driven, involving broad- based participation by civil society and the private sector in all operational steps.
b) Result oriented and focused on outcomes that would benefit the poor.
c) Comprehensive in recognizing the multi-dimensional nature of poverty, but also prioritized so that implementation is feasible both fiscal and institutional terms.
d) Partnership oriented, involving coordinated participation of development partners (bilateral, multilateral and non governmental).
e) Based on a long-term perspective for poverty reductions the world Bank Created no blue print for building a country's poverty reduction strategy. Rather they established key processes which should reflect a country's individual circumstances and program, there is the need to develop a comprehensive understanding of poverty and its determinants, beginning with an understanding of who the poor are, where there live and their main barriers to moving out of poverty. Furthermore, the multi dimensional nature of poverty (low income poor health and education, gender, insecurity power lessness etc) needs to be carefully, considered.

Micro-Finance Model for Nigeria Poverty Alleviation Strategy

Starting from the conceptual dimension of transfers of wealth and transfers through government fiscal operation, one will want to agree that in the current dispensation the country can afford realistically to adopt a model of transfer from the rich through the government fiscal operation and from the government through deliberate fiscal allocation to the poor to implement program that will alleviate poverty. Nigeria must pursue a progressive micro-finance model. The program must be such that will assist the totality of the needs of the groups that will participate. The credit must facilities production (economic activities), consumption (hunger etc.), social/welfare (health, education etc). The program must be such can serve as seed capital to provide fund for the development of promising ideas or products including the development of prototype. There are many school leavers with promising ideas and many handicraft workers who need only need only small seed capital to move out poverty.

The program must be such that can finance start-ups by providing funds for commercial production and marking, developed ideas and products. It should be available to finance expansion of commercially viable/successful business in order that the operator will not sink back into poverty. Consequently, micro finance model for Nigeria should be such that would have, the linked institutional framework coupled with fiscal support for

effectiveness. The chart showed the flow of revenue to the program and the credit service required of the program. The services must ensure the following:

i. Operations are concentrated in rural areas and focus on the micro enterprises.
ii. Ensure working capital loans. As regard credit, most micro-entrepreneurs need working capital loans.
iii. Do not include restrictions concerning the use of loan, allow for guarantee that matches their capacities such as personal guarantees and peer pressure. However, in implementing the strategy through the new institution, it would be quite instructive to utilize the result of the poverty assessment in order to establish priorities for financing. First, identify regions with high level of poverty and organize them into cohesive groups. Second, determine what transfer programmes you want to adopt. For example, grain coupon etc, which could be used as collateral to access micro-credit which could alleviate poverty. These regions would e pilot projects with adequate supervisory, monitoring and evaluation teams, for replicating in other regions. More importantly is the need to have financial regulatory authority to be part of the team for effectiveness and for completeness considering the current dispensation of Universal Banking.

Principles for Effective Micro-Finance Institution

The experience of micro-finance lending in Nigeria had not been quite successful from the formal statement of the success of informal model. However, most poor seem to appreciate informal lending. In order that the proposed model where we have linked institution ti purvey credit work successfully, the following principles should be considered to avoid the pitfall of the past institutions:

a. **Simplify services;** make the credit program customer-friendly. Use a simple application process (often not exceeding one page) appropriate to low levels of literacy and innumeracy and streamline operations to minimize staff time per loan,

b. **Offer small initial loans:** start with very small loans appropriate for meeting day to day financial requirement of micro enterprises and motivate repayment by offering larger loans as incentives for repeat customers.

c. **Localize services, focus on scale:** Locate close to entrepreneurs (in small scale industrial estates, villages etc). Select staff from local communities, including people with lower levels of education (and salaries) rather than from staff in formal banks. Locate where there is a critical mass of client in order to reduce transaction costs. Micro-finance programs reach sustainability in part by making large volume of loans.

d. **Motivate repayment:** Motivate repayment via group solidarity and joint liability. Group lending is efficient because it externalizes cost. Character-based lending to individuals (as opposed to groups) can be effective where the social structure is cohesive and there is little potential for abuse.

e. **Recognize that the poor do save:** Credit program are more sustainable when they are financed with personal savings. Savings are often half of informal finance. However, accepting deposits is labour-intensive and therefore quite costly. Moreover, unstable programs can rob the poor of their savings. Great care must be taken when an institution accepts fiduciary responsibilities.

f. **Charge full-cost interest rates (Factoring in inflation, loan losses and delinquency and the cost of loan funds).** The administrative costs of lending to the poor require interest rates that are substantially higher than rates charged by commercial banks. Micro entrepreneurs have shown a willingness to pay high rates for services that meet their needs. (CBN Economics and financial Review, 2004

Conclusion

This paper has established that micro-finance is indeed a strategy of poverty reduction. More importantly is the model of purveying credit to the poor as discussed in section two. It is a progressive strategy for Nigeria to have developed a strong linked institution by merging the formal, semi, formal and informal institutions that has in the past purveyed credit to the poor under one umbrella eg. NACRDB.

Looking ahead to the future of micro-finance programs in Nigeria, several conclusions could be drawn. First, there is significant room for improvement within the current programs using principles and practices established in this paper. Second, the unique conditions in Nigeria of having the best of time in revenue generation through oil wind fall, efforts must be made to strengthen the institution that have been merged, to also reduce poverty level before the 2003 election. The higher the level poverty in any democratically run economy, the lower the score for good governance. Third, micro-finance could still be run by other financial institutions in spite of the linked merger of NACRDB. However, serious issue of supervision must be tabled and discussed

thoroughly with the financial sector regulatory authorities. Fourth, issues concerning training should be viewed seriously. As shown, poverty is deep in Nigeria and education has been shown in the poverty assessment study to be negatively related to poverty. Training should not be restricted to reading and writing but more importantly to skills acquisition for those who had attended primary education and apprenticeships for some vocational jobs.

Fifth, is the issue of fiscal/budget subvention to micro-finance program. This is a challenge to the government and the regulatory environment. In conclusion, at an aggregate level, micro-finance services are a means of broadening economic participation to include marginal groups that have been left out previously. The main benefit is the heightened political stability that flows from having more stakeholders participate in the resource endowment of the country and thereby push growth and development to a sustainable level.

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