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Microfinance Banks and Economic Opportunities in the Informal Sector of the Nigerian Economy

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Abstract: This study analyzed the impact of micro finance banks on the financial frontier and on the exploitation and development of economic opportunities in the informal sector of the Nigerian economy. The analysis indicates that through deposit mobilization and credit delivery, micro finance banks have substantially expanded the financial frontier thereby significantly integrating the informal sector into the mainstream of the national financial system and consequently contributing to the transformation of the informal sector from subsistence orientation to market orientation. The study contends that micro finance banks are strategically positioned to expand the financial frontier and consequently stimulate the exploitation and development of economic opportunities in the informal sector through the provision of non-traditional banking services such as technical and managerial assistance, sale of output and input purchase financing, machinery and equipment leasing and community development financing. To sustain the impact, micro finance banks need to be strengthened in terms of skilled manpower, effective management and a better capital base, enabling policies and operational guidelines and correspondent relationship with commercial banks.

Key words: Community, micro-finance, rural, urban, informal, frontier

INTRODUCTION

The Nigerian economy is characterized by the existence of formal or institutionalized banking and financial systems and informal financial markets in both rural and urban areas. Formal financial institutions have been reluctant to lend to informal micro enterprises. The reluctance on the part of formal financial institutions to lend to informal micro enterprises may be attributed to a number of factors. First lending to informal micro economic units is considered typically risky. Informal micro economic units are unable to provide adequate collateral for credit. Second, most informal economic units in Nigeria are subsistence oriented or at best have limited profit motives because there are no plans for future expansion and as such capital accumulation through profits is not a prime objective of the business. Subsistence orientation constrains their repayment capacity making them default prone. For instance in the agricultural sector, dominated by numerous informal micro enterprises, Njoku and Nzenwa (1990) and Ojo (1985) have reported high rates of loan default. Also informal economic units are usually small, numerous and widely distributed spatially making credit administration and supervision not only difficult but also expensive. Limited access to formal credit in the informal sector is most acute in the rural areas. Consequently in 1977, the Rural Banking Scheme (RBS) was introduced in Nigeria with a view to improving access to credit and other banking services for informal micro economic units in the rural areas. The scheme compelled commercial banks to open rural branches alongside urban branches. It also compelled commercial banks to invest 50% of deposits mobilized by their rural branches in the rural areas. In spite of the scheme, the informal sector in the rural areas remained largely under banked. Table 1 shows that by 2004, about three decades after the introduction of the scheme, there were only 722 rural branches of commercial banks representing a mere 24% of total bank branches and an average of <1 rural bank branch per local government area. While there was an average of 31 urban branches per bank, there was on the average 8 rural branches per bank by 2004. Given the profit maximizing nature of commercial banks, Mbat (1982) contends that commercial banking does not appear to be the appropriate framework for rural banking. He identified the need for rural savings banks with specific clientele and tailored to the needs of their client communities. The community-banking scheme appears to have been a response to this need. The community-banking scheme is a coalescence and

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Table 1: Distribution of commercial bank branches by location

Years	No. of banks	Bank branches Urban	Rural	Foreign	Total
1977	19	474	13	5	492
1982	22	676	308	7	991
1987	34	947	529	7	1483
1992	65	1495	774	6	2275
1997	64	1727	675	5	2407
2002	90	2283	722	5	3010
2004	89	2765	722	5	3492

Central bank of Nigeria, Statistical Bulletin, 1998. National Bureau of Statistics, Annual Abstract of Statistics, 2006

modernization of two traditional institutions with which rural producers of agricultural and other products are familiar (NBCB, 1991). These institutions include the rotating credit institution or Isusu and the Community Development Association (CDA) or town union. The CDAs have provided the framework (social, economic and political) for self help initiatives in community development in most communities in Nigeria. Through Isusu, the rural poor have been able to access in most cases interest free debt capital, which together with their meager savings is invested in various micro enterprises that act as sources of livelihood for the poor. The Isusu and community development union institutions are not limited to the rural areas where they originated but have spread and become an integral part of informal economic networks on which also the livelihoods of the urban poor depend. The spread of the Isusu and community development union institutions into the urban areas and their effectiveness in addressing the credit needs of informal micro economic units may have informed the decision by the monetary authorities to transform community banks into micro finance-banks. The micro finance bank scheme is perhaps an attempt to integrate these institutions into the mainstream of the national financial system.

In concept a micro finance bank is a unit bank, self sustaining, owned and managed by a community or group of communities for providing deposit, credit, banking and other financial services to members of the community based on self recognition and credit worthiness. Micro finance banks are owned by CDAs local cooperatives, farmers unions, trade groups and indigenes of the community. According to Osawenyi (1993), micro finance banks by nature are controlled by the laws of the land, owned by the people, financed by the people managed by the people and serve the socioeconomic welfare of the people. Within the context of the micro finance banking scheme, a community refers to a group of people who posses a common bond in terms of residence, occupation, profession or other similar attributes and who interact fairly frequently in the pursuit of economic or social goals (Ukemenam, 2000). The objectives of the micro finance banking scheme in Nigeria include:

- Promotion of rural development through financial intermediation
- Stimulation of productive activities in the rural sector
- Development of banking habits in rural dwellers and ensuring the development of an integrated national financial system
- Improving the economic status of small-scale producers in the rural and urban areas

To achieve these objectives micro finance banks were in addition to traditional banking services to operate equipment leasing schemes designed to make inputs available to their clients and to perform such non-banking functions as may promote grass root development in their host communities.

In the light of the foregoing, the broad objective of this study is to analyze the impact of micro finance banks on the financial frontier and on the exploitation of economic opportunities in the informal sector. To achieve this objective the study will specifically:

- Determine the impact that micro finance banks have had on the financial frontier i.e., in integrating the informal money market into the mainstream of the national financial system
- Determine the contribution of micro finance banks to the provision of investment capital for the urban and rural poor
- Identify and analyze sustainable investment opportunities and viability options open to micro finance banks in the informal sector which can lead to an improvement in the income and standard of living of the majority of the people and which are also remunerative to the banks
- Make policy recommendations on the potential impact of micro finance banks on the exploitation of economic opportunities in the informal sector

The impact of micro finance banks on the financial frontier and the contribution of micro finance banks in the provision of investment capital for the exploitation of economic opportunities in the informal sector are discribed in this study.

MATERIALS AND METHODS

Theoretical framework: Every economy or economic system consists of surplus and deficit economic units (individuals and businesses). Without deficit units there will be no surplus units. Total deficits must equal total surpluses since the expenditure of one economic unit are the earnings or receipts of another unit. An economic unit may not be able to provide all the funds it requires all the time. An economic unit may therefore swing from a deficit status to a surplus status or from a surplus status to a deficit status at different points in time. An economic unit will therefore require the facilities of credit at one point in time.

Credit is obtaining control over the use of money or other forms of capital at present in exchange for a promise to repay in the future (Adegeye and Dittoh, 1985). The deficit unit takes control over the use of money or other forms of capital from the surplus unit while the surplus unit receives a promise of repayment at a future date from the deficit unit. Control over the use of money or other forms of capital at present with a promise to pay in future carries with it a cost. This cost is the reward to the surplus unit for making its money or other forms of capital available to the deficit unit. This reward should provide the surplus unit with a net return enough to induce it to place its resources at the disposal of deficit units. Credit is usually available to deficit units through financial intermediation.

Financial intermediation is the process through which surplus units come in contact and interact with deficit units. Through intermediation surplus units place their idle resources at the disposal of deficit units. Usually financial intermediation is brought about by the activities of financial intermediaries such as commercial banks. In Nigeria, commercial banks act primarily as deposit takers in the informal sector and are reluctant to lend (reinvest in) to the informal sector. In the process of transferring deposits from the informal sector to the formal sector, capital is invariably moved out of the informal sector. The capital flight from the informal sector and the reluctance of commercial banks to lend to the sector lead to limited access to credit for deficit informal economic units. This limited access to formal credit creates a demand for credit, which can only be met from informal sources. Consequently an informal credit market is created and sustained. The creation of the informal money (credit) market brings into existence the concept of the financial frontier.

The financial frontier is a market-based concept, which refers to the inter-phase between the formal sector and the informal sector (Von Pischke, 1991). Formal financial institutions limit their activities to the frontier. Inside the frontier is the formal sector consisting of formal intermediaries subject to government regulation and supervision, while the outside of the frontier comprises informal participants small scale farmers and business. Outside the frontier most financial transactions are personalized and conducted without intermediaries. Credit is often scarce or expensive or scarce and expensive. Most of the participants outside the frontier are often rural based and subsistence oriented. Expanding the frontier implies an integration of the participants and activities outside the frontier with participants and activities inside the frontier. It implies an expansion of the formal sector and a contraction of the informal sector. It is the integration of the informal sector into the main stream of the (inter) national financial system. The frontier is expanded where the poor and other small economic units have their first direct contact and sustainable interaction with the formal financial system. Institutions and innovations that expand the frontier must be sustainable to be successful. Informal institutions such as local money lenders, rotating credit cooperatives and community savings and loans associations tend to be more innovative and responsive to borrowers' needs and are also more accessible than banks and other formal institutions especially in rural areas and have lower lending costs when dealing with small scale farmers and business people. Despite these qualities, the extent to which informal institutions can fill the gap left by the inadequacies of the formal sector is probably quite limited in most cases. Informal institutions in Africa usually seem to operate at the extreme short end of the market, typically offering savings facilities and credit for one month term thus limiting the extent to which they are able to mobilize savings and channel them into genuinely productive investments (Von Pischke, 1991).

Von Pischke (1991) observed that new services may be innovative and economically and socially worthwhile when they break into the frontier by serving clients who did not have access to such services before or who had access but only at higher costs. For an innovation to be sustainable, overall costs of lending and borrowing must be reduced. He contends that sustainability occurs when the lender earns a profit from the service and when borrowers find the relationship with the lender at least as attractive as alternative relationships with other suppliers of credit. Innovation at the frontier probably occurs most naturally in deposit and money transfer services because many more people can be served through deposit facilities than through credit.

Pischke argues that sustainability does not require an infinite life or constantly increasing market share but that innovations are remunerative to the intermediary and the client. In dynamic and competitive markets sustainability presupposes innovations that ensure that intermediaries such as micro finance banks remain responsive to and participate in opportunities outside of the financial sector of the economy. Sustainability ensures the survival of the intermediaries and guarantees better services for people at the frontier. Innovations that expand the frontier in a sustainable manner also protect access to intermediation enjoyed by participants inside the frontier.

RESULTS AND DISCUSSION

Micro finance banks and the financial frontier in Nigeria deposit mobilization and loans and advances: In this study, the analysis of the impact of micro finance banks on the financial frontier in Nigeria is premised on the simple with and without test. Using deposit mobilization and credit delivery as the yardsticks, the question that is asked is what would be the impact with and without micro finance banks.

Table 2 shows that between 1992 and 2004 micro finance banks mobilized a total of 84.6 billion naira or an average of 6.5 billion naira per annum as deposits. In the same period, micro finance banks' total loans and advances amounted to 49.2 billion naira or an average of about 3.8 billion naira per annum. The value of deposits mobilized by micro finance banks indicate that there is a large reservoir of idle funds in the informal sector which without intermediation by micro finance banks would have remained outside of the formal money market. Similarly the value of micro finance bank's loans and advances indicate that there is effective demand for formal credit in the informal sector. While deposits mobilized by community banks increased by over 3000% from 639.6 million naira in 1992 to 21.4 billion naira in 2004, loans and advances also increased by over 7000% from about 150 million naira in 1992 to 11.3 billion naira in 2004. The indication is that outside the financial frontier, was an active and viable informal money market, unexploited by commercial banks. Through the micro finance-banking scheme, the surplus and deficit units who participate in this money market outside the frontier have been brought within the frontier. Total loans and advances of micro finance banks accounted for about 50% of their total deposits. The implication is that only about 50% of micro finance banks' total deposits may have been used to exploit economic opportunities in the informal sector. The other 50% may have been transferred to the formal sector through correspondent relationships, which the micro finance banks maintain with commercial banks. Given the high demand for investment capital within the informal sector, micro finance banks need to reinvest most of their deposits in the informal sector.

Loans and advances to agriculture: The economy of rural communities in Nigeria is agro based (Akwiwu *et al*., 2000) consisting of numerous informal micro economic units. Similarly most informal economic activities in urban areas are agro-allied. Thus agriculture and allied economic activities act as sources of livelihoods for the majority of the people the urban and rural poor by providing economic opportunities for the production, processing and marketing of agricultural products. Consequently, an improvement in the availability of investment capital to agriculture through the micro finance banking scheme will enhance the exploitation of economic opportunities in the informal sector and consequently improve the living standards of the majority of the people. Therefore, the loans and advances of micro finance banks to agriculture provide a useful indication of the level of contribution of micro finance banks to the economic empowerment of the majority of the rural and urban poor. Micro finance banks credit to agriculture decreased from a maximum of 21% of total loans to a minimum of 4% of total loans between 1992 and 2004. Credit to agriculture on the average, accounted for about 14% of micro finance banks loans and advances within the period (Table 3). This is an indication that the majority of the rural and urban poor may be marginalized in terms of access to debt capital under the micro finance banking scheme.

Table 2: Deposit mobilization and loans and advances of micro finance banks (₦M)

Years	No of banks	Total deposits	Total loans and advances
1992	334	639.6	149.6
1993	611	2188.2	708.2
1994	902	3216.7	1354.8
1995	745	2834.6	1209.1
1996	693	2876.3	1527.3
1997	674	3181.9	1744.5
1998	674	4454.2	2581.0
1999	471	5102.8	9274.5
2000	506	7689.4	3666.6
2001	128	3294.0	1314.0
2002	316	9699.2	4310.9
2003	564	18075.0	9954.8
2004	615	21407.9	11353.8
Total	(1992-2004)	84,659.8	49,149.1

CBN statistical bulletins; annual reports and statement of accounts (Various issues)

Table 3: Loans and advances of micro finance banks to agriculture

Years	Total loans[1] (₦m)	Agriculture/ Forestry[1] (₦m)	Percentage of total[2]
1992	149.6	29.5	19.7
1993	708.2	123.7	17.5
1994	1354.8	155.4	11.5
1995	1209.1	96.6	8.0
1996	1527.3	229.4	15.0
1997	1744.5	367.4	21.1
1998	2581.0	962.7	37.3
1999	9274.5	1007.2	10.9
2000	3666.6	656.6	17.9
2001	1314.0	77.6	5.9
2002	4310.9	390.5	9.1
2003	9954.8	625.0	6.2
2004	11353.8	483.1	4.3

CBN Statistical bulletins and annual report and statement of accounts (Various issues) 2. derived from 1

Invesment opportunities and viability options for micro finance banks in the informal sector: The informal sector is the source of livelihood for the majority of the population. The development of the informal sector is thus an imperative for the development of the entire economy. The micro finance-banking scheme can make a significant contribution to the development of the informal economy and consequently to national economic development by integrating the informal sector into the mainstream of the national economy. To make this contribution, micro finance banks need to provide services that are remunerative to them and their clients. Most micro finance banks have however limited their services to the traditional banking function of intermediating between Surplus Economic Units (SEUs) and Deficit Economic Units (DEUs). As a result some of the micro finance banks were unable to survive the stiff competition in the increasingly competitive banking industry.

To positively impact on the exploitation of economic opportunities in the informal sector in a sustainable manner i.e., to remain viable and at the same time relevant to the needs of their clients, micro finance banks in addition to re-engineering their traditional banking services need to identify and exploit other investment (non-traditional banking) opportunities in the informal sector of the economy. The unit nature of community banks and their specific and peculiar clientele confers on them some of the advantages of informal financial intermediation such as willingness to deal in small units, limited documentation, informal relationship between creditor and debtor, term flexibility and rapid response to loan requests which gives them comparative advantage over commercial banks in the informal sector. The following investment opportunities, which are remunerative to both banker and client are open to micro finance banks in the informal sector.

Deposit mobilization and credit delivery: Micro finance banks' deposit rates should be comparatively higher than commercial banks' rates to enable micro finance banks attract more deposits and expand the financial frontier. Through correspondent relationship with commercial banks, micro finance banks can serve as deposit centers or deposit takers for commercial banks especially in rural areas where the commercial banks do not have branches. In terms of credit delivery, the possession of a deposit account should be one of the eligibility criteria used by micro finance banks to select loan beneficiaries in their host communities. This will act as an incentive for informal economic units to open deposit accounts with micro finance banks. Micro finance banks should exploit their unit nature and localized clientele to establish close personal contact with their clients. This will reduce the cost of screening loan applicants and the chances of selecting default prone ones. Close personal contact with clients would likely reduce loan administration and supervision costs and ensure higher rates of debt recovery. The loans and advances rates of micro finance banks should be comparatively lower than the rates that obtain in the informal credit market in their host communities. Correspondent relationship with commercial banks will strengthen micro finance banks and put them in a better position to meet the demand for loans and advances by informal economic units in their client communities.

Provision of technical and managerial assistance to clients: Micro finance banks are not only located in, but also serve a clearly identified and delimited geographical area. Within the client communities, farming practices, processing techniques, land use systems, soil types, cropping patterns, livestock husbandry practices hand crafts and other informal economic activities are likely to be similar from one economic unit to the other. This creates an investment opportunity for micro finance banks in terms of the provision of technical information and managerial assistance to informal economic units in their client communities.

To exploit this opportunity, micro finance banks should hire skilled manpower and acquire a data bank on particular staple crop, most important livestock, predominant farming practice, storage, processing or production technique and hand craft within the client community with a view to providing their clients with information on new technologies and other technical and managerial assistance in their businesses. The banks can charge a fee for such services or provide such services free to clients who operate and maintain a certain minimum balance regularly in their deposit accounts. This can induce such clients to save in order to qualify for such services. This kind of assistance can also induce clients to increase output or to improve the quality of their output, earn high incomes and be in a better position to repay their debts.

Financing of sale of output and input purchase: Micro finance banks should not only provide their clients with credit for the purchase of inputs or sale of output but should also use their institutional status to strengthen the bargaining power of their clients in order to ease procurement and supply difficulties and to reduce grading, handling and transportation costs through bulk purchases of inputs and sale of output on behalf of their clients. The banks should charge a commission for assisting their clients to obtain better terms of sale and purchase from their customers.

Leasing of machinery and equipment: Micro finance banks should know that they have a comparative advantage over other public and private sector agencies in the provision of equipment leasing services in their communities due to a number of factors. First, micro finance banks are more familiar with their locality and knowledge of its environmental conditions will enable them to select and acquire appropriate machinery and equipment compatible with the reservoir of technical knowledge in the community. This will reduce operational and maintenance costs. Second micro finance banks are located in their client communities and are therefore likely to incur lower administration costs and overnight allowances for supervisory staff and for machine and equipment operators.

Community development financing: Micro finance banks can assist Community Development Associations (CDAs) by providing debt finance and technical assistance for community development projects. Micro finance banks should charge competitive interest on debt capital and a fee for technical assistance. Micro finance banks can provide Isusu groups credit for on lending to their members and serve as a link between donor agencies and community development associations and ensure effective utilization of development aid.

CONCLUSION

The micro finance banking scheme has substantially expanded the financial frontier i.e., integrated the informal money market into the mainstream of the formal financial system through deposit mobilization and credit delivery. Through the expansion of the frontier micro finance banks have contributed to the exploitation and development of economic opportunities in the informal sector. Agro and allied activities, which act as sources of livelihood for the majority of the people is still under funded under the scheme. However, the potential for further expansion of the frontier and exploitation of economic opportunities through non-traditional banking services such as technical and managerial assistance, equipment leasing, community development finance etc. is great. To sustain the expansion of the frontier and the development of economic opportunities in the informal sector, there is need to strengthen micro finance banks in terms of skilled manpower, effective management, a better capital base and information and communication technology facilities, enabling policies and operational guidelines and correspondent relationship with commercial banks. Supervisory and regulatory bodies need to monitor management performance closely to avoid distress and liquidation, instill confidence and cultivate the loyalty and trust of informal economic units.

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