

## Micro-Finance and Real Sector Growth in Nigeria

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### Abstract

*Microcredit is the provision of credit services to poor clients. While the words 'microcredit' and 'microfinance' are often used interchangeably, they have different resonances and are loosely attached to contrasting beliefs about the state of rural finance and the nature of poverty, (Robinson, 2001). The real sector of an economy refers to the sector responsible for the production and provision of tangible commodities, example, Agriculture and Manufacturing. The total contribution of Nigeria's real sector to GDP is not impressive at all, (CBN, 1993). Economic growth of the real sector refers to the steady process by which the productive capacity of the economy, measured over time, brings about rising levels of national output and income, (Todaro, 1979). Descriptive Survey Method (DSM) is used in this study to determine whether Microfinance Institutions are effective in boosting real sector growth, especially in Nigeria.*

**Keywords:** *Microfinance, Employment, Real Sector Growth. Abject Poverty.*

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### I. Introduction

Microfinance is the provision of financial services to low-income clients or solidarity-lending groups including consumers and the self-employed, who traditionally lack access to banking and related services. More broadly, it is a movement whose object is "a world in which as many poor and near-poor households as possible have permanent access to an appropriate range of high quality financial services, including not just credit but also savings, insurance, and fund-transfers." Those who promote microfinance generally believe that such access will help poor people out of poverty. Microfinance is a broad category of services, which includes microcredit. Microcredit is provision of credit services to poor clients. Although microcredit is one of the aspects of microfinance, conflation of the two terms is epidemic in public discourse. Microcredit refers specifically to small loans to the "very poor" without the stringent conditions of collateral.

On the other hand, microfinance refers to the broader term which embraces efforts to collect savings from low-income households, to provide insurance and, in some places (e.g. BRAC in Bangladesh), to also help in distributing and marketing clients' output, of course, in addition to the provision of small loans or 'microcredit.' Robinson (2001) provides a rich description of a "microfinance revolution" that is just beginning. While the words *microcredit* and *microfinance* are often used interchangeably, they have different resonances and are loosely attached to contrasting beliefs about the state of rural finance and the nature of poverty. The small difference in language signals, for some, a big difference in opinion. Microcredit was coined initially to refer to institutions like the Grameen Bank that were focusing on getting loans to the very poor. The focus was explicitly on poverty reduction and social change, and the key players were NGOs. The push to "microfinance" came with recognition that households can benefit from access to financial services more broadly defined (at first the focus was

mainly on savings) and not just credit for microenterprises. With the change in language has come a change in orientation, toward “less poor” households and toward the establishment of commercially oriented, fully regulated financial entities.

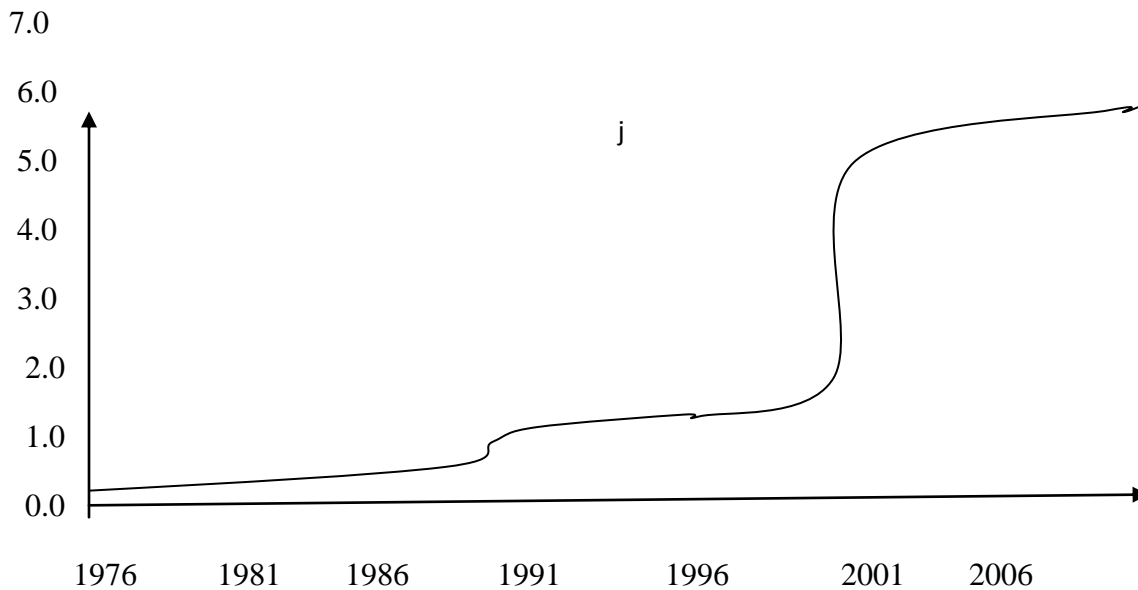
## II. Origins of Microfinance

Over the past centuries, practical visionaries from the **Franciscan** monks who founded the community-oriented **pawnshops** of the 15th century, to the founders of the **European credit-union** movement in the 19th century (such as *Friedrich-Wilhelm Raiffeisen*) and the founders of the **microcredit** movement in the 1970s (such as *Muhammad Yunus*) have tested practices and built institutions designed to bring the kinds of opportunities and risk-management tools that financial services can provide to the doorsteps of poor people. While the success of the **Grameen Bank** (which now serves over 7 million poor Bangladeshi women) has inspired the world, it has proved difficult to replicate this success. In nations with lower population densities, meeting the operating costs of a retail branch by serving nearby customers has proven considerably more challenging. *Hans Dieter Seibel*, board member of the European Microfinance Platform, is in favour of the group model. This particular model (used by many Microfinance institutions) makes financial sense, he says, because it reduces transaction costs. Microfinance programmes also need to be based on local funds.

## III. Contemporary Microfinance – The Grameen Bank of Bangladesh

The Grameen Bank of Bangladesh holds an iconic position in the world of microfinance. It is credited with proving that ‘the poor are bankable’; the Grameen ‘model’ has been copied in more than 40 countries; it is the most widely cited development success story in the world; and its charismatic Founder-Director, Professor Muhammad Yunus, was awarded the Nobel Peace Prize in 2006. By the end of February 2008 it had 7.4 million clients and outstanding loans of \$545 million. By any measure it is an organisation that has impacted greatly on the lives of many poor people and on ideas about microfinance, poverty reduction and international development. The group-based lending model, targeted at poor, rural women that is synonymous with the Grameen Bank contrasts markedly with the two other iconic microfinance institutions, *Bank Rakyat Indonesia* and *BancoSol* of Bolivia (see Hulme and Arun 2009).

The original Grameen Bank model comes out of what Robinson calls a ‘poverty lending’ approach, rather than the ‘financial systems’ approach that she, the Consultative Group to Assist the Poor (CGAP), and many US microfinance specialists prefer. However, unnoticed by many observers, the Grameen Bank made dramatic changes to its services around 2001 and 2002. Its new model (Grameen II), takes it much closer to a financial systems approach. Although Professor Yunus continues to champion the idea of microfinance for poor women, most obviously through the annual Microcredit Summit, the Bank he directs increasingly lends to non-poor clients, has moved aggressively into savings mobilisation, and is very much concerned with the overall profitability of the mix of its products. Grameen II reflects not so much a reform as a revolution in the Grameen’s strategy.



**Figure 1: Growth in Grameen Bank membership, 1976 – 2007**

Source: Grameen Bank Historical Data series, available at [www.grameeninfo.org](http://www.grameeninfo.org)

Over the 1980s and early 1990s the Grameen Bank steadily expanded, with large inflows of donor funding. By 1991 it had more than one million clients and a growing range of products – housing loans, agricultural loans and others. Alongside this, both the profiles of the Bank and of Yunus became increasingly international. The Bank was able to accommodate to the ascendancy of neo-liberal ideas of this era and to criticisms of those ideas. Yunus’s eloquent narrative presented the poor as ‘micro-entrepreneurs’, who could seize market-based opportunities once they had access to microcredit, (then seen as loans of around \$50 to \$200). But this was moderated: the Bank promoted women’s empowerment (sometimes Yunus presented this as the poor’s empowerment), collective action by groups, and social development. In effect, the Bank’s narrative allowed it to present itself as extending the benefits of capitalism down to the poor whilst, at the same time, being an alternative to orthodox capitalism.

Table 1: Growth of microfinance coverage as reported to the UN-Based Microcredit Summit Campaign, 1997 – 2007.

END OF YEAR	TOTAL NO. OF INSTITUTIONS	TOTAL NO. OF CLIENTS REACHED (Millions)	No. Of poorest Clients Reported (Millions)
1997	655	16.5	9.0
1998	705	18.7	10.7
1999	964	21.8	13.0
2000	1,477	38.2	21.6
2001	2,033	57.3	29.5
2002	2,334	67.8	41.6

2003	2,577	81.3	55.0
2004	2,814	99.7	72.7
2005	3,056	135.2	96.2
2006	3,244	138.7	96.2
2007	3,352	154.8	106.6

Source: Darley – Harris 2009

#### IV. Changing Paradigms in Microfinance Delivery

Microfinance was introduced and accepted as a key element in poverty reduction, which justified its place in development interventions. It helped organizations giving loans to become self-sustaining, appealed to NGOs, private sector, banks, government and donors. It suited all those engaged in development, to move from ‘dependence-creating’ to more ‘sustainable’ interventions, from grants to loans.

#### V. Modalities of Microfinance Delivery

##### A) The Credit Union Approach

One of the oldest modalities of microfinance delivery is the credit union, or financial Co-operative. In the informal sector, ROSCAs (Rotating Savings and Credit Associations) have always been an important way for poor households to fill the gap left by formal financial institutions. Credit unions are probably best characterized as “semi-formal”: unlike informal ROSCAs, they are registered entities subject to commercial law, but are not usually regulated or supervised under banking law, although in some countries specific regulations for credit unions are being developed.

These institutions are member owned and provide financial services – usually savings and loan services, in some cases insurance - to members. They are non-profit institutions and there are no external shareholders. Traditionally, membership in a credit union was the result of some common bond among the members: employment or membership in the same community. Closed bond credit unions are usually organized at the workplace and membership is open only to employees. Open bond credit unions operate in a given community and membership is open to any member of the community.

Where available, financial co-operatives often choose to become affiliated with a national apex institution which will provide training and technical assistance and channel resources from external donors to the national financial co-operative system. These national institutions may in turn affiliate with one of the international credit union apex agencies. The World Council of Credit Unions (WOCCU) – the largest of these international credit union apex agency – reports that there are now 40,421 credit unions, enabling 123 million members in 84 countries to gain access to affordable financial services.

## **B) The NGO Approach**

To many outside the microfinance sector, its natural delivery mechanism might be expected to be a non-profit making non-governmental organization (NGO). This modality was the basis of what has come to be called “the microcredit revolution” in both Asia and Latin America and the pioneering institutions in both regions were NGOs. For example, the Grameen Bank in Bangladesh, which founded many of the fundamental concepts we associate with microcredit such as small loans to groups of female micro-entrepreneurs and Prodem, the successful Bolivian microfinance institution that later became the first microfinance NGO to transform into a commercial bank, both started as NGOs. The breadth of outreach of NGOs varies greatly between countries. In South Asia, NGOs have much greater outreach in Bangladesh, for example, than in India or Pakistan.

In Latin America outreach is far greater in the smaller economies of Bolivia and Central America than in the larger economies of Brazil, Mexico and Argentina. Limits on the NGO modality are mostly regulatory. NGOs cannot access domestic or international capital markets. In most countries, NGOs cannot legally offer savings services and thus cannot mobilize deposits, using client deposits as a way to finance other parts of the organizations operations such as lending. Both of these restrictions in effect limit the scale of most NGO operations. In countries where microfinance NGOs have achieved significant scale, regulators have either come up with a regulatory framework suitable for microfinance institutions separate from banks (Bolivia), or have allowed the sector to flourish unregulated (Bangladesh), what some in the industry have referred to as “benign neglect”.

## **C) The Banking Approach**

The most recent entrants to the microfinance industry are commercial banks. This modality includes many variants: transformed microfinance NGOs, government owned development banks, reformed state banks and diversification into microfinance by existing commercial banks. The Khushhali Bank in Pakistan is an unusual example of a newly-established retail commercial bank specialized in microfinance. The transformation of NGOs into commercial banks is still a relatively new phenomenon, but so far they seem to be performing well in terms of profits and have been able to expand the scale of their operations significantly (Fernando (2004)). In comparison, state banks have generally underperformed. In the heyday of directed credit in the 1970s, subsidized loans often went to politically-favored wealthy-landowners rather than poor farmers.

Despite this repayment rates were low and many programs operated at a loss. However, many state owned banks have extensive branch networks, enabling them to achieve significant outreach. There are an increasing number of examples of commercial banks diversifying into microfinance, either directly or through partnerships with financial NGOs. Even big multinational banks such as ABN Amro, Citibank and Deutsche Bank are now involved in microfinance. The examples above of incorporation of microfinance into the formal financial system is paradoxical given that the initial motive of microfinance was to serve poor borrowers who could not have access to formal finance. In some cases, such as in Nepal or India, sector lending requirements may be the impetus behind diversification of large

commercial banks into microfinance. But ICICI Bank in India, for example, has expanded its involvement in microfinance beyond the minimum requirement and very little of their involvement in the microfinance sector now counts toward meeting the regulatory requirements. In these cases or others where such requirements do not exist, the motive seems to be profits and diversification of business lines. In Latin America in particular, there is a growing market for relatively small loans and in a number of countries, the larger MFIs have been generating considerably higher returns than have commercial banks. In contrast, smaller MFIs (principally NGOs) in the region show negative returns (Ramirez (2004)).

#### **D) Comparison of the Three Approaches**

The distinction between three approaches - NGO, credit union and commercial banking - is becoming blurred as credit unions and NGOs themselves take a more commercial approach to microfinance (see Charitonenko, Campion and Fernando 2004 and Drake and Rhyne 2002). For example, in the late 1980s, WOCCU embarked on a new strategy to renovate and strengthen credit unions using a commercially oriented approach, that has been particularly well-received in Latin America (Lennon and Richardson (2002) and Westley and Branch 2000). The more commercial approach among NGOs is exemplified by the small number of NGOs that have transformed into microfinance banks or regulated non-bank financial institutions.

Transformation is still far from a dominant trend in the sector, but many microfinance NGOs borrow funds from APEX institutions at market rates, requiring a more commercial approach to their overall operations. It should be noted that from an early stage in the evolution of the sector MFIs in Latin America have had a greater focus on commercial returns and financial sustainability than have their counterparts in Asia. This can be seen in the emphasis placed on loans to microenterprises rather than to individual households. However, in the aggregate, microfinance NGOs and credit unions do not cover costs. This can be seen in the fact that the average return on assets for MFIs and credit unions in the late 1990's was negative (at -4.5%); more recent figures suggest a close to breakeven position; see Ramirez (2004).

### **VI. The Real Sector of Nigeria's Economy**

The real sector of an economy refers to that segment of the national economy which is responsible for the production and provision of tangible commodities, e.g. Agriculture and Manufacturing sectors. The total contribution of Nigeria's real sector to GDP is not impressive at all, (CBN; 2008).

Before oil became a single dominating export item in the late sixties and early seventies, the structure of the nation's export was dominated by Agricultural commodities such as cocoa, groundnut, cotton, palm-oil and rubber. Non-oil exports dominating the economy then stood at about 93.7% of the total export earnings in the early 1960s, (CBN, 1993).

Incidentally, between 1960 and 1981, the average rate of growth was impressive at 22.1%. The share of non-oil export which was 76.4% in 1965 declined to 42.4% in 1970. On the other hand, crude oil export

which was valued at N118.8m or 2.7% of total export in 1960 increased sharply to N335.23m or 20.34% of GDP. Growth rate of crude oil export became significant in the profile of total earnings while that of non-oil export declined significantly, (Ojo, 1993).

The scenario painted above vividly captured the general situation in the non-oil sector, made up of agricultural goods such as food items and manufactured goods such as leather and products, wood, paper, minerals, beverages and pharmaceuticals. Some of these commodities were the main foreign exchange earners before the oil euphoria.

A reasonable inquiry into the composition of Nigeria's export portrays a disturbing structural imbalance. Obviously, the dominance of crude oil in the nation's export profile has made Nigeria a mono-product economy whose fate is just linked to developments in that sector. Nigeria's export sector is structurally defective and economically by her large population of about 150m, (census, 2003), and enormous material resources.

Following the sharp fall of oil prices as a result of oil glut, the danger associated with over dependence on this narrow and inelastic export base became manifest as it exposed the Country to the vagaries and uncertainties of a world oil market. Considering the country's international trade experience in this regard and the near total disappearance of commodities for export, the need to develop and produce manufactured goods for export such as standardized, intermediate, semi-finished and finished goods became inevitable.

As the Naira was stronger than the dollar up till 1980, there was general anti-export bias as it became cheaper to import than to export. Thus, the general question often asked was; what had Nigerian to export apart from crude oil? To date this lingers on because there has been widespread ignorance about the advantages derivable from exporting manufactured goods. According to the Manufacturers Association of Nigeria (MAN, 1994) banks did not help the matter either as they usually deny credit to export ventures, rather, banks preferred extending credit to importers or the merchandizing business.

Nigeria, like other developing countries which have to change from exporting primary commodities such as cocoa, rubber, palm-oil, hides and skins and gum Arabic, to the export of manufactured commodities such as textiles, beverages and refined products face a series of challenges of transforming the structure of the economy to suit the new circumstances. This includes the provision of higher rate of domestic financing for the expanded export effort, sufficient credit, adequate cover for risks from exports and to encourage new investment to create additional productive capacities for export expansion, (CBN, 1995).

## **VII. Real Sector Growth or Development?**

Economic growth of the real sector refers to the steady process by which the productive capacity of the economy, measured over time, brings about rising levels of national output and income. However, experiences in the mid-1970s, when GDP almost doubled but the misery of poverty, unemployment and

inequality worsened, has made people across the globe to agitate for ‘‘dethronement of GDP’’ as a yardstick for measuring progress, (Rodney, 1978).

What do we mean by *development*? In strictly economic terms, development has traditionally meant the capacity of a national economy, whose initial economic conditions has been more or less static for a long time, to generate and sustain an annual increase in its Gross National Product (GNP) at rates of perhaps 5% to 7% or more. A common alternative economic index of development has been the use of rates of growth of income per capita or per capita GNP to take into account the ability of a nation to expand its output at a rate faster than the growth rate of its population. Levels and rates of growth of ‘‘real’’ per capita GNP (monetary growth of GNP per capita minus the rate of inflation) are normally used to measure the overall economic well-being of a population, i.e. how much of real goods and services are available to the average citizen for consumption and investment, (Todaro et al, 2008).

Also, Dudley Seers (1979), posed the basic questions about the meaning of *development* succinctly when he asserted: ‘‘the questions to ask about a country’s development are thus; what has been happening to poverty? What has been happening to unemployment? What has been happening to inequality? If all three of these have declined from high levels, then beyond doubt, this has been a period of development for the country concerned. If one or two of these central problems have been growing worse, especially if all three have, it would be strange to call the result ‘‘development’’ even if per capita income doubled.

The view that income and wealth are not ends in themselves but instruments for other purposes goes back at least as far as *Aristotle*. Amartya Sen, the 1998 Nobel Laureate in Economics, argues that the ‘‘capability to function’’ is what really matters for status as poor or non-poor person. He argued ‘‘economic growth cannot be sensibly treated as an end in itself. Development has to be more concerned with the lives we lead and the freedom we enjoy.’’ Amartya Sen concurred with the views expressed by Rodney (1973).

### **VIII. Nexus between Real Sector Performance and National Development**

Obviously, documented evidence shows that about 80% of Nigerians subsist on less than US\$1.00 per day, that is, below the internationally recognised poverty line,(CIA World Fact Book). If these poor masses could have find something to do, they could lift themselves out of poverty and also boost the total national output of the entire economy. But where could they obtain the wherewithal to start any economic activity? *Beatriz Armendáriz and Jonathan Morduch* have provided reasons why capital doesn’t naturally flow to the poor,(Beatriz A. & J. Morduch: 1997). The lacunae created by absolute lack of capital on the part of the poor and national development, is being filled by Microfinance. In this talking, Microfinance delivery is a catalyst to real sector growth and national development.



## IX. Conclusion

Although much progress has been made, the problem has not been solved yet, and the overwhelming majority of people who earn less than \$1 a day, especially in the rural areas, continue to have no practical access to formal sector finance. Microfinance has been growing rapidly with \$25 billion currently at work in microfinance loans. It is estimated that the industry needs \$250 billion to get capital to all the poor people who need it. The industry has been growing rapidly, and concerns have arisen that the rate of capital flowing into microfinance is a potential risk unless managed well.

The idea of replicating the Grameen Bank around the world crystallised when the US based group called RESULTS, (which runs campaigns promoting microcredit) and its Director, an experienced lobbyist, came up with the idea of a Microcredit Summit. Since 1990, the UN had convened a set of global summits that had set goals for poverty reduction, education, gender equality and other issues. The 1997 Microcredit Summit was not a UN event – it was organised by RESULTS – but it presented as a global summit, with claims of ‘microcredit is a human right’ and speeches from heads of state. It set a goal of mobilising US\$21.6 billion, so that 150 million households would be able to access Grameen Bank-type loans by 2005. Some within the Microcredit Summit movement pushed for a focus on microfinance and a broader range of services but that did not suit RESULTS’ campaigning style. It needed a simple message. The Grameen Bank was a panacea, the world should replicate it!

In Nigeria, People’s Bank of Nigeria (PBN) was established to replicate the successes achieved by the famous Grameen Bank. Initial achievements of the people’s Bank became dented due to mismanagement and inconsistency in government policy. The real sector of the Nigeria economy benefitted immensely from microfinance as acknowledged by the Manufacturers Association of Nigeria (MAN), (Olu,2011).

## X. Recommendations

- i. The Nigeria government should establish and maintain microfinance institutions in order to assist the poor in easy access to credit.
- ii. Change in government has been noted as the main obstacle bedeviling sustenance of micro-finance in Nigeria
- iii. Youth empowerment and employment generation should be the main aim of micro-finance institutions in Nigeria
- iv. Government should encourage multiple MFIs across the country.

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