Assessment of The Micro, Small and Medium Enterprise (MSME) Sector in Nigeria

Volume 1: MSME Assessment

PRISMS: Promoting Improved Sustainable Microfinance Services

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ACRONYMS

ACCION	Americans for Community Cooperation in Other Nations, International
ACGSF	Agricultural Credit Guarantee Scheme Fund
BAS	Bank Analysis System
BDS	Business development services
BOFIA	Banks and Other Financial Institutions Act
BOI	Bank of Industry
CAC	Corporate Affairs Commission
CBN	Central Bank of Nigeria
CDF	Community Development Foundation
CDMR	Community Development and Microfinance Roundtable
CSP	Country Strategic Plan, USAID
DCA	Development Credit Authority
DFD	Development Finance Department, CBN
DFI	Development finance institution
DFID	Department for International Development, U.K.
EDF	Export Development Fund
EEGFS	Export Expansion Grant Fund Scheme
FCT	Federal Capital Territory
FDIC	Federal Deposit Insurance Corporation
FF	Ford Foundation’s Office of West Africa
FMBN	Federal Mortgage Bank of Nigeria
FSRCC	Financial Services Regulation Coordinating Committee
FSSC	Financial Sector Surveillance Committee
GBF	Growing Business Foundation
GDA	Global Development Alliance
GDP	Gross Domestic Product
GIS	Global Information System
GON	Government of Nigeria
GTZ	German Technical Cooperation
HIV/AIDS	Human Immunodeficiency Virus/Acquired Immunodeficiency Syndrome
IFAD	International Fund for Agricultural Development
IFC	International Finance Corporation
IR	Intermediate Result
LGA	Local Government Area
MABS	Microenterprise Access to Banking Services
MBS	Manufacture-in-Bond Scheme
M&E	Monitoring and evaluation
MFI	Microfinance institution
MOF	Ministry of Finance
MSME	Micro, small and medium enterprise
NACRDB	Nigeria Agricultural Credit and Rural Development Bank
NAIC	Nigerian Agricultural Insurance Commission
NAICOM	National Insurance Commission
NASME	National Association of Small and Medium Enterprises
NASSI	National Association of Small Scale Industries

NBCB	National Board of Community Banks
NDIC	Nigerian Deposit Insurance Corporation
NEEDS	National Economic Empowerment and Development Strategy
NERFUND	Nigerian Economic Reconstruction Fund
NESG	Nigerian Economic Summit Group
NGO	Non-government organization
NIDB	Nigerian Industrial Development Bank
NIPC	Nigeria Investment Promotion Commission
NORAD	Norwegian Agency for Development Cooperation
NRDCS	Natural Resources Conservation Scheme
OFID	Other Financial Institutions Department, CBN
PBT	Profit before tax
PLWHA	People living with HIV/AIDS
PMP	Performance Monitoring Plan
PMT	Performance Monitoring Tool
PRISMS	Promoting Improved Sustainable Microfinance Services
PRSP	Poverty Reduction Support Strategy, World Bank
RB2000	Rural Banker 2000
RFP	Request for proposal
R&D	Research and development
RIDS	Rural Infrastructure Development Scheme
RIFAN	Rice Farmers Association of Nigeria
RPED	Regional Program on Enterprise Development
SEC	Securities and Exchange Commission
SME	Small and medium enterprise
SMIEIS	Small and Medium Industries Equity Investment Scheme
SO	Strategic Objective
SOWESS	Social Welfare Services Scheme
SPEED	Support for the Promotion of Private Enterprise Expansion and Development
STEP	Support and Training Entrepreneurship Program
SUFFICE	Support to Feasible Financial Institutions and Capacity Building Efforts
UNDP	United Nations Development Program
UNIDO	United Nations Industrial Development Organization
USAID	United States Agency for International Development
WB	World Bank
YES	Youth Empowerment Scheme

EXCHANGE RATES

Year	Average	Ending
2004	138.42	–
2003	133.07	143.30
2002	126.40	130.62
2001	116.95	123.54
2000	105.14	110.50
1999	95.99	99.80
1998	86.46	89.80
1997	82.19	76.12
1996	81.86	78.00
1995	31.59	84.50

Source: http://www.Oanda.com[1]

[1] **OANDA, The Currency Site** is the advanced and comprehensive provider of foreign exchange, currency trading, and information services to FX investors, businesses, and travelers.

EXECUTIVE SUMMARY

The USAID-funded Promoting Improved Sustainable Microfinance Services (PRISMS) project is a microfinance assess, design, and implement project that will be carried out as part of USAID/Nigeria's Country Strategic Plan, FY 2004-2009. PRISMS will be implemented in direct support to Strategic Objective 12 (SO 12), which focuses on achieving "Improved Livelihoods in Selected Areas." To support this objective and mission interests, PRISMS will be designed to serve as an effective tool for increasing financial flows to SO 12 target areas in ways that result in increased rural incomes, expanded micro, small, and medium enterprise (MSME) activity, and in strengthened and sustainable policy and institutional frameworks for financial activity, particularly at the microfinance level. The approaches PRISMS takes to building financial linkages and installing capacity to maintain them in these targeted areas will also contribute to the achievement of USAID/Nigeria's SO 11, SO 13 and S0 14.[2]

Rationale for the Assessment. USAID/Nigeria sees a sustainable microfinance industry as a critical part of the foundation needed to support expansion of rural economic growth opportunities that will lead to sustained improvements in rural livelihoods. The challenge for the assessment phase was to determine the ways in which the mission could best use PRISMS – given an institutional and project landscape characterized by many actors and initiatives – to build a sustainable microfinance activity within the SO 12 context. In its Request for Proposal for the PRISMS activity, the mission set forth the following elements that it expected PRISMS would need to address to respond to the realities of the Nigerian microfinance environment and, given the level of resources available and the requirements of SO 12, define the most appropriate context for PRISMS activities:

- An improved policy and regulatory environment, with a focus on appropriate supervision and oversight of microfinance institutions (MFIs) and small and medium enterprise (SME) financial institutions by the Central Bank of Nigeria or other appropriate government agency;
- Strengthened MFIs using best practices for sustainable lending, savings, and other financial services activities;
- Increased capacity and interest of financial institutions to provide services and products to SMEs; and
- Enhanced coordination among public sector, private sector, and donor agencies supporting MFIs and SME financial development in Nigeria.

Objectives of the Assessment. The objectives of the assessment are to provide a comprehensive review of the MSME subsector and to determine where gaps and constraints exist in the provision of microfinance and SME financial and non-financial services. This analysis was used to identify which points of entry would most effectively support the mission's objectives and provide opportunity for PRISMS to fill gaps and provide effective linkage between MSME activities and rural economic development initiatives to contribute to USAID's SO 12. The PRISMS team then reviewed assessment findings in light of USAID/Nigeria's interests in improving the policy and regulatory environment, strengthening MFIs through best practices, increasing the flow of financial products and services to MSMEs, enhancing donor cooperation as well as private and public stakeholder cooperation in support of MSME development, and outlining recommendations that provide the basis

[2] These focuses of these other SOs are: SO 11 "Strengthened Foundations for Democratic Governance," SO 13 "Increased Use of Social Sector Services," and SO 14 "Reduced Impact of HIV/AIDS in Selected States."

for design of the PRISMS project. The assessment report is divided into two volumes. Volume I, “MSME Assessment” presents the assessment’s main findings and recommendations for USAID/Nigeria’s overall strategic approach to developing the MSME subsector; Volume II, “Draft PRISMS Design” presents an overview of the proposed design for PRISMS, as informed by the assessment findings and recommendations.

Volume I: MSME Assessment. This volume presents analyses organized around the four work packages: (i) Policy Environment; (ii) Legal Framework, Regulation, and Supervision; (iii) Supply Analysis; and (iv) Demand Analysis. The main findings and recommendation contained in Volume I suggest a way forward for USAID/Nigeria that is designed to overcome constraints and respond to gaps in current and planned activities, and to take advantage of and build on the mission’s comparative advantages. Volume I is presented in seven sections: (i) Introduction; (ii) MSME Subsector Overview; (iii) Providing an Enabling Policy Environment; (iv) Developing Appropriate Regulations and Adequate Supervision for Microfinance; (v) Supporting Increased Access to MSME Finance; (vi) Building Local Capacity to Provide Training in Demand-Driven SME Finance; and (vii) Enhancing Coordination of External Assistance to the Financial Sector. Each of these sections is supported by detailed analyses included in supplemental annexes that are organized according to the four work packages.

Summary of Main Findings

Policy Environment. There is a lack of a coherent and consistent national policy to support MSME finance and to guide the development of the microfinance and SME subsectors, however a draft of a national microfinance policy has been developed by the Development Finance Department (DFD) of the Central Bank of Nigeria (CBN) and it is currently undergoing review by domestic stakeholders and international experts. Given that it focuses on the adoption of cost-recovery interest rates and gives equal weight to savings as it does to credit as a useful service to microfinance clients, the content of the microfinance policy represents a shift away from the failed directed, subsidized credit programs of the past and represents the greatest potential for development of the MSME sector. It also presents the greatest risk if it is not finalized and implemented in an appropriate manner or fully accepted by the Government of Nigeria (GON).

Legal Framework, Regulation, and Supervision. The legal and regulatory framework is not supportive of microfinance or SME finance and the supervision capacity of the CBN’s Other Financial Institutions Department (OFID) is weak with respect to being able to effectively supervise the financial institutions falling under its jurisdiction – six development finance institutions, 769 community banks (282 of which have been licensed as of mid-March 2004), and 102 consumer finance companies. Microfinance regulation guidelines have been drafted by CBN’s DFD in cooperation with OFID and these are currently under review. As in the case of the microfinance policy, PRISMS support in revising these guidelines and finalizing them in an appropriate manner represents a potential high reward for the sector and another major risk if not done in a manner consistent with international best practices.

MSME Subsector Overview. Most Nigerians derive their income from a combination of agricultural activity and operation of an MSME. However, there is no single universally accepted definition of SMEs in Nigeria. Nigerian ministries, research institutes, agencies, private sector institutions, etc. use different definitions. Due in large part to this gap, statistics on the number, size, geographical distribution, and activities of the microenterprise and SME subsectors are partial and highly unreliable, but various reports have suggested that the MSME subsector may comprise as much as 87 percent of all firms operating in Nigeria. This percentage excludes the informal microenterprise subsector, which remains the main source of income and employment for most Nigerians. For the purposes of this assessment, the following definitions are used: microenterprises are usually informal businesses employing five or fewer workers, including unpaid family labor; small enterprises are usually in the formal sector with five to 20 employees; and medium enterprises employ 21 to 50 employees. Despite the definitional difficulties and lack of reliable and complete statistics on the MSME subsector in Nigeria, our best estimates suggest that there are about 8.4 million MSMEs in operation in Nigeria today. Given the paucity of available statistics, it is impossible to gauge exact numbers of MSMEs segregated by size, but it is plausible to suggest that the number of microenterprises may comprise 80 percent of the total number of estimated MSMEs (approximately 6.7 million); that small businesses may account for 15 percent of the total (about 1.3 million); and that medium enterprises may comprise 5 percent of the total MSMEs (around 420,000).

Demand for and Supply of Financial Services to MSMEs. MSMEs generally operate in an environment that provides them with virtually no policy support, coordination, and planning; significant legal barriers; and extremely limited access to financial products and services. Loans demanded by SMEs generally range from N50,000 to N500,000 and this represents the “missing middle” in terms of access to financial services. The 282 licensed community banks (as of mid-March 2004) are perhaps the largest formal financiers in this part of the market and a few commercial banks such as First Bank are beginning pilot programs to tap this market as well. There is also a demand-supply gap of microloans of N50,000 and less, suited to microenterprises. These are supplied to a more limited extent by community banks, by hundreds of capacity and capital constrained cooperatives, about 17 NGO MFIs that have reached more than 1,000 clients each (but which on a combined basis served at most 150,000 clients as at the end of 2003), and through targeted, subsidized credit programs via weak and subsidy-dependent state banks like the Nigeria Agricultural Credit and Rural Development Bank (NACRDB).

Demand for and Supply of Non-financial Services to MSMEs. The market for training has grown in response to demand driven by a growing awareness among MSMEs – mainly SMEs – of the need to improve management practices. The relatively newer market for business plan development is largely a result of funding requirements of financial institutions, especially through the Small and Medium Industries Equity Investment Scheme fund. Funding requirements are also driving slow growth for feasibility studies and accounting services.

The supply of BDS services is still extremely thin. The BDS market is characterized by limited competition, narrow range of BDS services offered, weak market capacity, outreach, and ability to cover costs. As with the supply of BDS to MSMEs, the supply of training and technical assistance to microfinance providers is inadequate. Unlike other segments of the economy, the proportion of the MSME sector with access to BDS services is still quite small, consisting largely of NGO MFIs and community banks.

The demand pull for microfinance training is to strengthen existing microfinance providers and to create new ones. With more formal institutions being created and existing organizations transforming into formal institutions to meet regulatory requirements, microfinance providers need assistance with formalizing operations, business planning, and training to compete effectively. It is important to note that most MFIs can be considered a type of SME, and issues that apply to the sector apply to them as well.

Summary of Major Constraints/Gaps and Recommendations

Promoting an Enabling Policy Environment

There is a lack of a coherent and consistent national policy to support MSME finance and to guide the development of the microfinance and SME subsectors. In addition, the continued government sponsorship of targeted, subsidized credit programs crowds out private provision of MSME financial services on a commercial basis. The following are recommendations to mitigate these constraints/gaps:

- Capitalize on existing relationships between PRISMS team members, the CBN, and other GON ministries to achieve a comprehensive and consistent national microfinance policy. This will require the establishment of a microfinance unit within the CBN that will formulate appropriate savings and credit policies to guide the GON in facilitating access to financial services by the MSME sector.

- Formalize a DFD-led microfinance working group/network to increase participation of the private sector in the delivery of financial services, facilitate agreement among network members on microfinance reporting and performance criteria, and determine approaches to establishment of necessary finance infrastructure (credit bureau, rating agencies, etc.).

- Assist in streamlining and strengthening the policy-making process, phasing out subsidized credit. A first step toward this will include a comprehensive review of subsidized credit activities, followed by modification of inappropriate policies and/or inefficient practices in government-sponsored credit and loan guarantee programs.

- Implement viable alternatives to directed credit and loan guarantee programs and develop a plan for transferring ongoing subsidized credit programs to a single institution and for phasing out of such programs within an acceptable time frame.

Developing Appropriate Regulations and Adequate Supervision for Microfinance

The legal and regulatory framework is not supportive of microfinance or SME finance and the supervision capacity of the CBN's Other Financial Institutions Department (OFID) is too weak to effectively supervise the financial institutions falling under its jurisdiction. Recommendations to improve the legal and regulatory environment for MSME finance and to strengthen OFID's supervision capacity include:

- Review the overall approach to creating a legal and regulatory framework for microfinance with CBN DFD, including determining whether regulation should be institution or activity based;

- Assist CBN's DFD and OFID in developing microfinance regulatory guidelines, and in rationalizing the roles of DFD and OFID within the CBN with respect to microfinance policymaking, regulation, and supervision;

- Assist in revising the CBN's Manual of Bank Regulations and Examination Procedures consistent with international best practices concerning adaptations for microfinance operations; and

- Provide capacity building to CBN's OFID to expose it to microfinance operations, best practices, and international experience in designing appropriate regulation and supervision for microfinance, and train CBN's OFID on appropriate supervision of microfinance operations.

Creating MFI Reporting and Performance Standards

Due in part to a lack of a strong microfinance trade association, standards for microfinance reporting and performance criteria have not yet been developed. These following steps are recommended to arrive at a set of mutually-agreed MFI reporting and performance standards:

- Set the stage for all stakeholders to align their interests and evolve a common vision and goal for a holistic performance rating tool and the identification of champions to drive the process within stakeholder institutions;

- Review existing reporting requirements to build and expand the scope to reflect the spectrum of stakeholder interests, and develop a draft MFI rating tool to test with a few MFIs in PRISMS and fine tune based on lessons learned from the test; and

- Train raters, inspectors, and examiners of the regulatory agencies (OFID) and private sector BDS providers in the microfinance industry i.e. accounting, audit, consulting, and training firms and networks of microfinance practitioners such as national association of community banks and a revived network of MFIs.

Supporting Increased Access to MSME Finance

Data on size and scope of the MSME subsector is poor, however, the best estimates suggest that less than 10% of the total 8.4 million MSMEs have access to microfinance or SME financial services. In addition, there is a lack of demand-driven, sustainable MSME financial services delivery models and linkages to target markets within the system. Only a handful of commercial banks are piloting MSME lending programs and the sustainability of these efforts is still unclear. The development finance institution focused on serving farm and non-farm micro and small-scale enterprises, NACRDB, is estimated to have reached less than 10,000 credit clients in 2003. NACRDB's financial services, like those of other development finance institutions, are highly subsidized and mainly supply-driven. The system of Community Banks is estimated to have the largest outreach in this subsector. Their combined borrowers in 2003 numbered about 60,000, however, only about half of the total 747 banks were assessed to be on a sound financial footing. Scarce data on cooperatives prohibits analysis of that system's outreach but it is generally understood that cooperatives and credit unions continue to be capacity and capital constrained, limiting their provision of financial services. Of approximately 100 NGO MFIs, about 17 have the most outreach, but together they reach fewer than 150,000 active microcredit clients. To support increased MSME access to demand-driven and sustainable financial services, we recommend the following:

- Identify and work with business leaders to develop market-driven economic clusters, and approaches to integration of financial and non-financial services in support of MSME development within the cluster;

- Identify viable participating community banks through a competitive tender process to drive MSME financial service delivery by creating sustainable linkages between participating community banks and economic clusters in targeted areas;

- Install microfinance units in participating community banks to serve microenterprises based on international best practices;

Why Community Banks?

- Past GON efforts to stimulate commercial bank and DFI lending to MSMEs have failed to achieve sustainable results.
- The donor community has traditionally supported microenterprise activity through NGOs but even after more than a decade of support, the largest 17 microcredit NGOs reach at most 150,000 clients on a combined basis compared with a potential market of 8.4 million MSMEs.
- NGOs cannot legall mobilize deposits, and therefore have difficulty expanding their outreach.
- The financial discipline required to run a successful financial institution conflicts with the social mandate of NGOs.
- There are an estimated 413 profitable community banks located throughout Nigeria.
- Community banks are close to the target market culturally and geographically, and they have experience working with MSMEs, and are interested in adopting international and regional best practices.
- Community banks have relatively low overhead costs, thus enabling them to profitably manage the large number of small transactions required for serving MSMEs.

- Strengthen viable member-based institutions, such as cooperative societies and producer organizations, playing important roles within commodity chains and economic clusters;

- Identify opportunities for inclusion of plans to address cross-cutting themes, such as HIV/AIDS, at-risk youth, gender, and the environment. Several potential opportunities for financial services, education, and referral for HIV/AIDS-affected persons are presented in the main text.

Closing the Demand-Supply Gap for MSME Non-financial Services

The supply of BDS to the Nigerian MSMEs community is extremely thin, particularly when looked at in terms of the number of MSMEs and the types of enterprise development support to which most require access. The BDS market is characterized by limited competition, narrow range of BDS services offered, weak market capacity, limited outreach, and an inability to cover costs. To overcome these constraints, the following recommendations should be considered:

- Donor programs need to be more carefully developed to encourage competition, innovation, and sustainability rather than continued dependency. Carry out all project work with BDS suppliers under competitive tender, and develop technical specifications for project-required services that define, introduce, and require innovative approaches that can lead to fee generation and sustainability. Organize and offer opportunity for selected BDS providers to interact with PRISMS short-term technical assistance providers each time they carry out an in-country assignment.

- Regardless of the type of BDS organization structure – NGO or consulting firm – operate only under the terms of contracts for service and technical assistance agreements that specify results and deliverables and provide for direct technical oversight.

- Leverage project resources by establishing partnerships with community and faith-based organizations, many of which are linked to larger formal organizations that have systems, capacities, and resources that can be applied to tackling problems associated with outreach and delivery of services. For example, support ability of targeted BDS providers to work with and through community-based associations to enable provision of BDS as group services and use community-focused and grounded mechanisms, such as those identified above, to support this activity.

- Design activities in which services are embedded; for example, in linking producer organizations to processing enterprises, make the provision of technical assistance and training part of the arrangement, and train BDS partners to identify, develop, and support such linkages. In particular, contract BDS providers to carry out market research and surveys that can then be made available to MSMEs through business associations. Work with associations and selected BDS providers to develop specialized subsector technical skills and training programs that can be sustained by the associations on a for-fee basis.

Building Local Capacity to Provide Microfinance Training and Technical Assistance

As mentioned previously, there is a lack of demand-driven, sustainable MSME financial services, delivery models, and linkages to target markets within the system. The following are recommended so as to build local capacity to provide microfinance and SME finance training and technical assistance:

- Support existing BDS providers, that are largely NGOs, to transform into commercial ventures by offering assistance with increasing internal capacity and institutional structures and developing appropriate products for a commercial MFI market, and encourage them to define their specializations;

- Carry out competitive procurement to identify short list of MSME training and technical assistance service providers, and build capacity of those service providers to deliver required training and technical assistance on a commercial basis;

- Adapt proven methodologies and packages for installing microfinance units in community banks (e.g. adapting the Philippines Microenterprise Access to Banking Services model to the Nigerian context);

- Expand on proven approaches to support community bank linkages to agricultural associations and producer organizations in the sustainable provision of financial services (e.g. adapting the Uganada Support for the Promotion of Private Enterprise Expansion and Development model to the Nigerian context);

- Support formation of associations as market facilitators to help structure the industry and perform or organize market development services. Offer support in the areas of coordinating the formation of groups and developing their institutional capacities.

Enhancing the Effectiveness of External Assistance

Donor interest and planning for projects in the MSME subsector is at an all-time high, making the need for donor coordination and synergy between current and planned activities paramount. In addition, the focus on building effective public/private sector partnerships for development is one of USAID's major pillars of operation. In the last couple of years, major initiatives such as the Global Development Alliance (GDA) have emerged to promote such partnerships in adjunct to the programs operated through USAID's individual country and regional missions. To promote donor coordination and leverage PRISMS activities, the following are recommended:

- Strengthen the ability of the financial sector donor working group to coordinate and advocate for financial sector development and MSME finance issues by playing a leadership role with DFID, and by merging the microfinance working group with the financial sector donor working group; and

- Maximize GDA opportunities by fostering private-public partnerships within the framework of economic clusters, and by heightening involvement of Nigeria's private business community through the commodity value chain approach to identifying economic opportuity.

Volume II: Draft PRISMS Design. The recommendations for design presented in this volume are based on team analysis of the strategic implications of assessment findings in terms of three design imperatives: the microfinance/financial services imperative; the institutional and project environment imperative; the USAID/Nigeria rural economic growth imperative. Together these imperatives provide the strategic context for determining the ways in which PRISMS can best be implemented, as well as a framework for responding directly to USAID/Nigeria's requirements with regard to identification of "major action areas and proposed elements for the PRISMS program, the comparative level of effort to be targeted to the micro, small and medium enterprise sectors and the ways in which action elements would most effectively address problem areas identified in the assessment and link effectively to USAID/Nigeria's SO12 IRs." (from Contract # 620-C-00-04-00037-00). Volume II is presented in five sections: Section A, Strategic Framework For Design; Section B, Guiding Principles For Prisms Design; Section C, Prisms Provisional Results Framework; Section D, Approach To Design Phase; Section E, Draft Outline Of Prisms Design Document.

As part of its Phase I activities, the PRISMS team carried out an in-depth assessment of the policy and program environment within which the PRISMS project would be implemented. This assessment was to provide the foundation for project design within a landscape shaped by numerous actors and initiatives, each seeking ways to contribute to emergence of a sustainable microfinance program and the related policy, regulatory, and institutional systems needed to support access to finance for millions of under-served Nigerian MSMEs. The PRISMS team will use assessment results to provide USAID/Nigeria with a design for PRISMS implementation that will build on and add value to current and planned activities in support of MSME development and financial access.

The scope for PRISMS design is rooted in the findings of the assessment process, which included an in-depth analysis of:

- MSME subsector characteristics;
- Current and planned CBN approaches to financial sector policy and regulation, particularly with regard to MFIs;
- MSME requirements for both financial and non-financial services;
- Commodity chain activity and related MSME opportunities in targeted areas;
- Current and planned activities of private and public sector organizations; and
- Projected and planned activities of USAID/Nigeria and other donors.

To facilitate linkages between assessment and design, main findings and recommendations of the assessment process are presented in the form of action areas that 1) address gaps and constraints, 2) build on USAID/Nigeria comparative advantages, and 3) fit within PRISMS resource constraints. The action areas for PRISMS design, as presented in the assessment report, are:

- Promoting an Enabling Environment
- Supporting Increased Access to MSME Finance
- Closing the Demand-Supply Gap for MSME Non-Financial Services
- Building Local Capacity to Provide Microfinance Training
- Enhancing the Effectiveness of External Assistance

The following pillars – based on assessment and on the design considerations – guide the PRISMS approach to the design phase:

Strengthening macroeconomic policies and microeconomic foundations. Nigeria's ability to compete globally is a function of both its macroeconomic policies and its business environment, or the microeconomic framework that supports business growth. Through a design that supports its ability to work with the Central Bank of Nigeria, while at the same time working with carefully selected economic cluster activities, PRISMS will have the ability to influence Nigeria's macroeconomic and microeconomic environments in ways that will have positive impacts that can translate into improvements in Nigeria's Growth Competitiveness Index, in increased MSME access to finance, and in increases in rural value-added.

Adding value to existing efforts. In a project environment where there are many support initiatives underway, particularly in microfinance, there is a need for USAID to make its breadth of microfinance experience available in ways that will lend support to the initiatives of others. PRISMS' design needs to incorporate roles for the project as an honest broker, a coordinator, a facilitator, and a mentor, particularly in the design and development of a sustainable microfinance industry.

Adapting best practices models that work. USAID global microfinance experience means that PRISMS will have access to models, for example, from the Philippines and Uganda that are adaptable to the Nigeria context in support of a sustainable microfinance industry. PRISMS' design needs to look at ways to facilitate adaptation of these models using competitive approaches to transfer and training that will upgrade the ability of BDS providers to innovate and deliver appropriate services.

Harnessing business initiative and market imperatives. Current expanded interest on the part of U.S. and other international firms in developing African markets is a function of both business savvy and corporate responsibility. African markets represent one of the last frontiers for business; Nigeria is one of the largest. Experience shows that there is increasing interest on the part of businesses to enter into alliances that promote both good business and good development. The increasing interest in GDA activities is one indicator of the fact that market and economic development imperatives can make good bedfellows. In this context, there is more work to be done, for example, in the case of USAID's cassava activities, to supplement current supply-sided approaches with more focused, business savvy strategies for sub-sector growth. PRISMS can be designed and implemented to provide impetus for formation of such strategies.

Leveraging, mobilizing and maximizing resources. Largely missing in the Nigerian context, yet sorely needed, is a project that maintains strategic perspective on the relationships between rural economic development and access to finance and is able to identify and initiate interventions that make good business sense and allow USAID to leverage participation of other resource partners – whether corporations, other donors, GDA, IEHA, etc. PRISMS needs to be structured so that it will package and promote activities specifically designed to generate additional funds through leverage activities.

Focusing on and promoting sustainability. Within the microfinance subsector and within the commodity chain activities assessed by the PRISMS design team, there is lack of understanding of what is required for sustainability, and on how it can be achieved. USAID has a clear focus on sustainability, on the impact of unsustainable practices on marketplace dynamics, and on what types of approaches and strategies might be used to support achievement of sustainability. PRISMS design must incorporate this focus in all action areas.

Mainstreaming cross-cutting themes (HIV/AID, gender, environment, youth). PRISMS will not have the resources to carry out extensive, separate programming in these cross-cutting areas. Rather, PRISMS interventions will need to be designed and implemented to maximize opportunities for integration of these realities into the fabric of all PRISMS activities. To do this effectively, PRISMS will be designed and implemented to maximize potential for linkages to other USAID SOs, and for integration of other SO themes into all SO-supported interventions and activities.

SECTION A

Introduction

A1. PRISMS Focus and Assessment Objectives

The USAID-funded Promoting Improved Sustainable Microfinance Services (PRISMS) is a microfinance assess, design, and implement project that will be implemented as part of USAID/Nigeria's new Country Strategic Plan, FY 2004-2009. The activities under PRISMS will directly support the Mission's agriculture and economic growth objective under the new Strategic Objective (SO) 12, which focuses on improving livelihoods in selected areas. PRISMS will directly contribute to the achievement of this SO by supporting enterprise development through increased access to critical financial and non-financial services such as business development services (BDS). The primary focus of PRISMS will be on the microenterprise sector, but PRISMS will also address, where feasible and practical, financial institutions, services and products that serve the needs of small and medium enterprises (SMEs) – the "missing middle" – as well. In addition, the activities under PRISMS will contribute to the achievement of objectives under the other SOs supported in USAID/Nigeria's new CSP.

Based on the PRISMS contract, the objectives for the assessment are to provide a comprehensive assessment of the MSME Subsector and to determine where gaps and constraints exist in the provision of microfinance and SME financial and non-financial services. This analysis was then used to identify which points of entry would most effectively support the mission's objectives and provide opportunity for PRISMS to fill gaps and provide effective linkage between MSME activities and rural economic development initiatives to contribute to USAID's SO12. The PRISMS team then reviewed assessment findings in light of USAID/Nigeria's interests in improving the policy and regulatory environment, strengthening MFIs through best practices, increasing the flow of financial products and services to MSMEs, enhancing donor coordination as well as private and public stakeholder cooperation in support of MSME development, and coming up with recommendations that provide the basis for design of the PRISMS project.

Proposed Timing of PRISMS Assessment, Design, and Implementation

Feb 2	Assessment team begins activities in Nigeria
Feb 2 – Mar 21	Assessment period
Mar 16	Submission of draft assessmnt report
Mar 18	Presentation of draft assessment report
Mar 22 – Apr 30	USAID reviews assessment documents and provides comments related to draft assessment report and draft design; final assessment report submitted
May 3 –29	Design period (incl. stakeholder workshop)
May 24	Submission of draft design, workplan, M&E plan, and implementation budget
May 26	Presentation of draft design documents
May 28	Submission of final design documents
June	Implementation begins

A2. Assessment Timing, Technical Approach, and Methodology

The assessment was conducted over a seven-week period, February 2, 2004 through March 21, 2004 (see adjacent box). The assessment team was made up of 13 members – eight expatriates and five Nigerian technical specialists (refer to the box below).

The assessment team followed an integrated "financial systems"[3] approach to analyzing the MSME subsector and its access to financial and non-financial services. The financial systems approach requires consideration of the

[3] The financial systems approach considers MSME finance as part of a country's general financial services market, focuses on the development of sustainable (subsidy-free) financial institutions, and recognizes that MSME clients are willing to pay the full cost

macroeconomic and sectoral policy environment, the legal and regulatory framework, the suppliers of financial services and their performance in terms of outreach and financial self-sustainability, and the nature of demand for financial services not only by farm and non-farm microenterprises in general but also with specific regard to gender issues, SMEs, and other potential market niches.

Due to the comprehensive nature of analysis implied by adopting a financial systems approach, the assessment team organized its data collection and analyses around four work packages: (i) policy environment; (ii) legal framework, regulation, and supervision; (iii) supply-side analysis; and (iv) demand-side analysis, which are included in the supplemental annexes. The assessment was carried by first performing a comprehensive review of relevant documents and studies. Annex A contains a list of all secondary data sources referenced in the report and Annex B is a supplemental bibliography that provides a comprehensive publications list and which serves as the basis for PRISMS' knowledge management activities.

PRISMS Assessment Team

Position	**Name**
Team Leader/MSME Finance	Douglas Leavens
Microfinance Specialist	Olubunmi Adetunmbi
SME Supply and Demand	Ronald Bielen
Agriculture/Rural Finance Specialist	Isaac Agbola
Deputy Team Leader/Policy & Regulation	Stephanie Charitonenko
Banking Policy Specialist	Samuel Adebiyi
Microfinance Demand	Kathleen Stack
Gender Specialist	Dennis Ivyatar
Microfinance Supply	Steven Goune
SME Finance	Olatoyosi Kolawole
Project Design and Integration Specialist	Laurel Druben
Monitoring and Evaluation and GIS Specialist	Mohammed Khatouri
Operations and Information Manager	Michelle Oliva
Project Office Administrator	George Oligbo
Administrative Assistant	Cordelia Chioma Dike

Over the course of the assessment, the teams gathered primary data based on interviews and focus group discussions held with more than 250 stakeholders nationwide (private enterprises, regulatory agencies, government officials, bankers, microfinance institutions, association leaders, business services providers, NGOs, USAID/Nigeria, and other donors). Annex C presents a list of all persons interviewed by stakeholder group.

The demand-side analysis considered both farm and non-farm MSME demand for financial services and non-financial services. Demand by agriculture-based or related MSMEs was assessed using a commodity value chain approach, based on several commodities of interest to USAID/Nigeria given current and planned projects – cassava, cowpea, millet, rice, and sorghum. Demand mainly by non-farm microentrepreneurs, gender issues, and the specific concerns associated with at-risk youth in conflict-prone areas was assessed using a combination of participatory rapid appraisal methodology, four MicroSave Market Assessment tools[4], and AIMS loan use and savings use tools[5]. For all the

of these services, if they are designed and delivered consistent with clients' specific needs (Von Pischke 1998, Otero and Rhyne 1994).

[4] MicroSave – Africa, Participatory Rapid Appraisal for Microfinance – A Tool Kit, Assembled and developed by Graham A. N. Wright, Shahnaz Ahmed and Leonard Mutesasira with help from Stuart Rutherford, Monique Cohen and Jennifer Sebstad, May 2002.

tools we attempted to obtain a sample of rural and urban clients, as well as men and women. The MicroSave tools adapted for the assessment teams use were: Financial Sector Trend Analysis that evaluates financial services used over time and why there may be changes in trends; a Seasonality Calendar that captures flows of income and expenditure over time and their impact on demand for credit, savings, and other financial services; a Life Cycle Profile that helps to identify life events that require lump sums of cash and how that impacts demand for financial services; and a Financial Landscape Analysis/Services Matrix that assists in revealing demand-supply gaps in terms of financial services. Annex D contains the main questionnaires used in the demand assessment.
The selection of locations for field visits by the assessment team was based on the following criteria: Chemonics' PRISMS contract specifications; the six geo-political zones and states of focus per the USAID/Nigeria Country Strategic Plan: 2004 – 2009; the SO past, present, and planned activities; and cross cutting and converging themes (see the next full page for a map of sites visited and USAID/Nigeria project sites by sector). Annex E presents a Gantt chart of field visits, including what assessment team members went where, and when. Annex F shares two models exemplifying best practices in expanding financial services to MSMEs and commodity chain focused economic clusters.

A3. Structure of the Assessment Report

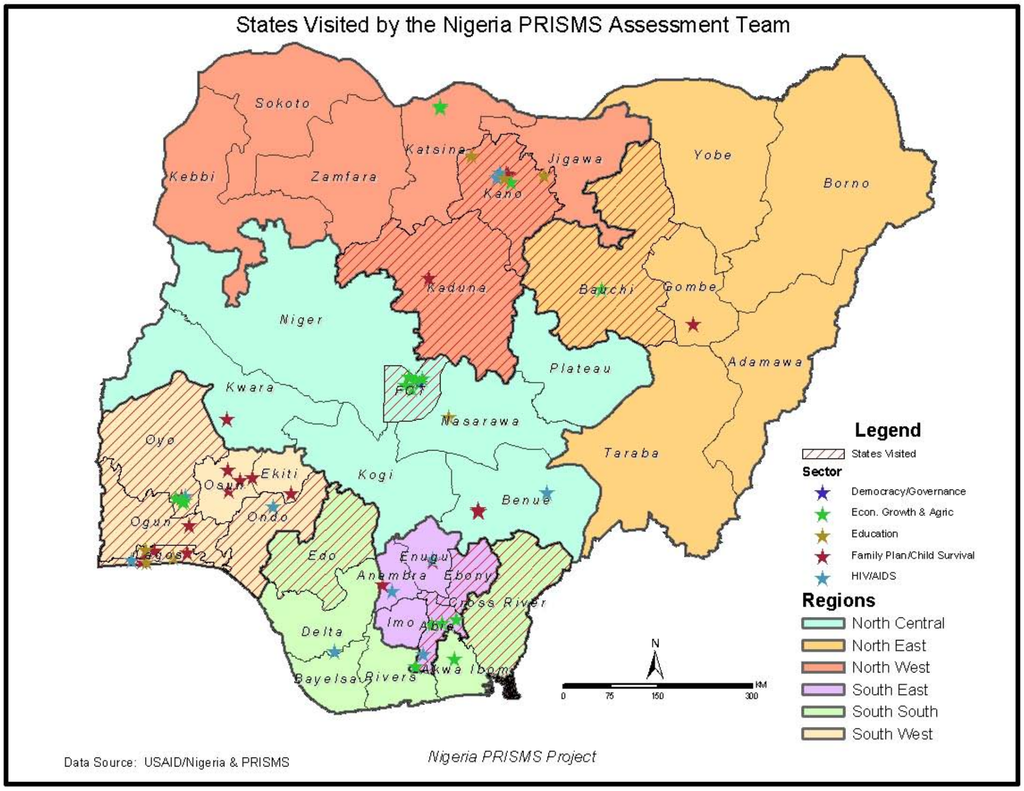
The assessment report is divided into two volumes. Volume 1, "MSME Assessment" presents the assessment's main findings and recommendations for USAID/Nigeria's overall strategic approach to developing the MSME subsector; Volume 2, "Draft PRISMS Design" presents an overview of the proposed design for PRISMS, as informed by the assessment findings and recommendations.

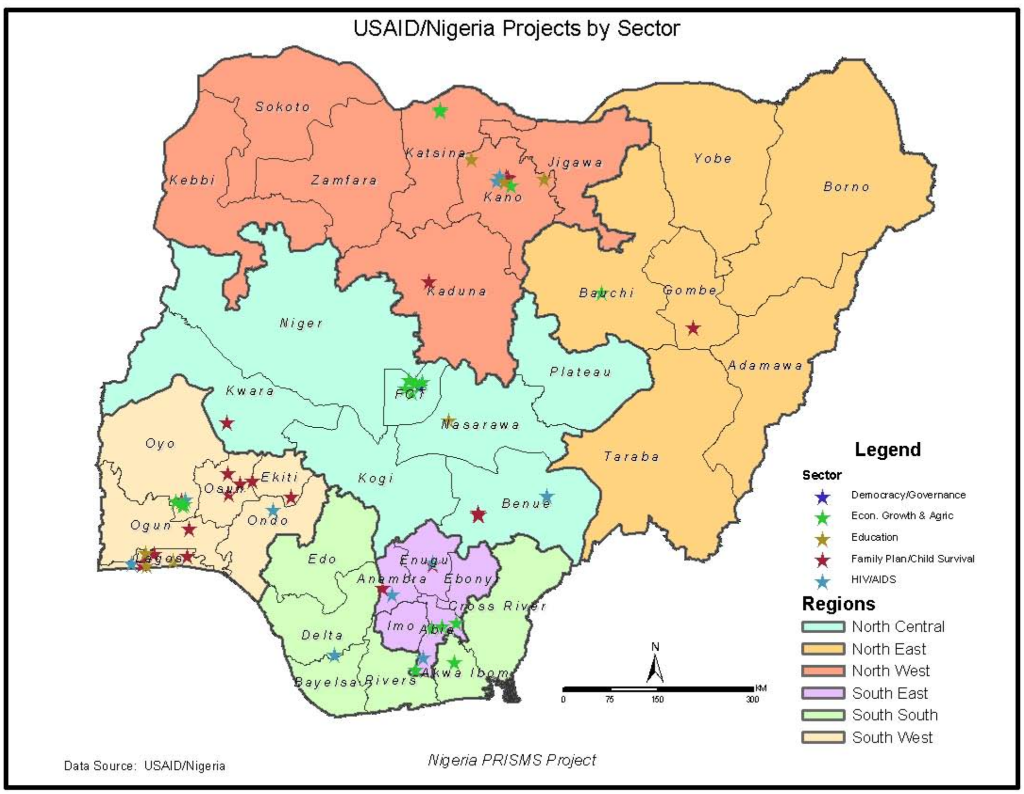
Volume 1 presents analyses organized around the four work packages: (i) Policy Environment; (ii) Legal Framework, Regulation, and Supervision; (iii) Supply Analysis; and (iv) Demand Analysis. The main findings and recommendation contained in this volume suggest a way forward for USAID/Nigeria that is designed to overcome constraints and to respond to gaps in current and planned activities and to take advantage of and build on the mission's comparative advantages.

Volume 1 is presented in seven sections, A – F. Section A continues with key terms and definitions. Section B presents an overview of the MSME subsector, including analysis of the size and composition of the subsector, relevant policies and programs, legal and regulatory issues, and the business environment for MSMEs.

Sections C – H present main findings and recommendations along several important, cross-cutting themes. Section C addresses the attributes of an enabling environment for MSME development and assesses whether the elements are present or not, notes inconsistencies and gaps, and recommends approaches to creating an enabling policy environment. Section C also analyzes the main legal, regulatory and supervisory issues of concern to MSME development, including the capacity of Central Bank of Nigeria (CBN) to effectively regulate the financial sector, and summarizes the changes necessary to establish an appropriate legal and regulatory framework and adequate supervision to support the growth and development of financially-sustainable providers of MSME finance. In addition, Section C reviews what financial infrastructure is necessary to support the

[5] AIMS stands for the Assessing the Impact of Microenterprise Services project of USAID's Office of Microenterprise Development. Nelson, Candace, Editor. Learning From Clients, Assessment Tools for Microfinance Practitioners, The SEEP Network, 2001.


States Visited by the Nigeria PRISMS Assessment Team
Sokoto
Katsina
Jigawa
Yobe
Borno
Kebbi
Zamfara
Kano
Kaduna
Bauchi
Gombe
Niger
Plateau
Adamawa
Kwara
FCT
Nasarawa
Oyo
Taraba
Ekiti
Osun
Kogi
Benue
Ogun
Ondo
Lagos
Edo
Enugu
Anambra
Ebonyi
Cross River
Delta
Imo
Abia
Akwa Ibom
Bayelsa
Rivers
Legend
States Visited
Sector
Democracy/Governance
Econ. Growth & Agric
Education
Family Plan/Child Survival
HIV/AIDS
Regions
North Central
North East
North West
South East
South South
South West
N
KM
0
75
150
300
Data Source: USAID/Nigeria & PRISMS
Nigeria PRISMS Project


USAID/Nigeria Projects by Sector
Sokoto
Katsina
Jigawa
Yobe
Borno
Kebbi
Zamfara
Kano
Kaduna
Bauchi
Gombe
Niger
Plateau
Adamawa
Kwara
FCT
Nasarawa
Oyo
Taraba
Ekiti
Osun
Kogi
Benue
Ogun
Ondo
Lagos
Edo
Enugu
Anambra
Ebonyi
Cross River
Delta
Imo
Abia
Akwa Ibom
Bayelsa
Rivers
Legend
Sector
Democracy/Governance
Econ. Growth & Agric
Education
Family Plan/Child Survival
HIV/AIDS
Regions
North Central
North East
North West
South East
South South
South West
N
KM
0
75
150
300
Data Source: USAID/Nigeria
Nigeria PRISMS Project

development and growth of a sustainable microfinance industry and remaining gaps. Section D reviews the demand for and main suppliers of financial services to MSMEs, including commercial banks, consumer finance companies, development finance institutions, community banks, cooperatives, NGO MFIs, and informal providers and suggests models and specific activities needed to increase access to MSME finance. Section D also includes analysis of the nature of demand of non-farm MSMEs and economic clusters along commodity value chains for financial services. Section E assesses of the demand for and the main providers of non-financial services to MSMEs. Section F reviews the primary suppliers of microfinance training and technical assistance and recommends ways in which to build local capacity to provide “best practices” training in MSME finance. Section G presents the main findings concerning external assistance to the MSME subsector provided by donors and the private sector and recommends ways in which USAID/Nigeria might enhance coordination in external assistance and leverage resources from the private sector.

Detailed analysis supporting each of the sections can be found in the Supplemental Annex 1- 4, which are based on the four work packages (policy environment, legal and regulatory framework, supply, and demand). Supplemental Annex 4 is of particular importance since it contains the demand analysis underpinning many of the main findings and recommendations contained in this report. The demand analysis estimates the size and composition of the potential client population that could be reached by MSME financial service providers and the type and range of financial products and services that these potential clients require. Special consideration is given to agricultural financing opportunities and financial institution linkages. Gender issues related to accessing credit for MSME development are also reviewed, as are issues related to HIV/AIDS and at-risk youth in conflict-affected areas.

A4. Key Terms and Definitions

Key terms used in this assessment report include microenterprise, SME, MSME, finance, microfinance, microcredit, microsavings, and MFI. Definitions for each are included below.

Microenterprise is considered to be a very small scale, informally organized business activity undertaken by poor people; excludes crop production by convention. For USAID program purposes, the term is restricted to enterprises with 10 or fewer workers, including the microentrepreneur and any unpaid family workers (USAID 2000, p.11). In the Nigerian context, however, microenterprises are usually informal and employ five or fewer workers.

SMEs are usually defined differently based on regional or country context. There is no single universally accepted definition of SMEs within USAID, among donor agencies, or across government agencies in Nigeria. GON ministries, research institutes, agencies, private sector institutions, etc. use different definitions (see adjacent box).

MSME Definitions

	Assets exc. real state			Annual Turnover			No. Employees		
in million Naira	Med	Small	Micro	Med	Small	Micro	Med	Small	Micro
Central Bank	<150	<1		<150	<1		<100	<50	
NERFUND		<10							
NASSI		<40	<1		<40			3-35	
Min. of Industry*	<200	<50					<300	<100	<10
NASME	<150	<50	<1	<500	<100	<10	<100	<50	<10
Arthur Andersen				<500	<50				

*National Council of Industry under the Min. of Industry revises SME definition once a year.

Source: World Bank 2002a, p.138.

Among these definitions, there is the greatest concurrence of opinion when it comes to defining MSMEs in terms of asset values than on any other basis. This is because in case of an economic downturn, the impact on turnover (e.g. sales) and the number of people employed is greater than the impact on assets values. For example, during a recession, there is a tendency for turnover to fall substantially and the number of employees to drop, but asset values (excluding real estate) may remain relatively unchanged (World Bank 2002b, p.1).

However, in the absence of reliable statistics, counting employees is less ambiguous and more verifiable as opposed to assessing firm turnover or assets. For the purposes of this assessment, the definitions of SMEs then in the Nigerian context are:

- Small business: usually in the formal sector with five to 20 employees; and
- Medium-sized enterprises: 21 to 50 employees.

MSME refers to the range of informal and formal enterprises with up to 50 employees.

Finance comprises the whole range of financial services to the rural, urban and peri-urban population at large. Financial services include savings facilities, credit, payment and transfer services, insurance and leasing.

Microfinance denotes the provision of financial services adapted to the needs of low income people such as microentrepreneurs, especially the provision of small loans, the acceptance of small savings deposits, and simple payments services needed by microentrepreneurs and other poor people (USAID 2000, p.12).

Microcredit is commonly defined in terms of loan amount as a percentage of average per capita income. The percentage used differs on regional and country contexts but generally falls in the range of 60 – 150% of GDP/capita. In the context of Nigeria, with a per capita GDP of N42,000 (about $300) in 2003, loans up to N50,000 (around $350) will be regarded as micro loans.

Microsavings are defined as savings accounts with a balance of less than N8,400 (about $50), i.e. less than 20% of the average annual income per capita.

MFIs are organizations whose activities consist wholly or in significant part of the provision of financial services to microentrepreneurs (USAID 2000, p.12).

SECTION B

MSME Subsector Overview

B1. Size and Scope of the MSME Subsector

With a GDP of about $40 billion, Nigeria is Africa's second largest economy (Nigeria's GDP in 2002 and 2001 was $43.4 billion and $42.5, respectively) (World Bank 2003, p.2). However, 70% of its population lives below the poverty line with an average per capita income of about $300 (population density and poverty statistics are presented on the following full page) (USAID 2003a, p.40). Its economy is a dichotomy between the oil and non-oil producing sectors, with the middle-income, oil-producing economy of perhaps five million people having a per capita income of about $2,200 and the rest of the population part of a poor, non-oil producing economy (World Bank 2003, p. 2).

Importance of MSMEs

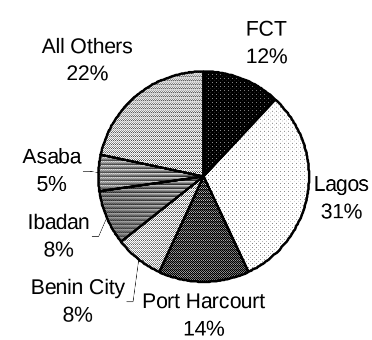
MSMEs have such a crucial role to play in the development of an economy that cannot be ignored. In fact, MSME development should form one of the country's development objectives. They serve as a resource base for skill acquisition for multinationals thereby replacing existing foreign sources. They are also training grounds for local skills and entrepreneurs, and could become channels for mobilizing local savings, ensuring a more equitable distribution of income and reducing the migration of manpower from the rural to the urban areas. Across the world, MSMEs are crucial for economic growth, poverty alleviation, wealth creation, the promotion of more pluralistic and vibrant societies.

Source: Adapted from World Bank 2002b, p. 1.

While oil and gas production accounts for 98% of the foreign exchange earnings and 84% of budgetary revenues, the agriculture sector is Nigeria's biggest employer (USAID 2003a, p.40). Most Nigerians derive their income from a combination of agricultural activity and operation of an MSME (USAID/Nigeria PRISMS contract section C-3.) Statistics on the number, geographical distribution, and activities of the MSME sector are very partial and highly unreliable. The best estimates available suggest that MSMEs comprise 87% of all firms operating in Nigeria, although the total number of registered firms in Nigeria is also unknown (World Bank 2002a, p.127).[6] The only available data appears to be the number of registered business names, the last good data for which is 47,171 based on 2002 registrations with the CAC. However, no breakdown of this number by enterprise size was available from CAC or NIPC.

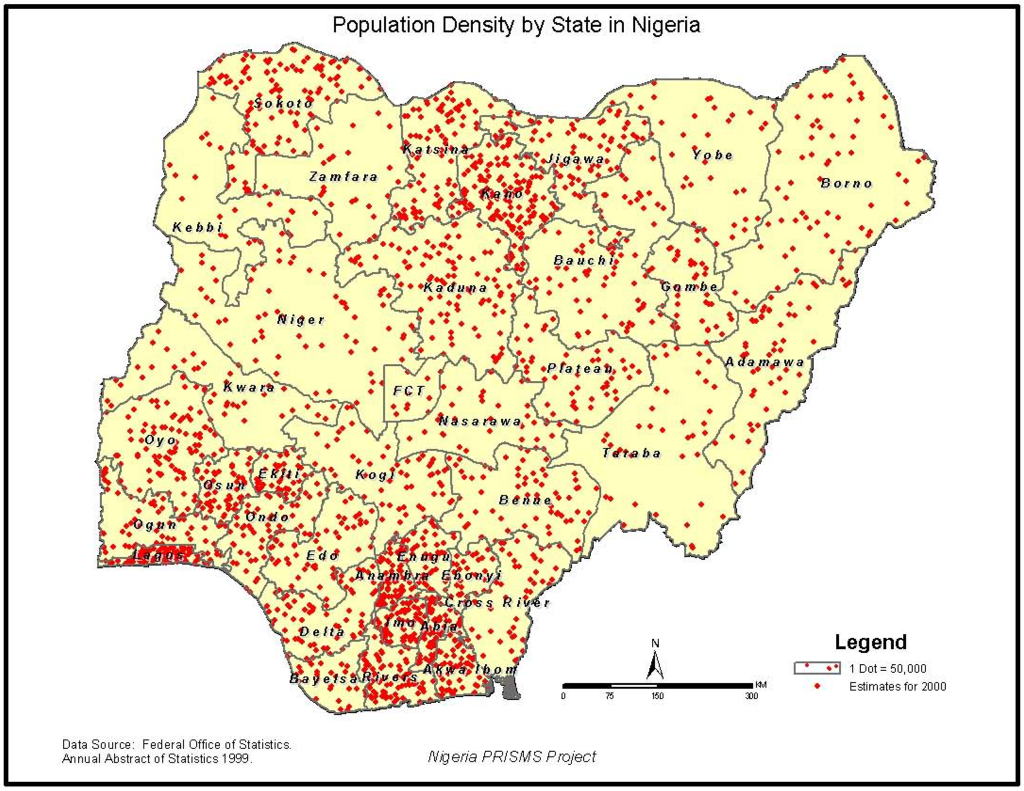
It is possible to estimate, however, the approximate number of MSMEs by using data on poverty and average household size. For example, 1996 FOS poverty statistics indicated that 55.8 million were below the poverty line and that there are approximately

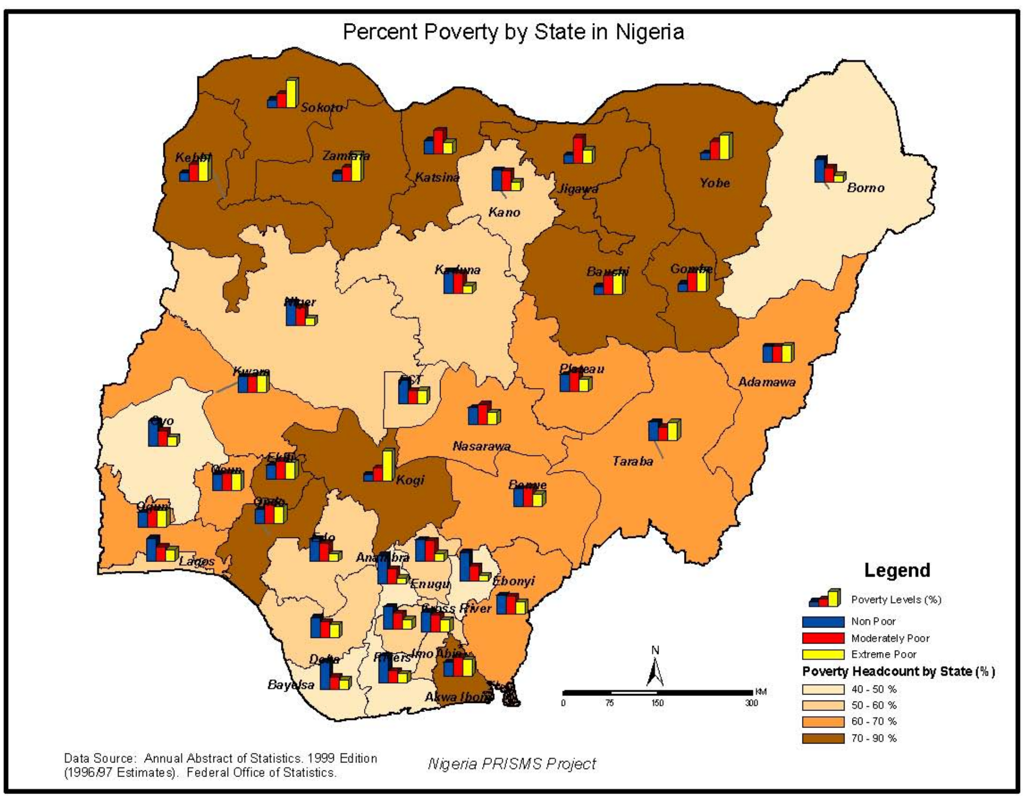
Registered Business Names by Major City, 2002



Source: CAC 2004.

[6] This percentage quoted in the World Bank report was reported as being from the Corporate Affairs Commission (CAC) in Abuja, Nigeria. It is also consistent to the best of our knowledge with earlier, similar estimates (87%) provided by earlier World Bank reports.


Population Density by State in Nigeria
Sokoto
Katsina
Jigawa
Yobe
Zamfara
Borno
Kano
Kebbi
Bauchi
Kaduna
Gombe
Niger
Adamawa
Plateau
Kwara
FCT
Nasarawa
Oyo
Taraba
Ekiti
Kogi
Osun
Benue
Ondo
Ogun
Lagos
Edo
Enugu
Anambra
Ebonyi
Cross River
Delta
Imo
Abia
Akwa Ibom
Bayelsa
Rivers
Legend
1 Dot = 50,000
Estimates for 2000
Data Source: Federal Office of Statistics.
Annual Abstract of Statistics 1999.
Nigeria PRISMS Project


Percent Poverty by State in Nigeria
Sokoto
Kebbi
Zamfara
Katsina
Jigawa
Yobe
Borno
Kano
Kaduna
Bauchi
Gombe
Niger
Adamawa
Kwara
Plateau
FCT
Oyo
Nasarawa
Taraba
Kogi
Benue
Anambra
Enugu
Ebonyi
Lagos
Cross River
Delta
Rivers
Imo
Bayelsa
Akwa Ibom
Legend
Poverty Levels (%)
Non Poor
Moderately Poor
Extreme Poor
Poverty Headcount by State (%)
40 - 50 %
50 - 60 %
60 - 70 %
70 - 90 %
Data Source: Annual Abstract of Statistics. 1999 Edition
(1996/97 Estimates). Federal Office of Statistics.
Nigeria PRISMS Project

five persons per household. A conservative assumption is that 75% of the total number of poor households (or 8.4 million) depend on a farm or non-farm MSME for their livelihood. This estimate is supported by an earlier CBN report that estimated the total number of micro and small-scale enterprises at seven million (ACCION International 2003, p.8).

Given the paucity of available statistics, it is impossible to gauge the exact number of MSMEs segregated by size, but it is plausible to suggest that the number of *microenterprises* may comprise 80% of the total number of potential MSMEs (approximately 6.7 million), that *small businesses* may account for 15% of the total (about 1.3 million), and that *medium enterprises* may comprise 5% of the total MSMEs (around 420,000).

Business name registration statistics and anecdotal evidence support the finding that most MSMEs, especially the larger ones, are clustered around population centers such as Lagos, Port Harcourt, and the Federal Capital Territory (FCT), however, many micro and small enterprises can be found operating at the village level throughout the country as well. Locations of most micro and small enterprises appear to be along secondary, tertiary, and quaternary roads and in and around market centers.

Characteristics of MSMEs differ by business size and a review of several of their attributes is useful to inform discussion of their demand for and the supply of financial and non-financial services. Although not all MSMEs display the same characteristics according to their size, the generalizations contained in the following table are useful in understanding the nature of demand by MSMEs and the reasons for demand-supply gaps.

MSME Characteristics	Microenterprises	Small Businesses	Medium Enterprises
Skills	Low: Uneducated but dynamic. Sole ownership	Medium: Have technology competence, engage in training and invest in apprenticeship system. Basic education at the very least High School Leaving Certificate or Trade Technical Certificate	High: Undertake technology upgrading, design adaptations in response to market. Highly educated, often with a university degree or higher
Technology	None to Low	Low to Medium	Medium to High
Competition	Medium to High	High	Medium to High
Products	Retail, Arts and Crafts, Textiles, Services, e.g. salons, tailoring	Manufacturing, Chemicals and Pharmaceuticals, Organized Retail	Telecom, IT, Specialized Retail Service e.g. restaurants, entertainment
Markets	Local	Local, National, Regional	Local, National, Regional
Links with BDS Providers and Other Support Institutions	Very Limited: few links with donor-sponsored providers	Limited: some links with donor and private sector providers complemented by in-house technical training, accounting and some routine functions, e.g. legal, management and technical consultancy	Extensive

Source: Adapted from World Bank 2002b.

The main activities undertaken my MSMEs may be segregated by size of enterprise. For example, microenterprise operations tend to be "low tech" and focused on retailing, arts and crafts production, and services such as salons, tailoring, etc. Small businesses make more use of various technologies as they grow to scale and simply be larger versions of microenterprises or be engaged in fundamentally different businesses that require more employees (5-25) to produce a product. Examples of these kinds of small businesses include small-scale manufacturing (e.g. furniture), chemicals and pharmaceuticals, and organized retailers such as clothing outlets, shoe stores, etc. Medium-sized business are less apt to be larger versions still of typical microenterprise-type operations and more likely to larger versions of small enterprises or other types of businesses that require more advanced technology or additional employees. Examples of medium-scale enterprises include telecom providers and specialized retailers such as restaurants and entertainment establishments.

B2. Business Environment for MSMEs[7]

Since the advent of the second Obasanjo Presidency in April 2003, the GON economic team has been leading an exercise to prepare a "National Economic Empowerment and Development Strategy" (NEEDS) that will fit within the context of Nigeria's Poverty Reduction Strategic Paper (PRSP). The NEEDS was recently released (on 15 March 2004) and MSMEs feature prominently in the strategy. To support its ability to achieve NEEDS objectives and priorities, the GON has initiated institutional reforms aimed at establishing an improved MSME enabling environment. As part of its overall commitment to the MSME sector, the GON has signed a $60 million project with the World Bank which will implement a system-wide approach through key government agencies to improving the business environment for MSMEs. The following subsections describe the business environment for MSME growth in terms of its: (i) recent and planned changes in the institutional and project framework; and (ii) remaining barriers to business.

B2a. Recent and Planned Changes in the Institutional and Project Framework

NIPC. The Nigerian Investment Promotion Commission has been restructured and reengineered to be more pro-private sector-led both in management and Governing Council leadership. The NIPC will serve as Government's executing agency (EA) under the World Bank's MSME Project. In this context, it will coordinate project activities across Federal and State Government agencies and participate as a member of the Review Committee. The Review Committee, with majority membership from the private sector and key public sector representatives (NIPC, CBN, MOF), will: (i) provide strategic guidance to the NIPC in its EA roles; (ii) review and select funding proposals in accordance with the Project Implementation Manual; (iii) review the annual progress reports; and (iv) address any major problems affecting project implementation.

SMEDAN. In 2003, the Government passed legislation to establish the Small and Medium Enterprises Development Agency of Nigeria, SMEDAN, as an umbrella agency to coordinate SME sector development. Under the World Bank MSME Project, SMEDAN will take the lead in developing a "learning agenda" based on lessons learned from the project's two BDS components and will be responsible for preparing annual MSME Competitiveness Reports. To support preparation of these reports, SMEDAN also will foster dialogue among business associations, private sector and government stakeholders and will incorporate annual cost of doing business surveys and other evaluations and research undertaken by the project and by SMEDAN itself. Other SMEDAN activities will include best practice workshops with leading Africa and international practitioners that will feed into topics and priorities to be addressed in annual MSME competitiveness reports.

SMIEIS. A 1999 initiative instituted by the CBN-headed Bankers' Committee, comprising the central bank and all banks as members, required banks to set aside 10% of pre-tax profits in a Small

[7] Portions of this subsection rely heavily on the excellent data and analysis by the World Bank in "Overview of SMEs" (World Bank 2002b).

and Medium Industries Equity Investment Scheme (SMIEIS) to be used for equity investment in SMEs. The scheme, which commenced in 2001, had amassed a fund of about N14.6 billion by mid-2003. Of this, approximately N4.3 billion or 29.4% has been invested – 52% in the real sector (agriculture and agriculture-related businesses). Investments in Lagos comprised about 80% of the funds. The GON remains committed to improving the accessibility to financial services by MSMEs and has agreed that banks should be permitted to allocate up to 10% of their SMIEIS contributions for investments in the microfinance sector (WB 2003 [Annex 2], p.38).

National Bank of Industry. In response to considerable expert advice, the Development Finance Institutions (DFI) sector was consolidated, in particular with the decision in 2000 to form the National Bank of Industry, which would administer loan programs for MSMEs at "lower than commercial rates." In 2002, NBI was created as a result of the merger of the Nigeria Industrial Development Bank (NIDB), Nigeria Bank for Commerce and Industry (NBCI), and the Nigerian Economic Reconstruction Fund (NERFUND) (World Bank 2003, pp.2-3). However, the consolidation has not been completed, and there are indications that NERFUND will remain an independent DFI focused on SME lending through providing wholesale funds to banks (USAID 2003b, p.22).

NERFUND. Unlike the two institutions with which it was to be paired, NERFUND has always operated as an "apex" lending institution, advancing medium and long-term wholesale funds to banks (and other DFIs) that originate and administer individual loans. This soundness of this practice, which is superior to direct loan disbursement, has been reflected in the somewhat better quality of NERFUND's loan portfolio when compared to the portfolios of DFIs that retail credit. Furthermore, NERFUND is by a significant degree the largest of the DFIs, holding around 50% of total DFI assets. It is also the most administratively efficient and has the strongest legal powers to collect overdue debts.[8] Given its focus on SME lending, NERFUND could provide a platform for development support – advisory assistance in management and operations performance improvement combined with loan capital or credit enhancement.
The unavailability of term loans is a serious failing of the Nigerian financial intermediaries sector, and a well-functioning DFI could help address this problem. However, the Federal Ministry of Industry Implementation Blueprint for a National SME credit guarantee scheme released in November 2003 indicates NERFUND has not yet achieved desired objectives (World Bank 2003, p.3).

Continued GON Supply Push of Directed, Subsidized Credit

The National Directorate of Employment (NDE) and the NACRDB signed a Memorandum of Understanding in February 2004 to lauch a new subsidized, directed credit program aimed at youth who graduate from NDE's "Open Apprenticeship Scheme" training program. The program allows graduates to submit "profiles" of the businesses they would like to establish to an NDE state office. These are then reviewed by state offices before forwarding them to the headquarters of NDE and, after "proper assessment," forwarding by NDE to NACRDB for loan disbursement of up to N250,000 for first-time borrowers. The interest rate to be charged under the program is a maximum 8% per annum.

Source: The Guardian newspaper, 18 Feb. 2004.

NACRDB. A second consolidation of the DFI sector resulted in the Nigerian Agricultural Cooperative and Rural Development Bank (NACRDB) emerging from the integration of the Family Economic Advancement Program (FEAP), People's Bank and Nigeria Agricultural and Cooperative Bank (NACB). While this consolidation of previously overlapping, supply-led efforts to expand access to finance for MSMEs can be viewed as a step in the

[8] NERFUND is supervised by the CBN, and has the power to debit the accounts of commercial banks at the CBN for pass-through loan payments due from final borrowers.

right direction, basic policies remain in place, for example with regard to interest rates (see box above) that are reminiscent of failed subsidized, directed credit programs of the past.

World Bank MSME Project. The GON and the World Bank reached agreement on a Micro, Small, and Medium Enterprise (MSME) project in February 2004. With an IDA credit of $32 million and local sources totaling $26.5 million, the project includes an innovative partnership with the International Finance Corporation (IFC) adding $1.5 million to undertake specific pilot investments. The total MSME project is $60 million over five years commencing in June 2004 through June 2009.

The MSME Project aims to increase the performance and employment levels of MSMEs in selected non-oil industry subsectors and in three targeted states of the country – Lagos, Abia, and Kaduna. To achieve this, the project in Nigeria will: (i) develop and strengthen the capacity of local intermediaries to deliver financial and non-financial services to MSMEs; (ii) reduce selected investment climate barriers that constrain MSME performance; (iii) mobilize, via (i) and (ii), increased private investments in MSMEs and intermediaries.

The World Bank project is based on a holistic understanding of what constitutes a healthy MSME environment and is designed to provide a framework for effective collaboration among stakeholders. For example, the relationship between land titles and property rights (ownership rights of property) in Nigeria complicates the issue of establishing adequate collateral for loans. The GON will focus attention on improving the acceptability of property as collateral and promoting a microenterprise growth policy that recognizes the need for making improvements in basic public infrastructure, such as roads, water, electricity, and communication, in order to lower the transaction costs of financial intermediation.

To take another example, to increase access of MSMEs to the financial system, various types of financial institutions, including: (i) private commercial banks; (ii) specialized banks; (iii) non-bank financial intermediaries (finance companies, community banks); (iv) NGOs MFIs; and (v) non-financial intermediaries like traders and agribusinesses, need to be able to enter and exit the MSME market freely. The CBN is working on this piece of the business environment framework by moving

World Bank-IFC MSME Intervention Areas:

The main four areas of activities are the following.

I. Access to Finance Component
A. Micro-finance Institutions
$15 million new private sector investments and establishment of at least two new MFIs. MFI loan portfolio cumulative disbursed of $75 million and MFI's portfolio at risk (arrears over 60 days) not greater than 5% after a second year of operation.
B. Commercial Banks
Three commercial banks to establish MSME downscaling programs; MSME loan portfolio cumulative disbursed of $75 million and MSME portfolio at risk (arrears over 60 days) not greater than 5% after a second year of operation.

II. Business Development Services - BDS Fund
At least 20 BDS providers assisted by the Fund, at least 20 products or services with sustained uptake improved or developed through support from the Fund; at least 75% cost recovery reached by participating BDS providers within a specified timeframe; at least 1,000 new MSMEs are supplied with BDS by participating BDS providers; up to 4,000 new (including indirect) jobs in 3-5 supply chains in selected industries.

III. Investment Climate
Streamlined procedures, integrated tax and business registration process, and reduction in transaction costs for company registration with the Corporate Affairs Commission – including a reduction in number of steps required to register a business from 9 to 6 and a 30% reduction in the time required; alternative dispute resolution mechanisms developed and implemented in up to three target states; secured transactions regime introduced in the each target States; regulatory framework updated for leasing industry; framework for and new credit bureau established.

IV. Public/Private Sector Partnership Development
Three Annual MSME Competitiveness Conferences; associated roundtable discussions held between Government and private sector to disseminate lessons, best practices, and success stories from the Project, and establish dialogue to improve policies and programs targeted at MSMEs; three Annual MSME Competitiveness Reports completed.

Source: World Bank. 2003, p.100-101.

toward a financial sector policy that will incorporate incentives to support such movement (CBN 2004).

SME Credit Guarantee Scheme. In November 2003, the Federal Ministry of Industry released an Implementation Blueprint for a National Credit Guarantee Scheme for SMEs. When approved, the scheme will establish a public-private sector limited-liability company, with controlling interest of the N500 million capital shareholding in the company held by private sector interests. The proposed guarantee capacity for the first five-year period is N150 billion funded at N15 billion by the GON under a low-interest loan with a 50-year term. The SME Guarantee Scheme would cover 80% of the loan principal and interest risk and the lending institution 20%. To be eligible for a guarantee, a firm has to fall within the official definition of SMEs, i.e. categorized as Micro/Cottage, SME whose total project cost is not more that N200 million (excluding the cost of land and working capital) and with a labor force of not more than 300 workers. Trading activities are explicitly excluded.

Provision for Microenterprises within SMIEIS. Under SMIEIS, commercial banks set aside 10% of their profit before tax for equity investment in SMEs. By December 2003, more than N20 billion has been set aside, out of which only about N7 billion has been disbursed. A dearth of viable projects and poor project preparation and presentation are reasons cited for slow disbursement. Much more significant (though less admitted) is the fact that Nigerian SME owners simply do not want to give away equity in their companies – to dilute their ownership or weaken their grip on what they perceive as a legacy for their children. Other projects cannot be financed before they undergo major restructuring. Finally, a major reason for slow disbursement is that banks that have contributed funds under the scheme are looking for solid, ongoing concerns in which to make equity investment. In this context, the preliminary indications that the proposed portion of SMIEIS fund being earmarked for microenterprises would be disbursed as loans rather than equity are particularly significant.

B2b. Remaining Barriers to Business

While the most significant obstacles facing MSMEs in Nigeria are poor infrastructure services and macro-economic policies, legal, regulatory, and institutional barriers continue to hinder firm performance, encourage firms to remain in the informal sector and discourage financial and non-financial service providers from responding to the MSME market. (WB 2003b pp. 5-8). These barriers exist in the areas of business registration, incentives, location, taxation and legal framework.

Registration. Investors register with the Corporate Affairs Commission (CAC) to incorporate their businesses. The process requires numerous steps and forms and is expensive, cumbersome and fairly time-consuming. The investor must also register with the NIPC, a process which is redundant and inefficient and adds layers to services already being delivered by the MoIA, the MoI (IDD), Federal Inland Revenue Service (FIRS), the NCS, and the NEPC. Investors must also apply for a Business Premises Permit from state-level authorities, which generally includes registration with state tax authorities. There are few if any written guidelines for state-level registration and this procedure presents the investor with additional delays. Overall, the study’s findings indicate that business registration in Nigeria is inefficient, complex, lengthy, and costly. Taken together, these processes require up to 49 steps for enterprise registration, which is a far cry from international best practice processes of 1-6 steps, and extremely non-competitive for a country of Common Law tradition, where “declarative” systems are the norm.

Incentives. Generally applicable incentives include: pioneer status, investment allowances to manufacturers and rural businesses, reinvestment and depreciation allowances, local raw materials use, labor intensive mode of production, local value added, in-plant training, infrastructure, investment in economically-disadvantaged areas, and research and development (R&D). Non-oil sector export incentives include: Export Development Fund (EDF), Export Expansion Grant Fund Scheme (EEGFS), Duty Draw Back and Manufacture-in-Bond Scheme (MBS), tax relief on income from bank loans supporting export activities and those to EPZ companies. Sectoral incentives cover the petroleum, solid materials, agriculture, and other sectors. At the state and local level, incentives are granted on an ad-hoc basis leaving room for corruption. Various taxes and levies are imposed in an apparently arbitrary manner and most SMEs find it useless to complain. Incentives and taxes are administered by the FIRS.

Location. Processes associated with corporate location in Nigeria include acquiring and registering rights to land, obtaining site development and building permits, arranging utility connections, and complying with site-related environmental impact mitigation legislation. Corporate location is largely the purview of state governments which are responsible for land allocation and transfer, as well as (in most states), site development approvals. Some states also operate environmental protection agencies. The federal government has primary responsibility for environmental issues and (for the moment) utilities provision, while Local Government Councils have jurisdiction over allocation of statutory rights of occupancy, collection of various housing and tenement levies and rates, construction of roads and streets, and sewage. While corporate location processes vary in terms of specifics depending upon the location of one's investment, the overall process regardless of location can be characterized as inefficient, non-transparent, slow, and expensive.

Taxation. While centrally coordinated to some degree, Nigeria's taxation system is one of fiscal federalism, with shared jurisdiction and transfer payments known as "Federal Allocation Allowances." Corporate tax level is fair (30%) but government capacity to administer collection is low. Tax structure is unclear and tax refunds are difficult to get. Customs duty laws are unclear regarding the base for calculation and the classification of products, and duty drawbacks are seldom forthcoming (although the situation is improving since the switch from duty drawbacks to duty certificates).

A new accounting system has been introduced ("Accounting for Taxes" SAS19). The system is reasonable and competitive by design, both in terms of fiscal pressure and tax administration procedures. The monthly payment and annual filing of employee income taxes, for instance, does not appear particularly cumbersome. However, state auditing and collection practices are less than ideal, while local government taxation and collection practices can be viewed as "predatory." Overall the system is far from transparent and corruption exists both in terms of transfer payment misappropriations and incentives administration.

Legal Framework. Inadequacies in the legal framework continue to provide barriers for SMEs. These include inadequate property rights, bankruptcy laws and leasing contracts. Laws are not interpreted with constituency in the courts and there is inadequate enforcement of existing laws and commercial contracts. The credibility and efficacy of the judicial system was questioned by many of the SME respondents involved in the mapping exercise carried out by the World Bank as part of its 2002 assessment mission. In general, the business community perceives the judicial system to be slow, corrupt, and not to be trusted. Knowledge of commercial law is low. Collateral redemption is very difficult and it can take more than one year to move a case through the court system.

The GON is seeking to deal with all these issues on a broad basis and has limited capacity to aspects of these issues particularly as they affect SMEs. Better coordination is needed between various governmental agencies. In this context, the World Bank MSME project (with its efforts to integrate tax and business registration processes and procedures; reduce company registration transaction costs; develop alternative dispute resolution mechanisms; introduce improvements to the secured transactions frameworks; and improve the regulatory framework for leasing) comes at a particularly opportune time.

SECTION C

Promoting an Enabling Environment

C1. Improving Microfinance Policy and Policymaking Processes

Current state of microfinance policy development. There is a lack of a coherent and consistent national policy to support MSME finance and to guide the development of the microfinance and SME subsectors. As has been discussed above, the GON has promoted numerous policies and programs aimed at poverty reduction and MSME development, many of which include subsidized credit. Recent moves to streamlining the GON's policies and programs are promising but much more needs to be done (see box at right). A draft of a national microfinance policy has been developed by the Development Finance Department (DFD) of the CBN and it is currently undergoing review by domestic stakeholders and international experts. Given that it focuses on the adoption of cost-recovery interest rates and gives equal weight to savings as it does to credit as a useful service to microfinance clients, the content of the microfinance policy represents a shift away from the failed directed, subsidized credit programs of the past and represents the greatest potential for development of the MSME sector and presents the greatest risk if it is not finalized and implemented in an appropriate manner or fully accepted by the GON.

GON Stance on Its Role in MSME Development

The public sector role is, at its best, one of facilitation, supporting the private sector to provide these *(MSME development)* services. At the firm level, an effective response that fills the financing and know-how gaps currently facing MSMEs in Nigeria will require a level of scale-up and replication that is only sustainable if it is demand-driven, commercial and private sector led. This, moreover, is the evidence of a growing body of global experience. The GON is, in collaboration with the private sector, committed to identifying and mainstreaming within Nigeria, different best practice approaches and models that have proven track records in sustainability and outreach and can be suitably adapted to the Nigerian context.

Source: World Bank 2003, p. 103

Membership of the National Working Committee for Microfinance

Government
CBN, NAPEP, NPC, FMF , FMA, Senate Committee on Agriculture, and House Committee on Banking and Finance

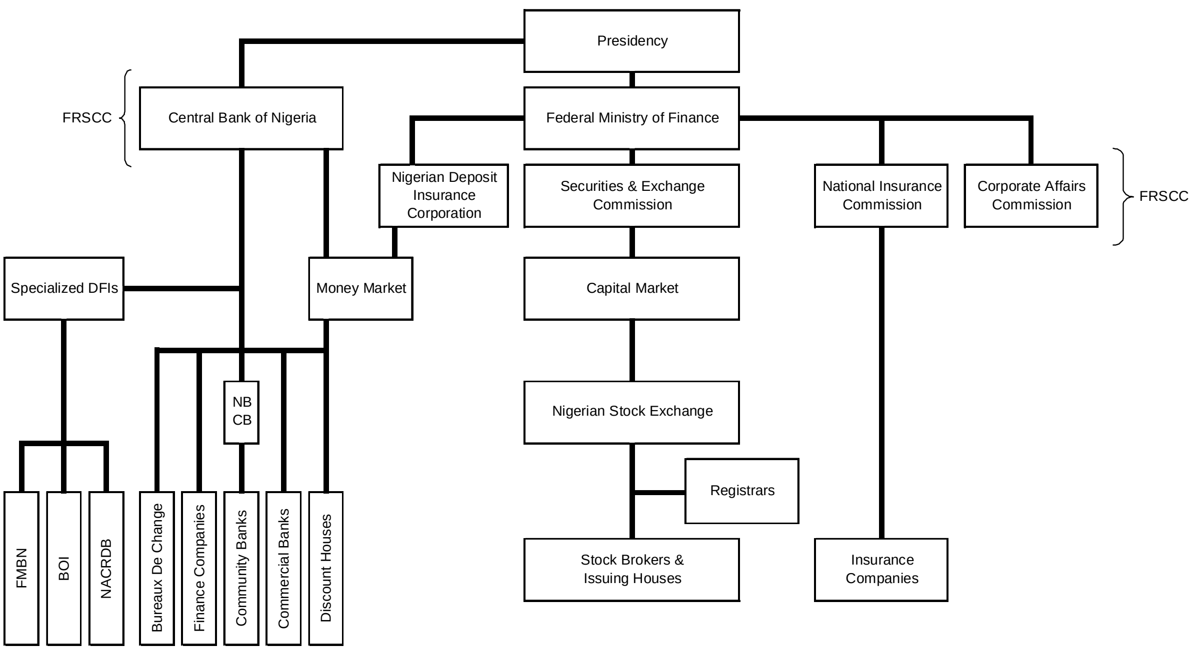
Private Sector
UBN, NACRDB, First Bank of Nigeria, UBA, Guarantee Trust, Zenith Bank, and City Express Bank

NGO MFIs
CRUDAN., Jos; Women Development Initiative, Kano; Sajju Institute and Research Foundation, Cross Rivers; LAPO, Benin city; DEC, Bauchi; Ubauaku Okpo Multi-Purpose Coop. Society Ltd., Akwa Ibom; Kanabi Women Association, Adamawa State; Partners for Development, Makurdi, Benue State; Women Development and Cooperative, Abeokuta; and CDF, Ikeja.

The need for a microfinance policy in Nigeria was not felt until September 2000, when a Communiqué drafted by participants at an international conference sponsored by USAID, DFID, and a few Nigerian companies on rural and microfinance mandated the CBN to draft one for the consideration of all relevant stakeholders. These stakeholders fall into two categories. The first category consists of members of the National Working Committee, drawn from selected government agencies, banks and microfinance institutions (see adjacent box), while the second category are international experts in microfinance who are expected to ensure that the draft policy conforms very well with international best practices. It is expected that this policy document, when finalized, will result in the emergence of a sound microfinance subsector, populated by sustainable MFIs that are an integral part of the financial system. Specifically, the new policy should help to track the entry and exit of operators, spell out licensing and operational/prudential standards, specify necessary institutional machinery for regulation and supervision, etc. It will also be necessary to have a policy framework that clearly specifies roles for the government and the MFIs so that the present ills in the operation of DFIs, like preferential credit targeting and subsidized pricing, are avoided.

Policymaking processes. The financial sector of the Nigerian economy consists of: (i) the policy-making and regulatory authorities, (ii) the financial markets, (iii) the development financial institutions and (iv) other financial institutions (see figure below). The CBN is at the apex of the financial sector, and is charged with the responsibility of promoting monetary stability, a sound financial sector as well as the growth and development of other financial institutions. In discharging these responsibilities, the CBN formulates and issues, from time to time, monetary policy circulars to financial institutions, especially those in the money market as well as the DFIs. CBN monetary policy circulars are usually serially numbered and are in two major categories: (i) the main circular issued once in two years spelling out broad areas of policy retention and /or policy change; and (ii) other subsidiary circulars issued as and when needed to fine-tune existing policies or introduce supplementary policy measures.

Institutional Map for Policymaking in the Nigerian Financial Sector



Apart from the CBN, there are other regulatory institutions in the financial sector, such as the Securities and Exchange Commission (SEC) which supervises the capital market, the National Insurance Commission (NAICOM) which supervises the insurance market, and the Nigerian Deposit Insurance Corporation (NDIC) which has the primary responsibility of protecting bank deposits in order to promote confidence in the banking industry. The NDIC also collaborates with the CBN in the inspection of licensed commercial banks and has, at the instance of CBN, performed the role of receiver/liquidator for some terminally distressed banks. For the purpose of coordinating the supervision of financial institutions, a Financial Services Regulation Coordinating Committee (FRSCC) was established in 1998 with the Governor of CBN as chairman. Other members of the committee are the Director-General, SEC; the Commissioner for Insurance (i.e. the head of NAICOM); the Registrar-General, CAC; a Representative of the Federal Ministry of Finance.

While the CBN utilizes the FRSCC forum to address financial policy issues affecting the capital and the insurance markets, it deals directly with commercial banks, community banks, specialized DFIs, Discount Houses, Finance Companies, Mortgage Institutions and *Bureaux de Change*. All the policy directives of the CBN to these institutions are absolute except in the case of DFIs, which, apart from the CBN, have supervising ministries, such as the Ministry of Industry for Bank of Industry (BOI), the Ministry of Agriculture and Rural Development for NACRDB, and the Ministry of Works and Housing for Federal Mortgage Bank of Nigeria (FMBN). Unfortunately, monetary policies of the CBN (especially those which emphasize best practices for financial institutions) have not always aligned with (the additional) targeted/specialized policies emanating from these supervising ministries. Primarily for this reason, virtually all the DFIs are very weak with sub-optimal performance.

Apart from the various poverty alleviation policies embedded in the operations of banking and non-banking financial institutions, there is also the National Poverty Eradication Program (NAPEP) of the federal government, which allows participation for virtually everybody in a bottom-up approach. All policies and programs relating to NAPEP are formulated, monitored and reviewed by a National Poverty Eradication Council, under the chairmanship of the President of the Federal Republic. The Council relies on a National Coordination Committee, chaired by an appointee of the President, for the implementation and the execution of all the directives of the Council. There are also State Coordination Committees and Local Government Monitoring Committees implementing and coordinating activities at the state and grass root levels. Some of the on-going programs of NAPEP are the Youth Empowerment Scheme (YES), Rural Infrastructure Development Scheme (RIDS), Social Welfare Services Scheme (SOWESS) and Natural Resources Conservation Scheme (NRDCS).

C2. Developing An Appropriate Legal and Regulatory Framework

The legal and regulatory framework is not supportive of microfinance or SME finance. Issues related to legal and business environment impediments to SME finance have been discussed in Section B. Related to microfinance, regulatory guidelines have been drafted by CBN's DFD in cooperation with OFID and these are currently under review. As in the case of the microfinance policy, PRISMS support in revising these guidelines and finalizing them in an appropriate manner represents a potential high reward for the sector and another major risk if not done in a manner consistent with international best practices. This subsection first deals with existing financial sector regulatory institutions, regulations, and processes and then explores international best practices concerning the adaptation of prudential guidelines for the specialized nature of microfinance operations.

The Roles of Regulation and Supervision in Maintaining a Healthy Financial Sector

Main Roles for Central Banks

- Macroeconomic stability, relating to domestic inflation and the foreign exchange rate
- Longer-term considerations of financial sector development
- Immediate issues of the sound management and financial health of financial institutions

Regulation. Promulgate entry, operational, and exit rules that represent the bounds within which safe yet efficient financial intermediation can occur. Some of these include:

- Licensing and minimum capital requirements
- Capital adequacy requirements
- Loan classification and provisioning

Supervision. Enforces regulated financial institutions' adherence to regulatory requirements.

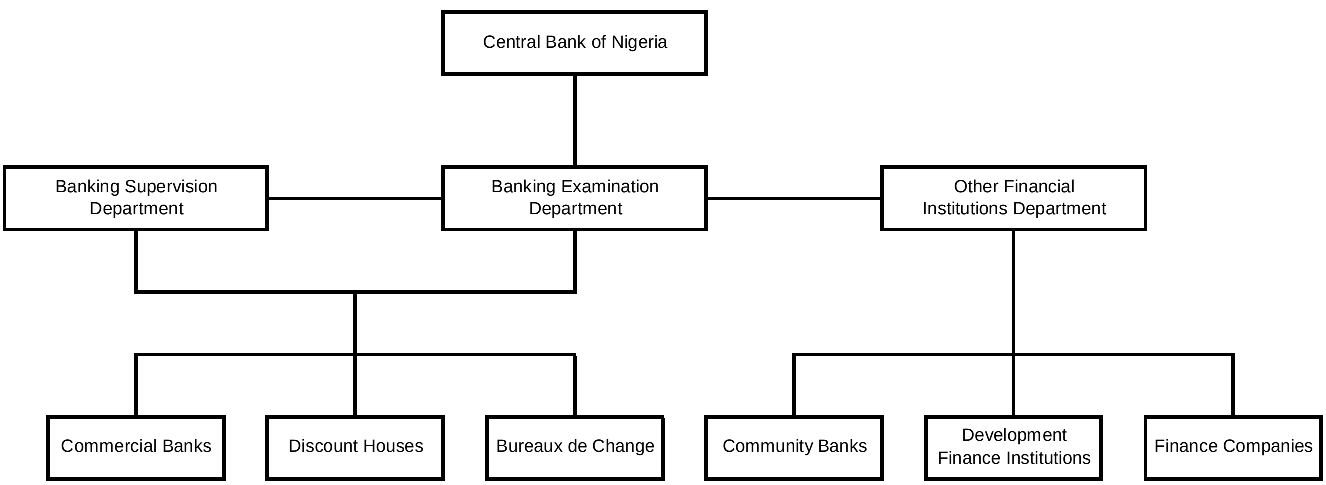
C2a. Current Financial Sector Regulations

The CBN is the apex regulatory authority of the Nigerian financial sector, deriving its legal authorities from the Central Bank of Nigeria Act 24 of 1991 (as amended in 1997, 1998 and 1999) and the Banks and Other Financial Institutions Act (BOFIA) 25 (as amended in 1997, 1998 and 1999). These laws superseded the CBN Act of 1958 and the Banking

Decree of 1969. Both Acts 24 and 25 gave the CBN more flexibility in regulating and supervising the banking sector as well as other financial institutions such as community banks, primary mortgage institutions, finance companies, *bureaux de change*, discount houses and development finance institutions, some of which hitherto operated outside the framework (see box above). For example, prior to the 1998 amendment of the BOFIA, the responsibility for supervision of financial institutions was split among several agencies.

The CBN was charged with the supervision of commercial and merchant banks (now universal banks with abolition of the dichotomy between commercial and merchant banking with effect from January 1, 2001). The National Board of Community Banks (NBCB) was responsible for the supervision of community banks in all respects with the exception of granting licenses which was entrusted to the CBN. Also, the FMBN became a regulatory body in 1989 with licensing and supervisory powers over mortgage institutions until these responsibilities were shifted to the CBN in 1998 (see the figure below). The governor of the CBN is also the chairman of the FRSCC, which was re-constituted in 1998 to harmonize the supervisory efforts of the various organizations such as the NDIC, NAICOM, SEC, and the CAC.

Institutional Map of Regulation and Supervision for Financial Institutions



The CBN is the sole authority responsible for the licensing and regulation of commercial banks in Nigeria. The CBN specifies conditions for the issuance and withdrawal of banking license, the opening and closing of branches, minimum paid up share capital, restructuring/re-organization as well as merger/disposal of banks, liquidity and capital ratios, corporate governance rules and practices, etc. The CBN is also responsible for ensuring that banks conform to international best practices as may be stipulated from time to time, especially under the Basle Accord. The CBN supervises the banks to ensure compliance with its rules, applying sanctions if deemed necessary for all infractions.

C2b. Common Adaptations of Bank Prudential Regulations and Supervision for MFIs[9]

Lower Capital Requirements. Minimum capital requirement should be low enough to attract new entrants to microfinance, but high enough to ensure the creation of a sound financial intermediary.

Risk Weighting of Assets for Unsecured Loans. The type of lending (unsecured or secured, and if secured, then by what type of collateral) affect a bank's risk weighting of assets, capital adequacy, and provisioning. Regulators should assess the riskiness of MFIs based on overall portfolio quality and repayment history rather than on the value of traditional guarantees. Historical performance of portfolios, statistical sampling of arrears, the adequacy of MIS, and the MFI's own policies for dealing with arrears should be taken into account.

Higher Capital Adequacy Ratios. The Basle Accord currently recommends a weighted capital adequacy ratio of 8% of risk-weighed assets. In view of MFI's generally lower ability to diversify their risk, they should be subject to higher capital adequacy ratios as a means to safeguard investor and depositor funds. Consideration should be given to applying ratios approaching 20% with potential lowering to 12%-15%, based on performance over time.

Stricter Provisioning. Provisioning requirements should be based on the average maturity of the loan portfolio. MFIs tend to have shorter average maturities, requiring more aggressive provisioning. While the Basle Accord requirements suggest provisioning of 25% for substandard loans, 50% of nonperforming loans, and 100% of loss loans, MFIs should increase this provisioning to at least:

10% of the unpaid balance	0-30 days in arrears;
25% of the unpaid balance	31-90 days in arrears;
50% of the unpaid balance	91-180 days in arrears;
100% of the unpaid balance	>180 days in arrears.

Higher Operational Costs Allowed. MFIs tend to have higher operational costs than traditional banks because they manage small loans and deposits. Allowing MFIs to offer incentive-based payments to staff; to have flexible hours of operation that are convenient to clients; and to engage in mobile banking, permitting them to disburse funds and collect payments outside branches, can help MFIs to minimize their operational costs. Allowing incentive-based payments to staff also would help the MFI to reduce portfolio risk. Regulators should not penalize MFIs for higher operating costs if the latter can demonstrate a reasonable return on average assets.

Customized Reporting Requirements. Not all the reporting requirements of traditional banks are applicable to MFIs; microentrepreneurs and small business owners usually cannot produce the amount of documentation required in traditional lending. Also, portfolio reporting formats should take into account the volume, loan size, and term of microloans.

International best practices also indicate that regulation and supervision of microfinance should be activity based and not institutionally based. This allows flexibility for a variety of regulated institutions to be engaged in microfinance and does not impose undo rigidity into the system that might prohibit entry except through establishment of a new type of financial institution or transformation of existing institutions with microfinance operations. In the Nigerian context, this

[9] This section is based on Berenbach and Churchill 1997, p. 43 and CGAP 1996, as quoted in Charitonenko and Rahman 2002, p. 43.

would imply that both commercial banks and community banks would be able to engage in microfinance, be subject to an adapted set of regulation and supervision procedures, and not have to establish subsidiaries or change institutional form in order to provide microfinance. Other specific recommendations concerning the process of developing an appropriate legal and regulatory framework for microfinance are shared at the end of this section.

C3. Building Effective Supervision Capacity

The CBN's capacity to effectively supervise the system is weak. The supervision capacity of the CBN's Other Financial Institutions Department (OFID) is inadequate with respect to being able to effectively supervise the financial institutions falling under its jurisdiction – 6 development finance institutions, 769 Community banks (282 of which have been licensed to date), and 102 consumer finance companies. Their capacity constraints are of particular importance in light of the fact that draft microfinance policy and regulatory guidelines may further strain OFID's human resources and technical capacity for effective supervision.

By virtue of the 1998 amendments to the CBN Act and BOFIA, what looked like an overlapping of supervisory roles between the CBN and NDIC had been streamlined. The primary role of NDIC, like the Federal Deposit Insurance Corporation (FDIC) in the USA, is now primarily to provide protection for bank deposits in order to promote confidence in the banking industry. In this regard, it collects 15/16 of 1 percent of banks' deposits as premium and pays depositors up to N50,000 in case of bank failure. While several episodes of banking distress since 1989 challenged the actual effectiveness of existing safeguards, NDIC has fulfilled this mandate rather successfully as receiver/liquidator, and it has been able to reimburse most insured deposits – although in many cases, depositors were deprived of their rights and insurance benefits for long periods of time. It must be noted, however, that the NDIC performs the role of receiver/ liquidator of terminally distressed banks only at the instance of the CBN.

The CBN and the NDIC now jointly agree the schedule of routine bank examinations each year. For example, in 2002, out of the 89 banks and discount houses scheduled for routine examination, the CBN examined 65 banks and 5 discount houses, while NDIC covered 24 banks. The two institutions also cooperate in respect of follow-up examinations (to ascertain level of compliance with examiners' observations), on off-site inspections, ad-hoc assignments as well as other spot checks.

To strengthen its ability to fulfill its mandate as the pivotal institution in charge of supervision and regulation of the financial system, the CBN commenced a restructuring and re-engineering program (called Project EAGLE), which has today resulted in remarkable improvement of the apex bank's people and processes. The Bank Analysis System (BAS), an application to improve the efficiency of banking supervision and examination, was acquired and installed as part of this process. In 2002, the Financial Sector Surveillance Committee (FSSC) was constituted with the objective of ensuring effective surveillance of the financial system. This committee is composed of the governor, his four deputies and the directors of banking supervision, bank examination, banking operations, other financial institutions, trade and exchange, foreign operations, research and legal services departments as well as the governor's office. Within its first year of operation, the committee was able to curb (quite remarkably) foreign exchange malpractices in the banks, facilitate the introduction of the Dutch Auction System for trading in foreign exchange (a development that has helped to moderate the demand pressure in that market), come up with the idea of a "life-boat facility" for sick banks, evolve policies aimed at improving corporate governance in the banks and enhance inter-agency cooperation within the framework of FSRCC. The FSSC is no doubt positively affecting the regulatory environment for the commercial banks, but the real challenge ahead of the CBN is how it intends to cope with the supervision and regulation of the other financial institutions, which in terms of financial power may be smaller than the commercial banks, but in terms of number, outreach and geographical spread, are quite enormous.

C4. Supporting the Creation of Adequate Financial Infrastructure

"Financial infrastructure" is a summary way to describe several types of formal institutions and informal practices that support the development and efficiency of financial services to MSMEs and the rest of the market. Critical financial infrastructure to support the development of MSME financing is currently missing, such as a strong microfinance trade association, local microfinance training centers, MFI reporting and performance standards, and a credit bureau that captures information relevant for making microlending decisions. While the lack of adequate microfinance training centers is discussed in Section F, the issues related to the lack of a strong microfinance network, of MFI reporting and performance standards, and of a credit bureau that captures information relevant to microlenders are examined below.

C4a. Microfinance Trade Associations

There has also been a lack of a strong microfinance trade association in Nigeria. This absence has retarded development of the microfinance industry as a whole in terms of data gathering and statistics, sharing of issues and advocacy to policymakers, establishing accounting and reporting standard, and criteria for performance assessment, to name a few. Only one microfinance associations exists – the Community Development and Microfinance Roundtable (CDMR) established in 1990 but it is constrained by multiple missions (mission creep or shift, based on the demands of various funders) and lack of broad-based membership and participation.

The earliest microfinance trade association in Nigeria was the CDMR. It was established by six NGO MFIs in 1990 and supported by funds from the Ford Foundation's Office of West Africa (FF), with the following aims:

- Provide training and capacity building services to member organizations;
- Provide a forum for exchanges and sharing among members; and
- Undertake advocacy role for microfinance.[10]

The initial members demonstrated high commitment to the association and membership grew to 20 MFIs by 2000. Activities focused on sharing of information of among members and training services, including governance, credit and financial management, monitoring and evaluation. With the cessation of FF funding support, entry of other networks in recent years, membership and participation in CDMR has waned considerably since its active early years.

C4b. Developing MFI Reporting and Performance Standards

Due in part to lack of a strong microfinance trade association, standards for microfinance reporting and performance criteria have not yet been developed. Three challenges are obvious; the first one is the mix of financial and non-financial service provision by many MFIs, particularly NGO MFIs.

[10] Based on discussion of microfinance network development found in "Poverty and Microfinance in Nigeria" by Godwin Ehigiamusoe.

Associated with this is the lack of standardized accounting with contributes to poor transparency of microfinance operations.

Second, is the lack of willingness and readiness of MFIs (community banks, NGO MFIs, and cooperatives) to open up their operations for independent ratings based on acceptable performance benchmarks. This challenge is against the culture of privacy and non-disclosure that is prevalent in the industry. To overcome this challenge, there is need for education of MFIs to see performance rating as a diagnostic instrument for monitoring and evaluating their performances as financial services providers. Ratings let organizations know their current standing against standards that are recognized and expected by formal financial institutions from which they intend to raise commercial funds. It is equally a powerful planning tool to set priorities, targets, and measure the impact of their services on an on-going basis.

The third challenge is how to arrive at a realistic and effective rating instrument that meets the demand of a well-structured commercial credit for a broad spectrum of MFIs in Nigeria. The existing rating services in Nigeria are designed for banks and therefore not suitable for evaluating MFIs. There is very limited local knowledge about the microfinance sector by the rating agencies that are available in the country (e.g. Bode Agusto and Co.). The community banks under OFID have evolved a performance rating system which the portfolio and management due diligence issues are addressed, however, it is not tailored to capture information specific to microfinance operations.

Given the growing relevance of microfinance as a tool for poverty eradication, enterprise promotion, and employment, there is need for deliberate action to develop a professional culture among practitioners through the regulatory and performance standards being promoted by the CBN. There is need to initiate a collaborative process to address the problem of multiple reporting requirements in the microfinance sector. In a

Ugandan Experience in Promoting Transparency in Microfinance

Between 2000 and 2003, microfinance donors in Uganda – including the African Development Bank (AfDB), the European Union (EU), the Norwegian Agency for Development Cooperation (NORAD), the U.K. Department of International Development (DFID), and USAID – created a reporting tool that is now used by all donors in the country. The Performance Monitoring Tool (PMT) went into official use in March 2003.

The purpose of the PMT is to reduce the administrative burden on MFIs created by multiple donor reporting formats. An additional purpose for donors is to apply good microfinance practice in tracking the performance of their MFI partners. The jointly developed tool is proof of the donor agencies' commitment to improving the transparency and accountability of their microfinance operations. Their successful collaboration illustrates the benefits of in-country donor coordination and harmonization for all stakeholders in the sector.

The PMT focuses on institutional performance rather than project-specific tracking of donor funds. Its purpose is to produce a quarterly report that adheres to accepted good practice in microfinance, which can be submitted to all donors. The five-page report includes selected items from an MFI's financial statements, detailed portfolio information, and 38 key strategic and performance indicators. The latter include indicators on profitability, liquidity, portfolio quality, operating efficiency, loan-officer productivity, capital ratios, and outreach. This quantitative data is supplemented by qualitative information in the narrative report.

Donors, MFIs, and clients have all benfitted from the development of the PMT. Donors in Uganda will now receive more consistent information from MFIs. The reports generated by the PMT meet international reporting guidelines and provide the comprehensive institutional information that donors need to understand and evaluate MFI performance. Because the PMT will significantly reduce time spent on reporting to donors MFI managers are expected to have more time to focus on the strategic and operational direction of their organizations. The reports created by the PMT are also expected to help MFIs manage themselves better by tracking a comprehensive set of institutional results, trends, and indicators. Because the PMT will help MFIs become more efficient, the clients of Ugandan MFIs are expected to reap the rewards of MFIs that are more efficiently managed, and thus more secure.

Source: Adapted from CGAP Direct: Case Studies in Donor Good Practices, No. 7 "Donor Collaboration and Transparency: Standardized Donor Reporting in Uganda," July 2003.

similar vein to the EU-funded Support to Feasible Financial Institutions and Capacity Building Efforts (SUFFICE) and the USAID-funded Support for Private Enterprise Expansion and Development (SPEED) project in Uganda, PRISMS could provide a platform for a multi-donor and CBN (DFD and OFID) to evolve a comprehensive reporting and performance rating framework that addresses the needs of all stakeholders. The case study of donor collaboration on standardized donor reporting project in Uganda in the attached box present a workable model with which PRISM can work in tandem with the policy initiative of the CBN in a value adding way. The main elements of this possible intervention are:

- Setting the stage for all stakeholders to align their interests and evolve a common vision and goal for a holistic performance rating tool and the identification of champions to drive the process within stakeholder institutions;
- Reviewing existing reporting requirements to build and expand the scope to reflect the spectrum of stakeholder interests;
- Developing a draft MFI rating tool and test with a few MFIs in PRISMS and fine tune based on lessons learned from the test; and
- Training raters, inspectors, and examiners of the regulatory agencies (basically OFID) and private sector BDS providers in the microfinance industry i.e. accounting, auditing, consulting, and training firms and networks of microfinance practitioners such as national association of community banks and a revived network of MFIs.

A successful execution of this approach will create a supportive environment for further microfinance sector development, effective management tools for MFIs, better coordination, and effective utilization of donor resources.

C4c. Credit Bureau

There is currently no private credit information bureau (CIB) in Nigeria. However, the CBN has a credit risk management system (CRMS) that is used in carrying out supervision of commercial banks. No commercial banks use it as a part of making lending decisions. As part of future plans for increasing the effectiveness of the financial system, there is need to promote public-private sector collaboration in the establishment of a commercially sustainable credit bureau. The World Bank’s MSME project has one component to provide specialized technical assistance toward the promotion of commercially viable, private sector operated credit bureau. The IFC plans to assess and document the experience gained in the use of the CRMS as a basis to establish the feasibility of a private sector approach to augment the current system. It will be useful for the long-term development of the microfinance industry in Nigeria to ensure that any proposed CIB contains information on microcredit so that it may be used by microlenders. This will particularly be important as competition between providers of microfinance heats up over time.

Recommendations for Policy Improvements

- Capitalize on existing relationships between PRISMS team members, the Central Bank of Nigeria and other GON ministries to achieve a comprehensive and consistent national microfinance policy, part of this will require establishment of a microfinance unit within the CBN.

- Assist in streamlining and strengthening the policymaking process, phasing out subsidized credit. A first step toward this will include conduct of a comprehensive review of subsidized credit activities.

- Modify inappropriate policies and/or inefficient practices in government-sponsored credit and loan guarantee programs.

- Formulate appropriate savings and credit policies to guide the GON in facilitating access to financial services by the MSME sector.

- Implement viable alternatives to directed credit and loan guarantee programs.

- Develop a plan for transferring ongoing subsidized credit programs to a single institution and for phasing out of such programs within an acceptable time frame.

- Increased participation of the private sector in the delivery of financial services.

- Formalize a DFD-led microfinance working group/network.

- Facilitate agreement among network members on microfinance reporting and performance criteria.

- Determine approaches to establishment of necessary finance infrastructure (credit bureau, rating agencies, etc.).

Recommendations for Regulatory and Supervisory Improvements

- Rationalize the roles of DFD and OFID within the CBN with respect to microfinance policymaking, regulation, and supervision.

- Review the overall approach to creating a legal and regulatory framework for microfinance, including determining whether regulation should be institution or activity based.

- Assist CBN’s DFD and OFID on the developing microfinance regulatory guidelines.

- Provide capacity building to CBN’s OFID to expose them to microfinance operations, best practices, and international experience in designing appropriate regulation and supervision for microfinance.

- Train CBN’s OFID on appropriate supervision of microfinance operations.

- Assist in revising the CBN’s Manual of Bank Regulations and Examination Procedures consistent with international best practices concerning adaptations for microfinance operations.

Recommendations for Developing MFI Reporting and Performance Standards

- Set the stage for all stakeholders to align their interests and evolve a common vision and goal for a holistic performance rating tool and the identification of champions to drive the process within stakeholder institutions.

- Review existing reporting requirements to build and expand the scope to reflect the spectrum of stakeholder interests.

- Develop a draft MFI rating tool and test with a few MFIs in PRISMS and fine tune based on lessons learned from the test.

- Train raters, inspectors, and examiners of the regulatory agencies (basically OFID) and private sector BDS providers in the microfinance industry i.e. accounting, auditing, consulting, and training firms and networks of microfinance practitioners such as national association of community banks and a revived network of MFIs.

SECTION D

Supporting Increased Access to MSME Finance

D1. Non-Farm MSMEs

As discussed in Section B, the best estimates suggest that there are about 8.4 million MSME operating in Nigeria today. The number of microenterprises may comprise 80% of the total number of estimated MSMEs (approximately 6.7 million) while small businesses may account for 15% of the total (about 1.3 million) and medium enterprises may comprise 5% of the total MSMEs (around 420,000).

Due to their small size and scope of operations, micro and small enterprises require relatively little capital investment to start, thereby offering a relatively high labor-to-capital ratio (World Bank, 2002b, p. 1). Over time, as some microentrepreneurs have enjoyed growth in their business, they have increased their debt capacity to have effective demand for loans in range of N50,000 to N500,000. These are so-called "graduated" borrowers that unfortunately find themselves caught in the "missing middle" in terms of access to financial services despite their business success (see adjacent box for an example).

The Honey Seller – Part of the "Missing Middle"

Laurentia is a member of Northern Cross River State Women Association. She was also once a primary school teacher. Her subgroup of 350 women in Calabar meets monthly to save and lend to the members. Laurentia produces honey in her home. She has built up her business, through the support of the association, to N100,000 ($740) in working capital. She uses family members to help her filter and bottle the honey which she sells by the gallon, bottle and in small measures to hospitals, schools and individuals. She even gets help from the local media to advertise.

There is a big honey factory in Calabar that bottles honey for exports. Laurentia would love to grow her business to supply the factory. But she cannot obtain enough working capital. She says she would have to have N300,000 ($2220) for this. No bank will give her a loan because she does not have the kind of collateral they want. If she had a big enough loan, she would buy the equipment and pay workers to help her to produce a large quantity of honey. Then she could sell to the honey bottling factory and really increase her profits. Unfortunately, Laurentia is part of the "missing middle" whose loan requirements exceed the ability of her association to finance, and who also cannot meet stringent bank requirements to access a large enough loan to meet the capital needs to grow her business.

Source: PRISMS Assessment Team Field Visit, 2004.

There is a Large Demand-Supply Gap of Financial Services to MSMEs. In addition to operating in an environment that provides them with virtually no policy support, coordination, and planning; significant legal barriers; MSMEs also have extremely limited access to financial products and services. Loans to SMEs, generally ranging from N50,000 to N500,000 represent the "missing middle." Community banks are perhaps the largest suppliers in this part of the market and a few commercial banks are beginning pilot programs to tap this market as well. There is also a demand-supply gap of microloans of N50,000 and less, suited to microenterprises. These are supplied to a more limited extent by community banks, by capacity and capital constrained NGO MFIs, and through targeted, subsidized credit programs via state banks like NACRDB.

Data on size and scope of the MSME subsector is poor, however, the best estimates suggest that less than 10% of the total 8.4 million MSMEs has access to microfinance or SME financial services. In addition, there is a lack of demand-driven, sustainable MSME financial services delivery models and linkages to target markets within the system. Only a handful of commercial banks are piloting

MSME lending programs and the sustainability of these efforts is still unclear. The development finance institution focused on serving farm and non-farm micro and small-scale enterprises, NACRDB, is estimated to have reached less than 10,000 credit clients in 2003. NACRDB's financial services, like those of other development finance institutions, are highly subsidized and mainly supply-driven. The system of Community Banks is estimated to have the largest outreach in this subsector. Their combined borrowers in 2003 numbered about 60,000, however, only about half of the total 747 banks were assessed to be on a sound financial footing. Scarce data on cooperatives prohibits analysis of that system's outreach but it is generally understood that cooperatives and credit unions continue to be capacity and capital constrained, limiting their provision of financial services. Of approximately 100 NGO MFIs, about 17 have the most outreach but even on a combined basis, this is expected to be less than 150,000 active microcredit clients. For further details, see Supplemental Annex 3.

According to the table below, the larger a firm, the more likely it is to have access to external sources of credit. Almost 100% of firms with more than 250 employees have access to credit compared to only 52% of what the PRISMS assessment team defines as MSMEs.

Percentage of Firms Having Access to External Credit

Group	Percentage Constrained
Full Sample	80.3
Micro (20-49)	51.7
Small (50-99)	81.8
Medium (100-199)	89.8
Large (200-499)	100.0
Very Large (over 500)	93.1
Foreign Owned	93.6
Indigenous	70.2

Source: World Bank, Nigeria Firm Survey, 2001

Unfortunately, there are also few domestic equity sources, as well as limited sources of export finance, and MSMEs do not participate in the stock market. This is due to their inability to meet the listing requirements as well as their persistent tendency to operate as much as possible in the informal sector. Many of the larger enterprises are also unaware of the advantages of using the stock market as a source of financing.

Commercial banks. According to many Nigerian observers and enterprise owners, few (if any) regulated financial institutions serve the MSME subsector at any significant level of scale or financial viability. Restricted access is less due to a shortage of liquidity in the banking system than a combination of systemic issues such as: (i) government over-borrowing; (ii) MSMEs being perceived as high credit risks; (iii) insufficient capacity in commercial banks to develop financial products and services responsive to the needs of MSMEs and to evaluate and monitor small loans effectively (World Bank 2003, p.5). Available short-term loans are usually approved for larger SMEs that engage in trading, rather than the more productive smaller-scale industries. In 2001, however, several commercial banks began microfinance pilot projects with their own funds. These included First Bank, Union Bank of Nigeria, City Express Bank and Guarantee Bank and Trust. There is little documented information available to assess the results of these pilots to date.[11] Recently, local banks like Citibank, United Bank for Africa, and Guaranty Trust Bank have piloted new specialized SME

[11] USAID, Office of Economic Growth and Infrastructure, 2001.

lending initiatives to support the sector. In addition, SMIEIS has accrued over N6.2 billion to date based on the 10% net profit retention from the approved accounts of 68 banks. In the first quarter of 2002, over N300 million worth of investments was made in six SMIEIS deals. Commercial banks are also increasingly defining a role for themselves in terms of wholesaling funds to financiers of MSMEs (see box below).

Community Banks. The 282 licensed community banks (as of mid-March 2004) are perhaps the largest formal financiers of MSMEs. Community banks are mandated to provide financial services (loans and savings) in specific communities. Capital and reserves of the community banking system increased from N1.03 billion to N3.82 billion in 2002 (CBN 2002, p.31). Total deposit liabilities amounted to N9.7 billion in 2002 while loans and advances made by the community banks amounted to N4.3 billion (CBN 2002, p.98). As these figures indicate, the performance of CBs with regard to MSME lending has been categorized by some analysts as “disappointing” mainly because their loan policies and products are not based on best practices in microfinance. Despite their widespread physical presence, deep local knowledge, and ability to mobilize sufficient deposits (on a combined basis at least) they have not realized their potential in making microcredit more readily available to micro or small-scale businesses.

Development Finance Institutions (DFIs). Six DFIs currently operate though none of these have served MSMEs effectively or efficiently. In recent years, these institutions have experienced growing losses. More than half of their loans have been classified as non-performing and their disbursements and assets have declined.

NGOs. A few other private sector MFIs, mainly NGOs, are serving the target market. In 2002, the CBN estimated that 17 major NGOs provided microfinance services in Nigeria. Their average loan size was less than N8,000 (about $50). These institutions tend to be weak operationally and financially. While a couple have a significant number of loans outstanding, the vast majority do not. On a combined basis, total outreach by NGO MFIs in 2003 was at most 150,000 clients. Only a few of these institutions utilize individual lending methodologies while most are based on the traditional Grameen model of joint liability and

Wholesaling Funds to Community Banks by Prudent Bank

Established in 1990 originally as a merchant bank, Prudent Bank converted to a commercial bank in 2000 and has established 30 branches to date in various locations around the country. Prudent Bank has a strategic focus to serve the financial services need of businesses in the “middle market” of the economy – microenterprises and small businesses typically engaged in trading, small-scale manufacturing, services, etc.

In an effort to expand its services to the microenterprise and small business sector, the bank piloted a pilot microcredit program in 2003 whereby it would wholesale funds to eligible community banks for on-lending. The bank developed criteria to determine eligibility of community banks to participate in the program. These are: (i) adequate local knowledge of the community and potential clients; (ii) number of years of operation; (iii) ability to serve as a disbursement agent for a wide variety of productive economic activities; and (iv) effective and sustainable credit culture that provides disincentives to credit default.

In April 2003, Prudent Bank established a wholesaling relationship with a Community Bank in Ile-Oluji, Ondo State. Prudent Bank earmarked a sum of N10million to the Community Bank in an escrow account. The Community Bank collates requests for loans from community members, appraises such requests, and make recommendation to a credit committee that is drawn from Prudent Bank, the Community Bank and the Ile–Oluji Economic Summit Group (a think-thank organization dedicated to the economic advancement of the community). The Community Bank monitors utilization of the on-lent funds, repayments, and submits monthly reports to the joint credit committee.

The first loan disbursed under this partnership was in June 2003. As at December 31, 2003, the sum of N7,570,000 has been onlent to 52 clients. The liquidity ratio (cash and near cash assets as a ratio of Deposit Liability) of the Community Bank improved from 57.73% in April 2003 to 69.7% in December 2003. Prudent Bank’s wholesaling program has facilitated closer interaction between the Community Bank and members of the community and facilitated expanded MSE access to credit.

Source: Assessment Team Interview with Prudent Bank, March 2004 mandatory savings combined with training. Additional details on three major NGO MFIs can be found in Supplemental Annex 3.

NGO MFIs remain capacity and capital constrained, however, two foundations provide funding support along with other services such as training and technical assistance – the Community Development Foundation (CDF) and the Growing Business Foundation (GBF).

Community Development Foundation. The CDF was founded in 1993 with funds provided by the Ford Foundation. The Foundation was primarily established for the purpose of meeting the funding and capacity building needs of young NGO MFIs supported by the Ford Foundation. The main CDF activities continue to be:

- Providing portfolio refinancing facilities to retailing community development MFI and direct lending for enterprise development to stand-alone primary groups;
- Providing institutional capacity building services for MFIs; and
- Arranging loan guarantee facilities to established MFIs.

CDF has focused on providing training and advisory services as a component of an integrated service to their clients. To date CDF has provided training and capacity building services to over 542 participants from different MFIs and NGOs in all the six geo-political zones of Nigeria. It also made capacity building grants worth N18.736 million to 123 organizations.

CDF also wholesales funds to client organizations (mainly NGO MFIs) that have demonstrated good track records in managing their credit programs and are committed to the objectives of self-help and sustainability. CDF lends at an annual interest rate of 21% for a period of 12 to 24 months, depending on the nature of the organization and the purpose of the loan. Through March 2004, CDF has provided loans amounting to N173.6 million to 241 institutions operating throughout Nigeria.

Growing Business Foundation. The GBF was founded in 2000 as an NGO with 12 corporate members, including several of the largest banks and oil companies in Nigeria. GBF was established to accomplish the broad mission, "To enhance collaboration amongst business, non-profit organizations and governments, to promote healthy economic development of communities and channel resources towards projects with sustainable wealth generating potential." Over the last few years, GBF has offered a mix of development program management for its private company membership by facilitating credit access and community development, providing wholesale loan funds for on-lending, and offering business and credit training to MFIs and their clients. Due to the locations of operations of their main funders, GBF's activities have been focused in and around Lagos, Eket, and Enugu.

GBF is a well-organized NGO that received ample support from its private sector members, however it is not very focused and appears supply driven based on the interests of its membership. Its wholesale and retail activities are heavily subsidized and unlikely to be sustainable without continued private sector funding.

Informal Providers of Microfinance. In Nigeria, especially in the southern states, moneylenders are a very important informal source of capital. Borrowers can approach them at anytime. They respond quickly and can even provide the cash on the same day. In brief, they can provide sufficient loan amounts at the right time to take advantage of opportunities. The primary complaints about moneylenders are the high level of interest charged (20 – 30 percent per month) and the short repayment period (2-4 weeks).

In Summary, while the GON, Banks, and NGOs have made efforts to provide loans to the MSME subsector, to date their efforts have been largely ineffective. Few commercial institutions in Nigeria have experience with MSME lending and they have not been able to manage their portfolios to create sustainable organizations. As a result, MSMEs have come to rely on local associations, private moneylenders, and family members for funding their businesses.

MSME Financial Services Demand-Supply Gap Analysis. In addition to nation-wide estimates of demand (e.g. 8.4 million MSMEs) based on secondary data, demand for MSME finance was also analyzed on the basis of primary data collected in four states – Bauchi, Cross Rivers, the Federal Capital Territory (in/around Abuja), and Plateau. Findings from these interviews are presented in terms of client preferences for credit and savings products and the particular financial needs of people affected by HIV/AIDS. Highlights from the demand-supply gap analysis are presented below and additional details on demand for finance can be found in Supplemental Annex 4.

Both rural and urban poor families lack access to adequate credit and savings services. Where services are available, capital is inadequate and effective interest rates are high. Opportunities and incentives for savings to build assets and pay for education, health care and housing are particularly lacking.

For the rural and urban poor, the most attractive source of "formal" financial services is the community bank. But community banks, although more accessible than commercial banks, have more processes and collateral requirements than the poor are able to fulfill. Often, a loan for N5,000–10,000, or even less, is all a trader needs to carry out her business but the bank cannot afford to make such tiny transactions following traditional banking practices.

The "missing middle" has particular difficulty accessing loans. Where the smallest businesses requiring less than N30,000 ($217) may access funds from their cooperative society or microcredit NGO, a food processor or small manufacturer has few or no options. A N30,000 ($217) loan can support an oil processing business and a N60,000 ($433) loan, a good sized poultry business. An urban microentrepreneur with a shop or stall in the market, or carpentry business may need N50,000 ($361) to N100,000 ($722) or more to capitalize the business. Yet, the bank will not talk with them because their collateral is inadequate. Additionally, many potential bank clients are illiterate and do not understand the banking system, yet they have the capacity to produce and repay.

Cooperative societies, producer and processor associations, ROSCAs, and even HIV/AIDS self-help groups perform an important financial intermediation role for those that cannot access more formal bank services. They may have as few as 10-15 members or hundreds of members. They mobilize capital through shares, membership fees, regular contributions and savings. Sometimes they borrow from formal financial institutions such as the thousands of cooperatives that are members of the cooperative financing agency in Bauchi. Many do not have this opportunity and may take costly loans from moneylenders, such as the rice producing multipurpose society in Cross Rivers that pays up to 20% a month.

An opportunity exists to assist community banks to develop products and services that meet the needs of microentrepreneur and producers. The banks need tools and processes to design loan, savings, insurance and other products suitable for a lower income clientele. Market research tools such as those used for this assessment can be adapted for use by the banks to help them design appropriate products. Banks will also need assistance in pricing and promotion of new products to a new clientele. Bank staff will need training in the use of these tools – not only their implementation – but how to translate findings into a product and delivery system that operates profitably. Banks can also benefit from client satisfaction tools to assist them to monitor the continuing appropriateness of their services.

To lower the costs of providing the small loans that microentrepreneurs need, community banks could work with cooperative societies and other self-help groups. It is well-understood that to effectively serve the poor in rural areas, services must be provided to them in the community. They must be regular, reliable and adapted to the types of economic activities people do. Cooperative societies, producers' groups and other self-help groups are close to their clients and can respond to them well, if given the opportunity. The groups would bundle loan requests from their members, apply to and receive one loan from the bank and on lend to their individual members. Bank staff would be hired and trained to strengthen the groups' management of loans and savings, and to access bank services.

Banks will require dedicated staff to deliver these products. The new staff will need training to organize and train the groups. They will need technical assistance for appropriate management and supervision of these staff, including the development of incentive systems to ensure timely and honest service. These staff will need to monitor the groups' management of financial services to their members.

Complementary Services. The assessment team discovered that a number of banks believe it is necessary to provide basic advice and training to their clients on cash-flow management and business practices. They report that the clients are more likely to succeed in business, repay the loans, and use subsequent higher loan amounts. The cordial business relationships that result enhance banker-consumer relations. Financial education also helps clients interact more successfully with financial institutions. A financial education service, provided that the income/expenses associated with training and technical assistance as accounted for separately, can be a powerful means to achieve better performance and consumer loyalty and should be considered as part of the PRISMS approach. Financial education can include referrals to business services providers, where they are available.

Poverty and Gender Issues. Poverty is widespread in Nigeria and although Nigeria has a wealth of human and natural resources, it falls below the average for sub-Saharan Africa on many poverty indicators. At least 66% of the Nigerian population is poor and lives at less than a dollar a day. Women and children are disproportionately represented among the poor to the extent that poverty is both an economic and a gender issue. It is the poverty state of women that links it with microfinance. The issue of gender equity in microfinance is potentially complicated and difficult but lessons learned from microfinance best practices around the world have led to preferential targeting of women clients by most MFIs in Nigeria. The study of MFIs and their clients in Abuja, Plateau, Bauchi and Cross-River States, found more that than 95% of clients are women. Most MFIs deliberately exclude clients that are men because they have proven to be relatively bad borrowers who prefer individual to group loans. The idea of operating in groups poses a challenge to men's participation and they prefer asset loans which are bigger, while women want working capital loans which are comparatively smaller. But the strongest argument given in favor of women is that they cause fewer problems and use their business profits to benefit members of the family.

For example, Lift Above Poverty Organization (LAPO) and Justice, Peace and Development Commission (JPDC) have shifted their gender portfolio of micro-credit loans to target more women. The poor generally have difficulty in accessing loans but women have a harder time than men do in accessing bank loans due to prevailing cultural and religious practices. Land, homes and property are in husbands' name precluding their use as collateral by women even if both paid for these assets. In many commercial and community banks in Nigeria, a written consent of the husband is needed for women to secure credit. There are gender variations in acceptance of BDS as a valuable service. Women clients are more eager to receive training and are willing to pay greater part of the cost than men.

The gender issues involved in staffing of microfinance institutions presents a contradiction. Whereas in many institutions, virtually all clients are women, the leaders of such institutions, on the other hand, are men. Very few MFIs are headed by women. This problem becomes clear as one move from South to North where there are religious and cultural complications affecting the relationship between men and women. Male credit officers in the North have a problem in reaching Muslim women, especially those in Purdah.

Impact of HIV/AIDS on Demand for MSME Financial Services. The HIV/AIDS epidemic in Nigeria is growing rapidly; adult HIV prevalence increased from 1.8 percent in 1991 to 5.8 percent in 2001. Although Nigeria's infection rate is lower than those of neighboring countries, this translates into a higher number of infections, given the large population. By the end of 2001, UNAIDS estimated that 3.5 million Nigerians were living with HIV/AIDS. Many of the PLWHA, like most of the poor, do not have access to any credit and do not have information about where they can go for credit. Commercial banks are normally inaccessible to the poor and women because of collateral and other requirements. Cooperatives and community banks have small capital bases and can not give credits to even half of those who need it. Additionally, community banks prefer to extend credit to civil servants whose salaries are paid in their accounts with the bank.

Many PLWHA do not even save for health care, because they do not have regular income to support their savings. Even those who are salaried people require good education for care and support so that they can think of savings, insurance to cover health costs, and loan default that may be due to periods of illness. In addition to access to financial services, education for care and support and vocational training are required by microfinance clients living with HIV/AIDS because this will link them to health services and will support their ability to undertake productive economic activities.

D2. Commodity Chain-focused Economic Clusters

D2a. Overview of the Agricultural Sector

Nigeria has a comparative advantage in the production of a variety of crops and livestock enterprises in different agro-ecological zones. The type of agricultural system, (crop or livestock production) as well as level of intensification is influenced by the level of technology and financial resources available for the private sector to undertake commercially sustainable operations in specific agro-ecological zones. Nigeria has six major agro-ecological zones that run transversely from west to east, namely *the humid forest* (mainly in the south), *the derived/coast savanna and the southern Guinea savanna* (part of the south and the entire middle belt), *the northern Guinea savanna, the mid-altitude savanna,* and *the dry Sudan/Sahel savanna all in northern parts of the country*. The Guinea savanna is noted for the production cotton, groundnuts, maize, millet, sorghum, soybeans, yam, cassava and vegetables. The humid forest, derived, and coastal agro-ecological zones are producers of tree-crops (cocoa, oil palm, rubber and timber), and food crops (cassava, yam, maize, pineapple, bananas, plantains, papaya, mango, orange, yam beans, and vegetables (fluted pumpkin, okra, tomato, and pepper).

Sectoral Composition of GDP, 1965 and 2001

Sector	1965	2001
Agriculture	68	43
Oil	8	13
Manufacturing and Construction	5	8
Services	19	36
Total	100	100

Source: USAID 2003a, p.3.

The importance of the agricultural sector in Nigeria is often underestimated, especially relative to oil. For the year 2001, agriculture's contribution to GDP was 43% while that of oil was only 13% (USAID 2003a, p.3). From the table at right, it is clear that agriculture's share of GDP has declined, while oil's has increased, however, oil's share reached only 30% of agriculture's in 2001. Crop agriculture constitutes 80% of total agricultural GDP whereas livestock contributes only a 13% share. Understandably, much emphasis is being placed on crop agriculture.

Agriculture is the dominant employer, with 70% of the population employed in agriculture. Despite agriculture's dominant position in both GDP and employment, it has failed to meet the needs of a growing Nigerian population. While the population has been growing at 3% per annum, food production has been increasing by only 1.5% per annum in the last five years (Ikpi 2001). Nigeria's food self-sufficiency ratio has decreased from a 98% level in the early 1960s to about 50% at present. Reversing this gap in food self-sufficiency is critical for Nigeria but very much possible due to the natural resources available. Key to closing the gap will be the adoption of improved technologies not only for production, but also for storage, processing and distribution. Timely availability of inputs, market information and the supply of the finance will also be necessary to achieve desired goals.

The agricultural demand section will concentrate on four commodity chains namely cassava, rice, sorghum and cowpea. Presidential initiatives are underway in cassava and rice. Nigeria imported about 1.9 million MT of rice worth US $500 million in 2002. This represented about 50% of consumption. Sorghum is a major industrial raw material in the breweries and beverages industries. Nigeria is the world's No. 1 producer of cassava and seeks industrial opportunities of value addition to increase the competitiveness of the crop in domestic and export markets. Cowpea rotated with cereal provides substantial benefits to producers for relatively little investment. Cowpea demand for human consumption was 3.8 million MT in 1999 against supply of 1.8 million MT. Improving production and processing efficiency of these four commodities can reap huge benefits for Nigeria.

D2b. Agricultual Demand for Financial Services

Demand for financial services in a commodity chain results from the drive to be more efficient and generate more income. Producers' demand for finance is basically driven by their need for improved technology, inputs including fertilizer, seeds, agrochemicals, small tools, labor, transportation, tillage, (either machine or animal), and packaging. Other commodity chain players require access to financial products for equipment leasing, crop financing, export financing, etc.

Demand for Agricultural Finance

"Farmers need a market as much as they need credit, Only a true friend will think of getting both for farmers; RUSEP is a true friend."

-Alhaji Maska, traditional head of Maska village, Katsina State

Source: RUSEP web site, www.rusep.org.

Empirical data on current aggregate demand for financial services in the agricultural sector is not available, however there is abundant anecdotal evidence by players across the diverse spectrum and scale of agricultural activities. Examples from the NACRDB, commercial banks (in particular, Union and First Banks) provide a proxy estimate of demand for agricultural finance. As part of its recapitalization effort, the NACRDB estimated and requested for a capital base of N50 billion to enable it effectively respond to the agricultural finance need of the country out of which N9.1 has been paid leaving a huge capital gap of N40.9 billion. The Union Bank is currently the leading commercial bank in agricultural finance with a portfolio of N1.5billion in 2003. Applications collected by Union Bank for this year total N2.8 billion, although approvals have not yet been issued. Findings from the First Bank, Plc. also indicate that there is no formal assessment of the level of demand for financial services by farmers. The bank acknowledged that it is not able to respond to all the requests made by its agricultural clients. The general range of loans in demand from their client market range from N20,000 to N250,000 to meet working capital needs for inputs and labor. Apart from farm level credit further analysis revealed, that there are also financing needs for MSMEs in agriculture and agro-processing. The scope for financial services needs include credit, savings, equipment leasing, and insurance.

D2c. Agricultural Demand for Non-financial Services

Improved technologies for production and processing as well as alternative utilization options for most tradable commodities are the non-financial services that are best understood in Nigeria. But, as the commodity chart on the next page illustrates, demand for non-financial services exists at all points along the chain. Businesses operating along the chain need access to business planning and market development and expansion strategies. They need assistance in the areas of management, training, financial systems, etc. And they need help from providers who understand the dynamics of the business in which they work. This expertise is not readily available to them.

The Financial Power of Non-financial Services

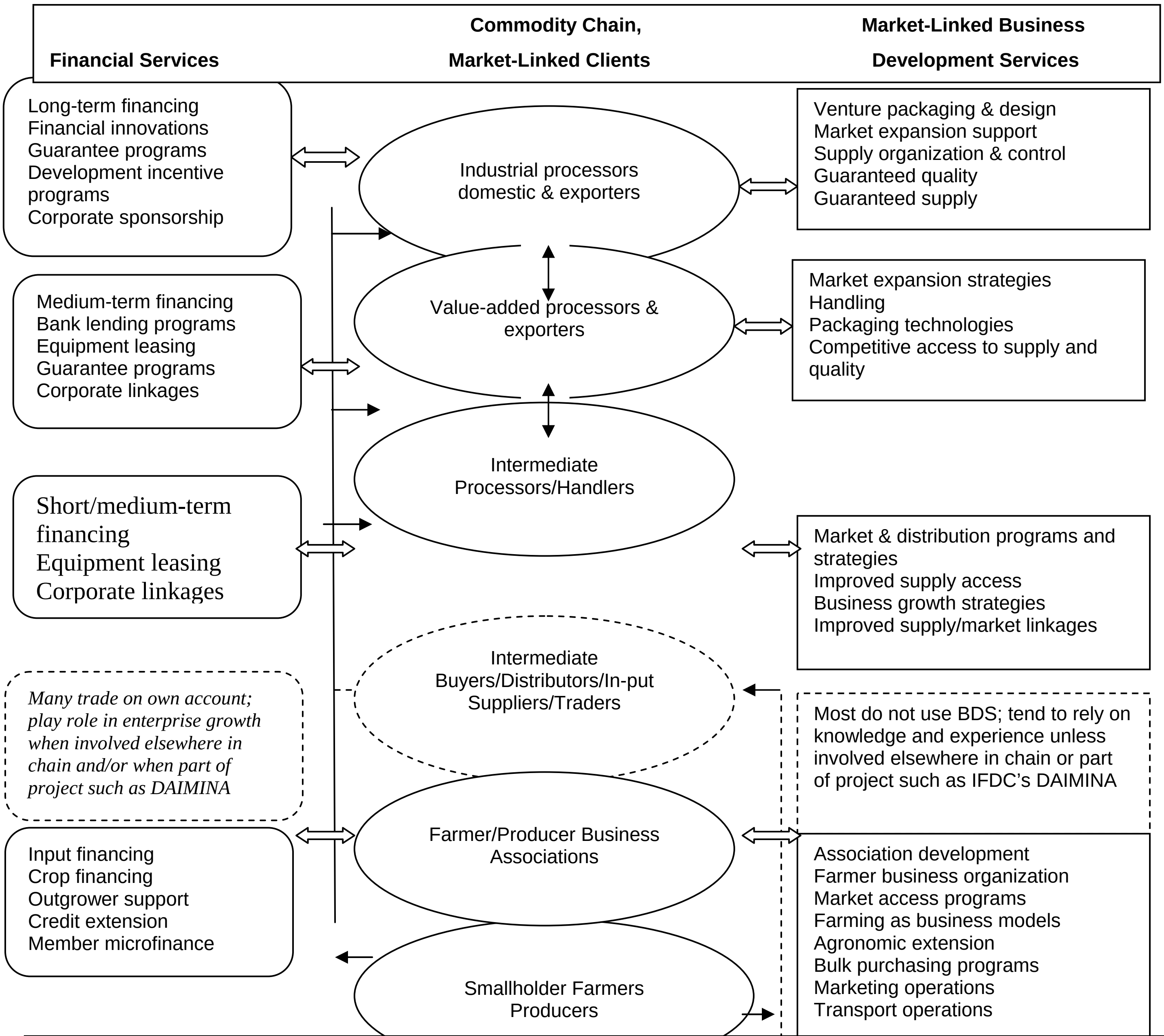
Dr. Ahmed Mustapha Falaki works with Sasakawa Global 2000's Nigeria Project. Working with farmer groups, the project has been successful in increasing yields, especially in maize. Collectively, groups have been able to source fertilizer in quantity directly from importers at substantial savings. Through group purchase, farmer groups have been able to receive discounts of up to 10% below prices offered to dealers. Importers have also been willing to provide transport in areas where the farms are accessible, thus saving still more money for farmers affilitated with the scheme. In Malawi, savings of 50% have been obtained through bulk purchase and distribution of inputs.

Source: PRISMS Assessment Team Field Visit, 2004.

D2d. Analysis of Commodity Chain-focused Economic Clusters

A commodity chain is the market-linked system that is in place to move agricultural commodities from the farm where they are produced into the marketplace. An example of a generic commodity chain model is shown below.

Commodity Chain-focused Economic Clusters



Strong economic clusters form around defined market opportunities and are grounded in strong linkages to producers. Strong producer organizations lower production costs by developing efficiencies in supply and delivery of inputs and related production and marketing services to members. Such organizations become sustainable when they are able to offer members a range of financial and non-financial services on a for-fee basis. Using best practices approaches, producer groups would extend financial services to members by working on a contract-for-services basis with financial services suppliers, e.g., community banks. PRISMS works with SO12 partners and other organizations to support the development and emergence of economic clusters, such as those in cassava, rice and grains/cowpeas, and to increase the flow of financial resources to the cluster. PRISMS leverages its resources by promoting and facilitating private sector buy-in and participation. PRISMS supports the ability of financial and non-financial service providers to design and deliver services.

There may be more or fewer layers on the chain depending upon the commodity, but the basic concept of commodity value chains and how they work is the same. Farmers are at the bottom of the chain and, most often and unlike the farmers working with Sasakawa as described in the box on the previous page, they have limited access to inputs, funding, markets, and technical support services. Because their final products are perishable commodities, they are often exposed to exploitation by middlemen who keep high margins for themselves and low margins for the farmers to mitigate the risk associated with post-harvest handling. In this context, the incentive for commercial production is weakened, commitment to quality is reduced.

The small farmer, the one at the bottom of the chain farming on less than two hectares of land, remains the engine of the Nigerian agricultural sector. His ability to scale up is a function of how well his challenges are managed. The lack of organized platforms to mobilize producer groups and use them to negotiate and deal in input and output markets is a major source of lack of competitiveness at this level of most agricultural commodity chains. The promotion and development of producer groups and farmer business organizations, as illustrated by examples coming in from Malawi, Uganda, and Zambia, is a viable strategy to achieve economies of scale that provide the impetus for realization of latent potential of producer groups within the commodity chain. The general assessments of the key players in the chain are described below while more commodity-specific, value-chain analysis is contained in Volume 2 of this report.

Farmer/Producer Business Associations. In the past, Nigeria's community-based trade groups operated through traditional cooperative principles. While many have failed, the self-help philosophy that drove them remains valid. Because most challenges faced by farmers are faced by all farmers, farmer's trade groups, or business associations, as they are beginning to be called, hold strong potential as vehicles for reducing production costs through group input and output marketing. Unfortunately most existing groups are not organized, efficient and effective in working into the marketplace. Where they are strong, they become effective business units which operate in the marketplace to take the place of middlemen and bring the middleman's margins to their members. Such groups are primary change agents and need to be strengthened to provide the basis for commodity chain productivity, effectiveness and efficiency.

Intermediate Buyers/Distributors/Input Suppliers/Traders. Depending upon the commodity and the time of year, there may be one or two layers of these service providers, Each layer represents another piece of the market price that *does not* go to the producer. In an increasingly effective commodity chain, this is the first level of consolidation. Providers at this level in the chain work in an economic sector that is highly risky. They will continue to operate under current practices, which include paying poor prices to farmers, until producers are organized and able to force competition by tendering for the provision of inputs to their members and/or by seeking to move up the market chain themselves. By making these moves, producer organizations force marketplace consolidation and competition. At present there is no competition at all in the downward flow of inputs to producers except among input suppliers who jockey for access to supply and work within small margins. As the chain strengthens, savvy distributors and suppliers in this part of the chain find ways to merge with other businesses in the chain or they innovate with new products and services.

Intermediate Processors/Handlers/Auctions. Intermediate processing of farm produce in Nigeria is handled, to a large extent, at cottage level. This processing includes cleaning, grading, weighing, bagging, etc. Some cottage processing may involve oil extraction from oil seed, peeling and grating of cassava, cleaning and winnowing of grains and cowpeas etc. At this level in the chain there is demand for equipment, operating capital, new technologies, market information, and quality assurance programs. For such operations leasing and trade credits and inter-firm linkage opportunities supported with guarantees may be options for consideration in financial and non financial services.

Value-Added Processors and Exporters. This category of value chain operatives are either producers of finished good or semi-finished industrial commodities. Cassava, sorghum, and rice fall in this category as they both have domestic and industrial application. The capital demand for both operating and capital items is rather high and difficult to source as commercial and community banks are not playing the roles expected of them. The inability of this category of value providers to access critical funding has largely been responsible for existence of the missing middle value added processors and processing in the rural and semi rural parts of the country. Some of the products of this category of service providers include industrial starch, corn grits, malted sorghum, yam flour, ground rice, crude ethanol, palm oil, etc.

International Processors, Exporters, and Importers. Corn/cassava starch, malted sorghum, corn grits, cassava pellets, etc, are industrial products valued and priced by urban-based international processors such as Cadbury, Nestle, Nigerian Breweries, Guinness, Lever Brothers, etc, who are responsible for processing this industrial commodities to finished consumer product.

Recommendations

- Identify and work with business leaders to develop market-driven economic clusters and approaches to integration of financial and non-financial services in support of MSME development within the cluster;

- Use viable community banks to drive the system;

- Identify potential participating community banks through a competitive tender process;

- Install microfinance units in viable community banks to serve microenterprises based on international best practices;

- Strengthen viable member-based institutions such as cooperative societies and producer organizations playing important roles within commodity chains and economic clusters;

- Create sustainable linkages between participating community banks and economic clusters in targeted areas; and

Why Community Banks?

- Past GON efforts to stimulate commercial bank and DFI lending to MSMEs have failed to achieve sustainable results.
- The donor community has traditionally supported microenterprise activity through NGOs but even after more than a decade of support, the largest 17 microcredit NGOs reach at most 150,000 clients on a combined basis compared with a potential market of 8.4 million MSMEs.
- NGOs cannot legall mobilize deposits, and therefore have difficulty expanding their outreach.
- The financial discipline required to run a successful financial institution conflicts with the social mandate of NGOs.
- There are an estimated 413 profitable community banks located throughout Nigeria.
- Community banks are close to the target market culturally and geographically, and they have experience working with MSMEs, and are interested in adopting international and regional best practices.
- Community banks have relatively low overhead costs, thus enabling them to profitably manage the large number of small transactions required for serving MSMEs.

- Identify opportunities for inclusion of plans to address cross-cutting themes such as HIV/AIDS, at risk youth, gender, and the environment.

SECTION E

Closing the Demand-Supply Gap for MSME Non-financial Services

The PRISMS team carried out a rapid assessment of providers of financial and non-financial business development services (BDS) to MSMEs. The assessment involved review of current and projected BDS program activities, focused discussions with microfinance practitioners, MSMEs, donors, and other BDS users, as well as a more in-depth capacity assessment carried out with about 20 BDS providers.

This section looks particularly at BDS being provided to MSMEs that produce and trade goods and services into the marketplace and form the client base for financial services, whether through NGO MFIs, community banks, etc. While MFIs themselves are usually SMEs, BDS supply to the MFI market is discussed in Section F to highlight the fact that MFIs, as the microfinance market matures and consolidates, are likely to require access to a range of services that is different from those required by non-financial MSMEs.

E1. An Overview of the Main BDS Providers and Services

The supply of BDS to the Nigerian MSMEs community is painfully small, particularly when looked at in terms of the number of MSMEs and the types of enterprise development support to which most require access. On the other hand, the fact that the size of this need does not translate into effective demand for BDS is illustrated by results of a survey of manufacturing small and medium sized enterprises located in and around Lagos carried out in 2000 by the United Nations University Institute of Technologies which found that only 9% of those surveyed regularly used external consulting services; 49% used such services occasionally and 42% made no use of such services. The fact that this target group was made up of SMEs most likely to use the services of BDS providers highlights the enormity of the challenges to building a sustainable demand and supply equation for the delivery of services to MSME clients. The challenge for PRISMS design is to find ways to respond to demand and supply constraints within the project context that will support design and implementation of new models for sustainable delivery of BDS to MSMEs.

Despite the small outreach of BDS providers, there a wide range of BDS organizational types and delivery vehicles. At the informal, or microenterprise, end of the scale, where the need for services is high and demand is low (ability/willingness to pay is not there), business support and entrepreneurship development services are provided through donor-financed projects, NGOs, GON-supported initiatives, grassroots community groups, producer organizations, and self-help business associations. The NGO BDS providers category, which includes faith-based organizations, community and self-help groups as well as business associations, dominates the provision of services to this market segment. Because the majority of these service providers have limited financial and technical capacity themselves, their service focus is largely on the provision of training using off-the-shelf training products that, in many cases, have not been appropriately tailored to client needs.

Services to the formal SME market are provided by consulting firms and individuals, affiliates of academic institutions, business membership organizations, NGOs, and even by other MSMEs (e.g. when input suppliers within a commodity chain provide services embedded within their business relationships). In this market segment, BDS providers focus largely on management, financial and business planning training. Again service focus is most often placed on generic technical assistance and training topics. Most providers lack capacity to offer tailored products, particularly in technical, subsector specific areas. For example, few have capacity to provide technical assistance and training that will support clients' ability to move up a value-added chain and/or to widen the product and service range they offer to target markets. And while there appears to be growing SME demand for assistance with improving product and market development strategies, few BDS providers offer this assistance on terms acceptable to both client and provider. The chart below illustrates the range of BDS providers, their services and sources of finance. It underscores the reality that few providers operate on a sustainable basis and the size of the role played by donors in shaping the marketplace.

Representative Providers of BDS to MSMEs	**Type**	**BDS Activity**	**Finance Sources**	**Sustainability/Growth Challenges**
FATE Foundation	NGO	Entrepreneurial and mgt. training, networking, access to consulting	Ford Foundation World Bank	Expand outreach, introduce new products, reduce operating costs, full cost recovery on services
Institute for Financial Planning	Private, for profit	Business mgt., financial planning, training, consulting services and investment advice	Training and consulting fees	Expand customer base and services to finance growth
National Association of Small Scale Industries	Not for profit, business association	Training, advocacy, Cooperative lending	Member subscriptions, donor funds (if available)	Increase # of dues-paying members; maximize its outreach potential; provide effective services
National Association of Small & Medium Enterprises	Not for profit business association	Advocacy, networking, market linkages and credit access facilitation	Subscriptions	Expand membership outreach, establish fee-for-services program, set up venture capital co.
Lagos Chamber of Commerce and Industries	Not for profit business association	Advocacy, networking, training, information services and consulting	Real estate rental, training fees, consulting fees; member subscriptions	Differentiated fee-for-service products for SMEs and large businesses,
Integrated Business Strategies	Private, for profit	Mgt. consulting services, credit access facilitation, training	Training and consulting fees	Expand customer base and services to finance growth
Benin Chamber of Commerce, Industry Mines & Ag	Not for profit business association	Advocacy, market linkages, market access, training, information services, credit rating services	Member subscriptions, trade fair fees	Expand member outreach; install effective fee-for-service program
Support and Training Entrepreneurship Program (STEP)	NGO	Mgt. and entrepreneurship training to MSMEs, business advisory services, research	Donors	Develop new products, introduce cost recovery methodologies; develop strategic plan to assist with balancing funding and mgt. requirements
Enterprise for Development Initiative (EFDI)	NGO	Capacity building, training, market and credit access to MFIs, SMEs and rural communities	Donors	Develop strategic plan, decide upon core competencies and target markets

National-level associations, such as the National Association of Small and Medium Enterprises (NASME), the National Association of Small Scale Industries (NASSI), the chambers of commerce, the Rice Farmers Association of Nigeria (RIFAN), and a wide range of other subsector trade associations are logical flow-through points for delivery of BDS services to MSMEs, particularly training, market information and advocacy support services that cannot be offered and sustained by other types of BDS providers. By structure and corporate charter, these organizations have a mandate to provide such services to their MSME memberships. They could, if organized and managed correctly, provide services on revenue-generation terms that would contribute to their overall sustainability. The potential for these member-representation organizations to play important support roles has not yet been realized.

E2. The Evolving MSME Marketplace for BDS

The lower end of the MSME market has traditionally included the large volume of entrepreneurs spread out in urban and rural communities across the country. These entrepreneurs operate as market vendors, salon operators, rice millers, shop keepers, casket makers, stone crushers, tailors, etc. Need for service is high; demand is low because few feel that they can afford to pay the prices that are attached to such services. Where demand does exist, it is spread out in isolated pockets so that delivery of services to individual firms is not cost-effective.

The demand potential for BDS services in the agricultural subsectors is high – if such services are appropriately organized and delivered. It is clear that if Nigeria is to meet its economic development challenges, farmers and their families, those who derive their livelihoods from farm-based enterprise activity, must be helped to organize and operate as microenterprises. Recent efforts in other African countries, for example, in Malawi, Zambia, and Uganda, have seen great strides made when farmers receive help to approach farming as a business.

There are organizations and associations already based in communities that can be tapped and assisted to provide appropriate BDS support services. In Nigeria, with its huge internal commodity markets and its potential for achieving volumes that will support value-added export, the key to moving forward is to organize and tap farmer-level potential by assisting farmers to organize and form business units through which they can operate to maximize market potential, decrease production costs and increase volumes. Some BDS providers, such as Sasakawa 2003, are providing services to this market segment.

BDS providers lack sufficient technical skills within subsector and value chain specializations. Serving microenterprises, whether on or off-farm, is a volume business that, at least at the outset, must be well-funded and based on highly efficient operations developed with good technical assistance and experience. It requires the right kinds of services – those that involve clients and build their capacity and organizations through approaches that decrease the cost of supply and lead to sustainability both for the target enterprises and the BDS providers themselves. To date, the larger and more organized NGOs, those that could with the right direction, develop or expand their operations to work more closely to clients to provide needed services on a sustainable basis, have not been adequately challenged and/or supported by donors to do so. Instead they have concentrated largely on carrying out activities for which donors have been willing to pay. Such supply-driven schemes have limited the capacity of both BDS providers and clients to attain required levels of efficiency.

There is insufficient competition being generated among BDS providers. International BDS best practice calls for moving toward an SME BDS marketplace that is characterized by numerous, competitive BDS providers who sell a wide range of BDS commercially, to large numbers and types of enterprises. Within best practices, market interventions are focused on overcoming market failures and taking advantage of opportunities to expand the service market for small (and medium) enterprises.[12]

While the emergence of strong producer organizations and business associations, is critical for MSME development, there is a major gap in the ability of BDS providers to provide relevant institutional development services. The development of Nigeria's MSME market for BDS services is constrained by the short supply of BDS providers and the insufficiency of the provider supply limits competition. Moreover, donors tend to rely on the capacity of several suppliers who have proven track records. For example, STEP (Support and Training Entrepreneurship Program) and FATE Foundation are NGOs that provide management and entrepreneurship training through various schemes. While both run good programs, they remain highly donor focused; together they command an important share of certain aspects of the BDS market. The World Bank's upcoming MSME project, which seeks to expand the number of quality BDS providers in the market, particularly within targeted value chains, has already identified STEP and FATE as key potential services providers. Yet the capacity survey carried out by PRISMS in support of the project design pointed to the fact that both of these BDS providers face the risk of being overwhelmed with their own growth and require assistance with strategic planning, sustainability strategies and BDS product development. The PRISMS survey underscored the need to remember that BDS providers are themselves SMEs, most of which need support to assess and address the opportunity costs associated with paying inadequate attention to such things as strategic planning and employee training needs.

Nigerian BDS providers lack innovation in their approaches to the MSME market. Growth of the MSME market for BDS services is further constrained by lack of innovation; for example, in the design of services and the use of technology. While it is a commonly held understanding that MSMEs often are unable to identify their business problems and requirements, BDS providers have not responded to this understanding by designing services that address these realities and thereby lead to expanded market share. Instead of designing services for which businesses can pay, for example, by breaking services into smaller, more financially palatable portions, each of which brings a tangible marketplace result, most BDS providers, whether NGOs or private consulting operations, are content to take the path of least resistance and sell services to donors rather than expand their potential market through innovation – either in technology or service design.

BDS providers find it difficult to develop delivery mechanisms through which they can both tackle the scale requirements of the MSME market and be efficient enough to reduce the costs associated with operating within this sector. The majority of BDS providers are small and tend to stay small because they do not have the capacity to absorb training and marketing costs. Their small size in turn limits their ability to expand their markets and scale up their operations. The cost of service delivery is a major determinant of products and services offered by most providers and the markets upon which they select to focus. Costs are managed by avoiding advertising, and travel, encouraging repeat business and depending on referrals or personal marketing.

In summary, the BDS industry needs an injection of innovative approaches that force competition and provide new models for industry growth. These models are not going to be found by taking traditional approaches to identifying gaps and meeting constraints. Solutions are going to come through projects such as PRISMS as they find ways to structure and operate into the marketplace in ways which lead to expanded competition, increased technical skill, improved service design.

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[12] McVay Mary, Meihlbradt Alexandra: "Background Reader, Business Development Services" : Developing Commercial Markets for BDS, Turin, Italy, September 2001, International Labour Organization, Small Enterprises Development (SEED).

Recommendations

While PRISMS is not a BDS project per se, the following recommendations focus on ways in which PRISMS might best approach working with providers of non-financial BDS services to support project activity.

- Donor programs need to be more carefully developed to encourage competition, innovation and sustainability rather than continued dependency. Carry out all project work with BDS suppliers under competitive tender.

- Develop technical specifications for project-required services that define, introduce and require innovative approaches that can lead to fee generation and sustainability.

- Regardless of the type of BDS organization structure – NGO or consulting firm – operate only under the terms of contracts for service and technical assistance agreements that specify results and deliverables and provide for direct technical oversight.

- Encourage and support rural outreach by challenging BDS providers to work with PRISMS professionals to design and set up profitable rural consulting practices.

- Leverage project resources by establishing partnerships with community and faith-based organizations, many of which are linked to larger formal organizations that have systems, capacities and resources that can be applied to tackling problems associated with outreach and high transaction costs of delivery of services.

- Investigate potential for a joint program with the NYCS, a program under which 85,000 Nigerian graduates carry out one-year of community service; e.g., work with the NYSC to develop a model for incorporating corps members into PRISMS activities and design and offer a train-the-trainer program through which BDS providers train youth corps members and monitor their participation.

- Support ability of targeted BDS providers to learn how to work with and through community based associations to enable provision of BDS as group services and use community-focused and grounded mechanisms, such as those identified above, to support this activity.

- Design activities in which services are embedded; for example, in linking producer organizations to processing enterprises, make the provision of technical assistance and training part of the arrangement and train BDS partners to identify, develop, and support such linkages.

- Contract BDS providers to carry out market research that can then be shared with MSMEs through business associations; work with and through associations and BDS providers to develop specialized subsector technical skills and training programs that can be sustained by the associations on a fee basis.

- Organize opportunities for selected BDS providers to interact with PRISMS short-term technical assistance providers each time they carry out in-country assignments.

SECTION F

Building Local Capacity to Provide Microfinance Training

As part of PRISMS assessment of BDS providers, the assessment team looked particularly at BDS providers who deliver services to MFIs. While MFIs themselves are usually SMEs, BDS supply to the MFI market is discussed separately in this section to highlight the fact that MFIs, as the microfinance market matures and consolidates, require access to a specialized range of services that is different from those required by non-financial MSMEs.

F1. An Overview of the Main Microfinance Training Providers and Services

The supply of BDS providers to MFI segment of the market is thin, as is the case with the supply of BDS providers to the MSME market. However, the MFI segment of the market is smaller, particularly when PRISMS looks more closely at the range of organizations providing microfinance services and divorces those that are dedicated to the provision of microfinance from those that have social goals and offer credit services as an adjunct to larger social packages. As PRISMS moves into design and implementation and works to support strengthening of microfinance and SME financial services delivery structure, it will be important to make such distinctions and target PRISMS support most appropriately. Therefore, for the purposes of assessment, we look specifically at the supply and capacities of BDS providers to provide 1) the type of training required by multipurpose NGOS – those that provide financial services as an adjunct to other technical and social services; 2) the type of training needed to support the further development and strengthening of financial operations, whether put into place by NGOs or by community banks, to support their ability to launch and maintain sustainable microfinance programs.

Microfinance Training and Technical Assistance Providers	Institutional Form	Main Activities	Funding Sources	Sustainability/Growth Challenges
Center for Microenterprise Development	NGO	Provision of MIS solutions, Information systems, microfinance management training	Ford Foundation Training Fees	New organization specifically established to support MFIs; minimal cost recovery; requires assistance to develop new products and sustainable approach
Growing Business Foundation	NGO	Provision and facilitation of wholesale loans to MFIs, credit training to coops	Membership subscriptions, private sector funds, interest on MFI loans	Well organized and managed, provides good services but is heavily subsidized; needs updated strategic vision on products and services
New Nigeria Foundation	NGO	Training in administration of community based development projects, financing of community cooperatives	Donors	Fully subsidized, good outreach across country but need assistance to leverage network, upgrade BDS and generate revenues
LAPO Services	NGO	Training, advisory, and consulting services	Parent organization	Heavily subsidized by parent

Microfinance Training and Technical Assistance Providers	Institutional Form	Main Activities	Funding Sources	Sustainability/Growth Challenges
Community Development Foundation	NGO	Provision and facilitation of wholesale loans to MFIs, credit training to coops; training, advisory, and consulting services	Donors, interest on MFI loans	Good organization and management, provides useful services but is heavily subsidized; needs updated strategic vision on products and services
Financial Institutions Training Center	Non-profit, member-owned	Management and technical training for financial institutions	Membership subscriptions; training fees	Operates at full cost recovery; would move into microfinance market as market evolves
Chartered Institute of Bankers	Not-for-profit business association	Certification exams, policy advocacy, research and training	Membership subscriptions, training fees	Operates at full cost recovery working with high end of market; would move into microfinance market as it evolves

The table above provides a representative overview of the range of BDS providers now offering services to microfinance institutions. The chart illustrates the fact that most organizations currently providing services to MFIs are NGOs themselves, most of which offer a limited service range concentrated on facilitating credit access. Some MFIs, such as the Lift Above Poverty Organization (LAPO), provide BDS to other MFIs as a subsidized service. Best practices call for LAPO to completely divorce this service provision from their MFI operations. The challenge here is that for the most part these organizations are not themselves models for the type of governance and management structures that are required within sustainable, best practices microfinance institutions.

F2. The Evolving MFI Marketplace for Training and Technical Assistance

As the CBN moves forward to define standards for operation at various tiers within the microfinance segment of the market, the market will evolve at a quickened pace and the training requirements for the entire segment will shift accordingly. Single-purpose MFIs will look for help with developing operating processes. As more formal institutions are created and/or existing organizations seek to transform into formal institutions to meet regulatory requirements, MFIs will need to formalize operations, business planning and training approaches in order to compete effectively. What is likely to emerge is a shift from the current scenario in which services to MFIs are largely provided by NGOs to a scenario in which NGOs continue to provide training to multi-purpose NGOs while services to MFIs are provided by specialist providers such as the Financial Institutions Training Center which moves downstream with its services as the market evolves and/or by associations formed by community banks and/or other MFIs to enable them to provide required training at reasonable rates.

Current MFI services are offered on a heavily subsidized basis, a fact which results in subsidy dependence for both the MFI and the service provider. Both providers and MFIs lack the business packaging skills needed to develop commercially viable and sustainable business operations. As a starting point, BDS providers must have the skills necessary to assist MFIs to develop and structure products for which MFIs will be willing and able to pay. The marketplace need for this is large; the challenge for PRISMS to address is the fact that neither Nigerian MFIs or their service providers have sufficient financial product packaging skills or adequate access to the models and approaches that are being tried in other locations.

Findings

- Proposed regulations will create a commercial and more competitive market that will drive a larger demand for BDS.
- To meet this demand, interventions have to focus on increasing the number of providers available and assisting existing providers to make the transition to become sustainable commercial providers.
- Increasing structuring within the industry will force BDS providers to develop new specializations.
- Existing BDS providers which currently provide training to commercial banks, for example, organizations like Financial Institution Training Center (FITC), are candidates for working PRISMS to develop products for MFIs.
- As the microfinance industry strengthens within the financial sector, opportunities exist to embed MFI training within the structure of the banking system itself; for example in the structure of interactions from commercial banks to community banks and from community banks to participating MFI onlenders.

Recommendations

- Adapt proven methodologies and packages for installing microfinance units in community banks (e.g. adapting the Philippines MABS Model to the Nigerian context).
- Expand on proven approaches to support community bank linkages to agricultural associations and producer organizations in the sustainable provision of financial services (e.g. adapting the Uganda SPEED Model to the Nigerian context).
- Encourage existing BDS providers to define their specializations.
- Support existing BDS providers that are largely NGOs to transform into commercial ventures, by offering assistance with increasing internal capacity and institutional structures and developing appropriate products for a commercial MFI market.
- Carry out competitive procurement to identify short-list of MSME training and technical assistance service providers.
- Encourage new entrants by providing the required training, assisting them with product development and marketing their services.
- Build capacity of participating service providers to deliver required training and technical assistance on a commercial basis.

- Support formation of associations as market facilitators to help structure the industry and perform or organize market development services. Offer support in the areas of coordinating the formation of groups and developing their institutional capacities.

SECTION G

Enhancing the Effectiveness of External Assistance

G1. Improving Donor Coordination

While formal donor coordination takes place in a few well-defined sectors such as agriculture and there is much informal coordination on private sector development, MSMEs, etc. there is no donor working group that formally exists to addresses financial sector issues in a broad sense. DFID called a meeting of donors in February 2004 and the decisions taken at that meeting by the group were to establish a Financial Sector Donor Working Group that would allow for donor coordination broadly within the financial sector and unified response to the GON on issues that impact the sector as a whole such as microfinance and MSME development. While the initial membership is included in the box at right, it is envisioned that other donors with interests in the sector will also join over time and participate in the monthly meetings that are planned to be held at least over the next six months while several donors are beginning or gearing up for projects that impact the financial sector.

Initial Members of the Financial Sector Donor Working Group

- DfID
- USAID
- World Bank
- IFC
- UNDP
- UNIDO
- EU
- FAO
- GTZ

There is a Microfinance Donor Working Group but for the last few years this has mainly centered on MicroStart Advisory Board Meetings and so has attracted donor interest but little working group activity other than between UNDP and MicroStart. There is a need to streamline these two donor working groups to increase efficiency and impact of donor efforts in microfinance and in the broader financial sector.

A donor working group supporting the development of a sustainable microfinance industry as an integral part of the financial sector has at least four major roles to play:

- Setting the medium to long-term strategic focus for development of the industry, government interventions, and donor projects;
- Getting agreement on operating principles and industry standards;
- Ensuring efficiency of time and budget allocations; and
- Improving communications and information exchange.

Setting the strategic focus includes pushing government to create and maintain an enabling environment for microfinance, including promulgating an appropriate national microfinance policy, creating of an adequate legal and regulatory framework for microfinance, and getting the government to cease directed, subsidized credit delivery. Getting agreement on operating principles may primarily be directed at developing standards for MFI reporting and performance monitoring. To ensure efficiency of time and budget allocations, a critical role of the donor working group will be to ensure communication of current and planned project activities. Opportunities for co-financing can then be explored. The donor working group can also serve a useful function in improving communications through regular meetings and exchanging information such as SOWs/TORs, drafts and final deliverables such as technical reports and papers meant for public consumption.

G2. Building Market-based Business Partnerships

The focus on building effective public/private sector partnerships for development is one of the USAID's major pillars of operation. In the last couple of years, major initiatives such as the Global Development Alliance (GDA) have emerged to promote such partnerships in adjunct to the programs operated through USAID's individual country and regional missions. From regional coffee and livestock marketing efforts in east Africa to Nigeria's venture forward with Shell Oil, GDA is supporting the emergence of new private-sector led ventures by using leveraging monies that supplement rather than take from the monies of individual USAID missions. For USAID/Nigeria, packaging activities that are eligible under GDA guidelines is one way to deal with resource constraints.

In addition, however, assessment shows that business partnerships are needed to move Nigeria's economy forward. In the extensive reading and field visits carried out by the PRISMS assessment team, there was little indication that Nigeria has even begun to tap the power of private sector initiative – even though the country is known throughout the world as a country of entrepreneurs and despite the fact that Nigeria represents a huge market, has a significant number of Nigerian enterprises manufacturing for local and export markets using locally sourced goods and is home to representatives of some of the world's largest companies which both source and distribute product.

To move from a focus on supply-sided technical development and to identify and structure real economic opportunities, it is necessary to develop and work with market-linked business activities. In this approach, projects are developed around business leaders who represent and can deliver guaranteed access to market. This can take place on a single-firm basis, or, increasingly, on an economic-cluster basis. For example, current work in Uganda being sponsored by USAID/Uganda is developing subsector economic clusters in coffee, cotton, dairy, fish, horticulture, maize and bean, and oilseeds. Clusters are formed by working with business leaders to identify and develop business and market development strategies that support their ability to drive the market opportunities they see, while, at the same time, driving development down through the commodity chain. Clusters of necessary private and public sector players are then formed around the business strategy.

Assessment shows a large pool of Nigerian-based companies, both local firms and representatives of international firms, that can be tapped with regard to the potential for identifying potential economic clusters. Experience shows that discussions with such firms are the starting point for building clusters and coming back to commodity subsectors with market-driven approaches. Volume 2 includes a list of these firms, many of which will be contacted during the PRISMS design phase to provide input to identification of the market partnerships most likely to have potential under PRISMS.

Recommendations

- Strengthen the ability of the financial sector donor working group to coordinate and advocate for financial sector development and MSME finance issues by playing a leadership role with DFID.

- Support merger of the microfinance working group with the financial sector donor working group.

- Maximize GDA opportunities by fostering private-public partnerships within the framework of economic clusters.

- Heighten the involvement of Nigeria's private business community.

ANNEX A

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ANNEX B

Supplemental Bibliography

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Canadian International Development Agency (CIDA)	Donor meeting on Agriculture and Rural Development Program Implementation Information Matrix	NA	NA
Central Bank of Nigeria (CBN)	Baseline Survey of Microfinance Institutions in Nigeria	Apr-02	NA
Central Bank of Nigeria (CBN)	Central Bank of Nigeria: Annual Report and Statement of Accounts for the year ended 31 December 2002	Dec-02	NA
Department for International Development (DFID)	HIV/AIDS and Private Sector Linkages	Aug-02	Enterprise Development Department
Department for International Development (DFID)	Donor meeting on Agriculture and Rural Development Program Implementation Information Matrix	NA	NA
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Department for International Development (DFID)	Making Markets Work Better for the Poor	Nov-00	Oxford Policy Management
Department for International Development (DFID)	Sources of Growth in Nigeria (Not for quotation/distribution)	Apr-03	Centre for the Study of African Economies, Oxford University
Department for International Development (DFID)	PrOpCom Design Report: Program memorandum: Promoting Pro-Poor Opportunities through Commodity and Service Markets (PrOpCom) (Not for quotation/distribution)	Jul-03	Chemonics International
Department for International Development (DFID)	Literature Search-Nigerian Growth and Markets	Mar-03	Roseline Abara, DFID/Nigeria
Deutsche Gesellschaft für Technische Zusammenarbeit (GTZ)	How to regulate and supervise microfinance: Key issues in an international perspective: Proceedings of the High-Level Policy Workshop, Kampala, November 1999	Dec-99	Alfred Hannig Edward Katimbo-Mugwanya (Eds.)
Deutsche Gesellschaft für Technische Zusammenarbeit (GTZ)	Regulation and Supervision, Microfinance Institutions: State of Knowledge	Aug-99	Stefan Staschen
Food and Agriculture Organization of the United Nations (FAO)	FAO Project Info Matrix	NA	NA
Government of the Federal Republic of Nigeria	Nigeria Investor Roadmap & Enabling Environment Strategy	Dec-02	PriceWaterHouse Coopers L.L.P.
Government of the Federal Republic of Nigeria	Poverty Profile for Nigeria 1985-1996	Dec-98	NA

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Lift Above Poverty Organisation (LAPO)	LAPO Proposal for Funding Assistance: Turn Around Economic and Health Care Empowerment Project (TAEHEP) for Poor Peasant Farmers	Dec-03	NA
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NA	Rural Agricultural Lending and Profit: Union Bank of Nigeria	Oct-00	Dr. Michael T. Marx
NA	LAPO Summary Assessment Report and Logical Framework	Feb-03	NA
NA	HIV/AIDS in Nigeria: Overview of the Epidemic	2002	NA
NA	Population and the Quality of Life in Nigeria	Mar-02	NA
National Council of Women Societies	National Council of Women Societies Nat'l Poverty Eradication Program (PRISMS RFP Attachment)	Nov-02	Dr. Bolere Ketebu-Nwokeafor, National President
Nigeria.gov.ng website	List of Commercial Banks in Nigeria	NA	NA
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United Nations Development Program (UNDP)	Microstart: Workplan, Jan. - Dec. 2004	Dec-03	ASA
United Nations Development Program (UNDP)	Review of UNDP's Global Microfinance Portfolio: Report from Field Visit to Nigeria (10/5/03-10/15/03)	Oct-03	Lene M. P. Hansen
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United States Congress	Microenterprise Bill HR 3818	NA	NA
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World Bank/Financial Sector Unit, Economic Management and Social Policy Department, Africa Region	Nigeria Financial Sector Review: Volume 1-Overview and Macro-Financial Environment Volume 2-Banking and Their Supervision Volume 3-Non-Bank Financial Institutions and Markets (Not for quotation/distribution)	May-00	NA
World Bank/Regional Program on Enterprise Development, Africa Region	Assessment of the Private Sector in Nigeria (PRISMS RFP Attachment)	Sep-02	NA

ANNEX C

List of Persons Contacted

Category	Stakeholder organization	Individual/s contacted	City	State	Zone
Academia	Ahmadu Bello University, Institute of Agricultural Research (IAR)	Dr. Ahmed M. Falaki, Head of Agricultural Extension Services Prof. A. O. Ogunbile, Department of Agricultural Economics	Zaria	Kaduna	NW
Academia	Ahmadu Bello University, NAERLS	Salihu S. Abubakar	Zaria	Kaduna	NW
Academia	Idachaba Foundation for Research and Scholarship (IFRES)	Prof. F. S. Idachaba	Ibadan	Oyo	SW
Academia	International Institute for Tropical Agriculture (IITA)	Abubakar Aboki, RUSEP Northwest Officer Dr. Wale Adekunle, Coordinator, ICS-Nigeria Dr. Alfred Dixon, Plant Breeder/Geneticist Jan Helsen, PROSAB Project Manager Dr. Patrick M. Kormawa, Agricultural Economist Dr. Lateef O. Sanni, Postharvest Specialist	Ibadan	Oyo	SW
Academia	Wealth Windows of Nigeria	Dr. Olu Makinde	Abuja	FCT	NC
Associations/ Networks	Chartered Institute of Banking of Nigeria (CIBN)	Chukwudi Odili, Principal Manager	Lagos	Lagos	SW
Associations/ Networks	National Association of Community Banks	Barr E. U. Nwaugo, National Legal Advisor Dr. Adebayo Oduwole, National President	Abuja	FCT	NC
Associations/ Networks	National Association of Small and Medium Enterprises (NASME)	Moses A. Makinde, President Alhaji Idris Momodu, 2nd National Vice President Ede U. Ubiji, Executive Secretary	Lagos	Lagos	SW
Associations/ Networks	National Association of Small Scale Industries (NASSI)	Charles Chukwu, Program Officer/Administrative Secretary Duwo Kuteyi, Vice President	Lagos	Lagos	SW
Associations/ Networks	National Board for Community Banks (NACOBS)	Lawal A. Davai, Acting Secretary/Chief Executive A. M. Otegbade, Director, Banking Inspection	Abuja	FCT	NC
Associations/ Networks	National Farmers Association of Nigeria (NAFAN)	Abubakar K. Wodi, 1st Deputy President General	Abuja	FCT	NC
Associations/ Networks	Nigeria Economic Summit Group (NESG)	Chris E. Onyemenam, Director, Operations and Administration	Lagos	Lagos	SW
Associations/ Networks	Rice Farmers Association of Nigeria (RIFAN)	Abubakar K. Wodi, National Chairman Daniel E. Aguchi	Abuja	FCT	NC
Associations/ Networks	Rice Mill Owners Industry Association	Chief James Ewuzie, Vice Chairman Tony Muoneke, Chairman	Abakaliki	Ebonyi	SE
Commercial Banks	Citi Express Bank	Yomi Ayantoye, Head, Energy, IT and Telecoms Temitayo Olu-Abogunrin Funke Smith, Assistant General Manager, Corporate/Investment Banking	Lagos	Lagos	SW
Commercial Banks	Cooperative Bank, PLC	Ariyo Ajaja, Managing Director/Chief Executive Layi Oriji, Commercial Banking Group	Ibadan	Oyo	SW

Category	Stakeholder organization	Individual/s contacted	City	State	Zone
Commercial Banks	First Bank of Nigeria, PLC	Bernard Bolgang Poyi, Head, Agriculture Business/SME	Lagos	Lagos	SW
Commercial Banks	Prudent Bank	Dotun Adeniyi, General Manager Banji Aderinwale, Investment Banking Group Timothy Oguntayo, Assistant General Manager, Investment Banking Group Akin Olusuyi, Investment Banking Group	Lagos	Lagos	SW
Commercial Banks	Union Bank (Edo)	Dapo Lagunju, Manager	Benin City	Edo	SS
Commercial Banks	Union Bank (Lagos)	A. B. Arikewuyo Mall Abdu Ibrahim, Senior Manager	Lagos	Lagos	SW
Commercial Banks	United Bank for Africa, PLC (UBA)	Peter Longe, Special Projects	Lagos	Lagos	SW
Donors/IPs	African Development Bank (ADB)	Olagoke Oladapo, Agricultural Economist	Abuja	FCT	NC
Donors/IPs	Budget Process Support Project	Paul Banerjee, Chief of Party and Senior Budget Advisor	Abuja	FCT	NC
Donors/IPs	Canadian International Development Agency (CIDA)	Amadi Aku, Environmental and Rural Advisor	Abuja	FCT	NC
Donors/IPs	Consultative Group to Assist the Poor (CGAP)	Robert Christen, Senior Advisor	Abuja	FCT	NC
Donors/IPs	David & Lucille Packard Foundation, Management Strategies for Africa	Marc A. Okunnu, Sr., Country Representative	Abuja	FCT	NC
Donors/IPs	Department for International Development (DFID)	Adiya Ode, Assistant Livelihoods Advisor Mavis Owusu-Gyamfi, Private Sector Development Advisor/West Africa Jan Wimaladharma, Assistant Enterprise Advisor	Abuja	FCT	NC
Donors/IPs	European Union, Delegation of the European Commission in Nigeria	Dr. Maryam Abdu, Project Officer, Rural Development	Abuja	FCT	NC
Donors/IPs	Food and Agriculture Organization of the United Nations (FAO)	Michael Marx, Rural Finance Officer	Abuja	FCT	NC
Donors/IPs	Ford Foundation	Chas Gore, Managing Partner, Otham Consultants	Abuja	FCT	NC
Donors/IPs	Grameen Foundation	James Dailey Michael Eber	Abuja	FCT	NC
Donors/IPs	GTZ, Employment-oriented Private Sector Development Program (EoPSD)	Ole Buch-Hansen, Financial Specialist	Abuja	FCT	NC
Donors/IPs	International Fertilizer Development Corporation (IFDC), DAIMINA Project	Samuel Adewuyi Makinde, Executive Secretary D. Ian Gregory, Director, Market Development Division Ahmed Rabiu Kwa, Manager/Marketing Services Dr. H. B. Singh, Chief of Party	Abuja	FCT	NC
Donors/IPs	International Finance Corporation (IFC)/African Project Development Facility (APDF)	Akin Adeoye, Business Development Officer, Abuja Frank Agure, Lagos Ismail Samji, Sr. Investment Officer, Global Micro & Small Business Finance Group, DC	Abuja	FCT	NC

Category	Stakeholder organization	Individual/s contacted	City	State	Zone
Donors/IPs	Job and Business Development Services (JOBS) project, Opportunities Industrialization Centers International (OIC)	Jacqueline Hardware, Country Rep., JOBS Steven Wisman, VP, Education and Training	Abuja	FCT	NC
Donors/IPs	Planned Parenthood	Sarah Onyango, MD, MPH, Regional Director, Africa Jennifer L. Potts, MPH, Director, International	Abuja	FCT	NC
Donors/IPs	Promoting Stakeholder Participation in Economic Transition (PROSPECT) Project	Paul King, Chief of Party	Abuja	FCT	NC
Donors/IPs	Sasakawa Global 2000	Dr. Ahmed Mustapha Falaki, Project Coordinator	Kano	Kano	NW
Donors/IPs	United Nations Development Program (UNDP)/MicroStart	Bertram Egwatu, Assistant Resident Representative, Poverty and Social Development Unit	Abuja	FCT	NC
Donors/IPs	United Nations Industrial Development Organization (UNIDO)	Jossy M. Thomas, Industrial Development Officer, Energy	Abuja	FCT	NC
Donors/IPs	United States Agency for International Development (USAID)	Regina Dennis, Project Development Officer Kingsley Ebule, Acquisition & Assistance Specialist Anne Fleuret, Senior Strategic Analysis Advisor Abdulkadir Gudugi, Agriculture Economist Andrew Igbo, GIS Information Manager Andrew Levin, PhD, Agriculture Development Officer (PRISMS CTO) Dawn Liberi, Mission Director Kenneth LuePhang, Contracting Officer Samuel Nwanokwu, Acquisition & Assistance Specialist Frank Okafor, Program Manager (PRISMS alternate CTO) Nduka Okara, Performance Monitoring Specialist Ann Oden, Education Program Manager Sheila O'Rourke, Senior Advisor for HIV/AIDS, SO-14 Team Leader Jackie Ramanitrera, Acquisition & Assistance Specialist Denise Rawlings, Deputy Mission Director Emanuel Uche, Democracy and Governance Program Manager	Abuja	FCT	NC
Donors/IPs	World Bank	Samuel Eremie Esther Gadzama, Agricultural Specialist Marilyn Swann Manalo, Operations Officer, Private Sector Dev. Unit, Africa Jane C. Miller, HIV/AIDS Specialist Peter J. Mousley, Sr. Private Sector Development Specialist, Private Sector Dev. Unit, Africa	Abuja	FCT	NC
Government	Calabar State Government	Margaret Ebokpo, Special Advisor to the First Lady on Youth Activities	Calabar	Cross River	SS
Government	Central Bank of Nigeria (CBN), Banking Supervision Department (BSD)	I. U. Kama, Assistant Director, Banking Supervision Department G. A. Oladejobi, Deputy Director, Banking Supervision Department	Abuja	FCT	NC

Category	Stakeholder organization	Individual/s contacted	City	State	Zone
Government	Central Bank of Nigeria (CBN), Development Finance Department (DFD)	Joe Alegieuno, Deputy Director, Development Finance Department Goddy E. Akpabio, Acting Director, Development Finance Department Paul Eluhaiwe, Assistant Director, Development Finance Department	Abuja	FCT	NC
Government	Central Bank of Nigeria (CBN), Other Financial Institutions Division (OFID)	Adedeji J. Adesemoye J. A. B. Babalola, Assistant Director	Lagos	Lagos	SW
Government	Corporate Affairs Commission (CAC)	Julius Omomoh, Director, Business Names Churchill Williams, Head, Public Relations	Abuja	FCT	NC
Government	Debt Management Office, Department of the Treasury	Francis Odubekun, Government Debt Issuance and Management Advisor	Abuja	FCT	NC
Government	Kano State Agricultural and Rural Development Authority	Muhammad Umar Kura, Managing Director Isa Malami, Assistant Director, Agricultural Credit/Marketing	Kano	Kano	NW
Government	Maska Local Government Authority (LGA)	Salihu Habibu Maska, Chairman, Maska LGA	Maska	Kaduna	NW
Government	Ministry of Agriculture & Rural Development, Project Coordinating Unit (PCU)	Gidado N. Bello, National Coordinator, Human Resources Development Dr. Salisu A. Ingawa, Director/Head of PCU M. A. Olusi, Crops/Agroforestry and Land Management (Ibadan)	Abuja	FCT	NC
Government	Ministry of Agriculture and Natural Resources, Kano State	Alassan M. Dawaki, Hon. Commissioner	Kano	Kano	NW
Government	Ministry of Women Affairs and Youth Development	G. I. Anyanwu, Personal Assistant to the Honorable Minister E. E. Archibong, Senior Admin. Officer, PRS Department M. E. Nwordu, Principal Admin. Officer, PRS Department Dr. B. N. Olorunfemi, Director, Planning, Research and Statistics A. Olowookere, Assistant Director, PRS Department Tiliza Ularam, Assistant Director, Women Affairs Department	Abuja	FCT	NC
Government	National Investment Promotion Corporation (NIPC)	Bello Hamza, SME Manager	Abuja	FCT	NC
Government	National Poverty Eradication Program (NAPEP)	Amne Sambo, Deputy Director, Outreach Services	Abuja	FCT	NC
Government	Nigerian Agricultural Insurance Corporation (NAIC)	Fola Daniel, Managing Director/CEO K. K. Yusuf, Executive Director/Operations	Abuja	FCT	NC
Government	Oyo State Agricultural Development Program (ADP)	S. A. Adegebo, Program Manager and Chief Executive Tunde Aderonmu, Director, Agriculture Extension Services	Ibadan	Oyo	SW
Government	USTDA (United States Trade Development Administration)	James S. Brown, Vice President, The Peoples Group, Ltd. Ronald W. Buatte, Senior Consultant, The People's Group, Ltd. Frank W. Naylor, Jr., Executive Vice President, The People's Group, Ltd.	Kano	Kano	NW
MSME Finance Clients	Akufo Farm Settlement	B. O. Adewumi, Chairman, Akufo Farmers Group	Ibadan	Oyo	SW

Category	Stakeholder organization	Individual/s contacted	City	State	Zone
MSME Finance Clients	Cares International	Dr. Mfon Akpaso, Executive Director	Calabar	Cross River	SS
MSME Finance Clients	Cassava Processors Association	M. O. Kolawole, Chairman	Ibadan	Oyo	SW
MSME Finance Clients	Cassava Processors Association of Nigeria (CAPAN)	Humphrey Okey Nweze, President	Aba	Abia	SE
MSME Finance Clients	Dass Women Cooperative	Esther Zakka Participatory Rapid Appraisal Focus Group for Demand Assessment	Dass	Bauchi	NE
MSME Finance Clients	Dawano grain market	Sani Uba Sarkin Kasuwa, Dawano market official	Kano	Kano	NW
MSME Finance Clients	Diamond Investment	Edward Ebri Participatory Rapid Appraisal Focus Group for Demand Assessment	Calabar	Cross River	SS
MSME Finance Clients	Maska Farmers Group	Abubakar Aboki, IITA	Maska	Kaduna	NW
MSME Finance Clients	Northern Cross River State Women's Association	Lucy Udia, Project Coordinator Participatory Rapid Appraisal Focus Group for Demand Assessment	Calabar	Cross River	SS
MSME Finance Clients	Rahama Women Multipurpose Cooperative	Habiba Lawal, President Helen Jammal, Senior Program Officer Participatory Rapid Appraisal Focus Group for Demand Assessment	Bauchi	Bauchi	NE
MSME Finance Clients	Susan Ohio Foundation/Investment Corporation	Herbert Ogar, Chairman/Founder Participatory Rapid Appraisal Focus Group for Demand Assessment	Calabar	Cross River	SS
MSME Finance Clients	Toro Salama Women Multipurpose Cooperative	Elizabeth Joshua, President Participatory Rapid Appraisal Focus Group for Demand Assessment	Toro	Bauchi	NE
Non-financial Services Providers	Agricultural Microcredit and Community Development Services (AMCoDS)	Michael Ajufo, Executive Director	Benin City	Edo	SS
Non-financial Services Providers	Benin Chamber of Commerce	Imalingmhe John Yesufu, Acting Executive Secretary	Benin City	Edo	SS
Non-financial Services Providers	Centre for Microenterprise Development (CMD)	Edna J. Ishaya, Managing Director	Lagos	Lagos	SW
Non-financial Services Providers	Enterprise for Development Initiatives (EfDI)	Emmanuel Azaino, Business Advisor Charles Akinola, Executive Director Samuel Kayode, Program Advisor Cyril Ugwu, Head, Enterprise Development and Finance	Lagos	Lagos	SW
Non-financial Services Providers	FATE Foundation	Bunmi Lawson, Executive Director	Lagos	Lagos	SW

Category	Stakeholder organization	Individual/s contacted	City	State	Zone
Non-financial Services Providers	Financial Institutions Training Centre (FITC)	Isaac Ajilima, Assistant Director	Lagos	Lagos	SW
Non-financial Services Providers	Institute of Financial Planning (IFP)	Austin Nweze, Director of Programs and Publications	Lagos	Lagos	SW
Non-financial Services Providers	Lagos Chamber of Commerce	Sade Mosuro, Director, Business Service Unit Adekunle A. Olumide, Director General Muda Yusuf, Director of Research and Information Services	Lagos	Lagos	SW
Non-financial Services Providers	New Nigeria Foundation (NNF)	Prof. Obafemi Ajibola, PhD, Managing Director/CEO Ayo Igandan Dr. Danjuma Ndackson, Program Manager	Lagos	Lagos	SW
Non-financial Services Providers	Support and Training Entrepreneurship Program (STEP)	Nike Bajomo, Head, Business Development Anthony S. Ita, Micro/Small Enterprise Consultant	Lagos	Lagos	SW
Non-financial Services Providers	Women of Hope, People Living with HIV/AIDS program	Modest Ene Esther Salami	Abuja	FCT	NC
Other Financial Institutions	Calabar Community Bank of Nigeria, Ltd.	Nkereuwem Onung, Manager Participatory Rapid Appraisal Focus Group for Demand Assessment	Calabar	Cross River	SS
Other Financial Institutions	Community Development Foundation (CDF)	Ndidi Edozien	Lagos	Lagos	SW
Other Financial Institutions	Cooperative Development Bank, PLC	Effiong Bassey, Business Development Comfort Edor, Operations Manager Participatory Rapid Appraisal Focus Group for Demand Assessment	Calabar	Cross River	SS
Other Financial Institutions	Cooperative Financing Agency, Ltd., Bauchi State	Madaki Ahmed, Acting General Manager Sadeeq A. Ibrahim Sadiku Waziri, Acting Chief Accountant Participatory Rapid Appraisal Focus Group for Demand Assessment	Bauchi	Bauchi	NE
Other Financial Institutions	Country Women Association of Nigeria (COWAN HQ/Ondo)	Chief Mrs. Bisi Ogunleye, National Coordinator	Akure	Ondo	SW
Other Financial Institutions	Country Women Association of Nigeria (COWAN/Jos)	Charity Bello, Treasurer, COWAN/Jos Jessica Vonkat, State Coordinator Participatory Rapid Appraisal Focus Group for Demand Assessment	Jos	Plateau	NC
Other Financial Institutions	Development Exchange Centre (DEC)	Asiya Isuwa, Program Coordinator Suwaiba Y. Jibrim, Program Officer, Projects and Training Participatory Rapid Appraisal Focus Group for Demand Assessment	Bauchi	Bauchi	NE
Other Financial Institutions	Farmers Development Union (FADU)	Ade Adedoja, Program Co-Coordinator	Ibadan	Oyo	SW

Category	Stakeholder organization	Individual/s contacted	City	State	Zone
Other Financial Institutions	Growing Business Foundation (GBF)	Gloria Ekpo, Manager, Business Development Jibola Kusoro, Finance and Investment Femi Omonehin, Head, IT	Lagos	Lagos	SW
Other Financial Institutions	Gwagwalada Community Bank Limited	E. C. Aliyu, Managing Director Participatory Rapid Appraisal Focus Group for Demand Assessment	Gwagwalada	FCT	NC
Other Financial Institutions	Haggai Community Bank	Richard Olubameru, Manager/CEO	Lagos	Lagos	SW
Other Financial Institutions	Informal Money Lender	Pastor Abu Eyo, Money Lender	Calabar	Cross River	SS
Other Financial Institutions	Informal Money Lender	Gabriel Okoba, Money Lender	Calabar	Cross River	SS
Other Financial Institutions	Justice Development and Peace Commission (JDPC)	Rev. Father Patrick Ngoyi, Program Coordinator	Ijebu Ode	Ogun	SW
Other Financial Institutions	Lift Above Poverty Organization (LAPO)	Godwin Ehigiamusoe, Executive Director Atane O. Emmanuel, Program Officer Auditor Abu N. Taiwo, Head of Audit Unit	Benin City	Edo	SS
Other Financial Institutions	National Council of Women Societies (NCWS) Garki Community Bank	Aboulrazzaq Aka'aba, Accountant Salisu A. Zango, Manager	Abuja	FCT	NC
Other Financial Institutions	Nigerian Agricultural Cooperative and Rural Development Bank (NACRDB)	Isa Mohammed Inuwa, Executive Director, Operations Rebecca N. Obaze, General Manager, Credit A. O. Martyns-Yellowe, Acting General Manager, Wholesale Banking Ibrahim Tukur, Acting General Manager, Special Projects	Kaduna	Kaduna	NW
Other Financial Institutions	Partners for Development (PDF)	Tricia Matthews, Program Manager Community Based Programs	Bauchi	Bauchi	NE
Other Financial Institutions	Urban Ministry	Mary Bature, Coordinator, Micro Credit Rev. Azi Samuel, Executive Director Participatory Rapid Appraisal Focus Group for Demand Assessment	Jos	Plateau	NC
Other Financial Institutions	Young People's Initiative	Excellence Eyo Offiong Uso, Chief Executive Director Participatory Rapid Appraisal Focus Group for Demand Assessment	Calabar	Cross River	SS
Private Sector	Chevron Nigeria Limited	Joseph A. Adeyemi, Lands and Sustainable Development Representative, Government and Public Affairs Joe Jakpa, Manager, Lands and Sustainable Development, Government and Public Affairs	Lagos	Lagos	SW
Private Sector	ExxonMobil	Adedayo Ojo, Public Affairs Manager Rita Umoren, External Affairs	Lagos	Lagos	SW
Private Sector	Syngenta	Patrick N. Ikemefuna, Managing Director, Chief Executive Officer	Lagos	Lagos	SW

ANNEX D

Questionnaires Used in the Assessment

FOCUS GROUP GUIDE: LIFE CYCLE PROFILE[13]

Name of community/group: ____

Date of Discussion: ____

No. of Participants in the Group: ____

No. of Men ____________________ No. of Women ________________________

Socio-Economic Status (Please circle one per line):

Poor	Moderate	Vulnerable Non-poor
Literate	Illiterate	
Rural	Urban	Peri-urban

OBJECTIVES:
Identify most important life cycle events and needs that require lump sums of cash to finance
Examine the implications of these events for household income/expenditure
Determine whether and how group participants plan to finance these typical life-cycle events and needs and what are their coping mechanisms
Determine what participants' think they can do to improve their ability to meet life cycle financial needs.

METHOD:
Participants rate life cycle events according to **degree of financial pressure** they cause.
Recorder documents discussions among participants as they complete the assessment of life cycle events.
Moderator asks the group questions to understand the implications of the life cycle events on households, their current coping mechanisms and needs for financial services.

TIME: 2 hours

PREPARATION:
Focus groups of 6-8 SHG participants arranged
focus groups represent different target groups (rural/urban, old/young, women/men, etc)
Find a closed area in which the discussion can take place undisturbed.
Have a chart and marker ready
Have enough small stones, seeds or bottle tops to show level of pressure (maximum 5 per event)
Cards for life cycle events
Select and train facilitators and recorders
Pre-test the activity and discussion guide.

[13] Based on Microsave's Participatory Rapid Appraisal for MicroFinance – A Tool Kit, May 2002

PROCEDURES:

Step 1. Introduce the Focus Group Discussion

1. Welcome the participants and thank them for coming.

2. Introduce the team. If you are working in two languages, the moderator should welcome the group through a direct translation. This gives a strong impression of their involvement in the session.

3. Explain the following.

Your group has been selected to participate in a special meeting. We would like to learn more about the events in your life that require significant expenditures and how you manage these. Your opinions are very important for helping us identify ways to improve financial services. I will be leading the meeting.

______________________________*will take notes and assist me.*
(Introduce the recorder.)

Names will not be recorded in the notes or in the presentation of results.

4. Ask the group participants to introduce themselves.

5. Explain the rules of the meeting.
    - This meeting has special rules that must be followed so we can obtain the information from your group and other groups we will talk to completely and correctly.
    - We will ask that you participate in an exercise to discuss the importance of various life cycle events and the money you need to address them.
    - There will be a conversation after the exercise to answer some questions.
    - We want to hear the opinions of everybody on the topics we are going to treat. The opinions of each of you are very important.
    - We have several important topics to cover so I will ask you to concentrate and not go off "from the trunk to other branches." Sometimes I may need to ask the group to return to the topic at hand.
    - Ask if there are any questions.

Step 2. Identify key life cycle events

1. Ask the participants the following.

What are the key household events or milestones that require significant expenditure from the moment that the household is established to death?
[Note to Moderator: Explain that a life cycle event is different from a "recurring" event such as food or rent. A life cycle event is one that does not occur so frequently.]

2. Write each suggestion on a card. When six suggestions have been given, work with the participants to lay the cards out in "life cycle order" starting from when they leave their parents' house to set up their own house until their death. Screen out recurrent expenditures and generate additional examples of events requiring sums of money larger than those that the participants usually have around the house.

3. Draw a life-cycle chart on paper and layout the cards along the horizontal axis of the chart.

4. Give the participants small stones. Ask them to put the stones in the columns for each key event/need to show how much need there is for lump sums of money or the "financial pressure" there is to pay for that event.
[Note to Moderator: "Financial pressure" can be a difficult concept to understand. Make it clear that it is not an amount of money that determines the number of counters to use, but rather the "pressure" involved in coming up with the money.]

5. Let them discuss. Listen and record important points made by the women.
[Note to the Recorder: Record the conversations that the group has as they decide how many stones to place and where to place them. Remember, the discussion is probably more important than the chart itself. Take lots of notes!]

6. When they have completed the analysis of "financial pressure" for each life-cycle event, probe how they amassed the lump sums to meet these---through savings, borrowing, etc.

Use questions such as the following.

- How do you prepare for life cycle events?
- What savings mechanism do you use? Where do you save? How? For how long?
- From whom do you borrow? How much? At what interest rate? What repayment period?
- How easy is it to get the loan? How long does it take to get the loan?
- How do you cope with unexpected difficulties when they occur?
- How can financial services be improved to help you deal with financial pressures caused by life cycle events.

7. Copy the final chart into your notebook.
It should look something like this.

LIFE CYCLE CHART

Maximum					*				
		*			*	*			
Financial Pressure		*		*	*	*		*	
		*		*	*	*	*	*	*
Minimum	*	*	*	*	*	*	*	*	*
Life Cycle Events	Establish House-hold	Marriag e	Birth of Child	Children in School	Child-ren's Marriag e	Pro-longed Illness	Death of Parents	Retire-ment	Death of Spouse

FOCUS GROUP GUIDE: SEASONAL FLOWS OF INCOME, EXPENDITURE, SAVINGS AND CREDIT[14]

Name of community/group: ____

Date of Discussion: ____

No. of Participants in the Group: ____

No. of Men ____________________ No. of Women ________________________

Socio-Economic Status (Please circle one per line):

Poor	Moderate	Vulnerable Non-poor
Literate	Illiterate	
Rural	Urban	Peri-urban

PURPOSE:
To assess the seasonal cash flows of existing and prospective microfinance institution clients, and their needs for and use of credit and savings services.

OBJECTIVES:
To assess seasonal flows of income and expenditure.
To assess use of credit and savings services.
To identify demands and needs for credit and savings services.
To identify demands and needs for business development services (as possible).

METHOD:
Focus group participants complete a seasonality chart of income, expenditure, savings and credit flows
Recorder documents discussions among participants as they complete the calendar.
Facilitator (moderator) asks focus group questions to interpret the calendar and identify use of and demands for financial services.

TIME: At least 2 hours

PREPARATION:
Focus groups of 6-8 SHG members arranged

- use members that are relatively homogenous for each focus group
- find persons that are familiar with the community in terms of general patterns of income, expenditure, savings and credit and business strategies
- focus groups represent different types of target groups (rural/urban, women/men, traders/services, etc.)

Find a closed area in which the discussion can take place undisturbed.
Review and revise draft calendar and discussion guide
Draw large calendar on manila paper for each team.

[14] Based on Microsave's Participatory Rapid Appraisal for MicroFinance – A Tool Kit, May 2002

Small stones/beans/seeds/bottle tops (maximum 5 per variable per month)
Select facilitators and recorders.
Train the facilitators and recorders in focus group techniques
Pre-test the discussion guide and revise as needed.

PROCEDURES:

Step 1. Introduce the Focus Group Discussion

1. Welcome the participants and thank them for coming.

2. Introduce the team. If you are working in two languages, the moderator should welcome the group through a direct translation. This gives a strong impression of their involvement in the session.

3. Explain the following.

Your group has been selected to participate in a special meeting. We would like to learn more about your financial management and use of financial services. We want your opinions about what the types of financial services you need. I will be leading the meeting.

______________________________*will take notes and assist me.*
(Introduce the recorder.)

Names will not be recorded in the notes or in the presentation of results.

4. Ask the group members to introduce themselves.

5. Explain the rules of the meeting.

   - This meeting has special rules that must be followed so we can obtain the information from your group and other groups we will talk to completely and correctly.
   - We are going to use a calendar to learn about how money flows in and out of your household.
   - There will be a group conversation after the calendar exercise to answer some questions.
   - We want to hear the opinions of everybody on the topics we are going to treat. The opinions of each of you are very y important.
   - We have several important topics to cover so I will ask you to concentrate and not go off "from the trunk to other branches." Sometimes I may need to ask the group to return to the topic at hand.
   - Ask if there are any questions.

Step 2. Fill Out the Seasonal Calendar

Ask the group how they track a one-year period. Is it by months, seasons or other events? Fill in the calendar column headings with periods that the group understands.

A. Income

Please start with the income row. Place the maximum number (5) of small stones (or whatever they are using) on the months when you get the most income.

Let the group discuss and place the small stones to show the relative **income** derived in these months.

[Note to the Recorder: Record the conversations that the group has as they decide how many stones to place and where to place them. Remember, the discussion is probably more important than the calendar chart itself. Take lots of notes!]

When they have finished the income line ask them the following questions. Use probing questions to obtain more information after each question to avoid getting vague answers.

For example:

- That is very interesting. Could you explain further?
- Would you give me an example of what you mean?
- I don't think I fully understand. Please tell me more about how [rephrase the question]

Questions:

- In what period do households receive the highest cash income?
- What are the most important sources of income for the household? What are the income generating activities people do here?
- Who carries out the different types of activities?
- What problems do people face in their income generating activities?
- (Probe: What problems with markets? Inputs? Production techniques? Money management? Transportation? What else?)
- Where do people get help to improve their income generating activities?

B. Expenditures

Next ask the group to fill out the **expenditure** line using the same process as above. Record their conversations.

After they are done ask the following questions.

Questions:

- In what months do the highest expenditures occur?
- What are the expenditures for? (Make sure they include loan repayments.)
- When is food plentiful and when is it scarce?
- How do you manage when you have expenditure needs and the money is not available?
- What ways do you try to reduce costs or minimize unnecessary expenditures?

C. Credit

Next ask the group to fill out the **credit** line using the same process. When they are done, ask them the following:

- What are the main sources of credit? What other sources of credit are there?
- (Probe for informal as well as formal sources.)
- Why are the sources of credit used? (Probe for what they like about the various sources; problems they have with various sources of credit.)
- What are the terms and conditions? What is the interest rate charged?
- Which period is credit needed and for what uses?

D. Savings

Next ask the group to fill out the **savings** line using the same process. When they are done ask them the following:

- Where and in what form (in-kind, cash) are savings made? (Are there ROSCAs, relatives, other organizations, friends, deposit collectors, etc that provide savings services?)
- What are the "rules" for savings with these groups? (amount, frequency of deposits and withdrawal, voluntary savings)
- Where and how are savings kept?
- What interest is paid on savings?
- What are the advantages of various savings services?
- What are the disadvantages of the various savings services?

Step 3. Check the rationale of the results of the calendar exercise.

The moderator should look at each column. If participants' responses do not make sense or there are anomalies, check with the group why these exist. For example, there might be an excess of expenditure over income in one month and a demand for credit. But despite this, participants are saving. Ask them why this is happening. There is usually a good reason.

The Calendar (Examples)

Month	Jan	Feb	Mar	Apr	May	June	July	Aug	Sept	Oct	Nov	Dec
Income												
Expenditure												
Savings												
Credit												

Month	Dry Season	School Starts	Planting Season	Rainy Season	Harvest	Festivals
Income						
Expenditure						
Savings						
Credit						

SAVINGS INTERVIEW GUIDE

Name of community/group: ______________________________

Date of Discussion: ______________________________

No. of Participants in the Group: ______________________________

No. of Men ______________ No. of Women ______________

Poor	Moderate	Vulnerable Non-poor
Literate	Illiterate	
Rural	Urban	Peri-urban

1. Economic Activity______________________________

1. Do you have savings? Where do you keep your savings?
2. Why do you keep your savings there? (probe about interest on deposits, safety, accessibility, etc.)
3. Why are you saving?
4. How many times have you withdrawn your savings in the past 6 months?
5. How did you use this money?
6. Who decided how to use this money?
7. If you had not had this savings, what would you have done?

FINANCIAL SECTOR TREND ANALYSIS

Name of community/group: ____

Date of Discussion: ____

No. of Participants in the Group: ____

No. of Men ____________________ No. of Women ________________________

Socio-Economic Status (Please circle one per line):

Poor	Moderate	Vulnerable Non-poor
Literate	Illiterate	
Rural	Urban	Peri-urban

PURPOSE:
To determine which financial services have been used over time, how and why use has changed.

OBJECTIVES:
To identify financial services available in the area from both formal and informal sources.
To assess the change in use of the financial services over time.
To determine which financial services participants like most and why.

METHOD:
Interviewers create a chart with sources of financial services both formal and informal and four columns indicating different time periods. (See attached.)
Moderator asks questions to assess availability, use and satisfaction with financial services.
Recorder documents discussions among participants.

TIME: At least 2 hours

PREPARATION:
Focus groups of 6-8 SHG members arranged

- Focus groups represent different types of target groups (rural/urban, women/men, traders/services, etc.)

Find a closed area in which the discussion can take place undisturbed.
Review and revise financial services matrix and discussion guide
Obtain small stones/beans/seeds/bottle tops (maximum 5 per financial service per period to indicate the use level of financial services available)
Select facilitators and recorders.
Train the facilitators and recorders in focus group techniques
Pre-test the discussion guide and revise as needed.

Step 1. Introduce the Focus Group Discussion

1. Welcome the participants and thank them for coming.

2. Introduce the team. If you are working in two languages, the moderator should welcome the group through a direct translation. This gives a strong impression of their involvement in the session.

3. Explain the following.

   Your group has been selected to participate in a special meeting. We would like to learn more about your financial management and use of financial services. We want your opinions about what the types of financial services you need. I will be leading the meeting.

   ______________________________*will take notes and assist me.*
   (Introduce the recorder.)

   Names will not be recorded in the notes or in the presentation of results.

4. Ask the group members to introduce themselves.

5. Explain the rules of the meeting.

   - This meeting has special rules that must be followed so we can obtain the information from your group and other groups we will talk to completely and correctly.
   - We are going to use a calendar to learn about how money flows in and out of your household.
   - There will be a group conversation after the calendar exercise to answer some questions.
   - We want to hear the opinions of everybody on the topics we are going to treat. The opinions of each of you are very y important.
   - We have several important topics to cover so I will ask you to concentrate and not go off "from the trunk to other branches." Sometimes I may need to ask the group to return to the topic at hand.
   - Ask if there are any questions.

Step 2. Fill out the Financial Services Matrix for This Year

Work with participants to review, edit and develop/expand the list of financial services asking the following questions:

What are the sources of loans, savings and other financial services that are available in this community? (Check the prepared list and delete services that are not used and add services that are used and not mentioned.)

Probe: What other sources of financial services are there in this community?

[Note to the Moderator: In many places, people are unwilling to admit to the existence of interest-earning money-lenders working in the communities, so tactfully probe to ensure all informal sources of financial services are reported.]

Ask participants to place a maximum of 5 stones in the column “This Year” next to the financial service to indicate the degree of use of the service this year.

Listen carefully to the participants as they complete their work.

Ask probing questions when they are done to explore:
For what purposes do you use the various types of financial services?
Why do you use ……… financial service the most?
Why do you use……….financial service the least?

Step 3. Fill out the Financial Services Matrix for Last Year, 5 Years Before, Ten Years Before

Ask the participants to put up to five stones in each of the different columns for each financial service to indicate the degree of the use of the financial service at different periods in the past.

Listen to the participants to understand why and how the financial services have been used over time.

Ask the following probing questions at the end if they have not already been answered.

- Why has the use of this service increased/decreased/stayed the same over time?
- Which services are more likely to be used by women? By men? Why? How and why has this changed over time?
- Which services are more likely to be used by the very poor? The not-so-poor? How and why has this changed over time?

Thank the participants for their help.

Financial Service	**This Year**	**Last Year**	**Five Years Before**	**Ten Years Before**
Formal:				
Formal bank: savings account; current account; deposit account; loan account				
Community bank				
Insurance company: life, health/accident, pension or other policy				
Formal employee pension or insurance scheme				
Building society loan or savings account				
Leasing company loan				
Post Office savings account or savings certificates				
Cooperative societies				
Semi-formal:				
MFI group-based savings and loan, or loan-only membership				
MFI individual savings and or loan account				
Credit Union (or Thrift and Credit Co-operative, or FSA)				
Informal:				
Moneylender				
Pawnbroker				
Deposit collector (private for profit, usually charging a fee)				
Money guard (employer, senior relative, patron etc.)				
Saving at home in a money box				
ROSCA (a cash round: a rotating fund received equally by all in turn) [ESUSU, ADASHI, ETOTO]				
ASCA (a non-rotating fund built by pooled savings from which some members borrow)				
Savings club (no loans)				
Reciprocal lending arrangements				
Informal insurance fund (e.g. by market traders to guard against a fire)				
Burial funds and other informal insurance for personal uses				
Saving with a supplier (who supplies goods/materials to saver)				
Event-specific contribution arrangements (e.g. we all pay 5,000 naira when a birth occurs)				

ANNEX E

Chart of Field Visits

ASSESSMENT TEAM SCHEDULE AND FIELD VISITS (STATES) BY TEAM MEMBER

Team Members	Firm	February: Week 1	Week 2	Week 3	Week 4	March: Week 5	Week 6	Week 7	Week 8
		S M T W Th F Sa	S M T W Th F Sa	S M T W Th F Sa	S M T W Th F Sa	S M T W Th F Sa	S M T W Th F Sa	S M T W Th F Sa	S M T
		1 2 3 4 5 6 7	8 9 10 11 12 13 14	15 16 17 18 19 20 21	22 23 24 25 26 27 28	29 1 2 3 4 5 6	7 8 9 10 11 12 13	14 15 16 17 18 19 20	21 22 23
Douglas Leavens Team Leader Microfinance Specialist	CII	ABUJA	ABUJA	A, LA, A	ABUJA	A, EDO, A	ABUJA	ABUJA	
'Olu' Olubunmi Adetunmbi Microfinance Specialist	DA	ABUJA	ABUJA	LAGOS	OG ON OY, A	A, K D, A	ABUJA	LA, ABUJA	
Stephanie Charitonenko Deputy Team Leader Microfinance Specialist	CII		ABUJA	LA, ABUJA		ABUJA	ABUJA	ABUJA	
Isaac Agbola Agricultural/Rural Finance Specialist	DA		ABUJA	A, KD KN, A	LA OY, AB EB, A	A			
Ronald Bielen Microfinance/Rural Finance Specialist	CII	ABUJA	ABUJA	A, KD KN, A	LA OY, AB EB, A	ABUJA	ABUJA	ABUJA	
Samuel Adebiyi Banking Policy Specialist	DA		ABUJA	ABUJA	ABUJA, LA	A			
Steven Goune Microfinance Specialist	VA				A, OG ON OY, A	A, K D, A			
Michelle Oliva Project Operations/Knowledge Management Specialist	CII	ABUJA/FCT	ABUJA/FCT	ABUJA	A, LAGOS	A, EDO, A	ABUJA	ABUJA	
Olatoyosi Kolawole SME Finance Specialist	CII				A, LAGOS	A, EDO, ABUJA			
Kathleen Stack Microfinance Specialist	FFH				A, PLATEAU BAUCHI	A, CROSS RIVER, A			
Dennis Ityavyar Gender Specialist	CII				A, PLATEAU BAUCHI	A, CROSS RIVER, A			
Mohamed Khatouri Monitoring & Evaluation/GIS Specialist	CII				A	A, K D, A	ABUJA		
Laurel Druben Deputy Team Leader Project Design/Integration Specialist	ITI					ABUJA/FCT	ABUJA/FCT	ABUJA/FCT	
George Oligbo Administrator	CII	ABUJA	ABUJA	ABUJA	ABUJA	ABUJA	ABUJA	ABUJA	A
Cordelia Chioma Dike Administrative Assistant	CII	ABUJA	ABUJA	ABUJA	ABUJA	ABUJA	ABUJA	ABUJA	A

= Workday = Sunday during assignment = Not working

STATES VISITED PLUS ABUJA/FCT (A)

Abia (AB)	Edo (ED)	Ogun (OG)
Bauchi (B)	Kaduna (KD)	Ondo (ON)
Cross River (CR)	Kano (KN)	Oyo (OY)
Ebonyi (EB)	Lagos (LA)	Plateau (PL)

ANNEX F

MSME Finance Models that Work: Philippines MABS and Uganda SPEED

MSME Finance Models that Work: Philippines MABS and Uganda SPEED

PRISMS has a unique opportunity to adapt two models of best practices with regard to providing financial and non-financial services to non-farm enterprises as well as agriculturally-based MSMEs operating at various points of the commodity value chain. The Philippines Microenterprise Access to Banking Services (MABS) Program is an example of a highly successful project geared toward expanding non-farm microenterprise access to sustainable microfinance by introducing specialized microfinance units within rural banks (similar to the community banks in Nigeria). The approach has paid off as over 95% of 132 participating rural bank units continue to operate their microfinance units, and at a profit. The Uganda Support for the Promotion of Private Enterprise (SPEED) Program represents another highly successful project that has expanded access to microfinance. While MABS focused on non-farm microenterprises, however, SPEED successfully taps MSMEs within the agriculture sector as well. Results and key success factors of both projects are described below.

Philippines Microenterprise Access to Banking Services (MABS) Program

Introduction. In 1998, USAID/Philippines along with the Rural Bankers Association of the Philippines (RBAP) initiated the MABS Program. The primary objective of this program was to work with rural banks to assist them to develop the capability to profitably provide financial services – both loan and deposit services – to the microenterprise sector. Since this program started more than six years ago, MABS participating banks have disbursed approximately $60 million[15] to more than 114,000 microentrepreneurs. The MABS program is working with 132 rural bank units[16] in the Philippines to help them profitably serve the microenterprise sector by not only transferring knowledge but also converting rural bankers into "true believers" in microfinance best practices and building their long-term capacity to successfully apply them.

> **Rural Banks as Ideal MFIs**
>
> *"… rural banks offer excellent geographic coverage. They are culturally and geographically close to the microentrepreneur and most rural bankers have established personal familiarity and relationships with the microenterprises in their areas".*
>
> Source: Maria Lourdes Pineda
> Compliance Officer, Rural Bank of Santo Tomas

The program focuses not only on developing appropriate microfinance loan products but also deposit mobilization strategies. It was noted that savings services are an important financial service that the poor needed as much or more than credit services. Without access to savings accounts, many poor people, especially the rural poor, have no convenient or safe place to store their savings. Banks are also encouraged to rely on savings mobilization strategies rather than external loans or wholesale funds to expand their lending portfolios. Total microdeposits accounts of the MABS participating banks as of December 2003 stood at 482,488 with PhP541 million ($10 million) in microdeposit balances.[17]

[15] Annual amounts in pesos are converted to US dollars using the average exchange rate for the month of December.
[16] Banking units include head offices and branches of the 55 MABS Participating Banks
[17] Micro-deposits are defined as deposits below PhP15,000 ($273).

By creating systematic processes for introducing microfinance to rural banks, MABS has facilitated the rapid expansion of microfinance in the Philippines. During the first phase of the MABS program, a systematic method for transferring microfinance best practices knowledge to rural bankers through a comprehensive technical assistance and training package, known as The MABS Approach, was developed (see adjacent box). This effort helped MABS to have a significant impact, allowing it to expand from its four original participating banks in late 1998, as demand for MABS' services increased, to now serving 132 rural bank branches. In terms of social impact, MABS participating banks predominantly serve female microentrepreneurs (85%) and almost all clients served by MABS participating banks are at or below the poverty threshold. In an impact study, almost half of all clients reported balance of participating banks' microfinance portfolios of only $124 at the end of December 2003, MABS has demonstrated that rural banks can serve the rural poor, in terms of both savings and lending, and make a profit in the process.

Key Elements of the MABS Approach

The MABS Approach includes intensive one-on-one technical assistance, workshops, seminars, in-bank coaching, and exposure and training visits to participant banks. Each bank is assigned a technical advisor who makes sure that the training and technical assistance are being delivered properly and efficiently. Each participant bank receives focused attention and support, which includes the following from MABS:

- Institutional Assessment
- Senior Management Orientation
- Market Research
- Product Development/Enhancement
- Business Planning
- Loan Administration & Management
- MIS Enhancement
- On-the-Job Training (including sessions on cashflow lending and zero tolerance towards delinquency)
- Development of In-House Training Capacity
- Operations Review

MABS' work with client banks yields the following results: development or enhancement of microfinance products, practices and procedures that follow best practice principles; implementation of a profitable microfinance line of business; and strengthened capacity not only to manage the microfinance operation, but to continually expand it. The general pattern of the MABS approach is to build up and then phase out the level of dedicated technical assistance and training.

Source: MABS 2004.

Enticing Bankers with Results. At first, many rural bankers were skeptical and doubted whether microfinance could be a profitable venture. However, as the program gained credibility and a few rural banks began to demonstrate the profit potential, many other rural bankers became interested in microfinance and demand for MABS' services increased. All 20 of the initial participating banks achieved profitable microfinance units ahead of schedule. In the financial projections, banks were expected to breakeven by the 12th month of their microfinance loan operations, but some banks posted positive cumulative net income as early as the 5th month.

Sustainability of MABS Program Achievements. In order to develop local capacity to continue the MABS technical assistance efforts after the phase-out of the USAID-financed technical assistance provided by Chemonics International, the MABS program has developed the capacity of two licensed service providers, local consulting firms that have been trained to offer *The MABS Approach* to additional rural banks. The MABS Service Providers will continue to provide microfinance technical assistance and training to interested rural banks even after the USAID project ends. As part of *The MABS Approach,* a heavy emphasis is placed on developing the rural banks' ability to conduct market research and to develop products that are responsive to the needs of microenterprises. A combination of classroom training and one-one-one technical assistance is offered on the following topics: market research, product development, financial projections, cashflow-based lending, enforcing zero-tolerance toward delinquency, internal control and fraud prevention, and microfinance loan administration and management. In addition to helping rural banks develop the capacity to profitably expand their loan and deposit portfolios to microenterprises, some have found that their traditional operations are also benefiting from the MABS' best practice principles.

MIS Development. In collaboration with almost 60 rural banks the MABS program also developed a windows-based banking software program, Rural Banker 2000 or RB2000, which is easily adaptable to the specific product mix of any rural bank, including microfinance services. RB2000 consists of basic banking modules for 1) deposit management, 2) loan management, and 3) general ledger accounting. The system also includes support modules for 1) financial product design, 2) cash dispense and ATM interface, 3) assessing charges, fees and taxes, and 4) general ledger interface. The system was also designed to meet the new electronic reporting requirements of the BSP. In order to ensure local support for RB2000 and to facilitate the rapid expansion of the program among rural banks, MABS is working with three private service providers who are independently installing this program throughout the country.

Keys Success Factors

Market Study. All banks are encouraged to carefully study the market in order to properly understand the microenterprise and low income sectors and develop loan and deposit services that clients can use and need. It also assists the bank to better understand the market and microfinance business opportunities. MABS has designed easy-to-use tools and survey forms that banks can utilize to assess market potential, collect information on the microenterprise sector, and analyze the competition from the formal, semi-formal, and informal players to better improve the design or enhance the savings service they offer.

Business Planning. It is important for banks to develop a business plan to determine the potential profitability of their loan product. MABS has developed a simple-to-use excel-based financial projection tool that allows banks to project future income and cashflows from their microfinance operations utilizing various interest rate scenarios to price their products competitively in order to earn a positive return.

Product Development. After conducting a market study, preparing an initial concept paper, and a business plan, banks are taught to carefully document all loan procedures and policies. The MABS Approach provides participating rural banks with a generic loan operations and procedures manual in electronic form that is then carefully customized with the bank operations staff.

Loan Administration and Management. Bank loan officers are taught to analyze both the character and the capacity of potential clients to repay loans by analyzing the cashflow and conducting appropriate credit/background checks. Proper procedures are also put in place to facilitate the rapid processing of loan applicants. First time borrowers are processed within one week and repeat clients are processed within one day. As part of The MABS Approach, a computerized management information system that monitors loan officer productivity, portfolio quality, and institutional efficiency is required of participating banks. Bank management is then taught how to properly monitor and manage their microfinance operations on a regular basis. Commitment from management to regularly monitor the performance of the unit has been crucial for banks that have successfully expanded their microfinance operations.

Zero-Tolerance Policy. As part of the effort to overcome the negative impacts of poorly-designed past government efforts to target poor rural borrowers, MABS advocates a zero tolerance policy for past due loans. “Zero tolerance” simply means that late payments are not acceptable and will hinder the borrower’s ability to access a subsequent loan. This message is instilled in the rural banks’ management and staff and, through them, communicated to borrowers. This policy has been extremely successful in helping the rural banks manage their microfinance portfolios with low levels of delinquency. Collectively, the microfinance units of

MABS' participating banks have maintained a portfolio-at-risk (PAR) ratio[18] of approximately 3%.

Customer Service. It is important for banks to treat all clients, especially microenterprise clients, as business customers of the banks rather than as "beneficiaries." Excellence in customer service is essential for retaining microenterprise clients.

Savings Mobilization Strategies. Mobilizing deposits not only provides an important service for rural and low-income clients but it also helps to induce a more demand-driven approach to financial services and, therefore, improves efficiency and profitability of rural banks. In designing microsavings services, it is important to analyze the market so that appropriate products are offered to meet client needs in terms of liquidity, return, and security. Under The MABS Approach, rural banks are encouraged to look at innovative ways to reduce the operating costs associated with managing small accounts(see adjacent box).

The "Ganansya Box" – Reducing the Transaction Costs of Savings Mobilization

Among the many services offered by several MABS participating banks include the use of savings boxes, which are called "Ganansya Boxes" or "Profit Boxes." This simple but innovative approach to offering small savings services grew out of the need to reduce the high transaction costs that were associated with daily and weekly pick-up of deposits from savers. These savings boxes have a small lock with the key that is kept by the bank tellers. When the client comes in with his/her "Ganansya Box", the bank teller opens the lock and deposits the funds to the client's bank account.

Several banks realized that the age-old concept of the "piggy bank," which was widely practiced in the Philippines, could also be used as a way to encourage people to build up their savings on a regular basis and capture these savings in the bank. They began offering this box as an alternative to the pick-up savings services. This innovative approach to offering small-scale savings services is now being copied by many other rural banks as a way to cut down on savings transaction costs.

Source: Owens and Wisniwski 1999.

Investment in Human Resource Development. The most successful rural banks are those that invest in their staff and who have strong management teams. Education is the most important investment a bank can make in order to increase productivity and efficiency of their operations. Incentive systems are also offered in the more progressive and successful rural banks.

Uganda Support for the Promotion of Private Enterprise Expansion and Development (SPEED) Program

Introduction. In 2001, the SPEED program was funded by USAID/Uganda with the mandate to increase:

- The use of financial services by small and medium enterprises (SMEs) by packaging business opportunities in which both MFIs and financial institutions (FIs) can participate;
- Levels of effective demand for Business Development Services (BDS) through improvements in the range and quality of services and providers; and
- The capacity of the commercial justice system to respond to business needs.

SPEED promotes USAID/Uganda's SO7 by facilitating the provision of financial, business environment and business capacity services to activities that will result in expansion of sustainable economic opportunities, particularly in rural areas. The project has three main technical goals: expanding financial services to meet the requirements of business growth, building business capacity of both enterprises and service providers, and improving the business environment.

[18] PAR is calculated as outstanding balance of micro-loans more than 30 days due over total gross micro-loan portfolio.

Results. SPEED initiatives have changed the project marketplace and, therefore, the nature of the activities in which SPEED can successfully engage. Specific changes that can be ascribed to SPEED are described below in terms of SPEED's three major project components.

Financial Services

- Facilitated passage of MDI legislation; readied six (target was three) microfinance institutions to apply for MDI status under the newly passed legislation.
- Assisted 6 of SPEED's nine partner MFIs to become profitable with loans outstanding increased by $9 million, or 96%, to $18.4 million.
- Facilitated flow of $8 million to MFIs from seven commercial banks.
- Expanded operations of leasing facility from $10.3 million to $16.6 million.
- Introduced financial sector interventions, such as DCA Guarantee program, SME lending training, Grow Your Business Program that led to increased lending to SMEs; DCA guaranteed 25 loans for $5.2 million in just 6 months, including loans in key subsectors such as fish, cotton, and oil seed processing.
- Increased flow "missing middle" loans by 54%.

Business Capacity

- Developed and introduced market-linked enterprise development model that uses private sector initiative and buy-in to drive agricultural expansion and build demand for financial and business development services; the model under implementation is working to reach 78,000 farmers.
- Established market-linked initiatives in coffee, cotton, fish and dairy that are now being integrated into USAID's new economic cluster activities.
- Supported establishment of two profitable BDS practices and assisted them to design and extend business growth services in conflicted areas in the north.

Financial and Business Environment

- Established the Long-Term Debt Working Group, a gathering of high-powered financial leaders from both the private and public sector, to address approaches to identifying and introducing appropriate debt mechanisms to support private sector growth.
- Established the Leasing Working Group to develop legal, regulatory and tax proposals that, when implemented, will have substantial positive impact on the availability of financing for SMEs.
- Developed Center for Arbitration, Dispute and Equitable Resource (CADER) into a professional business services organization.

- Rehabilitated and reorganized the commercial registries, with completely new records handling systems in place in both the land and companies registries.

Key Success Factors. Four attributes of the project have enabled these results under SPEED and each is described below.

SPEED as a Development Services Catalyst. From the outset, it was determined that SPEED would function as an effective intermediary and catalyst – finding ways to use its resources to add value to work underway and/or planned by others in the project marketplace. SPEED's cross-cutting focus on financial services, business capacity, and business environment supported the project's ability to enter the marketplace by finding ways to locate and add value to the more narrowly/sectorally focused initiatives of others, whether businesses, associations, or SO7 partners. Over the past 20 months, SPEED has become skilled at bundling and packaging development services and at working with key marketplace players -- private firms, sector leaders, bank directors -- to develop and implement market-driven responses to effective subsector development. And while SPEED is largely private sector-driven and focused, its approach has been singularly successful at building and implementing effective public and private sector partnerships. SPEED, as an effective development services catalyst, is positioned to play increasingly important roles in support of USAID SO 7 activities.

SPEED as a Financial Leader. The core challenge of the SPEED project is to increase financial flows to MSMEs, more specifically to the "missing middle," (companies requiring access to finance in the range between $2,000 and $250,000). To meet this challenge, SPEED identified ways to facilitate the ability of financial leaders and institutions to play expanded roles in the development marketplace. SPEED established mechanisms and activities through which the financial community could get increasingly intrigued and engaged in finding ways to make innovative financing mechanisms and approaches work. SPEED's strategic plan for its work with the financial subsector called for establishing SPEED's identity as an honest broker, operating with staff and expertise clearly credible to the financial community and introducing programs through which the financial community could begin to participate in testing and developing new approaches. This approach, which has already resulted in increased financial flows to SMEs, has also positioned SPEED to expand its financial brokering and innovation roles in support of both its own activities and those of other SO 7 partners during 2003.

SPEED's Integrated Enterprise Development Growth Support Model. SPEED was challenged to increase the market demand for business development services (BDS). Assessment of the business development services market showed clearly that existing BDS programs were not addressing the economic growth requirements of SPEED's target clients; more significantly, they were not conceptualizing the nature of the BDS/Uganda challenge in ways that would drive the enterprise growth results that SPEED sought. The term BDS itself appeared to be donor, rather than market-driven, while SPEED's challenge was to create marketplace changes. SPEED's response was to identify and classify service providers – associations, consulting firms, NGOs, companies and individuals – in terms of the roles they must play in developing and supporting market-competitive subsector frameworks for enterprise growth. The linkage of these providers within market frameworks shifted their focus from pursuing donor-driven opportunities to building market share for services. The SPEED Integrated Enterprise Development Growth Model on the following page illustrates how SPEED's business capacity program works with clients operating at various points in the commodity chain to drive the use of financial and enterprise development services.

SPEED's Strategic Interventions. SPEED's ability to work across subsectors, to package different types of enterprise initiatives and to collaborate with a wide range of partners positions

SPEED to identify opportunities for entry into programs and projects at the points where support is most needed and critical to successful impact. It also positions SPEED to leverage its resources to best effect. SPEED's structure and approach are unique in the project environment. While other projects and programs are constrained to operate within strictly defined subsectors and/or with strictly defined methodologies, SPEED's ability to adjust its modalities and support – within a framework of results that can be calculated in terms of financial flows and enterprise growth – positions SPEED as a unique resource within the realm of development activities underway within Uganda.

SUPPLEMENTAL ANNEX 1

Policy Environment

A. Macroeconomic Policy

Weak and unsteady economic growth remained one of the key factors aggravating poverty in Nigeria. Throughout the 1990s, especially between 1992 and 1998, real Gross Domestic Product (GDP) averaged only 2.6%, well below an average population growth rate of 2.8% over the same period. In real terms, per capita income has also fallen by 75% in the last 20 years, with 70% of Nigerians living below $1 per day (USAID 2003a, p.40). Nigeria currently occupies the 152nd position on the global Human Development Index, coasting in also at the 54th position among 94 developing countries ranked on the Human Poverty Index. Nigeria's Gini Index (the UNDP's measure of uneven income distribution) was estimated at 50.6 in 2003, underlining the fact that not only has the Nigerian economy been sluggish in terms of growth, there is also an increasing disparity in wealth distribution within the economy.[19] Many factors have worked together to put Nigeria in this dismal state of poverty aggravation. They include the persistent structural rigidities in the economy, typified by near total dependence on oil revenues, incessant deficits arising from government fiscal operations, pervasive incidence of corruption and its attendant cost on the cost of doing business in Nigeria, etc.

The return of the country to democratic governance in 1999 gave the semblance of a break from more than two decades of economic slowdown. Not only did the country witness the return of several international donor agencies, the government itself made strong statements, and indeed embarked on some major policy reforms to halt economic decline. But the performance of the economy still remained mixed. In 2002 for example, GDP recorded a modest growth of 3.3%, down from 4.2% recorded in 2001. These rates are still very low, especially when viewed against International Development Agency's findings in 2002 that substantial poverty reduction in Nigeria would require an annual growth of about five percent in agriculture and 8-10% in the non-agricultural economy. Still in 2002, the fiscal operation of the federal government resulted in a deficit of N301.4 billion or 5.1% of GDP. The level of deficit was only 4.0% in the preceding year. The expansionary fiscal operations of all the three tiers of government in 2002 also triggered a liquidity overhang in the financial sector. Broad money (M2) increased by 21.5% as against a growth target of 15.3% while narrow money (M1) rose by 15.9%, relative to a target of 12.4%[20].

Some policies and programs targeted at stimulating growth and redressing inequity have either been introduced already or are still being formulated. Some of these programs and policies are examined below, but since the tasks ahead are much more daunting, greater display of economic discipline and rigid commitment to persistent and sustainable growth have become matters of utmost importance. Government may actually need to halt all the remaining ill-designed policies and programs of the past and in their place introduce more market-oriented policies, which emphasize fair and equitable access to productive opportunities/resources. Specifically, the clearly disadvantaged micro-enterprises sub-sector, which has benefited more from private sector initiatives than government's, must be moved to the front of the burner – not as a weakling to be propped, but as a potentially virile business sub-sector that is in dire need of access to necessary infrastructure and other inputs that would aid it in maximizing its productivity and other business potentials. Already, a draft National Micro-finance Policy is being produced as a direct follow-up to the international conference on micro-finance which took place in 2000. The draft would be

[19] UNDP (2003): HDR 2003 – MDGs: A Compact Among Nations to End Human Poverty; Oxford
[20] Central Bank of Nigeria: Annual Report and Statement of Accounts, 2002

finalized after subjecting it to a detailed review by all stake holders, including international experts in microfinance.

In view of the heavy dependence of Nigeria on revenues accruing from petroleum activities, government fiscal activities have persistently been shaped by developments in the international oil market. In 2002 for example, government programs were seriously constrained by declining oil receipts and at the end of the year, a fiscal deficit of N301.4 billion (or 5.1% of GDP) was recorded. Unfortunately, government has not fully embraced or adopted the principle of saving for the raining day. Therefore, and in the absence of a buffer, its fiscal operations have been swinging in the same direction with price and supply (or quota) movements the petroleum market. One of the outcomes of the expenditure over-run in 2002 was a heightened pressure on price levels, resulting in an inflation rate of 12.9% recorded at the end of the year, as opposed to a target of 9.3% set at the beginning of the year. The actual inflation rate would have been higher, but for the good agricultural harvest (which is largely rain-fed) recorded during the year as well as the tight and proactive monetary policy stance of the CBN. Inflation however moderated slightly to 10.8% in October 2003.

B. Financial Sector Policies

In 2002, the Nigerian financial system comprised the CBN as the apex regulatory institution, 90 deposit money (or commercial) banks, 769 community banks, 6 development financial institutions, one stock exchange, 5 discount houses, 118 insurance companies, 80 primary mortgage institutions, 102 finance companies and 83 bureaux de change. To arrive at this point, there have been several reforms. For example, with effect from January 2001, the dichotomy between commercial and merchant banks was abolished and all the banks changed their licenses to one single universal banking license. The new license confers on each bank the right but not the obligation to operate in any segment of the financial market – capital market, money market and the insurance market – provided it has the relevant competence and can also satisfy the requirements of the regulators in each market. This new development has thrown up fresh challenges – especially those of supervision/surveillance and capacity building – both in terms of manpower and infrastructure.

Similarly, in order to maintain the health and robustness of the banking system, the CBN adopted in 2002 a contingency plan for isolating and resolving distress whenever it was sensed. This was through the initiation of a private-sector funded ‘lifeboat facility’, which banks with temporary liquidity problems can access. Under this arrangement, six of Nigeria’s largest banks agreed to grant special inter-bank support to banks with liquidity constraints, with the CBN acting as guarantor. The CBN is obliged to repay, within one week of default, the outstanding principal and accrued interest to any of the six lending banks. This lifeboat facility is given at 3.5% above the prevailing Minimum Rediscount Rate (MRR) and has a tenor of 90 days in the first instance, with an option of one roll-over, subject to a maximum tenor of 180 days. At the commencement of this arrangement in May 2002, which has further helped to strengthen cooperation and collaboration between the regulators and operators, N22.51 billion was granted to 11 banks, and four of them liquidated the facility within the time. Furthermore, the Dutch Auction System for foreign exchange management was re-introduced in July 2002 to moderate the problem of high and persistent demand pressure as well as its attendant effects on the exchange rate and the depletion of the nation’s foreign reserves. The CBN has also commenced a gradual implementation of the New Capital Accord by raising the capital adequacy ratio of commercial banks from 8% in 2003 to 10% in January 2004, but many challenges still lie ahead, including the promotion of a proper understanding of what has been described as a very complex and confusing accord document.

Because the activities of commercial banks in Nigeria have largely been urban-biased, the rural communities, where more than 70% of Nigerians live, have over the years been denied access to institutional funding. A World Bank-sponsored 1994 FAO report estimated that commercial banks supplied only 11% of rural dwellers' credit needs, while Rotating Savings and Credit Associations (ROSCAs) and family members supplied 40 and 30% respectively. These supplies – often short term and seasonal in nature – fell short of total demand. Those in need of medium and long term loans usually have no supply at all. To redress this bias, the Nigerian financial system has witnessed many state interventions over the last three decades primarily to improve access of farmers, the poor, the cooperatives and other target groups to financial services, as well as to enable them cultivate banking habits and achieve economic empowerment. Notable among these initiatives was the defunct ***Rural Branch Expansion Program*** introduced in 1977. Before this program, commercial banks in Nigeria had only 13 branches in the rural areas. However, under this program, the banks were allocated a certain minimum number of branches that must be opened in the rural areas within a specified period. For example, 200 rural branches were allocated under the first phase of the program which ended on June 30, 1980. Another 266 branches were allocated under the second phase, which ended on December 31, 1983 while under the third phase, which ran from August 1, 1985 to July 31, 1989, another 300 rural branches were allocated. The fourth phase of the program was suspended following the introduction of ***Community Banks (CBs)*** by the federal government in 1990. Out of a total of 766 branches allocated under the program, only 602 were opened, thereby bringing the number of rural branches of the urban commercial banks to 615. However, with the liberalization of the banking system in the late eighties by the CBN, most of these branches have been closed purely for lack of viability, and it is expected that CBs would fill the void.

Community Banks

Realizing the limitations of commercial banks to extend banking services to the rural communities on a sustainable basis, the then Directorate of Food, Roads, and Rural Infrastructure (DFRRI, established in 1987) addressed a memo to the Presidency on the need to establish CBs, and this was formally announced in the 1990 budget speech. The CB is designed as a unit bank, privately owned and managed by a community for mobilizing savings, creating credits, providing banking and other related financial services to its community. Originally, each CB is assigned a "catchment area", or a geographically delimited market in which no other CBs may operate, but this delimitation has today become tenuous. The number of CBs grew rapidly from 104 in 1991 to 1368 in 1995, when the issuance of provisional licenses by the National Board for Community Banks (NBCB) was suspended.

In July 1991, the National Board for Community Banks (NBCB) was established and charged with the responsibility for supervision and regulations of the CBs. The establishment of the Board and CBs were later given legal backing with the promulgation of the Community Banking Act No. 43 of 1992. The purpose of setting up CBs as indicated in section 1(1) of the Community Banking Act could be summarized as follows: (a) the promotion of rural development through the provision of banking and financial services; (b) the enhancement of rapid development of productive activities, especially in the rural areas; and (c) the improvement of the economic status of small-scale producers both in the rural and urban areas. At the inception of the community banking scheme, individual and Community Development Association's shareholdings were set at 5 and 30% respectively. However, this restriction on shareholding was lifted in July 2002 to enable interested investors decide on their shareholding, provided that they comply with the Companies and Allied Matters Act (1990) which requires that at least two shareholders shall incorporate a company. Furthermore, the Other Financial Institutions Department (OFID) has, through one of its circulars, classified CBs as SME as well as micro-credit institutions, implying that commercial banks can invest part of their funds, set aside under the Small and Medium Industries Equity Investment Scheme (SMIEIS), as equity participation in CBs. As at 2002, the minimum paid up capital for a CB is N5 million. This increase from N3 million was aimed strengthening the capital base of most of these banks, which have had virtually all their shareholders' funds eroded by accumulated losses.

Apart from the upward review of the share capital of CBs, there are a number of other policy initiatives, aimed at boosting the flow of finance to micro and small enterprises through the CBs. For example as from 2004, all agricultural lending by licensed CBs are eligible for coverage under the Agricultural Credit Guarantee Scheme Fund (ACGSF), operated by the CBN. Another policy initiative is their licensing by the CBN, which implies that their deposits can now enjoy insurance cover from the Nigerian Deposit Insurance Corporation (NDIC). The elimination or reduction of deposit losses in case a CB fails should, other things being equal, boost savings mobilization by the CBs. Closely related to this is the liberalization of interest rates operated by CBs. Until recently, the NBCB used to fix a cap for rates, but this has now become a matter of moral suasion only. Furthermore, OFID has assumed full responsibility for the supervision and regulation of CBs. Already, efforts have been initiated to have some of the inspectors in NBCB trained and transferred to the CBN. This move will ensure the adoption of best practices by the CBs and also improve corporate governance in the institutions.

Available records showed that a total of 769 CBs were in operation in 2002, compare to 747 in 2001. Out of this number, 282 had obtained final operating license from the CBN, while another 465 were asked to rectify some perceived lapses in readiness for licensing. Total assets/liabilities of reporting CBs stood at N15.5 billion in 2002 (or 0.6% of total commercial bank assets, implying that though CBs may have a wider spread and larger numerical strength, they constitute a negligible proportion of the banking system in terms of operating resources). Capital and reserves summed up to only N3.82 billion in the same year. The sectoral analysis of reporting CBs showed that general commerce dominated at 32.1%, followed by miscellaneous category at 24.4%. Manufacturing and food processing got 12.7% while agriculture and forestry got 9.1%. The average loan/deposit ratio stood at 22.5%, in contrast to 48% for commercial banks[21].

Performance of Community Banks in 2002

•	• **1998**	• **1999**	• **2000**	• **2001**	• **2002**
Number of Reporting Banks	569	471	506	128	316
Capital & Reserves N'm	1,479.3	2,048.6	2,773.6	1,034.8	3,825.6
Total Assets N'm	5,961.8	7,913.4	12,014.7	4,884.4	15,463.5
Deposit Liabilities N'm	3,870.8	5,102.8	7,689.4	3,294.0	9,669.2
Loans & Advances N'm	1,972.5	2,631.0	3,666.6	1,314.0	4,310.9
Investments N'm	244.7	436.7	450.2	304.3	925.5
Ave. Loan/Deposit Ratio	51.0	51.6	47.7	39.9	22.5
• **Sectoral Loan Distribution**					
Agric & Forestry N'm	607.2	918.2	1,613.7	77.6	390.5
Mining & Quarrying N'm	19.3	18.4	26.8	4.8	58.8
Manufacturing N'm	245.2	286.6	458.0	110.8	549.6
Real Estate & Construction	35.0	55.3	110.4	40.7	450.8
Commerce N'm	836.9	1,236.6	1,302.4	484.5	1,385.4
Transport/Communication	50.6	39.5	109.3	261.8	425.4
Others N'm	151.8	76.5	46.2	333.8	1,050.4

Source: CBN Annual Reports

Some of the challenges still lying ahead of CBs include the fact that they still have to clear their checks through commercial banks. However, this challenge is no longer limited to CBs alone, but to all commercial banks that are not "settlement banks" in view of the recent reform of the Clearing House. It is now mandatory for all commercial banks operating in the country to clear their checks through designated "settlement banks". There are only six of such banks as at

[21] Figures are from CBN Annual Report and Statement of Accounts, 2002

December 2003, out of a total of 90 commercial banks. The real challenge is actually for the CBs to clear their checks directly through the settlement banks, otherwise there may be a further bloating of costs if they clear their checks through banks that are not settlement banks. Another major constraint to improved performance is the level of skills available at the CBs. As they scale up to operate essentially as commercial banks (save only in some respects), the need for well-geared capacity-building measures to improve performance and compliance with regulations and also to bring about a drastic reduction in staff turnover cannot be over-emphasized. Given their numerical strength and extensive dispersal around the country, the current capability of the CBN to provide the type of supervision that CBs require is suspect. Perhaps another apex institution would not be out of place, committed to the specification and enforcement of standards in line with international best practice, as well as the performance of other promotional activities, but strictly on a commercial basis. The NBCB is gradually becoming irrelevant in the scheme of things and should possibly be wound up or reformed into CBs' apex bank and charged with more relevant and specific roles. At the moment, its status is unclear and may therefore just represent a waste pipe for budgetary resources.

Areas requiring further attention in the community banking system:

- Improvement in the quality of management in the CBs (i.e. capacity building)
- Continuous licensing of CBs and immediate extension of deposit insurance to the deposit of licensed ones
- Firm enforcement of prudential guidelines as defined for CBs
- Strengthening of OFID of CBN (especially the recruitment and training of inspectors) to assume effective control of supervision and regulation of CBs
- Promote strong partnership between commercial banks and CBs, such that CBs would be credit delivery channels for commercial banks. The definition of CBs as SMEs by the CBN makes it possible for SMIEIS funds to pass through CBs to micro-enterprises. Ditto for the new extension of ACGSF to CBs' lendings.
- Scrap NBCB and transfer their good inspectors to OFID of CBN

The Agricultural Credit Guarantee Scheme Fund (ACGSF)

The ACGSF was established in 1977 under CBN management with an initial share and paid up capital of N100 million and N85.6 million respectively, funded by the FGN (60%) and the CBN (40%). In December 1999, the share capital was raised to N1 billion, half of which was called up immediately. A further appeal in 2000 by the President of the Federal Republic that more capital be injected into ACGSF took the authorized capital to N3 billion. The CBN has fully paid its share of N1.2 billion while the federal government has only paid N1.05 billion out of its share of N1.8 billion, leaving an outstanding balance of N0.75 billion.

The ACGSF began operations in 1978 with the primary goal of encouraging banks to lend to agriculture by providing some form of guarantee against risks inherent in agricultural lending. In case of default, the lending bank is paid 75% of the loan in default by the Fund, net the amount realized by the bank from the disposal of securities pledged by the farmer. There is a wide range of securities, which could be pledged for loans and they include a charge on land, movable properties of the borrower, life insurance policy, stocks and shares, personal guarantee, and other more traditional forms of security acceptable to commercial banks.

The maximum loans which can be guaranteed by the Fund were originally fixed at N100,000 to individual farmers and N1 million to cooperative societies and other corporate bodies. Individual borrowers without tangible securities could also borrow up to N5,000. For this last category of borrowers, an introduction from a respected member of the community, usually a village head, would suffice. However, in response to increasing price realities and rising cost of farm operations, these limits were adjusted upwards with effect from January 2000. Thus, individuals without securities could borrow up to N20,000 under the scheme. Maximum borrowings by individuals and cooperatives/corporate entities were also raised to N500,000 and N5 million respectively.

The program provides coverage for all farming activities – food crops (comprising grains, tubers and roots), cash crops, livestock and fisheries. In order to ensure that loans are used for the purposes for which they are intended and foster repayment, the CBN organizes courses on finance and accounts for its Agricultural Credit Officers as well as their counterparts in the participating commercial banks. It also undertakes farm visits severally and jointly with officers of commercial banks in connection with pre-guarantee appraisals and post-guarantee monitoring of projects, and it investigates default claims submitted by the banks under the scheme. The CBN also holds regular meetings with farmers and officials of the participating banks, the Ministry of Agriculture at Federal and State levels, as well as other stakeholders on the operations of the ACGSF. As an incentive for efficient utilization of bank loans, farmers who benefit from loans under ACGSF and achieve outstanding performance in output, loan repayment, and adoption of good husbandry practices, are annually honored and designated as ‘farmers of the year’ and are presented with certificates of merit. Similarly, and beginning from 1995, the CBN introduced an annual award to the best bank – in terms of volume of lending – under the ACGSF.

From the inception of the program in 1978 to 1986, loans made under the ACGSF went to borrowers at concessionary interest rates. The justification was that the free market could not be relied upon to allocate adequate credit to smallholder agriculture, given the high risks associated with rain-fed agriculture and lenders’ high transaction costs associated with administering credit to widely scattered small-sized loans, which if fully passed to the farmers, would make their operations unprofitable. It was also widely believed that concessionary interest rate was one of the ways to redress the inequality between the ‘rich, urban economy’ and the ‘poor, rural communities’. The policy of subsidized interest rate was however stopped in 1986 following the deregulation of the financial sector within the framework of the Structural Adjustment Program (SAP). This move actually accorded with international best practice because rather concessionary interest rates achieving the intended policy effect, they have ended up encouraging corruption and credit rationing as well as weakening borrowers’ incentive to pay and lenders’ incentives for debt recovery. Moreover, concessionary interest rates usually create a bias towards accepting investment projects with low returns.

In view of what was perceived as a regime of high and discouraging interest rates to agriculture, the CBN introduced an Interest Drawback Program (IDP) in 2003, which aims at moderating the effective borrowing rate to farmers. Under this program, farmers who repay their loans under the ACGSF as and when due would be entitled to a refund of 40% of what they paid as interest on such loans. The sum of N2 billion has been earmarked for this program, to be contributed by FGN and the CBN in the same proportion as the share capital of ACGSF. The CBN has already paid its share of N0.8 billion. This program, which is expected to encourage timely repayment by farmers as well as encourage lending by more commercial banks under the ACGSF, is another interest subsidy, but it avoids the pitfall of upfront interest concessions such as resource wastes, loan diversion, corruption, exaggerated demand/credit rationing, market distortion/acceptance of projects with low returns, etc.

Summary Statistics on Loans Guaranteed. The number and value of loans guaranteed under ACGSF between 1978 and 2003 stood at 362,387 and N5.64 billion, respectively, but there have been three distinct phases in the Fund. The first phase was the period of a sustained increase in activities during the first twelve years (1978-1989), referred to by ACGSF management as the “pre-deregulation period”, with the cumulative number and value of loans guaranteed reaching 34,518 and N129.3 million respectively by 1989. Activities under the scheme peaked in 1989, after which they started declining as a result of high default rate by farmers and the inability of the CBN to honor its guarantee obligation to the lending banks.

The second phase was the eight year period, from 1990 through the end of 1997, marked by a general decline, with guarantees declining in number and value to 17,840 and N242.0 million respectively. The decline in the number of guaranteed loans during the second phase could be attributed to the ACGSF's concentration on the Self-Help Program. The Self-Help Groups Linkage Program was introduced in 1991 to arrest the downturn in the activities of the ACGSF and also to assist group members to inculcate the habit of regular savings and elicit their commitments to loan repayment. It was also designed to introduce savings to farmers as a pre-condition to borrowing. It encouraged the formation of new farming groups or the adoption of existing viable ones (either as registered cooperative societies or informal groups). The groups' members come together to save an agreed sum of money on a regular basis, over a period of time, with a partner (participating) bank of their choice. The banks are expected to make loans available to the groups in multiples of their savings. The savings are also expected to grow over a period of time and be able to serve as collateral for future loans. The self-help groups, which also have their loans guaranteed under the ACGSF, are ultimately expected to transform from informal to formal institutions with all the benefits derivable there-from. Since the SHG program became operational in 1992, considerable progress has been made in terms of savings mobilization.[22]

Deposit Mobilization through the ACGSF's Self-Help Group Program

	1994	1995	1996	1997	1998
No. of groups	185	340	313	626	1,083
No. of members	647	9,339	8,999	11,784	15,340
Savings Mobilized (N millions)	2.6	5.2	6.9	13.2	25.3

The third phase (1999 - 2003) has been characterized by the resumption of growth, both in terms of number as well as in the value of loans guaranteed, due largely to the renewed advocacy by the Federal Government for increased lending to the productive sectors of the economy, with special emphasis on micro, small and medium enterprises. This campaign also falls within the purview of the government's poverty alleviation drive. Furthermore, the Development Finance Department of CBN has, since 2000, been making promotional and enlightenment visits to commercial banks and relevant government agencies in order to boost their volume of activities under the scheme.

ACGSF Loan Disbursements and Repayments (1978 – 2003)

	Phase I: 1978-1989	Phase II: 1990-1998	Phase III: 1999-2003 (5yrs)	Total: All Phases
No. Guaranteed	57,024	210,120	95,243	362,387
No. Repaid	8,989	150,680	89,643	249,312
% Repaid	16	72	94	69
Vol. Gtd N'm	538	1,429	3,552	5,519
Vol. Repd N'm	65	964	2,337	3,366
% Repaid	12	67	68	61

Source: ACGSF Records, Development Finance Dept, CBN

Beneficiaries of ACGSF cut across various agricultural enterprises, farm sizes and geographical locations. The food crop sub-sector, comprising grains, tubers and root crops, has persistently taken the lion share of loans guaranteed under the scheme. In 2000 for example, it accounted for 87.4% of the total number of loans and 84% of total amount of loans guaranteed. In general, the ACGSF activities skewed in favor of micro and small-scale agricultural borrowers, who have historically found it difficult to obtain adequate credit. Farmers in all the 36 States of the federation have continuously benefited from the scheme.

[22] World Bank (2000): Financing Nigeria's Rural Micro and Small Enterprises

As at December 31, 2000 a total of 7,158 claims valued at N298.4 million had been filed with the ACGSF by the participating banks. Out of this, 3,250 claims amounting to N28.1 million had been settled. In other words, 45% of the number of claims corresponding to 9% of the value of guaranteed loans had been settled. Of the remainder, about 1,621 claims, valued at N69.6 million was repaid through intensive recovery efforts of ACGSF field officers. The balance of unsettled claims at the end of 2000, therefore, stood at 2,297 claims, valued at N185.4 million. The point must be made that there has been a gradual decline in the number and value of outstanding claims, due partly to improved loan repayment records under the scheme as well as more efficient response by the fund to claims filed by the banks. Delay in claim settlement has been canvassed as one of the serious constraints to a wider participation in ACGSF by commercial banks. (Another is the abolition by the CBN of sectoral prescription of minimum volume of lending to agriculture in the spirit of deregulation.) The CBN has not only committed itself to reducing this delay to the barest minimum, it is also engaging the banks in continuous dialogue to ensure that they comply with the scheme's settlement procedure when filing their claims. Making the ACGSF more potent and widely embraced as the CBN is currently doing should be seen in terms of the present realities, where commercial (deposit) banks, which account for more than 90% of total banking sector deposits, provide services to less than 25% of Nigeria's economically active population. In other words, the remaining 75% are currently being served by the informal financial sector, which is still dominated by the local moneylenders, self-help groups, friends, relatives, and the newly emerging microfinance institutions.

The CBN is already beginning to see a positive response to its vigorous efforts aimed at revamping the ACGSF as the number of banks participating in the ACGSF, which dropped from 31 in 1989 to only five in 1998, has short up to eight in 2003. These include Union Bank of Nigeria, First Bank of Nigeria and United Bank of Africa – Nigeria's three largest banks in terms of deposits, risk assets, customer base and branch network. Other banks in the scheme are Bank of the North, Habib Bank, Tropical Commercial Bank, Inland Bank and Intercity Bank.

To further widen the operating base under the scheme, the CBN has decided to admit licensed Community Banks as participants under the ACGSF with effect from 2004. Thus, licensed community banks, which are currently 282 in number, will be eligible to participate in lending under ACGSF and such lending shall qualify for guarantee under the scheme. This extension is covered under the existing laws governing the scheme since they are loans and advances made by licensed banks, and therefore no new laws are required. Beyond this extension however is, in our view, the need to give ACGSF guarantees to community banks themselves to enable them borrow from commercial banks and thereafter on-lend or retail the proceeds to their farmer-customers. Such a move, if accepted, would require an amendment of the existing ACGSF enabling law. Furthermore, in order to correct for the lopsidedness in the portfolio of guaranteed loans, which at the moment is skewed in favor of short-term, small seasonal crops, the CBN has introduced from 2003 a refinancing scheme for medium and long gestation agricultural enterprises. Under the scheme, banks that have already lent long-term to agricultural projects would be eligible to refinance such lending. However, the primary lending must have been made in accordance with the bank's standard lending practice.

Commendable Improvements:

- Increase in the number of participating banks from five in 1998 to eight in 2003
- Extension of ACGSF to cover agric lending by CBs

For further improvements

- Efficient claim settlement to participating banks
- Capacity enhancement at DFD of CBN

The Nigerian Agricultural Insurance Scheme

Although it commenced operations in 1987, the legal backing for the establishment of Nigerian Agricultural Insurance Corporation (NAIC) is the NAIC Act No 37 of June 1993, which mandated the corporation to provide insurance coverage to farmers, especially for loans granted by Nigerian Agricultural, Cooperative and Rural Development Bank (NACRDB) or for commercial bank loans guaranteed by the CBN under the ACGSF. Other specific objectives of the organization are: (a) to induce the provision of credit by financial institutions as insurance coverage is an added collateral; (b) to promote agricultural production by giving farmers confidence to accept new/modern innovations and inputs; and (c) to minimize or eliminate the need for ad-hoc government assistance during agricultural disasters. As a matter of fact, the risks that NAIC underwrites are the types that conventional insurance companies would not contemplate, such as natural disasters and other 'acts of God'. Statutorily, the corporation is also empowered to underwrite conventional risks. By December 2003, the corporation has brought its share capital to N200 million, the minimum specified by the National Insurance Commission (NAICOM), Nigeria's insurance regulator. The official premium on its agric cover is 7.5% per annum of the loan balance, 50% of which is expected to be paid by the borrower, 37.5% by the federal government and the remaining 12.5% by the respective state government in which the project is located. While many states have continued to honor their obligations to NAIC, the federal government has not readily been forthcoming, and there were strong indications that no payment of premium has been made to NAIC in the past three years. This has put the operations of NAIC in a dire financial strait, forcing the company to cross-subsidize its agricultural insurance with inflows from its non-agricultural underwriting.

At inception, the program covered only two crops (rice and maize), two types of livestock (cattle and poultry), and some commercial businesses like farm buildings, machinery, and equipment, but that has now been expanded to include 21 crops, nine species of livestock, and 12 types of commercial businesses, including fire, motor, general accident and marine. Even at that, the corporation is not resting on its oars as it continues to explore further areas of expansion within its core area of competence. The corporation currently provides cover not only for small farmers, but also to medium and large farmers on commercial basis. NAIC is still Nigeria's sole insurer of agricultural produce with its headquarters in Abuja and branches in all the thirty six states of the federation. This has to be, because farmers, especially, the small-holders, which constitute NAIC's primary constituency, are spread all over Nigeria's expanse land area. As a matter of strategy, the corporation is in alliance with the extension services of the Agricultural Development Programs (ADPs) to organize farmers into groups (in order to facilitate effective flow of information on risk prevention – through improved farm practices – and risk management through insurance cover.)

In 2001, NAIC posted a net profit of N3.9 million (US $35,500) from a total income of N128 million. In 2002, NAIC's total income increased to N201 million with the net profit climbing N32 million ($266,000). It was actually after a 1995 FAO consultation and subsequent revamping of NAIC's business practices, that the corporation first posted a 1996 profit of N1.8 million (about US$20,000). Before then, it has been un-interrupted losses for more than five years. Profits in 1997 increased to N15.2 million ($169,000). Also in 1997, NAIC provided 59,932 insurance contracts totaling N7.7 million (US$ 96,000). Eighty four (84) crop policies with a total sum insured of N6.8 billion and a premium of N177 million were written between 2000 and 2003. These figures represent 23%, 59%, and 74% of all crop policies handled by the corporation since it commenced operations in 1988. Similarly for livestock, the number of policies issued, the sum insured and the premium earned between 2000 and 2003 were 54%, 46%, and 68% of the total since the inception of NAIC. This implies that the tempo of NAIC activities in the last four years has been on the upbeat. From program inception to the end of 2003, 472,400 groups, cooperatives, and individuals were insured. The total sum insured was N42.8 billion, the total premium earned was N744.34 million, the total claims paid was N178.30 million, and the total number of claimants paid was 8,996. (See table on NAIC) NAIC does not receive recurrent funding support from the FGN, which is especially remarkable given NAIC's scope and scale of operations.

NAIC has emerged in the last few years as a highly successful agricultural insurance provider in terms of its diverse products offerings and its profitability, although the bulk of its income has been accruing from its non-agricultural underwritings. It has, however, suffered setbacks from the failure of the federal government to honor its obligations as well as from the general economic downturn in the agricultural sector and the reduced lending to agriculture by financial institutions. It is therefore not very clear what the future holds for NAIC, at least when viewed from the government's perspective. Would it be revamped and privatized, or would it be merged with NICON, another government-owned insurance octopus? If it is going to be revamped, then urgent attention needs to be paid to expanding its coverage at a sustainable rate of growth, from the current one percent of the farming households it currently serves to the 50% of farmers it is mandated to serve. If it is going to be merged with NICON as part of the move to streamline public institutions, then this should be given utmost priority. Given that agriculture employs over 90% of Nigeria's rural population and that cultivation is mainly rain-fed, labor-intensive, and of low technology, then the matter of agricultural insurance should not be handled with levity. Further more, attention should be paid to enhancing the communication systems between the staff of the corporation at the Abuja headquarters and those at the state offices as well as increasing the awareness of the general public about agricultural insurance services and the pivotal role of NAIC.

Table: Summary of NAIC's Activities

		Crops Policies	Livestock Policies	Commercial Policies	TOTAL
Number of Policies	2000-2003	84,005	44,988	2,570	**131,563**
	1988-2003	365,629	83,342	23,429	**472,400**
Sum Insured (N'm)	2000-2003	6,806.3	2,221.6	13,928.4	**22,956.3**
	1988-2003	11,492.1	4,854.4	26,475.2	**42,821.7**
Premium Received (N'm)	2000-2003	177.0	70.6	247.0	**494.6**
	1988-2003	237.7	103.5	403.1	**744.3**
Claims Settled[23] (N'm)	2000-2003	(128) 9.6	(201) 9.3	(100) 35.5	**(429) 54.4**
	1988-2003	(6,703) 45.8	(1,411) 19.4	(882) 113.1	**(8,996) 178.3**

Source: NAIC

Recommendations

- Capacity building and infrastructural support for NAIC to widen its coverage and improve operating efficiency. As activities are boosted, the need for subsidy will wane
- It is not advisable to merge NAIC with NICON to preserve NAIC's agricultural focus
- Greater awareness and publicity of NAIC's activities needed.

[23] Figures in parenthesis are the number of claims

Specialized Development Financial Institutions

The policy of promoting the establishment of development finance institutions (DFIs) at the national level in the deliberate quest to accelerate capital formation to finance priority sectors of the economy became popular in the early 1960s and the 1970s. Before the DFIs were various regional Development Corporations and/or Boards established for the same purpose. Three notable DFIs established in the 1970s were the Nigerian Agricultural and Cooperative Bank (NACB), which commenced operations in 1973 to raise output and encourage adoption of new agricultural technologies; the Nigerian Bank for Commerce and Industry (NBCI), created in 1978 to promote small and medium-scale enterprises; and the Federal Mortgage Bank of Nigeria (FMBN), which also begun in the late 1970s to fund housing. The Nigerian Industrial Development Bank (NIDB), which was saddled with the task of promoting the development of new industrial enterprises as well as expanding the existing ones through the provision of medium/long term loans as well as equity, was established in 1964. The National Economic Reconstruction Fund (NERFUND) was established in 1988 as a funding mechanism to bridge the gap in the provision of local and foreign (medium and long-term) funds to SMEs and to stimulate economic diversification. In 2000, the GON decided to streamline all its DFIs in order to improve their operational efficiency and eliminate duplication of functions. Consequently, there was a merger of NIDB, NBCI and NERFUND to form the Bank of Industry (BOI) in October, 2001. Similarly, a new Nigerian Agricultural, Cooperative and Rural Development Bank (NACRDB) emerged from the merger of NACB, the People's Bank of Nigeria (PBN) and the Family Economic Advancement Program (FEAP). PBN was established by the federal government in 1988 with an initial take-off grant of N30 million to meet the credit needs of small borrowers (including women in particular) who cannot satisfy the stringent collateral demands of commercial banks. On the other hand, FEAP was established in 1994 to, among other things, target poverty reduction through the provision of credit, especially to the rural poor; encourage the design and manufacture of machinery and equipment locally so as to provide a solid foundation for industrialization; and reduce rural-urban migration through the creation of employment opportunities at ward levels.

The Nigerian Agricultural, Cooperative and Rural Development Bank

Like its precursor, NACRBD is owned by the federal government and the CBN in the ratio of 60 to 40. The new bank requested N50 billion as take-off capitalization, but the shareholders have paid only about N9 billion. (NACB's share capital had just been increased from N1 billion to N1.5 billion before the merger exercise.) The true status of NACRDB in terms of ownership is still not very clear because the Bureau for Public Enterprises (BPE), the government's technical agency for its privatization program, is offering 51% of NACRDB shares for sale to a core investor or a consortium of foreign and/or domestic investors. Privatization may be a good idea for NACRDB, given its long history of viability problems and resource constraints.

There is much confusion surrounding NACRDB. The first is the issue of privatization mentioned earlier. Again, from the charter establishing the bank, it is expected to function as a commercial-cum development bank, taking deposits and providing loans to individuals and cooperatives for all types of agricultural projects, SMEs, etc. Although it is empowered to take deposits, it does not have a license yet as required by the Banking and Other Financial Institutions Act (BOFIA 1991 as amended). The new bank has just resumed lending in May 2001, and a directive has gone out from the GON that 70% of its loan portfolio should be granted to the poor (as 'micro-loans') at single digit interest rates, and the remainder to other clients. The bank defines micro-loans as loans below N250,000 ($1,850) - a definition that would no doubt afford the bank some flexibility in its operations. But the fact that government still exercises direct control on the operations of the bank may re-enact some of the debilitating experiences that the defunct NACB had. There is a potential threat for the survival of NACRDB, and this would make the bank ineligible for donor support. Under these confusing circumstances, it is also doubtful if the new bank would be able to provide meaningful services to its target or contribute remarkably and on a sustainable basis to poverty alleviation.

Out of the 350 banking outlets taken over from NACB and PBN, 150 have been closed, leaving 200 offices that have been rehabilitated and upgraded. Only staff of about 2,305 were retained out of 4,608 employed before the merger. Out of the five core conditions formulated and recommended by the IFAD/WB mission in November 2001 for the new NACRDB, only one is on the verge of being complied with, and that is equity participation by the private sector. The other three, namely that NACRDB obtain commercial banking license, that the bank calculate and charge interest on the basis of prevailing market condition, and that the federal government adopts viability and sustainability as the overall objectives of NACRDB, are all still outstanding.

Going forward, NACRDB must be allowed to operate on the basis of commercial principles. It must be allowed to charge market-determined interest rates. Secondly, steps must be taken to license it to mobilize deposits. Thirdly, the bank should be helped to a firm stand such that it could be listed on the Stock Exchange to raise capital. Meanwhile, some of the foreign exchange (related) losses in its books, arising from a prolonged era of reliance on external borrowing should be written off. Furthermore, the bank should diversify its operations and consider more innovative services such as equipment leasing and bulk input supply. The staff of the bank, in spite of their skills, have been under-priced should be well motivated and developed, but this would only be possible if and when the bank is allowed to operate as a commercial, profit-motivated concern. Finally, the elimination of political interference and the creation of a stable macroeconomic framework for the bank's operation are major challenges for the federal government, if the expected benefits from the reformed bank are to materialize.

What is harmful

- Interference of government in prescribing credit targeting and subsidized credit pricing
- Lack of attention given to both the credit and saving sides of the balance sheet
- Uncertainty about the status of NACRDB – will it be privatized
- Poorly motivated staff
-

What is recommended

- Government's direct interference in the bank's operation should give way to CBN's total regulation/supervisions
- All the bank's products should be priced at market rates
- Bank should be allowed to raise deposits (i.e. engage in true financial intermediation)
- Sell 51% of the bank's shares to private investors
- Further rationalize the bank's offices – post merger with People's Bank
- Pay staff motivating wages

Recently Introduced Programs in Support of Development Finance

Apart from the major institutional reforms already discussed, some new policies and programs are contained in the 2004/05 Monetary Policy Circular No 37, issued by the CBN, which aim at further redressing the urban-biased policies of the past. Some of these programs are:

a) National Credit Guarantee Scheme for SMEs. This scheme is expected to encourage financial institutions, particularly the deposit money banks to lend to small businesses, which have viable projects and good prospects of success, but are unable to satisfy the lender's collateral requirements. This scheme is different from ACGSF. Eligible beneficiaries of the new scheme would be micro, small and medium enterprises in manufacturing activities or related service industries, as officially defined by the National Council for Industry. The CBN has indicated it would issue the appropriate guidelines for the scheme in the course of 2004. It is expected that the experience acquired under the ACGSF would be brought to bear, in order to avoid the pitfalls of that scheme. This includes commercial banks' disenchantment with late payment of claims under the scheme.

b) Provision for Micro-Enterprises within SMIEIS. In the course of our interaction with officers of Banking Supervision Department of the CBN, we were hinted about the apex bank's intention to allocate 10% of SMIEIS resources to microfinance. Under SMIEIS, commercial banks set aside 10% of their profit before tax for equity investment in SMEs. By December 2003, more than N20 billion has been set aside, out of which only about N7 billion has been disbursed. Several reasons have been adduced for the low level of disbursement, including dearth of viable projects as well as poor project preparation and presentation on the part of project promoters. However, much more significant (though less admitted) is the issue of cultural resistance, especially on the part of SME owners, to dilute their ownership or weaken their grips on what are generally perceived as legacies to be handed over to next generations. Similarly, there are several projects that are in need of financial restructuring before they can be viable. Regrettably, most banks that have contributed funds under the scheme are only looking for active, going concerns for equity investment. There are some preliminary indications that the proposed portion of SMIEIS fund being earmarked for micro-enterprises would be disbursed as loans rather than equity.

c) Interest Drawback Scheme and the Revitalization of Community Banks. These measures are brought out here for purposes of emphasis, since they are part of the reform of the ACGSF and the Community Banks earlier discussed. Borrowers under the ACGSF who repay their loans as and when due would be entitled to draw back 40% of their interest costs, while ACGSF is also being extended to borrowing customers of licensed community banks.

Financial Sector

a) Interest Rates

The policy of interest rate deregulation, which started in October 1996 has remained in operation ever since, the only exception being the rates charged under some special poverty alleviation programs of the federal government, including interest rates on lending by NACRDB. The movement of rates has largely reflected the monetary policy stance of the CBN, including the movement of its baseline rate (i.e. the Minimum Rediscount Rate, MRR). Although the CBN's interest rate policies have largely been based on the need to ensure stability in the financial sector through effective savings mobilization and availability of investible funds to the productive sectors of the economy, this has not truly materialize. Commercial banks have been less transparent and unfair as they maintain wide margins between their savings and lending rates. For example, in 2002, average savings rate in the commercial banks was 3.7%, in contrast to a prime lending rate of 20.6%. The maximum deposit rate was 14.4% on 6-month money, in contrast to a maximum lending rate of 25.7%. Banks have continuously hinged the wide spread between deposit and lending rates on several cost factors outside their control, but the CBN, apparently unconvinced by this argument, has continued to employ moral suasion to persuade commercial banks to keep their lending rates at a maximum of 400 basis points above MRR. In 2002, MRR was 16.5%.

The issue of subsidized interest rate has lingered for too long, and needs to be eliminated completely. The only major institutional area where this still exists is in the operation of NACRDB and some special poverty alleviation programs being operated by the federal government. The government has always (and erroneously too) premised the policy of concessionary interest rate on the need to alleviate poverty by helping the weak, minimizing the cost of funds to rural dwellers and mitigating the high risk of rain-fed agriculture. But the experiences of rural micro and small entrepreneurs who borrow from private, informal sources at usurious rates and repay almost 100% as and when due, has not lent credence to this assertion. On the contrary, almost all cases of government-regulated subsidized interest rates have failed to achieve their intended effects. Rather, they have only succeeded in distorting and weakening the credit market. Concessionary interest programs are usually inefficiently run, and most beneficiaries are not the intended targets. Besides, subsidizing interest rates creates a bias towards acceptance of investment projects with low returns. It over-bloats effective credit demand, resulting in credit rationing. Because interest rate subsidy implies low returns to savers and (by implication) higher costs to non-subsidized borrowers, the success of NACRDB in mobilizing deposits (if and when it starts to do so), will depend in part on how quickly the government directive on subsidized interest rates are reversed. The only subsidy that could be advocated at this point is on technical assistance and capacity building, which will guarantee institutional viability and sustainability in the medium to long run.

b) Liberalization of Exports and Selective Banning of Imports
Virtually all forms of all restrictions have been removed on the export of goods and services, and exporters are free to keep their proceeds in special domiciliary accounts to which they have free and unfettered access. Efforts to enhance non-oil receipts through the use of incentives such as Manufacture-in-Bond and Negotiable Duty Credit Certificate have also remained in operation. Various promotional efforts are currently being pursued to stimulate SMEs to become exporters, but there are still some problems of structural rigidities to deal with. On the flip side of the coin, government in the last two to three years, has introduced a policy of banning the importation of some selected items, especially finished and frozen food and textile items (the Customs Department and the Ministry of Finance are working out the detailed list in order to make it public officially). The objective is not only to conserve foreign exchange, but also to protect the local producers of such items, some of whom are micro and small/medium enterprises (MSMEs). This should not be a permanent policy posture as it is capable of protecting inefficient firms, which in the long run would become internationally uncompetitive.

c) Policies and Programs Devoted to Poverty Alleviation and Rural Development
Government's policies on poverty alleviation and rural development have persistently emphasized the need to enhance the supply of credit to MSMEs in order to stimulate production, improve household income and enhance the quality of life. However, the impact of direct governmental support for this cause has been limited and disjointed, often characterized by inefficiencies and unwarranted subsidies. This suggests the need for a more viable and sustainable apparatus to confront the challenge and this definitely goes beyond state-sponsored institutions that are known to undermine the private microfinance market through subsidies, politically motivated lending decisions and poor instincts on loan collection. Though limited at the moment, commercial banks partnership with MFIs is growing, as a few MFIs are known to have taken bank loans, while Nigeria's three largest banks and a number of corporations have taken the initiative to create the Growing Business Foundation (GBF). In a recent study, the Seed Capital Development Fund (SCDF) estimated the unmet demand for microfinance loans at $214 million (N29 billion), thereby underlining the precarious nature of the problem of inadequate supply of credit.[24] This is a clear pointer to the need to focus only on the establishment of an enduring institutional framework to deliver credit to the rural poor.

One recent and major program of the government for poverty alleviation and rural development is the National Poverty Eradication Program (NAPEP). The blueprint of NAPEP, which was approved in January 2001 by the Federal Executive Council, listed four integrated sectoral schemes, namely Youth Empowerment Scheme (YES), Rural Infrastructure Development

[24] Estimate is from the Field Assessment Report of Nigerian MFIs by the World Bank.

Scheme (RIDS), Social Welfare Services Scheme (SOWESS) and Natural Resources Development and Conservation Scheme (NRDCS). These schemes are being implemented through government agencies (at all levels – federal, state and local), and when these prove inadequate, through NGOs and Donor Agencies. NAPEP is building relationship with MFIs, especially those who have good grasp of best practices. Good examples are the MicroStart MFIs of the UNDP. The Diamond Development Initiatives of Kano and the Community Development Fund of Lagos are equally helping NAPEP to identify MFIs in the northern and southern parts of Nigeria respectively, through which credit can be passed to the micro entrepreneurs. Again, the greatest challenge is that of institutional viability and sustainability.

Government Policymaking Process

Overview

The federal government of Nigeria, like its counterparts in Sub-Saharan Africa, has always set itself the goals of price stability, economic growth and balance of payment equilibrium, through the deployment of various policies, programs and reforms that are meant to complement the market or correct for market failures. Some streaks of successes sometimes emerged from the pursuit of these goals, but there have also been several instances where government intervention has resulted in worse failures than it sets out to correct in the first instance. This development can be better understood within two contexts: the history of Nigeria's economic planning process, and the nation's political structure.

From 1962 to 1985, Nigeria developed and, to a large extent, implemented four, five-year development plans, 1962-68, 1970-74, 1975-80 and 1981-85. All government economic objectives as well as the policies and programs for their attainment were embedded in these plans, although in virtually all cases, significant portions of these plans were not executed because of unanticipated financial and executive capacity constraints. The adoption of the Structural Adjustment Program (SAP) in 1986 was the government's major response to dwindling oil receipts (which constituted the main resources for implementing government programs). The more market-oriented SAP actually triggered remarkable economic gains between 1986 and 1988, but these gains were later eroded due to some major policy reversals. From the start of the 1990s, the government introduced the concept of three-year rolling plans, which were believed to be more flexible and amenable to periodic reviews. Every annual budget was expected to be cut from, or related to a rolling plan, but in reality, that linkage has been very tenuous, especially in recent years.

The second issue is Nigeria's political structure. Because Nigeria is a federal republic, each tier of government – federal, state and local – engages in the formulation and implementation of economic policies in those areas for which it has constitutional powers. (In the 1999 Constitution of the Federal Republic of Nigeria, there are exclusive responsibilities for the federal government. There are also concurrent responsibilities for both the federal and state governments, and there are residual responsibilities shared between the state and the local governments.) However, in spite of these constitutional provisions, there have been frequent cases of conflicts and duplication of roles – even under democratic governance, when the Constitution was supposed to be in operation. (On the other hand, under military governance, when the Constitution was usually suspended – and the military had ruled for 30 of Nigeria's 43 years of existence as a nation, it had been more of central governance, with other tiers of government forfeiting some of their rights to formulate and implement policies.) The inference from this is that the policymaking process in Nigeria has been bedeviled by serious uncertainties and instability – post-independence.

One other major issue is role of the public sector vis-à-vis the private sector. Public-private sector partnership in the formulation and implementation of economic policies is a recent phenomenon in Nigeria. Before now, government had always believed that it has the exclusive responsibility and wherewithal to transform and grow the economy. Therefore, it left little or no room for consultation with the private sector – be it the organized private sector, or the large informal segment, estimated at 70-80% of the labor force and constituting a major source of capital formation, especially in the rural areas. As a matter of fact, government committed huge resources into the direct production and distribution of goods and services for which it was ill-equipped. In addition, it has a record of historically favoring urban areas in the provision of infrastructure and human services. For instance, as of 1995, 63% of the urban population versus 26% of the rural population had access to water (expressed as a percentage of the population with access). Also, while 80% of water resources in urban areas are safe for drinking (i.e., treated), only 39% of the sources in rural areas are safe (World Bank, 1998). This overbearing stance of the government is now being redressed, first by institutionalizing public-private sector cooperation and collaboration; second, by an elaborate divestment of government interests (under the privatization program) from several enterprises for which the private sector is better endowed to run efficiently and profitably; and third by promoting the flow of resources into the long-abandoned rural areas.

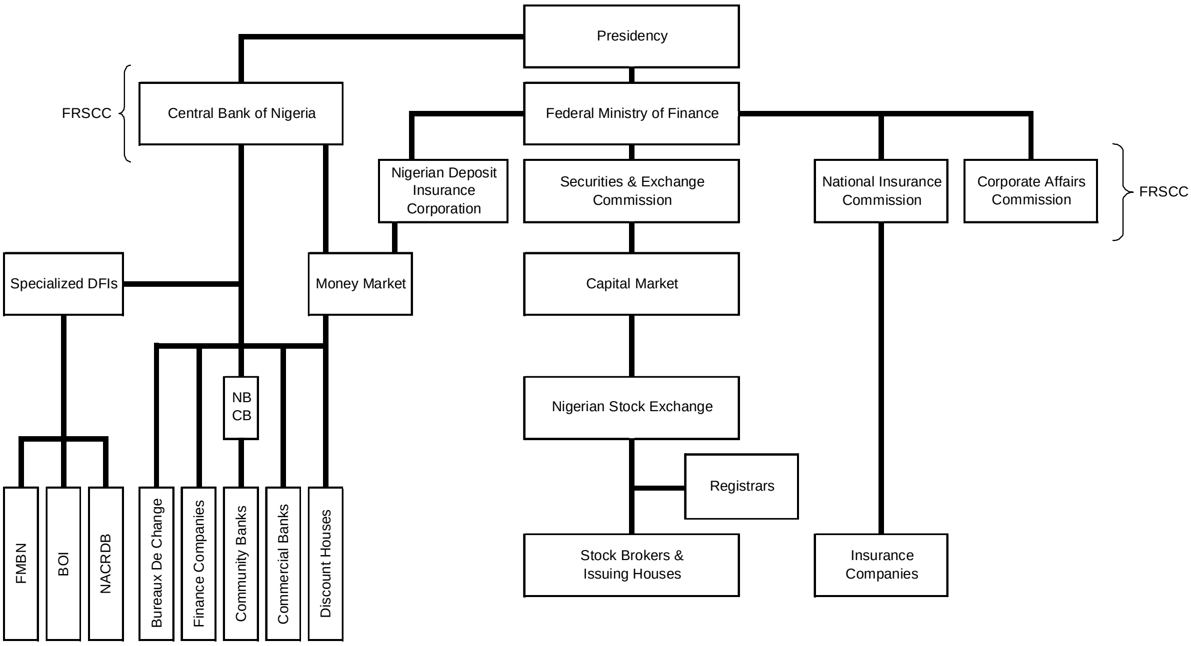
Policy Making by Sector

a) Financial Sector

The financial sector of the Nigerian economy consists of (a) the policy-making and/or regulatory authorities, (b) the financial markets, (c) the development financial institutions and (d) other financial institutions (see Chart 2.1). The CBN is at the apex of the financial sector, and is charged with the responsibility of promoting monetary stability, a sound financial sector as well as the growth and development of other financial institutions. In discharging these responsibilities, the CBN formulates and issues, from time to time, monetary policy circulars to financial institutions, especially those in the money market as well as the DFIs. CBN monetary policy circulars are usually serially numbered and are in two major categories (a) the main circular issued once in two years spelling out broad areas of policy retention and /or policy change, and (b) other subsidiary circulars issued as and when needed to fine-tune existing policies or introduce supplementary policy measures.

Apart from the CBN, there are other regulatory institutions in the financial sector, such as the Securities and Exchange Commission (SEC) which supervises the capital market, the National Insurance Commission (NAICOM) which supervises the insurance market, and the Nigerian Deposit Insurance Corporation (NDIC) which has the primary responsibility of protecting bank deposits in order to promote confidence in the banking industry. The NDIC also collaborates with the CBN in the inspection of licensed commercial banks and has, at the instance of CBN, performed the role of receiver/liquidator for some terminally distressed banks. For the purpose of coordinating the supervision of financial institutions, a Financial Services Regulation Coordinating Committee (FRSCC) was established in 1998 with the Governor of CBN as chairman. Other members of the committee are the Director-General, Securities and Exchange Commission (SEC), the Commissioner for Insurance (i.e. the head of NAICOM), the Registrar-General, Corporate Affairs Commission and a Representative of the Federal Ministry of Finance.

Institutional Map for Policymaking in the Nigerian Financial Sector



While the CBN utilizes the FRSCC forum to address financial policy issues affecting the capital and the insurance markets, it deals directly with commercial banks, community banks, specialized DFIs, Discount Houses, Finance Companies, Mortgage Institutions and Bureaux de Change. All the policy directives of the CBN to these institutions are absolute except in the case of DFIs, which, apart from the CBN, have supervising ministries, such as the Ministries of Industry for Bank of Industry (BOI); Agriculture and Rural Development for Nigerian Agricultural, Cooperative and Rural Development Bank (NACRDB); and Works and Housing for Federal Mortgage Bank of Nigeria (FMBN). Unfortunately, monetary policies of the CBN (especially those which emphasize best practices for financial institutions) have not always aligned with (the additional) targeted/specialized policies emanating from these supervising ministries. Primarily for this reason, virtually all the DFIs are very weak with sub-optimal performance.

Policies Relating to Commercial Banks

The CBN is the sole authority responsible for the licensing and regulation of commercial banks in Nigeria. Deriving its authority from the Central Bank of Nigeria Act, 1991(as amended) and Banks and Other Financial Institutions Act, 1991 (as amended), the CBN specifies conditions for the issuance and withdrawal of banking license, the opening and closing of branches, minimum paid up share capital, restructuring/re-organization as well as merger/disposal of banks, liquidity and capital ratios, corporate governance rules and practices, etc. The bank is also responsible for ensuring that Nigerian banks conform to international best practices as may be stipulated from time to time, especially under the Basle Accord. The CBN supervises and regulates the banks to ensure compliance with its rules, applying sanctions if deemed necessary for all infractions.

Banking licenses are issued only after the applicant has submitted to the Governor of CBN a feasibility report; a draft copy of the memorandum and articles of association of the proposed bank; a list of shareholders, directors and principal officers and their details; and such other details as may be requested. The prescribed application fee must also be paid, while the prescribed share capital must equally be deposited with the CBN. In its Monetary Policy Circular No 37 for year 2004/05, the apex bank encouraged all commercial banks to raise their minimum paid-up capital from the present level of N1 billion to N2 billion by the end of 2005. Cash reserve requirement was fixed at 9.5% for all banks, while liquidity ratio was put at 40%. The minimum ratio of capital to total risk-weighted assets has been increased from 8 to 10% with effect from 1st

January 2004. To improve on corporate governance in the banks, no one can be appointed to the position of managing director of a commercial bank unless he has a minimum of first degree in a business-related discipline and has acquired a minimum of 20 years post-qualification experience in the banking industry. There are specifications for other senior positions, and the CBN conducts thorough enquiries on all top management candidates and prospective directors. From 2001, no person is allowed to hold more than two non-executive director positions in the banking sector. Further more, part of the existing policies governing commercial banking operations is the Prudential Guidelines, which, among other things, stipulate that banks make general and specific provisions for all their risk assets. Specifically, for all credits that are outstanding for more than 90, 180 and 360 days, commercial banks are expected to make provisions of 10, 50 and 100% respectively.

In January 2001, the CBN abolished the dichotomy between commercial and merchant banks and replaced the dual licensing arrangement with one universal license. This development has leveled the playing field for all the banks, and has also intensified competition among them. Quality of service has no doubt improved within the industry, but the customer is yet to derive full benefits in terms of lowered cost of banking services, perhaps owing to the fact that the banking industry is still largely oligopolistic. Interest rates paid on deposits or charged on loans are market-driven, but the CBN influences the level and direction of rates by proactively adjusting its base-rate (called Minimum Rediscount Rate, MRR) to reflect prevailing market conditions.

Towards the end of 2003, the CBN began the process of reforming the check clearing system by designating some banks as "Settlement Banks." These are banks that meet the following criteria:

a) Capacity to provide a clearing collateral of not less than N15 billion worth of treasury bills (this condition is liable to regular reviews);
b) Ability to offer agency facilities to other banks and to settle on their behalf, nationwide;
c) Branch network in all the CBN locations;
d) Ability to satisfy volume and value criteria, which will not be less than 2.5% of the volume and value of cleared items.

Other banks that fail to meet the above criteria are expected to do their clearing through the settlement banks. As at January 2004, only seven Nigerian banks have satisfied the conditions and these are First Bank, Union Bank, United Bank for Africa, Afribank, Zenith Bank, Guaranty Trust Bank and Standard Trust Bank. There are speculations that the CBN might limit the number of settlement banks in Nigeria to a maximum of ten.

Policies Relating to Community Banks (CBs)

Until 1996, the National Board for Community Banks (NBCB) was primarily responsible for formulating policies governing CBs as well as supervising their operations. The Board also provided subordinate loans to augment CBs' initial capital, sanctioned the appointment of managers by the individual CBs, and provided training. Today, the CBN performs virtually all the roles hitherto performed by NBCB. More specifically, the CBN – through its Other Financial Institutions Department (OFID) – is responsible for licensing and supervising CBs. Comprehensive guidelines for the operation of CBs in Nigeria have been issued by the CBN, spelling out, among other things, licensing eligibility criteria, board and management requirements, maintenance of reserves, rendition of returns and prudential requirements.

In July 2002, the CBN issued a circular to CBs, removing the restriction on their shareholding structure such that individuals and Community Development Associations (CDAs) can freely decide on their percentage holding. Before this circular, individuals and CDAs could not hold more than 5 and 30% respectively of the shareholdings of a CB. In that same circular, CBs were classified as SMEs/Micro-credit institutions to enable them access funds for development –

beyond their shareholders' funds and deposits. Earlier in 1999, the CBN issued a circular requesting all CBs to increase their share capital to N5 million.

Policies Relating to Development Finance Institutions (DFIs)

As was indicated earlier, and in addition to the impression created in the figure above about the policy making process for specialized DFIs, each of the DFIs also receive policy directives from their supervising ministries, especially on matters such as loan targeting and loan pricing. Most of the time, policies emanating from the ministries to the DFIs are at variance with the market-driven stance of the CBN – a development that has, over the years, compromised institutional viability on the part of the DFIs and reduced the efficacy of monetary policy implementation on the part of the CBN. The most effective way forward is to subject all DFIs to international best practices as the CBN may suggest from time to time, while all the ministries currently influencing the policy process of the DFIs should focus their attention on infrastructure development, which would impact positively on the productivity and cost profile of the vulnerable group that they (i.e. the ministries) seek to protect.

Policies Relating to Microfinance

The need for a microfinance policy in Nigeria was not felt until October 2000, when an international conference on microfinance mandated the CBN to draft one for the consideration of all relevant stakeholders. These stakeholders are in two categories. The first category consists of members of the National Working Committee, drawn from selected government agencies, banks and microfinance institutions, while the second category are international experts in microfinance who are expected to ensure that the draft policy conforms very well with international best practices. It is expected that this policy document, when finalized, would result in the emergence of a sound microfinance sub-sector, populated by sustainable MFIs that are easy to integrate with the Nigerian financial system and with good potentials to run on a well harmonized and standardized platform. Specifically, the new policy should help to track the entry and exit of operators, spell out licensing and operational/prudential standards, specify necessary institutional machinery for regulation and supervision, etc. It would also be ideal to have a policy framework that clearly specifies roles for the government and the MFIs such that the present pitfalls in the operation of the DFIs (– like preferential credit targeting and subsidized pricing) are avoided.

Other Non-bank Institutions and the Policy Process

The Discount Houses (DH), the Bureaux de Change (BDC), the Insurance Companies, the Nigerian Stock Exchange (NSE) and the Finance Companies (FC) constitute the other group of institutions that are within the financial sector and are driven by distinct policy processes. While NAICOM is charged with the effective administration, supervision, regulation and control of the business of insurance in Nigeria, SEC is the regulatory authority for NSE, the Issuing Houses and the Stock broking firms. On the other hand, CBN is the policy maker for DHs, BDCs, and FCs, deriving its power from the CBN Act, and Banks and Other Financial Institutions Act, both of 1991 (with their amendments). In response to CBN policies, DHs have relieved the CBN of some public debt management problems while also facilitating the use of Open Market Operations for the management of financial sector resources. From January 1997, the CBN took over the licensing of BDCs from the Federal Ministry of Finance and they are today authorized dealers in travelers checks. They also have access to the official (Inter-bank Foreign Exchange Market, IFEM) funds. These are bold measures to moderate the distortions at the foreign exchange market, usually created by the existence of huge premiums between official and parallel market rates.

Poverty Alleviation and Rural Development Policies

Apart from the various poverty alleviation policies embedded in the operations of banking and non-banking financial institutions, there is also the National Poverty Eradication Program

(NAPEP) of the federal government, which allows participation for virtually everybody in a bottoms-up approach. All policies and programs relating to NAPEP are formulated, monitored and reviewed by a National Poverty Eradication Council, under the chairmanship of the President of the Federal Republic. The Council relies on a National Coordination Committee, chaired by an appointee of the President, for the implementation and the execution of all the directives of the Council. There are also State Coordination Committees and Local Government Monitoring Committees implementing and coordinating activities at the state and grass root levels. Some of the on-going programs of NAPEP are the Youth Empowerment Scheme (YES), Rural Infrastructure Development Scheme (RIDS), Social Welfare Services Scheme (SOWESS) and Natural Resources Conservation Scheme (NRDCS).

D. Agriculture Sector Policies

Historical Overview

Nigeria has witnessed, four distinct agricultural policy regimes, the first covered the entire colonial period and the first post-independence decade from 1960 to about 1969; generally referred to as the Pre-1970 period. The second covered the period from 1970 to about 1985 or the oil boom period. The third phase started from about 1986 in the structural adjustment period; and, the fourth is the post-structural adjustment era, from 1993 to 1997.The period of 1998 to date is described as the new agricultural policy period during which a democratic government is in place and the private sector, market orientation is stronger than ever before.

The Pre-1970 Period

Agricultural, policies in the 1950s and 1960s, was largely by seen as creating government-owned agricultural development corporations and launching farm settlement schemes. These actions had their relevance more rooted in a social welfare philosophy than in well considered body of sustainable economic thought. In the post independence era 1960-1969, government philosophy of agricultural development shifted in favor of a support for agricultural research, extension with an almost exclusive focus on export crops, commodity marketing, and pricing activities. It was, however, becoming quite clear towards the end of the 1960s that the Nigerian agricultural economy will decline, some of the signs of this imminent decline included emerging agricultural problems e.g. declining export crop production and food shortages.

The Oil Boom Period (1970-1985)

This season was a period of heavy of government intervention in agriculture, particularly the federal government. There was a generally held view in government that the solution to increasing Nigeria’s agricultural performance lie in direct involvement of government in agricultural production activities. The windfall from crude oil in Nigeria reinforced this approach and the decade of the l970s and early 1980s witnessed an unprecedented deluge of agricultural policies, programs, projects and institutions. Major policy instruments during this period included agricultural commodity marketing and price control through the commodity boards, free agricultural research and agricultural extension, subsidized input (fertilizer and agrochemicals); agricultural mechanization etc. The private sector role during this era was almost non existent beyond smallholder subsistent agriculture that is the livelihood of most Nigerian. The agro-allied multinationals were during this era compelled by government fiat to engage in a “backward integration” program for production of raw materials. The program collapsed because of failed macro-economic and lack of core competence in agriculture by the corporations.

Structural Adjustment Period 1986-1993

The poor performance and failure of the state led approach to agricultural development, reversed fortunes from crude oil export and a crushing debt burden as well as an unhealthy investment climate due to military dictatorship led to the need for drastic restructuring of the economy. This structural adjustment program (SAP) was therefore launched in July 1986. The most important single policy instrument for this was the devaluation of the Naira and market liberalization which gave market forces more opportunity in determining the roles of key players in the agricultural sector. Other elements of the era included reduction in administrative controls as well as withdrawal of government intervention in the commodity markets and the abolition of the commodity boards. Government saw itself as a provider of institutional frameworks for the smooth operation of a free market system and generally, for the creation of a more favorable environment for increased investment in the economy. The economic philosophy underlying the structural adjustment program had as its key elements the principles that agriculture was essentially a private-sector business and the role of government largely facilitating and supportive of private-sector initiatives. This policy led to some agricultural growth and improved incomes due to deregulation of commodity trade and enhanced access to markets by producers.

Roles of Tiers of Government in the New Agricultural Policy

Under the new policy regime, the GON is responsible for the provision of a general policy framework, including macroeconomic policies for agricultural and rural development and for the guidance of all stakeholders; support for rural infrastructure development in collaboration with state and local governments; research and development of appropriate technology for agriculture, including biotechnology.

The State Governments will be primarily responsible for the promotion of the primary production of all agricultural commodities through the provision of a virile and effective extension service; ensuring access to land for all those wishing to engage in farming and development and management of irrigation facilities and dams.

The Local Governments will be expected to take responsibilities for the provision of effective extension service; provision of rural infrastructure to complement federal and state governments' efforts and mobilization of farmers for accelerated agricultural and rural development through cooperative organizations, local institutions and communities.

According to the policy document, the Private Sector will seek to exploit enabling environment provided by the government for profitable agricultural investment. In particular, the public sector is expected to play a leading role with respect to investment in all aspects of upstream and downstream agricultural enterprises and agri-businesses.

Post SAP Agricultural Policy 1993-1997

There was an interim or transition agricultural policy document which was finalized an operational 1988 and remained operative until the year 2000. In year 2001, a new policy document was launched; the new policy document bears most of the features of the old one, but with more focused direction and better articulation of the private sector led thinking. In a broad sense, the objectives of the new agricultural policy include the achievement of self-sufficiency in basic food supply and the attainment of food security; increased production of agricultural raw materials for industries and increased production and processing of export crops, using improved production and processing technologies. The key features of the new policy are as follows.

- Promotion of crop competitiveness through the introduction and adoption of improved husbandry appropriate technologies, encouragement of environmentally sustainable practices and value creation.

- Improved risks management through the agricultural insurance.

- A national approach to a comprehensive and integrated extension delivery system under the Agricultural Development Programs (ADPs).

- Active promotion of agro-allied industry to strengthen the linkage effect of agriculture on the economy.

- Provision of such facilities and incentives as rural infrastructure, rural banking, primary health care, cottage industries etc, to encourage agricultural and rural development and attract youths (including school leavers) to go back to the land.

The new Agriculture policy 1998 -2004
The new agricultural policy heralds a policy direction with strategies that lays the foundation for sustained improvement in agricultural productivity and output. The new strategies involve creating a conducive macro-environment to stimulate greater private sector investment in agriculture; rationalizing the roles of the tiers of government and the private sector in their promotional and supportive efforts to stimulate agricultural growth (Box 1); increasing budgetary allocation and other fiscal incentives to agriculture and promoting the necessary developmental, supportive and service-oriented activities to enhance agricultural productivity; and rectifying import tariff anomalies in the trade of agricultural products, promoting the increased use of agricultural machinery and technologies.

Constraints to Effectiveness of Agricultural Policy
Policy Instability & Inconsistency
One of the major constraints to agricultural policy effectiveness political instability, over the years, there has been a high rate of turnover in agricultural policies, with many policies formulated and reversed by successive governments. In many case agricultural policies and programs of government tended to be conflicting and uncomplimentary e.g. government's domestic food production policy and its cheap food import policy are inconsistent and self defeating.

Top Down Policy Development process
The base of the agricultural policy formulation process in Nigeria had, in the past, been rather narrow as the level of consultation and participation by stakeholders are low or sometimes non existent. In the circumstance, such policies lack grassroots support and the popular mobilization required for their success is often neglected with mass social protest as inevitable consequences.

Poor Implementation and Institutional Framework
Formulation of policies are often treated as ends in themselves, rather than being a means to desired ends, therefore little attention is paid to efficient and detailed implementation. Government and the civil service often ignore of the purpose of policies and focus on bureaucracy with corruption and rent seeking behavior becoming the dominant consideration in the execution or non-execution of the policies. Institutional arrangements for policy and program coordination are poor leading to duplication of efforts and context for turf by government agencies that ordinarily should work in tandem. Inadequate monitoring and evaluation arrangements for policy implementation had also led to situations in which policies and programs tended to lose focus on original goals and without performance standards to measure policy outcomes.

Major Agricultural Policies
Some of the key agricultural policies and their transformation over the epochs listed above are as follows.

Commodity Marketing and Pricing Policy
The instrument of agricultural commodity marketing and pricing policy was the establishment of six national commodity boards in 1977 to replace the regional, multi-commodity boards. The six

national commodity boards were for cocoa, groundnut, palm produce, cotton, rubber and food grains, with the grains marketing board being the first effort to focus on food crops. The National Grains Board handled maize, millet, sorghum, wheat, rice and cowpeas through a guaranteed minimum price policy whereby floor prices were nationally set for each of the six grain crops as guaranteed minimum prices and buyer of last resort when market prices fell below the guaranteed minimum. The board also operated a strategic grain reserve scheme. This policy was abandoned during the Sap era and a private-sector commodity and futures exchange market (COMEX) was proposed in the 1995 budget to fill the vacuum created by the abolition of commodity boards. However, the exchange is yet to be operational.

Input Supply and Distribution Policy

Government policy on input supply and distribution initially focused on a state controlled supply of modern inputs like fertilizers, agro-chemicals, seed and seedlings, machinery and equipment, and so on. The centralization of fertilizer procurement and distribution in 1975 by the federal government led to inefficiencies and rent seeking behavior. The National Seed Service (NSS) was created in 1972 to produce and multiply the improved seeds of rice, maize, cowpea, millet, sorghum, wheat and cassava with government as the sole distributor of improved seeds.

Government over the years has withdrawn direct participation in agrochemicals with partial control on fertilizer still in force. Government is now under the new agric policy concerned with creating a conducive environment for profitable investments in the production and distribution of inputs such as improved starter materials, animal health drugs, fertilizers, etc. How much this is fully complied with by the government remain to be seen in the coming months.

Agricultural Input Subsidy Policy

As far back as the 1950s, various regional governments in Nigeria subsidized the prices of key inputs, especially the prices of agro-chemicals used in the production of export crops. But in the early 1970s, input subsidy policy became centralized and its application extended to food crops. The policy instruments adopted comprised of *Fertilizer subsidy*: which ranged from 75% in 1976 and 1979, to 50% in 1980 and while the states were required to absorb the remaining 25 percent. However, the total percentage subsidy was subsequently reduced to 50 percent; *Seed subsidy* of 50% percent or more on various improved seeds produced by the National Seed Service. Subsidies on *agro-chemical* varied, but were generally over 50 percent. *Subsidy on tractor hire service* which was mostly operated at the state level ranged from about 25 percent to about 50 percent of the actual cost of tractor services. In recent years government is withdrawing from agricultural input procurement, distribution and pricing activities, to allow the private sector take a leadership role.

Agricultural Cooperatives Policy

This policy was adopted to mobilize rural people for social and economic development through establishment and building of agricultural cooperatives. The policy thrust was the use of agricultural cooperatives for the distribution of some farm inputs as well as imported food commodities and the promotion and support for the establishment of cooperative farms and group enterprises. The policy is still in force, however, there are on-going moves to carry reform the cooperative laws in he country and make them more private sector oriented with limited role for government.

Water Resources and Irrigation Policy

River Basin Development Authorities (RBDA) wee established in 1977 to develop irrigation facilities around the country’s water resources. The scope of work of the RBDAs cover land preparation, development of irrigation facilities and construction of dams, boreholes and roads. Between 1979 and 1983, they became the major instrument of government’s direct agricultural production through large-scale mechanized farming. The RBDAs were partially commercialized in 1992 at which time subsidy on irrigation water supplied to farmers were removed. In the new policy of the government emphasis has shift to developing small dams as a more cost effective way of utilizing water resources for irrigation in the country.

Agricultural Credit

The Nigerian Agricultural and Cooperative Bank (NACB) was established in 1973 as a specialized DFI credit institution for agriculture and rural development, which went into distress in 1998. An Agricultural and Credit Guarantee Scheme ACGS was also established in 1977 to provide loan guarantees for commercial banks to lend a certain portion of their portfolio on agriculture at a government determined. Due to SAP and the non redemption of guarantee obligations by the CBN, the scheme is currently not being fully utilized by most commercial banks in the country. The People's Bank of Nigeria was established in October 1989 to provide credit to the informal sector in both urban and rural areas; the bank has now been merged with the new Nigerian Agriculture, Cooperative NACB to create the National Agricultural Cooperative & Rural Development Bank (NACRDB). A National Agricultural Insurance Company was established in 1987 to operate and administer the Nigerian Agricultural Insurance Scheme to indemnify farmers and their creditors from losses resulting natural hazards. The cumulative failure of government in these policy areas has led to new approaches under the new agricultural policy to focus more on provision and improvement of rural infrastructure to attract investment and financial services. Community banks took off in December 1990 with the mandate to carry out banking businesses at local level and their role in the financial system was to provide effective banking services in rural area as well as support small enterprises in the urban and peri-urban areas. Community banks were to be privately owned, although the Federal Government had undertaken to provide loan funds and technical support services. The community bank is undergoing a reform and full integration with the financial system with the hope of enhancing their effectiveness.

The new policy thrust focuses on integration and linkage of rural financial institutions to the formal banking sector through promotion, regulation and supervision of the growth of non-bank financial institutions with emphasis on savings mobilization at the grassroots. Other components of this new thinking include modification of the credit delivery system to include the cooperative and community-based organizations as delivery channels to reduce transaction costs.

Agricultural Research and Development

The major instruments of agricultural research policy was a decree promulgated in 1971 that created an Agricultural Research Council of Nigeria with the power to coordinate and control all agricultural research activities in Nigeria. This policy was changed in 1973 to allow the federal government to take over all research institutions, in 1975, yet another change occurred with the establishment of 14 institutes. In 1977 the National Science and Technology Development Agency was created to coordinate all research activities in Nigeria.

The funding of agricultural research in recent years has declined with limited results in the stated areas of national interests including biotechnology, breeding of predators for the biological control of crop pests. There is currently a low level of private sector in the funding of agricultural research; most of the research activities in the agricultural sector are done by international agencies of which the IITA is the most prominent.

Agricultural Extension and Technology Transfer Policy

The most important feature of agricultural extension policy in the 1970s was the establishment of the Agricultural Development Projects (ADPs) which launched in 1975 to replace the old system of state-based general agricultural extension service. The basic strategy involved the use of a unified agricultural extension system under the aegis of state-wide agricultural development programs (ADPs) designed and funded by the World Bank. An important relatively recent development in agricultural research and extension in the country involved the creation of institutional arrangements for a strong linkage between agricultural research, extension and farmers. In 1987, the National Agricultural Extension and Research Liaison Services (NAERLS) evolved through a long process to become the hob for planning and co-ordination of agricultural extension nationally. One recent institutional change in respect of agricultural research and development in the country involves the creation of the National Agricultural Research Project (NARP) in 1991 to fund priority agricultural research, strengthen agricultural research institutions and promote agricultural research - extension - farmer linkage. In spite of the huge resources and effort the Nigerian agriculture extension systems has remained largely supply led and unsustainable. The government and all stakeholders are currently in the process of restructuring of the extension delivery systems to make it demand driven and decentralized with increasing role for the private sector.

The Land Use Decree

The basic instrument of land use policy was the Land Use Decree promulgated in 1978. Under the decree, ownership of land was vested in the hands of state government in “trust for the people”; and user rights were to be granted to people through statutory rights granted by state governors in respect of urban land, and customary rights were granted by local government councils in respect of rural land.

The implementation of land development policy in the country was largely the responsibility of a National Agricultural Land Development Authority (NALDA) established in 1991. NALDA’s mandate covered provision of strategic support for land development and the promotion of the optimum utilization of the nation’s rural land resources. However, NALDA proved to be ineffective and was subsequently scrapped.

SUPPLEMENTAL ANNEX 2

Financial Sector Legal Framework, Regulation, and Supervision

Financial Sector Legal Framework

The major laws governing the operations of financial institutions in Nigeria are the following:

The *Central Bank of Nigeria (CBN) Act* No 24 of 1991 and its amendments in 1993, 1998 and 1999, which empowers the CBN to, among other things, promote monetary stability and a sound financial system in Nigeria. For example, section 27(3) of this law empowers the bank to conduct open market operations and issues other forms of stabilization securities, while section 28(b) authorizes the bank to issue guidelines to any person and any institution that engages in the provision of financial services, including bureaux de change, DFIs, community banks, discount houses and insurance companies. In the past few years, the CBN has been able to issue guidelines governing the operations of virtually all the financial institutions in the country, but there are obvious gaps in capacity to monitor adherence to these guidelines.

The *Banks and Other Financial Institutions Act* (BOFIA) No 25 of 1991 and its amendments of 1998 and 1999, which is the main legislation that sets the regulatory and supervisory framework for financial institutions. While section 57 requires all financial institutions, other than insurance and stock broking companies, to apply and obtain operating license from CBN before commencement of business, section 59 empowers the bank to supervise and regulate the activities of all financial institutions, including specialized banks. The Act also encompasses various prudential rules that are in line with, or inspired by, international standards and best practices. There is a proposal to review this law pending at the National Assembly, but even in its present form, there are still many critical provisions that the CBN lacks the capacity to implement, especially with regards to other financial institutions, different from commercial banks.

The “*Prudential Guidelines*” issued by the CBN in November 1990 is another important document. It dwells extensively on loan classification and rules for establishing allowances against impaired loans and expected losses as well as off-balance sheet items. Commercial loans are generally classified into three - sub-standard, doubtful and lost, and banks are expected to make 10, 50 and 100% provisions respectively for each category. There is also a requirement for 1% general provision for all loans. In April 2001, the CBN introduced special rules for classifying and providing for loans made to all tiers of governments and their agencies. Provisions of 50 and 100% are expected for performing and non-performing assets respectively. This is one of the CBN’s strategies to redress the crowding out of the private sector by the public sector.

The *Statement of Accounting Standards* issued by the Nigerian Accounting Standard Board in 1990 was tailored to the need of banks and non-bank financial institutions to provide guidance for accounting policies and methods that should be followed by these financial institutions in the preparation of their financial statements. This initiative was taken to remedy unacceptable practices within the industry and ensure greater consistency among banks’ accounting policies.

The *Economic and Financial Crimes Commission Act*, 2002 was enacted to give birth to a commission with powers to investigate all financial crimes as well as coordinate and enforce all economic and financial crimes laws such as the *Failed Banks (Recovery of Debts) and Other Financial Malpractice in Banks Act No 18* of 1994, the *Money Laundering Act* No 3 of 1995 (as amended in 2002) and the *Advance Fee Fraud and Other Fraud Related Offences Act* No 13 of

1995. The commission is also empowered to adopt measures to eradicate economic and financial crimes and facilitate rapid exchange of scientific and technical information with bodies within and outside Nigeria, performing analogous functions. The commission may identify, trace, freeze and confiscate proceeds derived from terrorism and other financial crimes. Within the framework of curtailing financial crimes, the CBN now insists that all banks operating in Nigeria must strictly observe the "Know Your Customer" or KYC rule.

Just as there are some inherent weaknesses in the legal framework for financial institutions in Nigeria, there are also the challenges of limited technical capacity for enforcement. While a comprehensive bill to amend BOFIA and minimize the perceived weaknesses in the legal framework is pending before the National Assembly, the issue of enhancing technical capacity still remains a major challenge that should attract an equally important attention. Specifically, a most pressing legal and regulatory issue is the need to strengthen CBN's capacity to supervise and enforce prudential regulations on the DFIs that have recently come under its supervision.

As already prescribed by the World Bank, there is also the need for an enhancement of property rights as well as the framework for secured transactions, such that a wider range of assets (tangible or intangible) can be used as collateral for financial transactions. In particular, Nigeria's current system for creating, perfecting, and enforcing security interests has serious weaknesses, which need to be addressed. This inadequate system negatively affects the costs of credit transactions, the characteristics of credit contracts, and the degree of access by rural micro and small-scale entrepreneurs to financial services.

Suitable reforms would include: (a) introducing a new law of secured transactions, which would allow effective use of movable assets, including equipment, inventory, receivables, and consumer goods as collateral; (b) improving the efficiency of public registries, permitting lenders to record pledges of land and housing, and provide quick access to information about existing liens; and (c) introducing a mechanism for expeditious recovery of collateral, including foreclosure of mortgage loans. Restructuring public registries and an improved legal framework are necessary conditions for well-functioning rural financial markets.[25]

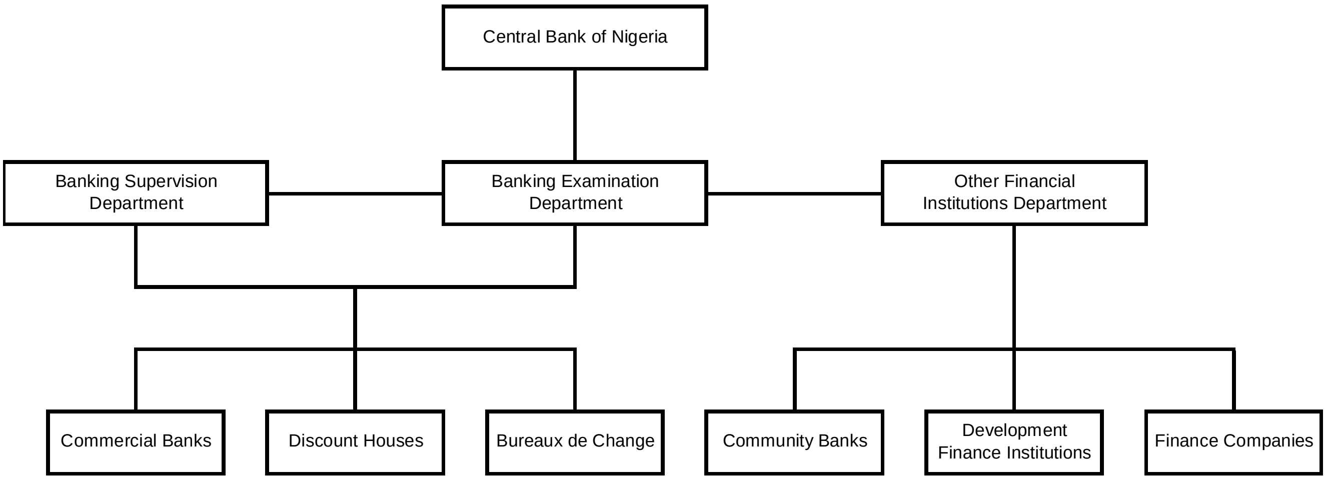
Regulation and Supervision of Financial Institutions

The Central Bank of Nigeria (CBN) is the apex regulatory authority of the Nigerian financial sector, deriving its legal authorities from the Central Bank of Nigeria Act 24 of 1991 (as amended in 1997, 1998 and 1999) and the Banks and Other Financial Institutions Act (BOFIA) 25 (as amended in 1997, 1998 and 1999). These laws superseded the CBN Act of 1958 and the Banking Decree of 1969. Both Acts 24 and 25 gave the CBN more flexibility in regulating and supervising the banking sector as well as other financial institutions such as community banks, primary mortgage institutions, finance companies, bureaux de change, discount houses and development finance institutions, some of which hitherto operated outside the framework. For example, prior to the 1998 amendment of the BOFIA, the responsibility for supervision of financial institutions was split among several agencies. The CBN was charged with the supervision of commercial and merchant banks (now universal banks with abolition of the dichotomy between commercial and merchant banking with effect from January 1, 2001). The National Board of Community Banks (NBCB) was responsible for the supervision of community banks in all respects with the exception of granting licenses which was entrusted to the CBN. Also, the Federal Mortgage Bank of Nigeria (FMBN) became a regulatory body in 1989 with licensing and supervisory powers over mortgage institutions until these responsibilities were shifted to the CBN in 1998 (see the figure below). The governor of the CBN is also the chairman of the Financial Services Regulation Coordinating Committee (FRSCC), which was re-constituted in 1998 to harmonize the

[25] World Bank (2000): Financing Nigeria's Rural Micro and Small Scale Enterprises

supervisory efforts of the various organizations such as the Nigerian Deposit Insurance Corporation (NDIC), National Insurance Commission (NAICOM), Securities and Exchange Commission (SEC) and the Corporate Affairs Commission (CAC).

Institutional Map of Regulation and Supervision for Financial Institutions



By virtue of the 1998 amendments to the CBN Act and BOFIA, what looked like an overlapping of supervisory roles between the CBN and NDIC had been streamlined. The primary role of NDIC, like the Federal Deposit Insurance Corporation (FDIC) in the USA, is now primarily to provide protection for bank deposits in order to promote confidence in the banking industry. In this regard, it collects 15/16 of 1% of banks' deposits as premium and pays depositors up to N50,000 in case of bank failure. While several episodes of banking distress since 1989 challenged the actual effectiveness of existing safeguards, NDIC has fulfilled this mandate rather successfully as receiver/liquidator, and it has been able to reimburse most insured deposits – although in many cases, depositors were deprived of their rights and insurance benefits for long periods of time. It must be noted, however, that the NDIC performs the role of receiver/liquidator of terminally distressed banks only at the instance of the CBN.

The CBN and the NDIC now jointly agree the schedule of routine bank examinations each year. For example, in 2002, out of the 89 banks and discount houses scheduled for routine examination, the CBN examined 65 banks and 5 discount houses, while NDIC covered 24 banks. The two institutions also cooperate in respect of follow-up examinations (to ascertain level of compliance with examiners' observations), on off-site inspections, ad-hoc assignments as well as other spot checks.

To strengthen its ability to fulfill its mandate as the pivotal institution in charge of supervision and regulation of the financial system, the CBN commenced a restructuring and re-engineering program (called Project EAGLE), which has today resulted in remarkable improvement of the apex bank's people and processes. The Bank Analysis System (BAS), an application to improve the efficiency of banking supervision and examination, was acquired and installed as part of this process. In 2002, the Financial Sector Surveillance Committee (FSSC) was constituted with the objective of ensuring effective surveillance of the financial system. This committee is composed of the governor, his four deputies and the directors of banking supervision, bank examination, banking operations, other financial institutions, trade and exchange, foreign operations, research and legal services departments as well as the governor's office. Within its first year of operation, the committee was able to curb (quite remarkably) foreign exchange malpractices in the banks, facilitate the introduction of the Dutch Auction System for trading in foreign exchange (a development that has helped to moderate the demand pressure in that market), come up with the idea of a “life-boat facility” for sick banks, evolve policies aimed at improving corporate governance in the banks and enhance inter-agency cooperation within the framework of FSRCC. The FSSC is no doubt impacting positively on the regulatory environment for the commercial banks, but the real challenge ahead of the CBN is how it intends to cope with the supervision and regulation of the other financial institutions, which in terms of financial power may be smaller than the commercial banks, but in terms of number, outreach and geographical spread, are quite enormous.

Regulation and Supervision of Commercial Banks

Licensing. No person can carry on any banking business in Nigeria except it is a company duly registered in Nigeria and holds a valid banking license issued by the CBN. The embargo placed on licensing of new banks was lifted in 1998 by the CBN, and licenses are issued only on the submission of a feasibility report on the proposed bank. This report must be accompanied by a draft copy of the memorandum and articles of association of the proposed bank, a list of shareholders, directors and principal officers, the prescribed application fee (currently N500,000), the deposit of a sum equal to the minimum paid-up share capital (currently N2 billion), and any other information that may be required. When an application is approved, a license fee of N5 million is payable. When any condition is attached to the issuance of license, the bank should make good those conditions within the stipulated period, otherwise, the bank would be guilty of an offence. There are no limitations on who may own shares of a licensed bank, just as there are no limitations on the percentage that may be owned by a foreign shareholder. However, sources of fund are investigated to ensure they are not linked to drugs, and no director, who is a shareholder in many banks, can sit on the board of more than two banks. Again, there are specifications as to the minimum qualifications and experience that principal officers of the bank must have to ensure sound corporate governance. The practice of a board chairman serving simultaneously as a chairman/member of board committees has also been stopped.

The prudential regulations governing commercial banking operations in Nigeria are as follows:

Minimum Paid-up Capital. In the light of the naira exchange rate depreciation, rampant inflation and, erosion of capital due to mounting losses in loan portfolios, the minimum paid-up capital for commercial banks was increased to N1 billion for existing banks and N2 billion for new banks with effect from December 31, 2002. All banks are however expected to raise their paid-up capital to N2 billion by December 31, 2005.

Capital Adequacy Ratio. In keeping with international standards, the minimum capital ratio to total risk assets was raised from 8% in 2003 to 10% from January 1, 2004. Furthermore, every bank is expected to maintain a ratio of not less than 1:10 between its adjusted capital funds and total credit, net of provisions.

Limitation on Risk Concentration. The maximum amount of loan that could be made to an individual is fixed at 35% of shareholders’ funds, unimpaired by losses. There are however no limitation in terms of geographical spread or diversification of loans.

Liquidity Reserve Requirements. Two reserve requirements used to serve prudential and liquidity management purposes are the cash reserve requirement and liquidity ratio, which from January 1, 2004 have been fixed at 9.5% and 40% respectively. While interest would be paid on cash reserve in excess of 8%, the CBN provides for the likelihood of reducing liquidity ratio in the course of 2004 as the problem of excess liquidity in the banking system abates.

Loan Classification and Provisioning. Since 1990, banks have been required to establish general and specific provisions. Each licensed bank should have at least 1% in general provision in addition to specific provisions made on the basis of perceived risk of default. As for specific provisions, for principals repayment not yet due, provisions should be made as follows: i) for sub-standard category, (i.e. unpaid principal and/or interest remaining outstanding for more than 90 days but less than 180 days), the minimum reserves requirement is 10% of the outstanding loan balance; ii) for doubtful category (unpaid principal and/or interest remaining outstanding for more than 180 days but less than 360 days), the minimum reserves requirement is 50%; and iii) for lost category (unpaid principal and/or interest remaining outstanding for 360 or more), the minimum reserves requirement is 100%. From July 2001, the CBN introduced special provisioning requirements for lending by commercial banks to all tiers of governments. Banks were directed to make 50% provision for performing credits and 100% for classified credits.

Insider Lending. The BOFIA limits the amount of unsecured loans and advances to N500,000 to a bank's shareholder, director, executives, officers and their relations.

Other non-prudential regulatory requirements are:

Limitation on types of financial services authorized. With the introduction of universal banking in 2001, commercial banks in Nigeria have no restriction on the types of financial services they can provide, but when rendering non-banking services, they are expected to comply with the operating rules of the relevant regulatory body (NAICOM for insurance and SEC for capital market services).

Annual External Audit and Information Disclosure. All banks are expected to open their books for external audit at the end of the accounting year. This audit shall be carried out by a member of a professional accounting body in Nigeria who is in professional accounting and audit practice in Nigeria. The audit shall indicate, among other things all infractions of CBN regulations, including the anti-money laundering act. As stated in Article 27 of the BOFIA, audited annual accounts of banks must be published in a daily newspaper but should be forwarded to the CBN not later than four months after the end of its fiscal year for review prior to publication. As regards the form and content of the annual accounts, financial statements should comply with the accounting standards laid out in the Statement of Accounting Standards published by the Nigerian Accounting Standard Board.

Internal Supervision Requirements. Commercial banks in Nigeria are expected to set up internal control units, whose primary duties should be to monitor internal operations and ensure compliance with all statutory regulations. In order to promote safer behavior and the adoption of best practices, supervisory authorities have started to provide banks with more detailed guidance on all sensitive internal control issues. Furthermore, each commercial bank is expected to appoint Money Laundering Compliance Officers who would be responsible for enforcing the provisions of the Money Laundering Act of 1995. The Chief Compliance Officer in each bank should not be below the rank of general manager.

Interest Rate Rules. Commercial banks fix deposit and lending rates in response to market dictates. However in view of perceived wide spread between deposit and lending rates, the CBN employs moral suasion to encourage banks to narrow the spread. More specifically, the CBN expects commercial banks to keep their lending rate at not more than 400 basis point above its base (or minimum rediscount) rate.

Customer/Market Targeting Requirements or Quotas. With the liberalization of the financial system in the late 1980s, all forms of targeting had been abolished. Today, commercial banks are only implored, through moral suasion, to lend to the productive sectors of the economy. The current SMEIS is actually a product of moral suasion.

Deposit Insurance. It is compulsory for all licensed commercial banks in Nigeria to insure their deposits with NDIC. The premium payable is currently 15/16 of one percent of deposits.

Rules Governing Loan Security and Collateral. The CBN expects every bank to properly protect itself in its lending operations, and also to make appropriate provisions for non-performing assets. It has also imposed a ceiling of N500,000 on loans to any of the directors of the bank on self-recognition.

Credit Information Sharing. A credit bureau has been established at the CBN and all banks are expected to report all their credits to the bureau.

Movement toward risk-based supervision. The CBN has already started the process of shifting from a quantitative approach to a more risk-based approach, in response to Basle. Furthermore, the CBN has adjusted to the NDIC's system of structuring its operations by banks rather than by tasks. Beyond this level however, is the need for the CBN to start giving consideration to the intrinsic strength of each institution – may be based on the CAMEL (C for capital, A for asset base, M for management, E for earnings and L for liabilities) rating system (already in use by NDIC), rather than the existing, across the board, capital requirements.

License Revocation. Section 34 of BOFIA empowered the CBN to turn over any bank with a deteriorating state of affairs to the NDIC, which in turn shall request the bank, especially those with a risk-weighted assets ratio below 5% but above 2%, to recapitalize within a stipulated period, failing which the Corporation may recommend the revocation of license to the CBN. Whenever the license of a bank is revoked in this manner, NDIC would obtain a Federal High Court order to wind up the affairs of the bank. Other triggers for license revocation are failure to operate within the boundaries specified in the operating license, failure to comply with any obligation imposed upon it under BOFIA and the CBN Act, or a state of insufficient assets to meet the liabilities. Despite the wave of closures initiated over the recent past (thus demonstrating a genuine willingness to rid the banking industry of insolvent banks) supervisors' decisions are still influenced by political concerns.

Regulation and Supervision of Consumer Finance Companies

Section 28 of CBN Act 24 of 1991 (as amended) as well as Sections 56-61 of BOFIA 25 (as amended) empowered the CBN to regulate and supervise the activities of Finance Companies (FCs). In this regard, the CBN issued guidelines for the operations of FCs in 2002, the major highlights of which are as follows:

Definition. An FC is a stand alone entity licensed to provide financial services such as fund management; equipment leasing; hire purchase; debt factoring; debt administration; LPO, project and export financing and financial consultancy to consumers as well as to industrial, commercial and agricultural enterprises. FCN may also issue voucher, coupons and credit cards.

Licensing. Licenses are issued upon the payment an application fee of N10,000 and the deposit of N20 million as share capital, provided of course, that no increase in capital must be undertaken without CBN's approval. All sources of funds contributed as share capital should be verified and adjudged acceptable. Applicants would also provide a detailed feasibility report, the names and curriculum vitae of proposed members of the board of directors, the shareholders as well as top management staff. Other fees payable are the non-refundable licensing fee of N50,000, annual licensing renewal fee of N20,000 and change of name fee (if applicable) of N10,000. By December 2002, only 49 out of the 102 FCN have met the minimum capital requirements.

Directors and Management Requirements. No current employee or director of a commercial bank would be eligible for the post of directors in an FC except the FC is promoted by the bank, and no director could be appointed without CBN's consent. The CBN reserves the right to conduct investigation into all cases of high turnover of senior officers, including, in particular, the punishment of any officer for disallowing fraudulent activities or spurious resignations to cover up fraud. Both the chief executive and each head of department in a FC are expected to have a degree/equivalent or relevant professional qualification with 7 and 5 years post-qualification experiences respectively.

Commencement of Operation. A FC could commence operation after it has disclosed its location and date of take-off to the CBN and has also obtained (in writing) the CBN's consent to do so.

Sources of Funds. A FC is not authorized to accept deposits. It is therefore an offence to advertise or solicit or accept money on deposit. An FC's sources of funds are limited to shareholders' fund and borrowings.

Returns. FCs are expected to render quarterly returns to the CBN, not later than 14 days after the quarter in question, and the returns should cover areas such as assets (performing and non-performing), liabilities, profit and loss, investments, borrowings, credits to other institutions, off-balance sheet items, etc. Penalties ranging from N2,500 to N100,000 are applicable for late or false returns, and both the FC, as a corporate entity, and the directors may be answerable for defaults in the rendering of returns. Furthermore, all FCs are expected to submit audited accounts for the consideration and approval of Director, Other Financial Institutions Department, CBN not later than four months after the end of the financial year, and the approved account should be published in at least one national daily newspaper.

Prudential Guidelines

Capital Funds Adequacy. The minimum capital/risk weighted assets ratio for an FC is 12.5% and any FC with a lower ratio, or with a ratio of less than 1:10 between its capital funds and net credits are forbidden from granting fresh credits, paying dividends or borrowing from the public, and may forfeit its operating license if it fails to recapitalize within a specified period.

Maintenance of Capital Funds and Dividend Payment. At least 15% of profit shall be transferred to statutory reserve until the reserve fund equals the paid up capital. Thereafter, the percentage accretion should be 10%. No accretion to reserve or payment of dividend is allowed until all pre-operational costs have been written off and the appropriate capital adequacy ratios have been met.

Single Obligor Limit. The maximum exposure to any single individual or investment in any company should not exceed 20% of the shareholders' funds, unimpaired by losses. Any contravention would attract fines of N100,000 and N10,000 respectively on the FC and the director respectively.

Borrowing Limits. No FC should borrow more than N50,000 from any single individual, or more than 10 times its shareholders' funds, unimpaired by losses.

Provision for Classified Credits. The same ratios specified for commercial banks are applicable to FCs, but in addition, they are expected to perform quarterly assessment of their loan portfolios for classification purposes.

Investment in and Revaluation of Fixed Assets. Not more than 50% of an FC's shareholders' funds could be invested in fixed assets, and revaluation of assets is permitted only once in 5 years. The difference between the market and the historical value of the assets being re-valued must be discounted 55%.

Disclosure of Interest. All directors having any interest in an advance, loan or credit facility are expected to disclose this to the other directors, failing which the director would be liable to a fine of N100,000 or outright removal from office.

Opening/Closing of Branches. An explicit approval of CBN is required before the opening or closure of any branch, otherwise a fine of up to N200,000 may be imposed in the first instance, plus an additional N10,000 for each day the branch remains opened or closed without due authorization.

Display of License and Interest Rates. It is mandatory for each FC to display its license and applicable interest rates conspicuously in its business offices.

Establishment of Internal Controls. Each FC should establish an internal control unit to monitor and ensure compliance with both external and internal regulations as well as to report on a quarterly basis to the Director, OFID of the CBN all frauds and attempted frauds. There is a penalty of N25,000 per quarter for failure to comply with this rule.

Restructuring and Schemes of Arrangement. No FC is allowed to take any restructuring step aimed at restoring operational viability without first obtaining the approval of the CBN, through the Director of OFID.

Prohibitions. Apart from the fact that FCs are not allowed to take deposits, they are also precluded from dealing in foreign exchange or engaging in businesses other than the ones for which they are licensed. Furthermore, no FC may give credit against the security of its own shares.

License Revocation. Contradiction of these guidelines, persistent activities prejudicial to the Nigerian economy, submission of false returns, etc could trigger license revocation by the CBN

A review of the statutory returns of FCs in 2002 showed the following general lapses:

- Low capital base
- Absence of manuals of operations and documented policies
- Poor credit administration and accounting systems
- High proportion of non-performing assets as well as high overhead expenses, both of which imply thin margins
- Absence of internal audits in most FCs
- Low level of liquidity and training of personnel.

Regulation and Supervision of Development Finance Institutions (DFIs)

Although section 59 of BOFIA (as amended) gave wide powers to the CBN to regulate and supervise DFIs in Nigeria, there is no major achievement to date on the part of the CBN. This is due in part to the wide geographical and functional dispersion of these institutions vis-à-vis the limited human and material resources at the disposal of the CBN. The most remarkable step the CBN has taken over the years has been to request the DFIs to render regular, timely and accurate returns as well as to submit their audited accounts to it before publication. Although the CBN has established a special department (OFID) specifically for the regulation and supervision of these ‘other financial institutions,’ the resources in that department still fall far below requirements.

The principal DFIs in Nigeria are the Bank of Industry (the product of the merger between Nigerian Industrial Development Bank (NIDB), Nigerian Bank for Commerce and Industry (NBCI) and National Economic Reconstruction Fund (NERFUND); Nigerian Agricultural, Cooperative and Rural Development Bank (the amalgam of Nigerian Agricultural and Cooperative Bank (NACB), Peoples Bank of Nigeria (PBN) and Family Economic Advancement Program (FEAP); and Nigerian National Mortgage Bank (NinamBank) – proposed to result from the merger of Federal mortgage Bank of Nigeria (FMBN) and Federal Mortgage Finance Limited (FMFL).

Apart from the CBN, each of these major DFIs also has supervising government departments such as the Ministry of Agriculture and Rural Development for NACRDB, Ministry of Works and Housing for NinamBank and Ministry of Industry for BOI. Quite frequently, these ministries also issue policies and guidelines which the DFIs are expected to abide by. For example, NACRDB has instructions in 2003 from its supervising ministry to grant 70% of its loans to the poor (‘micro-loans’) at single digit interest rates. Virtually all the time, the (seemingly protective and market-distorting) regulatory instructions of the ministries contradict the market-oriented policies of the CBN. This is one of the major reasons why most DFIs have neither been viable nor run on a sustainable basis. The CBN described the performance of the DFIs in 2002 as unimpressive, in spite of the restructuring and recapitalization of six of them. Clearly, there is an urgent need to further streamline and strengthen the regulatory arrangements for DFIs in order to bring them into the mainstream purview of banking regulation and supervision in Nigeria.

Regulation and Supervision of Community Banks

The National Board for Community Banks (NBCB), a government agency, funded through the fiscal budget and staffed with government employees, was originally created by the federal government to “promote, develop, monitor, and supervise” the community banking system. Therefore, its Department of Banking Inspection was responsible for on-site and off-site inspection of CBs. This department would collect and appraise the statements of accounts submitted by the CBs in addition to field inspections. Off-site supervision was subject to the willingness of CBs to submit monthly reports and annual reports. In 1998, compliance with monthly reports was less than 60 % of existing CBs while the percentage of those submitting annual financial statements, which was mandatory for all CBs, was even lower. Although the NBCB was performing its supervision of CBs with the CBN, there has been no systematic reporting of its functions. One of the main NBCB instruments for promotion of CBs – the matching loans to augment CB working capital – has benefited only 313 of all banks created since 1990, for a total of N 110 million, out of which N 48 have been repaid. Most of these loans were granted before 1996, and presently, NBCB does not have the resources to continue this line of support. However, acting under the provisions of BOFIA, the CBN has taken over the supervisory responsibility of CBs, meaning that the NBCB is currently left with functions that exist only on paper. With the supervision function gone to CBN, and since the promotion and development functions as originally conceived for NBCB do not match the current need for consolidation and effective integration of community banks with the mainstream financial market, the federal government should review the status of NBCB as quickly as possible. However, its inspectors, who have continued to work with CBN/NDIC as team members in CB inspections, should be transferred to the CBN in view of their field experience.

In 2002, the CBN issued comprehensive guidelines for the operations, supervision and regulation of CBs. The major highlights are as follows:

Licensing. An approval in principle to set up a CB can be obtained from the Governor of CBN upon the submission of an application for licensing, supported with an application fee of N20,000 and a paid up capital of N5 million. [There are no more restrictions on the ownership of CBs, outside the provisions of Companies and Allied Matters Act, CAMA, which stipulates that at least two people must subscribe to the share capital of a company. In other words, the restrictive shareholding structure of 5% for individuals and 30% for Community Development Associations (CDAs) has been removed to enable individuals and CDAs freely decide on their percentage holdings in CBs.] Other required documents in support of application for license are the draft memo and articles of association; a list of shareholders as well as the proposed organization chart showing the board, management and staff; the name of the CB and a detailed list of its proposed services; and the proposed training program for staff and management. Other financial requirements are the non-refundable licensing fee of N50,000 and change of name fee of N5,000.

Board and Management Requirements. The approved size of board is between 3 and 7, while the manager and the accountant of the bank must each possess a recognized university degree/equivalent or professional qualification with at least 3 years post-qualification experience. It is a requirement that all CBs obtain CBN approval for all their top functionaries, including the directors.

Returns. All CBs are required to render quarterly returns to the CBN not later than 28 days after the expiration of the quarter. The required details are similar to that which is required from FCs. Every year end, the CB would also submit its audited financial reports not later than four months after the end of each accounting year. All CBs are expected to publish their audited accounts after they have been approved by the CBN. There is a fine of N1,000 for each day a return is delayed, and any director that contributes to the delay could be fined up to N50,000 or even be removed from the board of the CB.

The prudential regulations governing community bank operations in Nigeria are as follows:

Investment in Treasury Bills (TBs). A minimum of 5% of total deposits must be invested in TBs.

Reserve Ratios. Minimum liquidity and capital adequacy ratios are 30 and 8% respectively, but the 5% investment in TBs would not count in the computation of the liquidity ratio. Each CB should also maintain a 1:10 ratio between shareholders' fund unimpaired by losses and net credits.

Single Obligor Limit. This has been pegged at 10% of shareholders' fund, unimpaired by losses, and should embrace all forms of exposure – whether they be loans or guarantees. There are sanctions to the CB or its functionaries linked to any violation of the single obligor limit. These include revocation of operating license and loss of office, among others.

Statutory Reserves. No transfer to reserves should be made until pre-operational costs and losses have been made good. Thereafter, a minimum of 25% of profit after taxation should be transferred to reserve fund every year until the reserve fund is equal to paid-up share capital. When the reserve fund is equal to or in excess of paid-up capital, a sum equivalent to a minimum of 12.5% of net profit should be transferred.

Audit and Appointment of Auditor. Each CB should annually appoint, from the body of practicing accountants in Nigeria, an auditor for its records. This auditor, who should not have any direct or indirect interest in the CB, must be approved by the CBN and must indicate in its report of findings all cases of contravention of BOFIA, losses that erode capital funds and threats to the interest of depositors in the CB. The CBN reserves the right to appoint auditors for CBs that fail to do so and any auditor who fails to observe all the cautions stipulated in the guidelines could be fined up to N50,000 or have his status as auditor determined.

Advertisement. No CB may place deposit mobilizing advertisement in the press until the CBN has consented to the advert concept.

Prohibitions. No CB is allowed to open, close or relocate a cash office without CBN clearance. Any agreement or arrangement which seeks to alter the ownership of a CB or merge it with another body must be consented to by the CBN. A CB should not engage in commercial, agricultural, industrial or any other business undertaking except with the prior approval of the CBN.

Checks on Insider Abuses. To forestall cases of insider abuses, no CB should appoint anyone as director who is a director of another CB, or allow to be outstanding against a director or any firm in which the director has interests, aggregate credit facilities of up to N50,000.

Revocation of License. Failure to comply with CBN directives or engaging in activities prejudicial to the Nigerian economy and/or outside the scope of its operating license may trigger the revocation of license to a CB. Submission of false and misleading information during and after the processing of application for license as well as failure to meet matured obligations to customers may also trigger license revocation.

In 2002, the CBN licensed 282 of the 747 CBs that were in operation and carried out pre-licensing examination on 182 others. Furthermore, routine examinations were conducted on 116 CBs, with the following lapses featuring prominently:

- Lending without adequate collateral;
- Failure to adhere to guidelines, particularly in respect of single obligor limits;
- Preponderance of non-performing insider-related facilities;
- Inadequate provision for non-performing assets; and
- Weaknesses in board and management, internal controls, accounting systems, credit administration and loan recovery.

This is a good pointer to areas requiring urgent support to make the best of the community banking system. On the part of CBN, there is an obvious problem of capacity gaps, which must be addressed, so that the bank would be in a position to spotlight these weaknesses in the CB system and proffer early amelioration, before they assume damaging systemic proportion.

Regulation and Supervision of Cooperatives

Cooperative activities are concurrent in the Constitution of the federal republic of Nigeria, implying that both the federal and the state governments are involved in their regulation and supervision – although the federal government has placed more emphasis on agricultural cooperatives than other forms of cooperatives (such as consumer cooperatives, thrift and credits/savings and loans). There are two levels of regulation in the Nigerian cooperative movement, namely self-regulation and governmental regulation. The self-regulatory mechanism thrives on the three-tier layout of the cooperative movements, namely the primary, secondary and the tertiary levels. At the primary level are the various cooperative Societies, composed of members who also appoint officers among themselves. Members protect their interests in a mutually reinforcing fashion. Each primary society is a member of a secondary institution or Union to which some self-regulatory rights are conceded. The Unions, in turn, belong to apex or tertiary institutions, which also relates to the Unions as semi-regulators within the self-regulatory arrangements.

In every State of the federation, there is a Registrar of Cooperatives, who registers all cooperative societies, unions and federations (as the apex institutions are called), after satisfying some pre-registration conditions in terms of membership size, clear specification of objects, preparation and application of acceptable bye-laws, attainment of a minimum financial clout, appointment/election of acceptable officers from among the members, etc. In addition to registering the societies/unions, the Registrar also appoint and deploy Cooperative Inspectors and Auditors, who conduct regular inspection/audits of the cooperative institutions to ensure that their operations and their bye-laws accord with the cooperative laws of the federation. Only members of a cooperative society may benefit from its activities and the operating profits. While portions of operating profits are shared by members in accordance with their paid-up share capital in the society, other portions are ploughed back to create reserves. Reserves are shared among members only in cases of liquidation of the society. Each society is expected to hold an Annual General Meeting (AGM) at which the results of operation in any given year are presented to members for their approval.

The performance of the Nigerian cooperative system has been poor, first because of the relative lethargy on the part of government to encourage this institutional arrangement, which promises resilience and good opportunities to its members; and second because of the absence of a clear focus and limited knowledge amongst those who assume leadership in the cooperatives. In other words, there is a clear case of capacity inadequacy to initiate and run an effective cooperative system on a sustainable basis. This should be the focus of policy in the near term.

Regulation and Supervision of NGO MFIs

There are currently no regulatory/supervisory arrangements for NGO MFIs in Nigeria. The only official capture of donations to NGOs for their operations is by the National Planning Commission (NPC), and there are indications that even the NPC has been slack in this regard. However, the new policy on MFIs, which is being put together by the CBN, may help to plug this void.

SUPPLEMENTAL ANNEX 3

MSME Financial Service Providers

Overview

The combined outreach of the MSME finance institutions in Nigeria is estimated to cover less than 20 million people. This estimate includes the combined clientele of the former Peoples Bank of Nigeria, Nigeria Agricultural and Cooperative Bank, Family Economic Advancement Programme, Cooperatives, NGOs, Rural Banks and Community Banks. In a nation where 70% of the estimated 120 million populations is living below poverty level, there are about 80 million poor and low-income people that need to be reached with financial services.

The limited scale and outreach of lending to MSMEs does not correspond to the high level of government, donor, and banking sector resources invested in this sector over the past 20 years. The total estimated NGO MFI client base is between 150,000 and 200,000 borrowers, not including all the members of numerous cooperatives, government agricultural financing schemes, and informal ROSCAS that poor people have come to rely on. The gap is vast given Nigeria's acknowledged high potential for achieving significant growth in the MSME sector.

To provide a regional context, in Mali, where more limited resources are allocated to MFIs and NGOs, client coverage has been more extensive, reflecting the greater capacity of supply institutions to deliver loans affordably and efficiently. The same is true in Guyana and Benin, where micro-credit reaches a substantially larger proportion of the poor. In those countries, the growth of the MFI industry has achieved maturity with institutions exhibiting a greater capacity to absorb capital. Supply-side providers have the institutional capacity to utilize established standards and policies (both at the country and regional level), thus fostering intermediation from the private commercial banking sector.

Among the many systemic constraints to the growth of micro and small business lending in Nigeria is the history of instability, high corruption and poor public resource allocation that marked the era of military rule and short-lived civilian governments following the 1970 civil war. The result of the centralized top-down subsidized development approach of the federal government was that 70% of the Nigerian population (or approximately 80 million people) is living below the poverty line according to USAID/Nigeria estimates, and per capita GDP was only $300 in 2003 (USAID 2003a, p.40).

Current Nigerian policy makers consider MSME development as the key to a viable strategy for addressing the needs of poverty alleviation. The GON's just released NEEDS strategy will help to define this development strategy further. The focus on MSMEs is demonstrated by the discussions underway at the Central Bank and the MOF regarding the establishment of standards for regulating the activities of providers of financial services. They want to ensure that the various NGOs, community banks and non-financial intermediaries that constitute the fabric of the micro-finance and SME lending industry play a sustainable role as resource providers, and ensure protection of the publics' financial resources.

The challenge facing the supply side of micro-lending lies in the gap between the size of the very limited population currently served by MFIs and licensed providers, and the vast number of households that are still out of reach of regulated MFIs. According to World Bank estimates, over 80% of the rural population is still served by traditional money lenders. The formal sector has been ineffective in serving the poor despite outreach campaigns to increase client access. The main challenge that the financial industry has to overcome is that it has become fragmented between many providers of undifferentiated products and has been unable to achieve any significant level of growth leading to achieving the next stage of its lifecycle. To bridge this gap will require a market based approach that builds on a strong enabling environment, promotion of best practices, and a competitive based business development strategy that promotes healthy competition.

Lending Practices – Where We Are Now

Several factors affect the poverty lending supply chain, both within the lending institutions themselves and externally due the complexity of the Nigerian financial sector and capital markets. The Nigerian economy's constant state of transition until recently has brought instability to the general economic environment. The structure of interest rates encourages short-term lending, reflecting the risk of capital erosion due to a high level of inflation. Default risk is high and capital rationing precludes access by businesses and borrowers to a large pool of liquidity held by commercial and community banks. On-lending by MFIs is practiced, but the spreads are often too low to cover operational costs. MFI outreach to the rural populations has not yet become extensive. Several factors are at work that affect the supply of financial services. These include:

- Lack of rural transport and communication networks: Outreach in many parts of the country is inhibited by the distance from towns and inability of financial institutions to reach many people year round;

- Formal financial institutions are concerned about the risk in lending to non-literate populations. This can be overcome by using appropriate group lending products in credit plus education programs. Mali and Niger have high illiteracy levels and yet successful programs exist in both countries. Staffing with women supervisors is a challenge, but necessary in Islamic cultures where women are the key clients;

- Risk management preoccupation. The short-term structure of loans is caused by the need to match the maturities of savings mobilized (which are also short-term).

Among the internal factors are:

- MSME loan providers have not specialized in any specific group of customers; and

- MSME loan providers have not developed differentiated products based on client demand analysis to meet the specific needs of groups of customers with better and more targeted products.

The result is a plethora of institutions that offer the same packages, with the only exception being a few NGOs that provide integrated loans[26]. Effective loan demand is not met, and the majority of the MFI lending programs use a "one-size-fits-all" approach, which makes it difficult to match lending terms with the true customers' needs. The focus is therefore on the client's ability to pay and not on creating real value, which in the long run will lift and improve lives in a sustainable way. Consequently, lending is restricted to those with banking experience or good payment history with the lending institution.

MFI and NGO clients are usually women, who received approximately 95% of all microfinance loans. Farmers, producers and food processors have also benefited from small loans, however, lending to SMEs has not received the same attention as microcredit. In addition, several factors

[26] The loan delivery model of NGOs reflect the need to satisfy other preoccupations that are tied to poverty and should not be totally discounted in addressing loan growth and demand.

are discussed in greater detail in the following pages to explain the slow increase in lending to SMEs. The principal cause is lack of adequate capital. In addition three has been a policy gap at the GON and CBN level regarding the microfinance policy framework that is needed to provide guidance to the MFI industry. In the current supply environment, it is very difficult for SME lending to blossom because financial institutions do not have either the capital structure, management capacity, systems, or the training to manage the level of business risk and sophistication that SMEs bring along with their applications.

In terms of attaining the USAID's S012 objectives, these findings are important because agricultural lending must take into account the agricultural production calendar and the role played by each actor in the supply chain. Lending to producers must take into account weather constraints and the requirement to match producers' cashflow generation cycle with payment schedule. Food processors are primarily concerned with production cost and distribution, and finally traders must match shelf life for their production and time to sale needed to generate the necessary cashflow to repay debt. The lending institutions perceive that low literacy of the targeted clients and the mismatch of current lending practices with the needs of intended clients may be partly to blame for the poor performance of this sector over the past several decades.

Lending Practices – Where We Need to Be

Most of the lending institutions we assessed, be they NGOs, cooperatives or community banks, need to develop management systems that rationalize operations and interact effectively in the market place, especially in economic cluster areas where perceived agricultural growth opportunities exist. These lending institutions must address the systemic complexities of financial markets using their understanding of customer values to engineer their contributions to small and mid-sized traders, producers and SMEs.

All formal lenders so far have used simple standard business models. This has not allowed the formal lenders to penetrate markets the way traditional lenders have done. Until now NGOs efforts have lacked focus and served primarily as disbursement agencies for the transfer of financial resources. Many community banks have been savings mobilization engines to intermediate the spread between their clients' savings rate and those offered by larger banks. To deepen intermediation, they must adopt strategies to unbundle their products by aligning customer needs with their delivery systems. To generate a change in performance, they must gain a deeper understanding of the needs of different market segments in the economic areas they serve in order to differentiate the requirements from the needs common to all. The one-size-fits-all approach prevailing in current delivery models is not viable. It often leads to inefficient resource allocation and does not provide value. Thus, these institutions must provide a high degree of differentiation through smart customization, tailoring their business streams to provide value by developing a clear understanding of what customers needs to obtain desired results, create customized products that capture market share, and deepen strategic relationships without constraining scale.

The lending organizations must also improve management capacity to align their business streams with changes in customer values. At its core, each institution must conduct studies to differentiate products and segment business flows to satisfy customer requirements regarding cost, value, speed and quality. Success factors for this new strategy include:

- Understanding value and demand. This will require a clear understanding of how to capture value and the drivers of value and opportunity for the customer;

- Identifying customer choices based on the businesses and customers that lenders' serve with the goal to identifying improvement levers;

- Develop an understanding of cost to market and drivers of cost to market, risks and complexities;

- Define the best fit to deliver differentiated value proposition while ensuring quality;

- Realign lending organizations, people, processes, governance through technical assistance; and

- Manage change and business execution by aligning lending organizations leadership and priorities, and mobilizing staff.

These interventions will require, in many cases, a complete re-engineering of lending institutions, especially NGOs and community banks.

Recommendations

It is unlikely that government financial institutions and cooperatives can achieve rapid results in carrying out a program requiring such extensive institutional change. The degradation of their management structure in government organizations and cooperatives is extensive and can only be changed through industry consolidation that can be forced or induced to allow champions and best practice providers to prosper and grow. Conversely, several NGOs and community banks exhibit potential for strengthening institutional capacity and modify their culture to manage growth (LAPO, JDPC and DEC for NGOs). Supply models of regulated community banks such as City Express, the Calabar Community bank and NCSW Garki community bank in Abuja and the Bauchi cooperative in Bauchi show promise for eventual achievement of efficiency in lending operations that will allow capital growth. A stable legal, regulatory and political environment is also a pre-requisite for community banking success.

1. Main Service providers to Microenterprises

Despite the banking system's best efforts and government funded credit schemes, the vast majority of financial services in Nigeria are still being provided by the specialized and traditional retail financial intermediaries. This is particularly true in rural areas and the urban informal sector where most of the poor and low-income people live and operate their small and micro enterprises. Formal banks' outreach remain limited in these areas. Commercial banks are generally unwilling and unable to provide financial services for small-scale borrowers and savers. The cost structures, lack of interest and inexperience of the banks in assessing risk in this market as well as the unfavorable macro economic environment prevent banks from providing effective financial services to the poor and low-income people. Successive governments have taken public sector initiatives to address the issue of poverty alleviation through provision of specialized financial services. Many state banks and special government programs established for this purpose have had mixed results; some went into distress while others have had limited impact relative to resources at their disposal. The fortunes of micro, small and medium enterprises within the rural and urban settings remain constrained despite these efforts.

1.2. Providers of financial services

There are three broad categories of providers of financial services to small, micro and medium enterprises in Nigeria. These are:

- Formal financial Institutions
- Semi-formal financial institutions
- Informal financial services providers

1.2.1. Formal Financial Institutions

The Nigerian financial system is comprised of the Central Bank CBN, which acts as the monetary and regulatory body, 90 licensed banks, 282 community banks, that are licensed by the Central Bank, 6 discount houses and 102 finance companies. In addition, there are numerable mortgage institutions, insurance companies and other financial intermediaries. The vast majority of these institutions are very small and insignificant players in the small and micro enterprise sector.

Ten banks dominate the Nigerian banking system. They account for 53.1% of total deposits, 46.5% of credit and 50.8% of total assets. The oligopolistic nature of the banking system rests largely on the extensive branch network of the “old generation” banks and the customer confidence/loyalty they have built over the years. One of the measures adopted to address this oligopolistic situation to encourage foreign banks, mergers and acquisitions and the adoption of information technology; however the success of these initiatives is still debatable. The three types of formal financial institutions that provide microfinance services are commercial banks, development finance institutions and non-bank financial institutions.

Commercial Banks

Commercial banks have been unwilling, and often unable, to meet the demand for financial services to small-scale borrowers and savers. Their cost structures and lack of experience in assessing the risks in this market preclude them from effective provision of these services. For these reasons the banks have strongly resisted investing their SMIEIS funds in MSMEs. Retail level micro finance institutions have begun to spring up to fill the existing gap while working along with community banks, credit unions, lease finance companies and the cooperative movement. The cooperative movement, which used to be the leaders in this market, seem to be diminishing in their effectiveness and outreach.

Community Banks

Institutional factors

Community banks are specialized unit banks set up to promote rural development through providing finance and banking services. By doing so, they also aim to improve the economic status of small-scale producers in both rural and urban areas. There were about 1,600 incorporated community banks in the country when the program started. Due to poor performance only 800 are currently operating while the Central Banks regulates about 282. Since the Central Bank took over regulation, the minimum paid in capital has increased from the original value of N250,000 to N5million.

Community banks operate under a specialized (decree Number 46 of June 23, 1992). This law stipulates that community banks be incorporated as a private company with a minimum membership of fifty persons. The community banks were originally regulated by the National Board for Community Banks (NBCB). This board was dissolved in 1999 and Community Banks now report to the Other Financial Institutions Department (OFID) of the Central Bank. The Central Bank is currently reviewing community bank activities with a view to improve laws guiding their operations and the Central Bank has developed updated guidelines and regulatory framework. Nevertheless, most community banks still need capacity building so that their staff understand and comply with these regulatory requirements by the CBN for sound operation of the system, making it more competitive and providing security for the deposits made by members of the public.

Community bank staff recognize the importance of savings mobilization and collection of deposits from the general public. They do retail lending to traders, merchants and small and micro enterprises, charging competitive market rates of interest on their loans.

The level of MIS development varies from one community bank to the other, however compared to the operators in the semi formal and informal niches, the community banks appear to have a somewhat more advanced level of accounting and record keeping system. This is largely driven by the statutory reporting requirements of the regulatory authorities for the Community Banks. The CBs still lack the automated data management systems required for modern transactional retail banking.

There is linkage between community banks and the commercial banks and some intermediation is taking place, but this is not widespread. Prudent Bank Plc, a new generation bank, is currently testing the possibility of providing wholesale finance to community banks that have capacity for providing retail microfinance services in defined geographic locations as well as in specific enterprise sectors. Their model could be leveraged to address the challenge of low liquidity in the community banking sector.

The following constraints were identified on the basis of interviews held with a few managers of community banks and executive members of the National Association of Community Banks, a voluntary association of all registered CBs in Nigeria:

- Poor quality of operations leading to poor performance and high distress rates
- Low quality of services and poor operating environment
- Lack of protection for customers funds due to non-insurance of NDIC
- Low capitalization of community banks and lack of access to commercial bank facilities.
- Inadequate management information systems

The governance and management structures of community banks are designed to suit the regulatory and due diligence requirement of OFID. Representatives of shareholders are appointed to the board of CBs at the annual general meetings, and thereafter the board takes on the governance responsibility on behalf of the shareholders. In the past, ownership of CBs seem to have been overregulated leading to investors adopting all kinds of methods to veil their equity holdings.. This led to boards that served the interest of a few veiled but powerful owners, thereby negatively affecting the quality of lending of CBs with lack of transparency and actual distress in the sector.

Most community banks are managed by retired old generation bankers and some by former cooperative managers and inspectors. Coupled with less than competitive remuneration for their services, community bank staff do not have sufficient experience to offer appropriate leadership, innovation and dynamism that are required for successful operations.

Business operations

Community banks offer vast coverage due to their widespread diffusion throughout the country. Unlike commercial banks however, they are not positioned to leverage a branch network to increase access to their services. By law, they operate as stand alone unit bank institutions with only one branch.

With a total combined equity of approximately N7 billion ($520M), their capital base is weak. Most Community Banks cite lack of capital as the biggest threat to their operations. They mobilize savings from customers for lending, but such savings barely cover the funding gap required to meet growing customer demand. To alleviate this constraint, certain banks have divided their lending into two windows based on loan amounts. The larger loans are concentrated in the lower spectrum of the market (the very poor borrowing N300-5,000) and the small or medium-scaled enterprises or NGOs that may borrow up to N5 million, although this does not occur often due to lack of lending capital. For example, NCSW Garki bank has NGOs and cooperative societies among its clients in the small enterprise window. The majority of their loans however, are micro-loans to women farmers and traders who are identified through personal contact or when they apply for credit. Interest rates vary widely. The range of nominal annualized rates is between 30-50%. The rates are negotiable with a base that is about 24% p.a. SME development is not their focus, nor has any research been conducted to determine the size that market.

One of the constraints impeding the growth of savings mobilized by community banks is the lack of information networks. Many of them have had to resort to setting up cash centers to collect savings deposits. The result is small loan sizes (Naira 5,000 - 250,000 on average), and high cost for mobilizing funds. Because customers have a limited ability to pay high interest rates, these costs are often not passed onto borrowers. The deposits are short-term. Increasingly, borrowers need longer maturities to match the business cycles they intend to finance, especially farming and trading. In order to be competitive with private banks, community banks pay 5% on deposits, which reduces their small lending spreads.

Few community banks have explored the possibility of raising equity in capital markets, through debt issuance of long-term bonds, or Initial Public Offering. Community bank managers cite the lack of interest and competition from private industry as the main reasons why this option is often not considered. Some banks are willing participants, but they lack resources to deploy in the micro-lending segment of the market. Poor understanding of micro-finance and perceived high cost and risk of doing business with micro-entrepreneurs is another reason often mentioned.

Institutionalization of modern management practices has been a challenge because many community banks have been unable to attract talent. Lending costs remain high, as are client service costs. The community banking networks have not yet fully utilized IT capacity, thus their cost structures still reflect very high administrative inefficiencies. Most community bank managers want to use IT to manage operations but they lack the know-how and capacity to select and deploy software technologies to improve loan management. Salaries offered are not fully competitive with private sector commercial or retail banks, so the community banks have to conduct extensive internal training. This is often not long enough or of good quality. A direct consequence of insufficiently trained staff is limiting decision making to the top management ranks, thus impeding growth of initiative and decentralization. The second is the high rate of resignations among workers to join commercial banks once they acquire adequate skills that make them attractive to other financial sector organizations.

The Gwagwalada Community Bank acknowledges that outreach is needed because most potential customers cannot afford transportation. This community bank is exploring mobile banking as a way to alleviate the geographical constraint. They note, however, that some clients prefer not to work with community banks because they are perceived as being inferior to other banks. The largest savers prefer to take their money to private banks. The community bank has considered using promotional campaigns and infrastructure investments to improve its public image but has not been able to launch these efforts due to lack of funding. Low literacy skills of potential clients in rural areas is also cited as impediment to market penetration. Clients are often unaware of the potential benefits of formal credit and banking services in general. The banks do not have the wherewithal resources to mount information campaigns and training to turn these potential customers into clients. The community banks have also complained that they do not receive enough government support to resolve some of their logistical and image problems.

NGOs

Institutional framework

NGO-MFIs are capitalized with grant funds raised primarily from foreign private, bilateral and multilateral donors. There is currently no special law governing NGOs. Usually they register under one of two broad laws. One involves incorporation as a company limited by guarantee under section III of the Company Allied Matters Decree. The other option is Incorporated Trustees. There is currently no regulation guiding the operations of Microfinance NGOs in Nigeria. All microfinance NGOs as such operate outside the regulatory system and are not subject to prudential supervision and regulations.

Business operation

Various savings products targeted at members of the NGOs. Interest rates on savings and deposits are lower than the prevailing savings rate in the banking sector, however, lending rates on loans given by NGOs are usually above market rates and range between 25-45%.

The NGOs have rudimentary management information systems. In addition, most NGOs in the absence of regulatory and reporting obligations have relatively little interest in improving their information systems. In a few cases where management and board are enlightened and strong, some importance is attached to the need to possess modern information systems. Even in such cases, the level of sophistication is low compared to international standards.

Most NGOs have not had experience in obtaining bank loans, although they hold and maintain bank accounts. The major challenges facing microfinance NGO sector include the following:

- The lack of effective governance systems including board development.
- Most NGOs pay relatively little attention to developing human resource and management skills. They operate under a volunteer and non/low wage basis. Consequently there is need for a comprehensive management development program.
- The absence of regulatory framework is a major challenge to the growth of the sector. NGOs cannot refer to enforceable standards against which they can measure their performance and set objectives for efficiency and effectiveness.
- Fraud and mismanagement represent a major challenge in some MFIs. This derives largely from poor governance and inadequate management information systems.
- NGOs lack access to bank finance in order to supplement grants from donors and improve liquidity.
- NGOs do not provide protection to depositors and savers, most of whom have low income and are poor.

- NGOs do not have prudential guidelines to ensure due diligence in portfolio management.
- NGOs lack effective linkage with the formal banking sector.
- Broader financial sector policy regimes discriminate against microfinance and small enterprise lending.

Similar to the case of cooperatives and credit unions, NGOs are governed by their general assembly and appoint boards of directors or trustees to provide oversight and management guidance. Board often include members of the organization. With few cases, the boards of NGOs have very limited experience in financial and macro-economic matters critical to the future success of their organizations. This situation opens up opportunities for sub-optimal policies and governance of NGOs.

Most NGOs are member-managed, although in the best cases the NGOs hire professional managers to run the organization. Due to weak governance structures and less than competitive staff remuneration the NGOs are not able to attract and retain a high caliber of managers to run the organization. Often times the NGOs end up being micro-managed by their board and/or subjected to poor leadership and executive management.

Lease & Finance Companies

The equipment leasing business started in Nigeria over 30 years ago. During post civil war reconstruction efforts and the oil boom, the lease finance sector grew rapidly. This growth continued until the early eighties when the Equipment Leasing Association of Nigeria (ELAN) was formed. Currently there are about 55 corporate equipment leasing and finance companies in Nigeria. There are 82 members in all (55 corporate, 18 individuals, 19 associate members). The association has a full-fledged secretariat with elected officials, serving as a governing board and an executive secretariat managed by professional staff. ELAN provides capacity building support to all its members and has developed two courses for its members.

Lease finance companies are capitalized by shareholders funds. They also get funding through special savings and deposits as well as medium-term funds from the commercial. Leasing finance companies are specialized departments and/or subsidiary of commercial banks. In a few cases such companies are incorporated as finance houses under the non-bank financial institutions decree. Common law and components of other related laws govern the practice of leasing finance in Nigeria. The present legal framework is inadequate for regulating the relationships between the parties to a lease agreement. The lack of legislation for lease finance is a major hindrance to capital inflow and the growth of the sector.

The core markets for lease financing are large companies and also small and medium sized enterprises. They usually finance medium and long term equipment leasing and offer special deposit products targeted at high net-worth individuals and companies. Lease finance companies are formally incorporated as companies, and licensed as non-bank financial institutions. They have formal governance structures, with reporting and regulatory requirements. They have board of directors elected by the shareholders at the annual general meetings of the companies.

Management of these companies is strong and highly professional with a free hand to run the companies under clear policy and procedural guidelines determined by the board of directors. They possess advanced and computerized information systems that allow for storage and easy retrieval and their operation are tied tightly to the banking sector. Apart from maintaining accounts with commercial, the receipts and payments of finance companies are also routed through the banks.

The main challenge of this market niche is the absence of long-term funds. Short-term market sources constitute the main sources of funds for most finance companies in the country, and this has constrained the growth of lease financing in Nigeria.

Proposed PRISM intervention

Lease finance is a specialized area of the financial industry. We expect PRISM intervention in lease finance company sub sector to concentrate in area in which small and medium-sized companies operate. Lease finance companies have the level of sophistication necessary for analyzing the type of services offered, and the financial industry needs this product to meet the demand for capital. Leasing is a good alternative to purchasing under certain economic and tax conditions. Should the current policy environment improve, we expect to see increases in leasing limited to equipment acquisition, focusing on capital leases and not on operating leases. This service will be accretive to the institutions that operate upstream on the agricultural supply chain and are needed to boost production or improve processes. Lease financing could be structure as a by-product of the community banks.

Development Finance Institutions

The introduction of universal banking in 2001 has streamlined the operation of banks and is creating a more competitive financial system. The Nigerian Agricultural and Rural Development Bank (NARDB) is a government owned merger of the defunct Nigeria Agricultural and Cooperative Bank (NACB) and the Peoples Bank. Recapitalized with a sum of ₦1.0 billion in 2001, the NARDB acquired and restructured the extensive branch network of NACB (379) and PBN (278) to serve as a special purpose bank for providing agricultural loans and micro credit services to rural people.

These institutions are government owned and suffer from chronic neglect and institutional decay. They are high cost providers and, despite subsidized interest rates that distort markets, they have been unable to deliver value to customers. Their delivery systems are very inefficient, slow and unsuitable for most customers. We do not expect any PRISM intervention involving these institutions because it would take too long to build capacity to make them efficient providers of capital to the market segments targeted by USAID.

1.3. Semi formal Institutions

1.3.1. Cooperatives

These are savings and thrift cooperative and credit unions. They are perhaps the oldest form of semi formal microfinance institutions in Nigeria. It is estimated that there are about 2,000 cooperative unions in the country. Cooperative Unions operate through state level apexes known as federations. Overall there is a national apex known as the Cooperative Federation of Nigeria (CFN). Some of the states, e.g. Bauchi and Rivers state own cooperative Finance Agencies. There are at least two Cooperatives Banks in which Cooperative Unions own substantial shares through their federations.

Credit Unions are capitalized through the equity (shares), duels, savings and investment income. Cooperative Unions operate under the cooperative laws of the state governments. The state cooperative legislation derives largely from the Nigerian Cooperative Societies Decree of 1993. The activities of Credit Unions are regulated through Cooperative laws. The law specifies the guidelines for membership, portfolio and liquidity conditions.

The core clientele of Cooperative Unions are primary cooperative societies, which in turn provide services to their members. Their popular loan products include the following; i) wholesale lending from unions to societies and ii) retail lending from societies to individuals and savings products include membership savings.

Interest rates offered on deposits and savings, are usually lower than prevailing market rates. The cooperative unions mostly have rudimentary and manual record keeping and accounting. This makes information based management decision difficult. Information storage and retrieval is very difficult. The statutory requirements for data collection remain a strong motivation for Cooperative Unions to keep records, but the quality of records is still low as is the speed of retrieval.

Although the Credit Unions hold bank accounts, they do not enjoy the use of bank facilities as much as they would like to do. In many cases, Cooperative Unions do not have access to bank credit lines to on-lend to their members.

The most pressing issues and challenges facing the Credit Unions are:

- Lack of sufficient access to bank loans in order to expand operations and reach out to more societies and members.
- High level of fraud by credit union officials.
- Lack of effective governance and poor record keeping standards.
- A culture of poor management culture and lack of modern management skills.
- Inadequate technology and management information systems.

The general assembly of members is the supreme organ of a credit union. The general assembly elects an executive council that handles the governance function on behalf of the general assembly. Because of the tradition of restrictive membership, the executive boards of cooperative are not able to attract sufficient skills and experience to match that of the manager. This often leads to fraud.

Credit Unions hire specially trained cooperative officers to manage the affairs of the union. These officers are usually graduates of cooperative colleges. They have vast knowledge of cooperative principles but often lack the modern management skills to run a complex institution such as cooperative unions.

Proposed PRISMS intervention

The credit union industry has completed the first stage of growth and is now entering the consolidation phase so that best practice can providers carry it to the next stage of maturity. In addition resources have become scarce. We believe that the current cooperative supply model does not offer the best prospect for achieving the capacity level that the industry needs to improve its impact on poverty alleviation especially in the agricultural sector. Too much needs to be done and will take too long for PRISMS to realize the benefits of technical assistance interventions that build capacity.

There may be, however, specific geographical areas, such as Bauchi, where cooperative credit unions provide good prospect for achieving success in increasing access to small scale agriculture. In those instances, the focus should be on providing targeted technical assistance to enhance efficiency and outreach. It is also possible through PRISMS to develop linkages between this model and the NGO and community bank’s in areas where the cooperative model has worked in the past such as Bauchi. The Bauchi Apex Cooperative organization seems well positioned to serve as a champion.

1.3.2. Other Cooperatives and financial intermediaries

These institutions play a role in the agricultural input supply chain because they usually target farmers and large and medium producers and processors. They are well positioned in some keys states where commercialized agricultural production could increase substantially. Consequently they cannot be ignored when considering potential partners contributing to of S012 performance. However, any alliance with cooperatives or other financial intermediaries must be handled on a case by case basis, focusing on those with the wherewithal to deliver services affordably. Several approaches should be considered including contracting to purchase services from them with the condition that they need to improve their efficiency in service delivery and build capacity for absorbing new capital.

2. Informal Financial Institutions

Characteristically these traditional and community based micro credit and savings organizations operate daily or market day savings services to a number of micro and small entrepreneurs. These group of service providers are called mobile bankers (Alajos), as well as operators of traditional savings and loan services. They operate in open markets where they collect daily savings from traders and keep money on their behalf for a fee. The practice is very old, generally believed to have originated from southwest Nigeria and spread to other parts of the country as well as elsewhere in West Africa.

There are many people involved in this business. No count has been made on how many practice this trade. There is no national umbrella association for mobile bankers in Nigeria. However there are local associations in Kano and Kaduna. CDF conducted research in May 1999 which indicated that only 20% of mobile bankers belong to local associations while 70% of those that do not belong to an association indicated interest in forming one.

The mobile bankers are capitalized through personal savings of their operators, as well as by fees earned on operations, which is currently about 8.3% of the total amount deposited by customers. **N**o law currently governs money lending operations. It is an open and free market. There are apprenticeship programs for new entrants. Generally the degree of acceptability is determined by the pedigree of the entrant in his or her area of operation.

Basic bookkeeping of daily transactions involves a manual register of clients; ledgers; loan book; cashbook and passbook. As part of risk management, mobile bankers operate savings accounts with banks. With these accounts they are able to keep their deposits and make additional income on interest. The key challenge in operating this niche market includes professionalizing management of this informal sub sector as well as building capacity for the promotion and development of a mobile banker association in Nigeria.

3. Performance Assessment by Institutional Type

NGOs

Institutional Performance Analysis

In its effort to bridge the economic gap between the poor and rich, the NGO community has mobilized civil society, especially in rural areas, to encourage the poor to lift themselves from poverty and fulfill the entrepreneurship potential for which Nigerians are famous. NGO lending programs are usually rural based, placing strong emphasis on group lending to local farmers who must organize into "societies". JDPC developed its lending activities with assistance from Microstart, the UNDP program. They have been quite successful in mobilizing savings and meeting borrower's needs. Their repayment rates reflect their excellent performance in developing and managing good outreach activities within their faith-based constituent groups. COWAN's approach, on the other hand, centers on providing the poor with integrated services to address other social and personal needs.

Savings mobilization has not kept pace with demand for credit. Capital is scarce, and not growing because of poor recovery rates. COWAN estimates its lending capital at N150M, which is well below the amount needed to meet demand. FADU is reportedly holding discussions with a local commercial bank to borrow loan funds. Efforts to deepen financial intermediation through the participation of commercial banks have been slow and difficult. FADU is trying to get local commercial banks in Ibadan to participate but it has met resistance due to lack of bankable collateral, despite pledging its new building downtown Ibadan. COWAN has also been approached commercial banks to borrow funds, but bank approval is unlikely.

NGOs use their members' savings as a source of capital but also as a risk mitigating tool to reduce the incidence of default and keep servicing costs low. The strength of their delivery system lies in their ability to mobilize their members and address other social welfare needs of their borrowers. At COWAN, for example, loan officers operate under the motto "no savings, no loan" and loans are usually linked to other CEDPA-supported project activities such democracy and governance. Thus, it is not surprising that these institutions encourage linkages with other health, family planning and social programs that they managed with other donor funds. Microfinance is seen as a means to an end, not necessarily as a professional business practice.

Financial analysis

Key Portfolio data

	COWAN (2003)	**FADU** (2003)	**JDPC** (2002)	**LAPO** (2003)
Active clients	no data	95,000	2,737	23,270
Outstanding loan balance[27]	N158,000	N205,904	N24,102	N205,904
Average loan size	N150	no data	N7,000	no data
GDP per capita	$315	$315	$315	$315
Number of savers	260,000	no data	4,385	4,339
Amount of savings[3]	N10,805	N44,107	N11,63	N48,669
Loan loss rate	no data	no data	no data	no data
Portfolio at risk (>90 days)	25%	no data	no data	7.4%
Administrative efficiency	0.47%	34.20%	33.75%	82.01%
Operational self-sufficiency	0.38%	8.15%		126%
Operational efficiency	no data	20.00%	31.34%	54%
Debt/Equity ratio	no data	50.30%	46%	22%
Adjusted return on assets	-25.2%	-13.6%	13.46%	no data
Commercial liabilities	0%	0%	0%	0%

Our diagnostic analysis of financial management and administration systems, loan operations services, accounting and internal control systems and business planning and analysis, indicate that most of the NGOs (JDPC is probably the only exception) are heavily subsidized and still poorly capitalized. They are losing money and using donor funds to remain in business. Few NGOs understand capital markets or what it takes to attract equity capital or issue long-term debt.

[27] Thousands

Administrative efficiency

Low administrative efficiency is partly to blame for their financial losses as is lack of cost accounting skills to manage spreads and set lending rates so that they cover their own cost of funds. Risk management is limited to using the mitigating effect of group lending. NGOs often provide loans to support activities whose cashflow streams do not match the short-term nature of their savings deposits.

Operational efficiency

Operational efficiency is low in most institutions. Many of the NGOs do not have adequate systems for managing aging. The process is manual and loan servicing and follow-up is not a well developed practice. Poor lending practices have added risks to portfolios and increased operating costs. This threatens financial sustainability in most NGOs. Many are not operating as going concerns.

Delinquency

Delinquencies are unusually high across the entire universe of NGOs and most can be attributed to low client follow-up. In several NGOs, delinquencies are over 30% despite efforts in outreach. Inadequate loan underwriting and poor logistics are also to blame. Many NGOs have revealed that that they lack transportation or the ability to communicate effectively in the field. Data is often processed manually which also adds to delays in collecting and processing data. Finally institutions are not managing this key component of lending effectively. We found very few using the aging report to monitor recovery and standard reports to manage loan operations.

Interest rate policy

Most NGOs do not use structured methodologies to estimate the rates they should charge (cost of funds pricing). Training in how to establish interest rates charged to clients so that it covers capital cost is needed at the majority of the institutions visited. This could be accomplished by holding CGAP training courses available on the Internet or using structured lectures. This has to be followed by short workshops and refresher courses to ensure that NGOs staff use these techniques.

Profitability

Most NGOs find profitability quite elusive. They receive subsidies from donors and others that they use to offset operating losses. With the exception of JDPC and LAPO, most of the NGOs that we visited sustained substantial operating and net losses. This situation reflects both the pervasive poor recovery rates on loans disbursed and poor cost management. Furthermore, lending rates are often set too low to cover operating cost, and the prospect for increasing margins on loan is very dismal given the general economic condition of borrowers. It is also important to note that market distortions stem from government supported programs such as the one managed by NARDB in Kaduna that undercut the NGOs. They offer an 8% rate on loan or 15% (on average) below market rates. This adds to the pressure on community banks and NGOs to keep their lending rates low. The low interest rates are a major constraint on financial intermediation. The commercial clearing banks perceive NGOs as inefficient organizations. The mounting losses of NGO MFIs hide their potential for serving the micro lending sector profitably.

Revenue accounting and financial reporting

Revenue recognition, provisioning and accruals for loan losses are not applied uniformly across the NGOs. As a result, financial data are inconsistent and often misleading. Consequently, it is difficult to assess the true state of NGO operational and financial self-sufficiency with reasonable accuracy. Measurement tools used to gauge various efficiency and effectiveness metrics are distorted by the use of inaccurate or incomplete data. For example, loan loss provisions are not estimated properly, and thus the value of loan portfolios and operating profits (losses) are most likely overestimated (underestimated). When estimating loan loss reserves, most institutions (JDPC is the notable exception) do not write down the value of the losses in their loan portfolio until the debt has become irrecoverable.

Furthermore, CGAP rules are not applied consistently across the NGO universe, nor are generally accepted accounting (GAAP) standards. COWAN's books are particularly deficient, so that none of the information they provided can be relied upon as accurate for assessing the true state of affairs in that institution. This points to the need for standard setting by policy makers using the Microstart model to achieve the results such as those seen at LAPO, JDPC and DEC in Bauchi state.

Proposed PRISM intervention for NGOs

The current NGO providers of loans to the poor do not understand clearly the supply chain of delivering effective loans. Effective lending is a process that begins with an analysis of markets and businesses, selection of key clients and eventually credit analysis and loan disbursement to clients who exhibit the risk profile that the bank's loan officers deem acceptable, based on underwriting standards and credit scores set and approved by management. The NGO MFIs serve very fragmented markets.

NGO loan portfolios are not demand driven, yet the products offered are consolidated. For example, within the traders category, there are several value providers who control various access points in the agricultural distribution chain for yam grower, chicken producer and fruit processor. Lending to members of this commodity chain must be specialized and tied to cashflow generation, shelf life and time to market for their products. These economic actors seek bridge or working capital loans not short-term consumer loans to finance their role in the production commodity chain.

Capacity building interventions in this area may consist of training senior management in market research, segmentation and product design. The precondition for this activity's success is that management have the skills base for applying the knowledge related to their commodity chain.

Some institutions will require new and/or supplemental leadership to ensure that staff receiving this training are also preparing to assume to reins of management in the re-engineered institution. This is a necessary condition for success in many NGOs visited by the team. Many of these NGOs have been in operation for ten years or less. They are beginning to encounter the governance issues faced by organizations in transition in order to allow new managers to make the inevitable change from growth to consolidation. The focus of these organizations should be strengthening organizational capacity and the ability to manage operations efficiently, while current leaders continue their advocacy role and contact with the communities.

The welfare orientation of the NGOs is encroaching on the need for these institutions to adopt commercial orientation required by the new market paradigm. The integrated one-size-fits-all approach to lending is costly and ineffective. In such circumstances, the NGOs will find it hard to adhere to the forthcoming compliance rules from the Central Bank of Nigeria that will emphasize prudential norms, cost efficiency in order to better rationalize the distribution of banking resources in the land, and modernization that will help the NGO sector to grow and remain cost competitive with the formal banking sector. Because many NGOs want to be all things to their constituents, they have incurred substantial losses and their programs have become ineffective due to their poor recovery rates. They have eroded their lending capital considerably and may even be facing bankruptcy. Through the inevitable effect of industry consolidation, these suppliers of finance will fall off the supply chain and thus should be left to operate until “death does them apart.”

For those NGOs that deliver loans efficiently, such as LAPO, DEC and JDPC, an NGO credit delivery model needs to be strengthened with Nigeria-adapted best practices based on our experience elsewhere in Africa and Asia. Institutions using best practices provide coverage and offer efficient networks that can be leveraged to increase access. Technical assistance to improve their capacity to manage loans and increase their outreach will be based on successful experiences and tested models. The NGOs will also need training on how to raise equity capital.

Community Banks

These institutions serve the higher end of the micro lending market with vastly superior results compared to NGOs. Examples of successes include the Calabar community bank and the NCWS Gharki community bank in Abuja that we visited. These institutions have strong balance sheets and are operating at a profit. Their principal performance area include the following:

Increasing default rates due to unsuitable loans

Recovery from defaulters is often not pursued aggressively in line with best practices in the industry.

Ineffective loan monitoring

These banks need to improve the quality and timeliness of information provided to loan officers. Loan officers do not monitor loans or maintain regular contact with customers. Often borrowers are not visited for several months and the distance between the community bank offices and the location of borrowers has been cited as the main reason. Information on delinquent loans is also developed manually and often does not reflect the true status of the loan at the time of client visit, leading to loan officers delivering stale payment information, which adversely impacts repayment rates and customer service.

Low operating efficiency

This metric is still low compared with international standards. Community banks need to manage operation cost and develop information systems to increase operations efficiency, especially as relates to loan processing and disbursements.

Proposed PRISM intervention for Community banks

The community banks wish to be perceived as mini commercial banks, in contrast with the intent of the laws that established them. They are losing focus on what business they should be in. That is to provide services to the lower tier of financial markets and explore market opportunities offered by microfinance and microenterprises. Best practice interventions should focus on delivery of micro-credit to the very poor and developing risk management skills and loan supply models that can make the return on capital invested in this segment of the business attractive and competitive.

Some emphasis should be placed on training of the staff of community banks on how to use capital markets to increase liquidity and how to manage the liquidity thus acquired. Very few microfinance institutions, be they NGOs or community banks, understand the challenge of liquidity in banking. Training senior and mid-level managers in asset liability management can yield very high results.

Community banks financial management practices are sub par. Very few community bankers understand their capital structure or how to establish and structure capital – how much debt and how much equity is needed under particular operating conditions and maturity - Cost accounting is another challenge as many credit suppliers lack knowledge and understanding of their costs, and thus do not price services profitably or above break-even. Capacity building interventions in this area should include building information technology capabilities to streamline accounting and reporting systems, as well as loan portfolio management. Community banks need to monitor repayments and delinquencies and need effective tools and reporting to complete this important task. Capital erosion is slowly weakening their capacity to meet demand, because too many of their loans are either delinquent or non-performing.

In addition to the capacity constraints noted above, structural issues are plaguing the quality of service delivery by the community banking sub-sector. There are too many community banks chasing too few good customers. We may be facing a likely "dot.com" type boom because the barrier to entry is very low. An examination of several banks indicates that many of them are using their status to collect deposits and reinvest in T-Bills or short-term bank acceptances. The result is income derived from these investment activities often exceeding interest earned on loans disbursed. Without regulatory intervention, this approach might balloon into a large pool of speculative liquidity thus hurting an already fragile economy. Policy makers should consider raising the capital required to establish a community bank, and take measures that encourage or "induce" consolidation to force low performing banks to leave or merge. This approach should be designed to foster Commercial Bank participation. Commercial banks would then be in a position to acquire community banks and inject much needed best practices and capital into micro lending.

One other approach to adding efficiency into commercial banks is, through appropriate policy dialogue, the participation of commercial banks such as City express whose success story is narrated below:

Commercial Banks and Microfinance: The City Express Bank Case Study

In 1999, City Express Bank began their own microfinance program branded Microstart (no relationship to the UNDP program). City Express Bank CEB collaborated with University of Ibadan Consultancy Services Unit, UI Consult and Nationwide Agency for Individual Development and Eradication of Poverty, Nat.aide. Under this collaboration, UI Consult and Nat.aide will provide the training of participants in the scheme while CEB will provide the loan fund to finance the enterprises to be set up by the clients of the program. Microstart aimed to provide entrepreneurial skills and micro credit facilities to young unemployed graduates. The two key components of the program include training of unemployed Nigerians in entrepreneurial and business planning skills and providing financial support to start small businesses.

With N120 million ($860,000) as start-up capital, they designed a one-size-fits-all 18 month N60,000 loan product with a six month moratorium and repayable in equal monthly repayments over 12 months. The bank made 1,000 loans, each supported by a co-guarantor. The interest rate was 16% p.a. based on an 8% cost of funds, the 8% spread seemed generous, but was not enough to cover the cost. Although most of the loans were eventually repaid by the end of 2002, the overhead cost of collecting payments and following the guarantees all over Lagos made the service unprofitable. The bank decided to take a break and learn from their experience during which time the International Rural and Microfinance Conference of September 2001 became “an eye opener” for the bank. After knowing about best practices around the world and realized that with some time and effort City Express could do a much better job offering microfinance services.

Now with two year of study and planning, including the Ford Foundation sponsored Micro fin training and a US Embassy supported study tour to the 2003 Global SME conference in Los Angeles, City Express is preparing to re-launch its Microstart program. Motivated by a community development focus, City Express has been developing and discussing proposal papers with Lags in Oyo and Undo States on how to collaborate on a microfinance e based poverty reduction programs in these states.

City Express is already providing lines of credit to three community banks in Lagos. Approved for a three year period, each line carries interest of 22.5% p.a. and is reviewed every six months. The bank also discount checks that community banks presents for clearing. While the collection risk to City Express is low, the service offers immediate liquidity for the community banks, especially on upcountry checks that could take a week or more to clear. Under this arrangement City Express advances a maximum of 75% of the face value of the check being presented for clearing, charging a 1.0% flat fee. For example, the bank charges a $10 fee for discounting a $1,000 check and the community bank receives $750 immediately and the $250 balance when the check has cleared. For comparison, if the community bank were to borrow $750 for 7 days at 22.5%, the cost would be $3.28 vs. the $10 flat fee for discounting the check. If the check takes more than a week to clear, the effective cost to the community bank keeps decreasing as the rate is flat regardless of how long it take for City Express to collect the money they have already advanced to the community bank. So what makes this an attractive service to the community bank is the ability to receive immediate funds for checks in collection, regardless of how long that takes, without needing a line of credit with City Express. The community bank can turn around and lend the funds at the same or a higher rate.

4. Informal Lenders

Little is know of the operations of ROSCAS and other informal money lenders such as ESUSUS. The body of knowledge available to researchers is concentrated in the high interest rates they charge their customers for taking their funds out of turn, which are well above those available through the formal sector. Their customer base is usually rural and non-urban. Yet they’ve remained in business and continue to serve a larger group of the poor (probably 80%), including small traders and farm producers. A campaign at educating the public and demonstrating the benefit of working with formal sector should be deployed to raise awareness among borrowers of alternative sources of capital.

NGOs, Community banks and other formal intermediaries penetration of this market is predicated on their ability to improve their lending capacity (capital) and efficiency. This customer base is also very fragmented Service and other accompanying measures to help these potential customers make the transition to the formal sector is an imperative for success. Some demonstration model and testimonials can be used to make that case convincingly. The NGOs and community banks must be available and operating to meet customer demand. If they are not available and accessible, this transition will not occur.

LIFT ABOVE POVERTY ORGANISATION (LAPO)
Not for Profit Organization – Benin City, Edo State

Summary Description
Godwin Ehigiamusoe, founder and Executive Director, started a spontaneous microcredit program in 1987. By 1989 he had contacted Grameen Bank, traveled to Bangladesh, and began receiving advice. Lift Above Poverty Organization (LAPO), a local NGO not-for-profit company limited by guarantee, was started in 1991 with the help of a grant from the Ford Foundation. A board with a majority of client members was created in 1995. Reflecting its mission as a poverty-focused development organization, there are three semi-independent donor funded programs run under the LAPO NGO: LAPO Development Center (LADEC); LAPO Health Project; and LAPO Consultancy Services. Lyobo-LAPO Community Bank is a separate for-profit company majority owned by LAPO.

In 2000, LAPO began participating in the UNDP MicroStart program, with technical assistance provided by the Bangladeshi MFI, ASA. ASA introduced measures to simplify products and procedures and cut costs. Eight new branches were opened over the next two years. In March 2002 LAPO took over a failed community bank as a hedge against anticipated Central Bank restrictions on MFI deposit taking. To date, Lyobo-LAPO Community Bank is far smaller that the MFI. It is separately incorporated and has its own board of directors.

LAPO COMPANY PROFILE (US$'000)	**31-Dec-00**	**31-Dec-01**	**31-Dec-02**	**31-Dec-03**
Gross Loan Portfolio	$423	$602	$917	$1,437
Annual Change in Gross Loans	*1.7%*	*42.3%*	*52.3%*	*56.7%*
Portfolio at Risk in whole $	*n/a*	*n/a*	*n/a*	$55,431
Number of Clients Outstanding	10,566	13,859	18,740	23,270
Annual Change in Number of Clients Outstanding	*16.4%*	*31.2%*	*35.2%*	*24.2%*
Number of Loans Outstanding - estimated	10,124	13,859	11,019	15,475
Average Loan Balance (per clients)/Actual Amounts	$42	$43	$83	$93
Total Assets	$657	$788	$1,105	$1,592
Equity, including capitalized grants from 2001	$419	$841	$1,128	$1,355
Net Income, before loan loss reserve in 2003	-$13	$27	$171	$165
Number of branches	12	18	22	27
Total LAPO Staff	74	107	140	191
Total Credit Operations	64	84	109	160
Credit Officers	53	59	77	121
Ratio Credit Officers to Other Credit Operations	4.8	2.4	2.4	3.1
Return on Average Equity	-3.0%	3.2%	15.2%	12.2%
Operating Expense / Average Gross Loans	*24.7%*	*40.2%*	*33.5%*	*32.1%*
Portfolio at Risk / Gross Loan Portfolio	n/a	n/a	n/a	3.86%
Number of Clients / Credit Officer	199	235	243	192
Number of borrowers per staff	137	130	79	81
Portfolio Yield	22.3%	33.9%	45.6%	48.2%
End of Period MicroRate Exchange Rate / US$	109.6	111.6		
Official Ending Exchange Rates - PRISMS	110.5	123.4	130.62	143.3

Highlights

Strengths
Substantial microfinance experience combined with capable management, a broad branch system, and an efficient branch staff has provided a base for continued growth. Improvements in the computerized accounting system are providing information for financial analysis and management decision-making. LAPO is well established, has international exposure, and a reputation as an innovator in the Nigerian microfinance sector. The current capital base, mainly comprised of capitalized grants, is adequate for licensing under the proposed CBN microfinance regulations, and would support significant portfolio growth provided there is adequate liquidity from client deposits, loans or capital to meet increased loan demand.

Weaknesses
The new ACCPAC accounting system is not fully integrated into LAPO's operations. There have been difficulties in launching the Southern Horizon M2 loan-tracker software over the past year, limiting branch automation and MIS development. On average, branches are under capacity in terms of members and loans outstanding, due to inefficient old branches and continued rapid branch expansion. Portfolio quality is not well measured. The rapid rate of loan portfolio growth, 152% over the last three years, has created a serious funding gap. The existing not-for-profit legal structure and the housing of diverse development activities in the same organization hinders LAPO's ability to become a licensed MFI, attract commercial loan funding or commercial investors to sustain growth.

Opportunities
Operating in a virtually limitless market and with an efficient, and under utilized, branch network, LAPO has the potential to become a highly profitable, fast-growing MFI. New microfinance regulations being put in place by the Central Bank this year will create an opportunity for LAPO to be one of the first NGO MFIs to transform to commercial status. Donor support is available from variety of sources for capacity building activities directly related to commercialization.

Threats
The prospect of a regulated microfinance banking sector is starting to attract community and commercial banks, increasing the level of competition. The new World Bank MSME project is intended to foster good MFI models and to encourage competition as well. Once the industry opens up, retention of market share and the ability to attract investor capital could make achieving full financial sustainability more difficult.

Credit Operations

LAPO utilizes a group solidarity model of self-selected groups, with five members each, combined with three to six similar groups, forming unions of between fifteen and thirty members. There follows six weeks of training prior to being admitted as members. A N250 joining fee is required before applying for loans.

Most unions meet weekly to conduct loan disbursements, repayments and savings transactions. The rural branch groups meet only monthly due to the larger distances which credit officers and clients have to cover to reach the groups. As a result, the efficiency of the officers at rural branches is higher, as they can look after more groups than officers in urban centers. The longer time between payments in the rural branches can lead to greater delinquencies as members need to set aside money to meet the higher monthly installments. Repayment information on rural versus urban branches was not assessed for this report.

Terms, interest rates, and repayment

Members must accumulate savings equal to 10% of the loan amount before a loan is approved, and there is a compulsory saving of N20 ($0.18) per week. Savings balances attract interest at 6% p.a., and members are able to withdraw savings that are in excess of the 10% of loan requirement.

Loans attract interest at 3.0%-3.5% per month flat (36% to 42% p.a.) repaid over a 31 or 32 week period in equal installments. There is a two-week grace period before repayment begins. In addition to the interest rate, there is a one-time risk premium of 2% of the loan amount. The risk premium serves as credit life insurance.

Credit Products

LAPO offers three principal products, regular loans, Xmas loans, and emergency loans. Asset loans, also sourced from the branches, are now approved at head office by the Microinvestment unit, which is a separate entity with its own set of books.

Regular loans start at N8,000 ($58) to a maximum of N50,000 (US$360). Loans are supposed to increase by N2,000 increments, but in practice some branch managers allow faster progress depending on an assessment of the lender. Repeat loans are disbursed upon repayment of the existing loan, but members are only allowed one regular loan at a time.

Xmas business loans are on the same terms but are repaid over a shorter period of 12 equal weekly payments. They are used to increase inventories during the festive period. Not all branch managers allow these loans.

Emergency loans: All of these loans are supposed to be approved at head office.

Asset loans: Asset loans are approved at head office by the Microinvestment unit. These loans have longer repayment terms and vary in size from N30,000 to N200,000 ($220 to $1,450) and attract interest at 5% on the reducing balance. They do not carry the 2% risk premium of other loans. Reportedly only a few such loans have been made.

While LAPO's products are standardized, past evaluations found that different branches may apply different standards. Some branches apparently found that the rigid ASA single loan product structure under MicroStart did not meet their clients' needs. On the one hand, such innovation is a sign of creative management; however, it also indicates a lack of central control and internal audit procedures. Some reports state management could be more open and responsive to client service suggestions from the branches.

Management information systems

LAPO continues with the manual accounting and loan documentation system introduced by ASA at the branch level. Compared to an automated loan tracking system, the manual procedure is inefficient, and the amount of manual entries and transferring of data from one record to another significantly increases the chance of errors. The MicroRate & GMRA review done in 2001 notes that the system does not track portfolio quality in any meaningful way. The only measurement done is the repayment rate. Portfolio at risk is not known, with head office being unaware of rescheduled loans so long as they are repaid within the initial loan period. Furthermore, the system does not allow head office to pick up deviations from the standard loan terms, as evidenced during GMRA's branch visits, because the branches only supply summary reports to head office, since it is not practical within a manual system for head office to get information on each individual loan.

Grameen Foundation has been working with LAPO for the past year to install the new accounting and loan tracking systems. As of March 2004, they are reviewing the progress achieved and determining addition action required. USAID Washington has been funding this technical assistance.

Iyobo-LAPO Community Bank

LAPO is the majority, but not sole, shareholder of a failed community bank that it rescued at the request of the Central Bank. The bank started operating again at the beginning of 2001 and generated a profit of N3.1 million in its first year of operation. At the end of December 2001, the bank had outstanding loans and overdrafts totaling N10.5 million, and held savings totaling over N4 million (US$35,842).

The focus of the bank is to make financial services and resources available to the informal sector. Two primary loan products are offered, business opportunity loans and business support loans.

Business opportunity loans do not require collateral, relying on the domiciliation of business contracts secured by borrowers. Loan amounts range from N100,000 to N1 million ($740 to $7,400), attract interest at 8% per month on the declining balance and have a maximum term of two months. Most of the loans granted are of this type. The business support loan is aimed at traders in the nearby market, but at 96% p.a. has proven to be too expensive and has not really taken off. The bank also provides temporary overdraft facilities for periods up to two weeks, and charges interest at 21% p.a., the maximum allowed by the CBN in 2001.

The bank appears to be run by competent, and suitably prudent, management. It could, in future, serve to be a significant source of funding for the lending operation provided that significant savings can be mobilized. There is no exposure for LAPO with the exception of a equity investment that increased from N2.1 million ($14,655) in 2001 to N8 million ($56,089) in 2002. Management accounts for 2003 show a further N6 million investment, bringing the total to N14,037,600 ($97,960). This significant investment by LAPO in the community bank could reflect a board decision to position the community bank subsidiary to pay a future role in financing the growth, and possibly the commercialization of the LAPO microfinance operations. The results of the community bank are not consolidated into LAPO’s results.

Non-financial Services

The three semi-independent units reflect the broader poverty alleviation aims of LAPO.

- LAPO Development Centre (LADEC) is the largest of the three non-financial services, employing eleven people (up from eight in 2001). It implements social development programs, provides training on gender equality and other relevant topics, publishes the LAPO newsletter, and carries out impact studies.

- LAPO Health Project conducts a maternal and child health awareness program, and distributes posters and information regarding health related issues, with four employees (up from two in 2001).

- LAPO Consultancy Services provides advisory services to other microfinance and enterprise development organizations, and is generally well regarded by other MFIs met during the PRISMS assessment. There are three employees (up from two in 2001).

While according to management, donors and clients fund the activities of these units and steps have been taken to separate MFI performance from the other activities, the information available for 2004 did not provide this breakout making it difficult to analyze alone performance of the microfinance operations. The recommendation made by MicroRate in 2001 that these operations be spun-off still stands.

Organization

LAPO's first board of directors was formed in 1995, replacing a committee of borrowers. The current board has seven members (down from eleven in 2001). There is a new Chairwoman since 2001, but two of the directors elected by the membership are still serving. The changes seem to bear out the Executive Director's statement that there are on-going efforts to strengthen the board in preparation for commercialization.

Since 2000, total LAPO staff has increased from 74 to 191. Almost all of this growth was in the credit staff as the branch structure expanded from 12 to 27. Each branch has three or more credit officers, each responsible for 300 to 500 clients. The branch manager reports to an area manager, who oversees five branches and reports to the head office. During 2003, Grameen Foundation USA commissioned an experienced MFI financial consultant to carry out institutional strengthening activities, including development of: a) Internal audit procedures manual and set up of an effective internal audit department; b) Finance & Accounting procedures manual and documentation of the organization's policies; and, c) internal controls and enhancement and improvement of relevant management procedures. A follow-up review in January 2004 revealed that much of the implementation process faltered when the consultant left in September 2003. Grameen Foundation USA is currently reassessing the situation to determine next steps.

Financial Performance

Capital Adequacy
The balance sheet reveals two main sources of funding, donor grants and client savings. Equity, net of long term investments, property and equipment, covers 64% (N131 million). Savings, less 12% reserves, covers another 21% (N43 million). That leaves 15% (N32 million) to be covered by other sources. Since 1991, the loan portfolio has increased a cumulative 139%. The growth in capital has not kept up.

Asset quality
As at December 1, 2003, the aging schedule showed six branches with past due loans totaling N7,943,218 ($55,431). While this is a reasonable PAR of 3.9%, the past due under 30 days is 31% of the total, a dangerously high ratio, but almost all of the delinquencies are located in one "old" branch that management states it is cleaning up. Management reported that four of the older branches do not have the new, tighter controls and thus create most of the delinquencies. In January 2004, N1.6 million of the 120 day past due loans were written off, and further steps are being taken. The portfolio yield at 48% is in line with the annualized interest rate of 42% flat, indicating that loan delinquencies are probably not wide spread.

A portfolio aging report is now being produced and indicates that the portfolio at risk is 3.9% of the gross loan portfolio. The PAR shows N7.9 million in past due loans, with 31% 30 days past due, most of that at just one branch that management is addressing. A loan loss provision of N1.6 million was made in January 2004, which covers 76% of the loans 120 days past due. Management reports further provisions will be made. The policy on provisioning for bad and doubtful debts, which includes the procedure for write-off of past due accounts, should be implemented consistently to ensure accuracy of portfolio collectible as reported.

FINANCIAL RATIOS	31-Dec-00	31-Dec-01	31-Dec-02	31-Dec-03
Capital Adequacy				
Debt / Equity	57.2%	24.9%	22.6%	50.1%
Asset Quality				
Portfolio at Risk / Gross Loan Portfolio	n/a	n/a	n/a	3.9%
Write-offs / Average gross portfolio	0.0%	0.09%	2.60%	0.00%
Loan loss reserves / Portfolio at Risk	n/a	n/a	n/a	40.94%
Loan loss provision exp. / Average gross portfolio	2.2%	3.8%	3.4%	2.7%
Management				
Operating Expense / Average Gross Loans	24.7%	40.2%	33.5%	32.2%
Number of Clients / Credit Officer	199	235	196	192
Number of borrowers per staff	137	130	79	81
Earnings				
Net income / Average equity	-3.2%	-9.2%	6.2%	13.9%
Net income / Average assets	-2.1%	-6.7%	5.0%	10.0%
Portfolio Yield	23.7%	29.8%	40.7%	43.6%
Cost of borrowed funds	0.6%	3.1%	2.3%	2.7%
Liquidity				
Current Ratio (Current Assets/Current Liabilities)	2.1	4.4	4.6	4.7
End of Period MicroRate Exchange Rate / US$	110	112	-	-
Official Ending Exchange Rates - PRISMS	111	123	131	143

Management

The ratio of operating expense to average gross loans has been decreasing over the last three years, but is still at 32%. The objective is to reduce the cost of running the operation to less than 20%, and best practice MFIs run around 10-12%. As long as the non-financial services provided by LAPO are consolidated into the figures, and run by the same management structure, it will be difficult for LAPO to achieve sustainable operation ratios.

Another indicator of inefficiency is the ratio of clients to credit officers. Currently and on average, credit officers manage 192 clients against a goal of 300 to 500. With a 54% increase in the reported number of clients from 2002 to 2003 and an increase in credit officers from 77 to 121 (up 57%), LAPO was just keeping the ratio even. The total number of branches has also been growing rapidly, from 18 in 2001 to 27 in 2003 (a 50% increase). All this growth has put a strain on management, efficiency, and capital adequacy. Management now needs to consolidate and improve the contribution to earnings from each branch.

Earnings

The return on equity was 6.2% in 2002. The unaudited management figures for 2003 show an ROE of 13.9%, a good performance. LAPO has been generating a surplus since 2001, however the ratio of operating expenses to average gross loans is still running at 32%. The best practices goal is under 20%, and some best performing MFIs are close to 12%. LAPO. Management states that the cost of making a loan is currently 12:100. LAPO is trying for 10:100, while they note that ASA, who introduced the MicroSave methodology, is able to lend at a cost of only 5:100.

On current performance, LAPO provisional figures for 2003 show operational sustainability of 1.43 and a net surplus of N23.6 million. For February 2004, the operational sustainability dropped to 1.27 due to a N1.6 million loan-loss write-off. Adjusted for the write-off, operational sustainability actually rose to 1.59 in January, with a net surplus for the month of N2.2 million.

The portfolio yield has been increasing steadily since 2000 from 25% to 48%, indicating that the portfolio is generally performing and interest is being collected. The major areas to work on are cleaning up the portfolio at risk in a few branches and improving the number of clients managed per credit officer, a rate that has been steadily improving but is only at 192 at the end of 2003 when the minimum target is 300 clients per credit officer. A slow down in the rate of branch expansion and concentration of growth of existing branches is called for.

Liquidity
Liquidity is one of management’s biggest concerns. Cash on hand fell from N13 million in 2002 to only N5 million at the end of 2003. The ratio of current assets to current liabilities, indicating the organization’s ability to met short term payments, was 4.6:1 in 2002 and virtually the same in 2003. Given that 90% of the current assets are in loan portfolio, a better measure of liquidity is the quick ration that measures cash and bank deposits to current liabilities. That ratio fell from only 0.42:1 in 2002 to 0.10:1 in 2003. In short, LAPO appears to have a liquidity crisis. Management is actively seeking addition credit facilities and will need to curtail lending activities without new sources of funding.

For the first time, LAPO entered into a sizeable soft loan arrangement during 2003 totaling N48.6 million ($340,000) to help fund the growth in the loan portfolio. If LAPO were to pay the going 24% commercial bank interest rate on the soft loan, the interest cost alone over one year would consume half the 2003 net income. This is not a long term solution to LAPO’s funding gap. That single loan is covering 23% of the loans outstanding. A more balanced structure needs to be put in place, as management knows. A longer term solution would be to expand the level of client deposits, which currently are equal to only a quarter of the loan portfolio. In most commercial financial institutions, including microfinance institutions, the deposit base is larger than the level of loans outstanding, thus providing a relatively stable source of funding for intermediation.

LIFT ABOVE POVERTY ORGANIZATION

UNADJUSTED BALANCE SHEET (Naira '000)	**31-Dec-00**	**31-Dec-01**	**31-Dec-02**	**31-Dec-03**
		Restated 2002		
ASSETS				
Cash and Banks	5,370	20,739	13,365	5,038
Temporary Investments				
Net Loans	48,991	74,285	119,750	205,904
Gross Loans	46,361	74,285	119,750	205,904
Performing Loans	*423*	*73,538*	*125,525*	*205,904*
Portfolio at Risk	-	-	-	-
Loan Loss Reserve	(2,630)	748	(5,775)	-
Interest Receivables				
Other Current Assets	438	2,263	11,165	17,221
Current Assets	**54,800**	**97,287**	**144,280**	**228,163**
Long Term Investments	2,959	-		24,408
Property and Equipment	19,509	32,449	36,451	38,786
Other Long Term Assets	-	-	-	
Total Assets	**77,268**	**129,736**	**180,731**	**291,357**
LIABILITIES				
Client Savings	16,769	20,849	31,019	48,671
Short Term Time Deposits	-	-	-	-
Short Term Funding Liabilities	9,097	-	-	
Other Short Term Liabilities	328	1,055	334	
Current Liabilities	**26,194**	**21,904**	**31,353**	**48,671**
Long Term Time Deposits	-	-	-	-
Long Term Funding Liabilities	-	4,000	2,000	48,585
Quasi-Capital Accounts	-	-	-	-
Other Long Term Liabilities	-	-	-	-
Total Liabilities	**26,194**	**25,904**	**33,353**	**97,256**
EQUITY				
Capital - Grants	-	110,414	148,682	171,754
Earnings (Losses) Period	(1,425)	(11,499)	(3,699)	23,651
Retained Earnings	15,344	-	-	(3,699)
Other Capital Accounts	31,894	4,917	2,395	2,395
Total Equity	**45,813**	**103,832**	**147,378**	**194,101**
Total Liabilities & Equity	**72,007**	**129,736**	**180,731**	**291,357**
Source of Financial Statements	Audited AFS	Audited AFS	Audited AFS	Management Reports
End of Period MicroRate Exchange Rate / US$	109.6	111.6		
Official Ending Exchange Rates - PRISMS	110.5	123.4	130.62	143.3

LIFT ABOVE POVERTY ORGANIZATION

UNADJUSTED INCOME STATEMENT (Nira '000)	**31-Dec-00**	**31-Dec-01**	**31-Dec-02**	**31-Dec-03**
Interest and Fee Income	10,302	17,957	39,509	70,797
Cash Interest and Fee Income	*10,302*	*17,957*	*39,509*	*70,797*
Accruals (Int.. Receivables)	-	-	-	-
Interest and Fee Expense	(110)	(800)	(667)	(1,788)
Net Interest Income	**10,193**	**17,157**	**38,842**	**69,009**
Provision for Loan Loss	986	2,297	3,252	658
Net Interest Income After Provisions	**9,206**	**14,860**	**35,590**	**68,351**
Operating Expense	10,741	24,262	32,510	52,324
Personnel	*5,699*	*10,835*	*19,585*	*26,651*
Other Administrative Expense	*5,042*	*13,427*	*12,925*	*25,673*
Net Operating Income	**(1,534)**	**(9,402)**	**3,080**	**16,027**
Other Income	110	2,485	4,720	7,624
Investment Income	-	-		
Other Non-Extraordinary Income	*110*	*2,485*	*4,720*	*7,624*
Other Expenses	-	-	-	-
MFI's Inflation Adjustment (if any)	-	-	-	-
Other Non-Extraordinary Expenses	-	-	-	-
Net Not-Operating Income	**(1,425)**	**(6,917)**	**7,800**	**23,651**
Extraordinary Items	-	10,229	14,552	-
Extraordinary Income-Operating Grants	-	*10,229*	*14,552*	-
Extraordinary Expense	-	-	-	-
Net Income Before Taxes	**(1,425)**	**3,312**	**22,352**	**23,651**
Taxes	-	-	-	-
Net Income	**(1,425)**	**3,312**	**22,352**	**23,651**
Source of Financial Statements	Audited AFS	Audited AFS	Audited AFS	Management Reports
End of Period MicroRate Exchange Rate / US$	109.6	111.6		
Official Ending Exchange Rates - PRISMS	110.5	123.4	130.62	143.3

Development Exchange Centre (DEC)
Not for Profit Organization – Bauchi, Bauchi State

Summary Description

Development Exchange Centre (DEC) was established as a local NGO in 1987 with a seed grant from CUS, a Canadian Development agency. In 1990, DEC launched its first loan program sponsored by the Ford Foundation.

DEC targets both rural and urban women in four states: Plateau, Bauchi, Gombe, and Yobe. It is one of the few microfinance organizations operating in the Northern region of Nigeria, and works to assist women to improve the conditions of their lives and status in their communities through the provision of micro-financial services, training, workshops and information sharing.

In August 2000 DEC joined the UNDP sponsored MicroStart project and was operating three branches as of mid-2002. The information in this review is based on the MicroStart midterm evaluation conducted in May 2002.

DEC COMPANY PROFILE	**31-Dec-00**	**31-Dec-01**
Gross Loan Portfolio in whole $		
Annual Change in Gross Loans	*n/a*	*316.8%*
Portfolio at Risk in whole $		
Number of Clients Outstanding, MicroStart program	900	2,961
Annual Change in Number of Clients Outstanding	*n/a*	*299.0%*
Number of Loans Outstanding	495	1,641
Average Loan Balance (per client) / Actual Amounts	n/a	n/a
Total Assets	$43,562	$150,521
Equity, including capitalized grants	$15,995	$58,970
Net Income	$1,592	$7,301
Number of MicroStart Branches	1	3
Total MicroStart staff	5	14
Credit Officers	3	9
Return on Average Equity	10.0%	12.4%
Operating Expense / Average Gross Loans	*5.0%*	*7.0%*
Portfolio at Risk / Gross Loan Portfolio	0	0
Number of Clients / Credit Officer	300	329
Number of borrowers per staff	99	117
Portfolio Yield on Gross Loans	22.9%	23.0%
Portfolio Yield on Net Loans	23.4%	23.6%
Official Ending Exchange Rates - PRISMS	110.5	123.4

Highlights

Strengths
The senior management team are good thinker/decision makers with analytical and financial management capacity. There provide competent and close-knit leadership and operate a democratic, interfaith organization. The organization has a good knowledge of its clients. At the time of the midterm assessment, it was reported DEC had the necessary physical assets and financial base to carry out its mission to target the poor, rural women, both Christians and Muslims. Overall, DEC has a good reputation and well is known in the areas it works.

Weaknesses
The new MicroStart methodology was not appropriate for many of DEC's existing clients, who were primarily agriculturalists, not just petty traders. The DEC field staff stated they lacked confidence to run the MicroStart operations. There was a serious disparity in remuneration between the DEC's higher salary structure and the ASA MicroStart structure, which created considerable friction.

Opportunities
Given DEC's outreach in four Northern states, it has a high growth potential based on a large market and few competitors. DEC could become a major multi-region MFI and create a major breakthrough.

Threats
Religious restrictions on women and civil unrest can disrupt loan repayment. Various federal government poverty programs were eroding the market with subsidized loans and interest rate ceilings, which diminished the loan repayment culture. In a positive trend, the GON has been moving away from these programs over the past three years.

Credit Operations

The financial portion of this review is limited to the MicroStart credit program introduced by ASA in 2000 and funded by UNDP. The rationale for introducing a new model was that the ASA methodology is sustainable, achieves rapid and large-scale outreach, is cost effective, and the loan tracking system is simple and enables cash flow and delinquency management. The "old credit program," mainly funded by Ford Foundation, was very expensive and not built on a sustainable model. Overall DEC management agreed the ASA model was superior. However, DEC's management was concerned that transformation could cut out a portion of its former market, mainly the rural agricultural clients it had been serving for over 15 years. DEC's traditional clients were women engaged in farming, animal fattening, grain selling, and petty trading. The ASA model only lends to petty traders. Information gathered by PRISMS indicates that DEC's market has eroded under the rigid ASA model and has been seeking ways to blend the two methodologies.

Terms, interest rates, and repayment
Under MicroStart the loans are for 44 weeks at 32% flat interest repayable in equal weekly installments after a two-week grace period. Savings are mandatory, with 10% of the first loan required before the a loan of N6,000 is disbursed.

Under the "old credit program" loans are for 6 to 12 months at 36% flat with a balloon payment of principal and interest at the end of the term. There are no mandatory savings.

Credit products
Under the MicroStart model there is a single credit product. After successfully repaying each loan, the next loan increases in steps. There is no option to accelerate payments in order to repay early and obtain a new, larger loan, although management was considering the need for some flexibility.

Under the old model it was difficult to determine portfolio in arrears until the end of the six or 12 month term due to the balloon payment feature. However, that structure fit the seasonal nature of the agricultural activities clients were engaged in. The ASA model seeks to eliminate the repayment risk associated with agricultural lending by limiting the activities financed to petty trading, which is a daily activity rather than seasonal.

DEC has two savings products, mandatory and voluntary. However, few clients have used the voluntary savings option. Interviews reported borrower reluctance is based on the lack of funds to save after meeting business investments and family financial obligations, fear that the program will not continue, and a lack of understanding of the interest benefit derived on savings or the purpose of savings.

Management information systems
All MFIs under the MicroStart program use the same manual loan tracking system provided by ASA. This system is not integrated with accounting, but has been praised by all users for its simplicity and internal controls. It provides numerous reports on activities, and is the primary means of managing liquidity. On the other hand, management reports can take several days to weeks to compile and require additional training to utilize the information in management decision making. Automation and integration with the accounting system are required before DEC would be ready to come under CBN-OFID supervision due to the controls and monthly reporting required.

External audits were being conducted every four years by a licensed private accounting firm. As well, DEC employs a fulltime internal auditor who reports to the Program Coordinator. The auditor visits branches monthly to verify accounts, books, and the record keeping at all levels including area mangers, branch managers, and credit officers. As well, the auditor regularly checks receipts and payment documentation and takes random samples from client groups.

Unlike several of the other MicroStart MFIs, DEC has financial management and analysis capacity, including a dedicated financial manager and accountants. At the time of the MicroStart assessment in February 2002, DEC’s financial team was not involved in the financial management of the MicroStart program. ASA prepared the financial statements, tracked operational expenses and client accounts, prepared closing statements of records, and interpreted financial data for management. DEC’s management team wanted to consolidate MicroStart reporting centrally at head office in parallel with other accounting and financial management duties, rather than outsourcing these activities to ASA.

MicroStart I ended in July of 2003 and was temporarily extended through December 2003. ASA has since left Nigeria leaving the MicroStart programs to take over financial management responsibilities. The outcome has not been reported. However, the departure of ASA opened the opportunity for DEC to integrate financial reporting and analysis in order to conduct its sustainability planning.

Non-financial Services

DEC's mission is to assist women to improve conditions of their lives and status in their communities through the provision of microfinance services, training, workshops and information sharing. DEC was concerned that this sense of mission might be diluted by MicroStart's straight business approach. This combination of social service and microfinance is common in NGO community development programs. Separation of the activities into separate legal structures is necessary before the microfinance program can become sustainable and subject to regulation.

Organization

Consistent with its mission and organizational mandate, DEC serves only women, both Muslim and Christian, in rural and urban areas. DEC selects markets strategically based on demand, size and proximity to branch offices. The PRISMS assessment team confirmed that the restriction to financing petty trading under the ASA model has eroded DEC's traditional agricultural client base is having a significant negative impact on DEC operations, a concern management expressed in 2002.

DEC seeks credit officers that are smart, outgoing, have a good attitude, can apply theory in practice, and have the required educational qualifications (SSCE diploma). All of the credit officers are hired locally.

DEC received ASA MicroStart training in 2000. Many branch managers and credit officers interviewed in 2002 for the MicroStart evaluation felt they were ill equipped to execute their jobs well, citing a need for more training and better preparedness before working in the field. Both branch mangers and credit officers requested additional formal training from ASA for staff that did not benefit from earlier training as an incentive to employees who have worked with the program since inception. Branch managers conduct credit officer training.

Salaries under the ASA model are one of the difficult issues facing DEC management. As with many NGOs that rely on donor funding, the DEC salary structure was not affordable in a low-cost microfinance program serving the very poor. Accordingly, ASA reduced the salary structure for the MicroStart program by half for branch managers by 62% for credit officers, and din not provide any incentives for improved performance or results based rewards. The split between old program officers and the new MicroStart staff caused a great deal of tension. DEC management was working to find a way to ease the salary disparities, achieve financial viability, relax staff friction, and retain staff. The PRISMS team was not able to find out how successful management has been in coping with this very challenging situation.

DEC management believes that employee benefits must be improved in order to attract and retain good staff to work their way through the MicroStart ranks. DEC had a joint savings account that employees could join with DEC matching up to 10% of salaries per month. Employees are entitled to the accumulated amount when they leave. DEC wanted to add a retirement plan or health insurance, rather than an allowance for health services, as well as providing career development opportunities and non-financial incentives such as training. DED was also considering purchasing mopeds or motorcycles and offering them to its MicroStart staff on a lease-to-buy basis. This would mitigate the risk of theft on public transportation, potentially cut transportation costs, improve vehicle maintenance and upkeep, as well as offering significant benefit to its employees.

Financial Performance

Capital Adequacy

DEC has been consistently well funded by international donors since 1990. The Ford Foundation, CUSO and PAC supported DEC in its early years. The Ford Foundation, EZE, Development and Peace, and the Federal Ministry of Women's Affairs have largely funded DEC since the mid 1990s. Updated funding information since 2002 was not available. However, it is known Ford has stopped funding microfinance projects pending an evaluation, and GON poverty reductions programs are under review. Funding under the MicroStart program was one of DEC's chief difficulties with disbursement lags running four to five months, which caused significant liquidity problems. The start of MicroStart II has been delayed from July 2003.

Management is interested in pursuing sources of borrowed capital. As of 2002, the only borrowed funds were N200,000 from an individual at 18% interest. The final payment was made in January 2002. Twice DEC discussed borrowing from banks, Habib Bank and Washington Bank, but were unable to secure a deal. UNICEF approached DEC with a proposal to lend funds, however, the terms were not favorable requiring loan ceilings. DEC was planning to discuss borrowing options with Growing Business Foundation.

Since the available financial information covers only the MicroStart branches, which were fully funded by DEC head office, capital adequacy for the entire operation can not be assessed.

FINANCIAL RATIOS	31-Dec-00	31-Dec-01
Capital Adequacy		
Debt / Equity	172.4%	155.3%
Asset Quality		
Portfolio at Risk / Gross Loan Portfolio >30 days	n/a	0.14%
Write-offs / Average gross portfolio	n/a	n/a
Loan loss reserves / Portfolio at Risk	n/a	1430.0%
Loan loss provision exp. / Average gross portfolio	2.0%	2.0%
Management		
Operating Expense / Average Gross Loans	5.0%	7.0%
Operational Self-sufficiency	222.5%	201.1%
Number of borrowers per credit officer	298	319
Earnings		
Net income / Average equity	19.9%	19.9%
Net income / Average assets	7.3%	7.7%
Portfolio Yield	22.9%	23.0%
Cost of borrowed funds	0.0%	0.0%
Liquidity		
Current Ratio (Current Assets/Current Liabilities)	6.4	6.8
Official Ending Exchange Rates - PRISMS	111	123

Asset quality
DEC provisions 2% of its portfolio for loan loss and writes off uncollectible loans after one year. The reported repayment rate was 98%, although the basis, on-time or cumulative, was not stated. During the first two years of MicroStart, DEC was experiencing a 99+% on-time repayment rate.

Management
A ten member volunteer Board of Directors comprised of professional men and women as well as program representatives governs DEC. The Board gives strategic direction on policy matters for the organization. The gender distribution is 70% female and 30% male, with four presiding members representing the credit program. The secretary of the board is also DEC’s Program Coordinator. DEC’s board is engaged, meets quarterly, and is well represented in terms of skills, background, and professions. The board of directors is presided over by a board of trustees, which are custodians of DEC’s property and play advocacy and arbitration roles. The Board of Trustees meets annually.

DEC’s competent, analytical, close-knit and high functioning management team is a definitive organizational strength. DEC employs an effective democratic leadership model: a seven-person management team, lead by the Program Coordinator, manages DEC’s day-to-day operations. The composition of the management team is designated by function as well as geography: Program Coordinator, Program Officer Microfinance, Program Manager Bauchi Area Office, Program Manager Gombe Area Office, Finance and Administration Officer, Information and Documentation Officer, Projects and Training Officer. There are two women on the management team. All of DEC’s management is well qualified and experienced professionals; and most have been with the organization for several years.

Earnings
Based on the MicroStart figures for 2000 and 2001, the ASA managed program was operationally sustainable. In 2002, operational sustainability was 200%. However, this ratio does not take into account the subsidized management and training provided by ASA, or the allocation of DEC head office overhead to the MicroStart branches. The return on equity was reported at 20% and the return on average assets at 7%. Both results would normally be consider as very good, but as the figures are not consolidated with the rest of DEC’s operations, no such claim can be made.

The portfolio yield is 23%, which is low compared to the flat interest rate of 32%. This could be due to the difficulty in calculating the average portfolio outstanding during a rapid period of growth, and based on other information obtained, including the almost 100% on-time loan repayment rate reported by the MicroStart mid-term evaluation, it is likely that interest is being collected as planned and the portfolio quality was not suffering.

Liquidity
Interbranch transfer and borrowings from the central account at head office are the main vehicles for liquidity management. Each branch manages its own cash and in the event of shortages, branches borrow from one another or the head office. DEC has been looking to secure a loan facility as another way to alleviate temporary cash constraints.

DEVELOPMENT EXCHANGE CENTRE

UNADJUSTED BALANCE SHEET (Naira '000)	31-Dec-00	31-Dec-01
ASSETS		
Cash and Banks	669,983	1,412,537
Temporary Investments		
Net Loans	4,130,908	17,132,914
Gross Loans		
Performing Loans	*4,215,212*	*17,568,590*
Portfolio at Risk	-	-
Loan Loss Reserve	(84,304)	(435,676)
Interest Receivables		
Other Current Assets		
Current Assets	**4,800,891**	**18,545,451**
Equipment	15,950	40,100
Depreciation	(3,190)	(11,210)
Net Fixed Assets	12,760	28,890
Total Assets	**4,813,651**	**18,574,341**
LIABILITIES		
Client Savings	755,750	2,712,315
Short Term Time Deposits	-	-
Short Term Funding Liabilities		
Other Short Term Liabilities		
Current Liabilities	**755,750**	**2,712,315**
Long Term Time Deposits	-	-
Long Term Funding Liabilities, DEC	2,290,470	8,585,139
Quasi-Capital Accounts	-	-
Other Long Term Liabilities	-	-
Total Liabilities	**3,046,220**	**11,297,454**
EQUITY		
Capital Grants Brought Forward		1,591,500
New Capital Grants	1,591,500	4,608,500
Retained Earnings		
Retained Earnings Brought Forward		175,931
Earnings (Losses) Period	175,931	900,956
Total Equity	**1,767,431**	**7,276,887**
Total Liabilities & Equity	**4,813,651**	**18,574,341**
Source of Financial Statements	Audited AFS	Audited AFS
Official Ending Exchange Rates - PRISMS	110.5	123.4

DEVELOPMENT EXCHANGE CENTRE

UNADJUSTED INCOME STATEMENT (Nira '000)	**31-Dec-00**	**31-Dec-01**
Interest and Fee Income MicroStart Branches only	482,532	2,507,127
Cash Interest and Fee Income	*482,532*	*2,507,127*
Accruals (Int.. Receivables)		
Interest and Fee Expense	(9,840)	(16,346)
Net Interest Income	**472,692**	**2,490,781**
Provision for Loan Loss	84,304	351,372
Net Interest Income After Provisions	**388,388**	**2,139,409**
Operating Expense	212,457	1,238,453
Personnel	*28,642*	*364,117*
Other Administrative Expense	*183,815*	*874,336*
Net Operating Income	**175,931**	**900,956**
Other Income	-	-
Investment Income		
Other Non-Extraordinary Income		
Other Expenses	-	-
MFI's Inflation Adjustment (if any)	-	-
Other Non-Extraordinary Expenses	-	-
Net Not-Operating Income	**175,931**	**900,956**
Extraordinary Items	-	-
Extraordinary Income-Operating Grants		
Extraordinary Expense		
Net Income Before Taxes	**175,931**	**900,956**
Taxes	-	-
Net Income	**175,931**	**900,956**
Source of Financial Statements	Management Reports	Management Reports
Official Ending Exchange Rates - PRISMS	110.5	123.4

Farmers Development Union (FADU)
Not for Profit Organization –Ibadan, Oyo State

Summary Description

The Farmer's Development Union (FADU) started in 1989 to provide microfinance to very poor women living on less than $1 per day. Its focus is on farm credit and financing traditional agro-based microentrepreneurs along with community development training programs to help members with farm management, record keeping, and production techniques.

FADU is the largest private sector microfinance / community development institution in Nigeria when measured by the number of members. FADU reports 500,000 members (81% women) with 18% to 19% active borrowers (95,000 to 100,000) as of 2003. Many of the women work in agriculture or related processing enterprises, such as pressing palm seed oil and soap making. It is an apex organization, serving rural development societies in 29 states divided into 31 zones including about 8,000 villages and sub-urban areas divided into 9,500 groups of 10 borrowers each.

FADu COMPANY PROFILE	**31-Dec-02**	**31-Dec-03**
Gross Loan Portfolio in whole $	$1,287,050	$1,402,118
Annual Change in Gross Loans	*n/a*	*8.9%*
Portfolio at Risk in whole $	*n/a*	n/a
Members as reported by Management	500,000	500,000
Number of Clients Outstanding, Management	90,000	95,000
Annual Change in Number of Clients Outstanding	*n/a*	*5.6%*
Number of Loans Outstanding - estimated	20,000	25,000
Average Loan Balance (per clients)/Actual Amounts	$64	$56
Total Assets	$2,477,256	$2,235,695
Equity, including capitalized grants	$1,952,645	$1,874,537
Net Income	-$139,930	-$308,950
Number of zones (run by credit officers)	31	31
Total FADU Staff (est. employees, consultants and volunteers)	346	346
Credit Officers, estimated based on zone structure	380	380
Return on Average Equity	-7.2%	-16.5%
Operating Expense / Average Gross Loans	*42.7%*	*34.2%*
Portfolio at Risk / Gross Loan Portfolio	n/a	n/a
Number of Clients / Credit Officer	237	250
Number of borrowers per staff	124	131
Portfolio Yield on Gross Loans	31.2%	10.7%
Portfolio Yield on Net Loans	38.3%	12.8%
Official Ending Exchange Rates - PRISMS	130.62	143.3

Highlights

Strengths
FADU has a broad and deep outreach into rural areas serving large numbers of poor rural men and women. They also provide a range of credit and other services to members. The organization has extensive microfinance experience and exposure to best practices in community development and microfinance to build on. In September 2002 management reported 67,000 borrowers, 91% women, indicating they grew 42% growth in just over a year to the end of 2003. However, gross loans increased 20% from 2002 to 2003, far less than the reported increase in membership.

Weaknesses
The microfinance portion of FADU is reportedly operationally self-sufficient (according to the financial controller), but the rest of the operations are completely donor funded. The consolidated management accounts reviewed are not audited and do not separate out the microfinance operations from the non-financial activities. As a result, the sustainability and strength of the finance operations can not be fully assessed. The organization remains highly donor dependent overall and seems to adapt its programs to fit any funder's objectives, indicating a lack of management focus on operational or financial sustainability.

Opportunities
Given its history and large network, FADU could be a significant provider of sustainable microfinance services to a large number of clients. The major challenge is to clearly separate the financial services from other non-financial services so the potential for achieving sustainability can be fully assessed, and built on. Most likely there needs to be significant capacity building in systems and operations, a tighter focus on core microfinance products and services based on assessed client demand, and a reduction in operating costs. The opportunity to obtain a microfinance license from CBN under the new regulatory guidelines could provide an important incentive to make the microfinance operations sustainable.

Threats
The loss of funding from the Ford Foundation and the Age office building grant in 2003 is an indication of the tightening donor policy on funding MFI operations long-term. FADU did obtain a grant of N52 million from EED/EV, an 80% increase from 2002, to fill the gap. Increasing competition could also have a negative impact on operations as other microfinance lenders, commercialized NGOs, community banks, and even commercial banks begin to enter what has been a closed market.

Credit Operations

FADU extends loans to development societies, which on-lend to individuals. In that sense it is an apex lender rather than a direct microfinance operator. FADU does not mix traders and farmers in the same group so that all group member know the business they are involved in, and the risks, and can not be fooled or cheated by the other members. The client base is 45% distribution groups, 20% processing groups, and 35% agricultural producer groups.

Terms, interest rates, and repayment
Individuals apply for a loan to their group, groups to their development society. Loans are approved and granted to the societies from the Zonal office (all savings are held by the Zonal office), which maintains the bank account. Management of the loans, including distribution and repayment enforcement, belong to the development societies, while Districts guarantee loans to the Zone.

Savings requirement: 25% of value of loan. Members save a minimum amount each week.

Interest rates: Loans 42% flat; savings 7%

Repayment terms:
- Working capital loans – 6 months
- Agricultural loans – 9 months
- Equipment loans – 12 months

Average size of loan: N20,000 to N300,000 made to the society members' society.

Average time period between original request for a loan and receiving a loan (or negative response from the zone) is two weeks.

Credit Products

FADU offers group loans to most clients, but there is a special department for individual loans described below.

FADU has three loan products:
- Working capital loans are for N25,000 to N100,000 for a period of six months made to a group of 10 women. Each group member receives between N2,500 and N25,000 depending on their need and ability to repay.
- Agri-business loan are for nine months and cover planting and harvesting. This includes preparing the farm, buying the cassava seedlings, and purchasing inputs (especially in the core states where cassava is a main crop).
- Processing loans are for 12 months and are usually to purchase equipment, which is estimated to have a two-year average life. With the rough handling of equipment at the village level and limited maintenance, equipment life is usually shorter than the normally expected period. Food-mills, both electric and petrol, are common purchases.

Individual loans
Successful businesses, especially those that have grown under the FADU program, can be recommended by their societies for an individual loan of N100,000 to N300,000. These are handled by a separate FADU department (FISS).

There are some savers, but most members are interested in receiving loans for farm inputs, fertilizer, equipment, spring water pumps, chemicals for cocoa, and the like. Palm oil is a typical agricultural processing activity. The men climb the oil palm trees and cut the palm kernel bunches. According to FADU, this could not be women's work. Then the women press the oil, put in containers and sell in the market.

The economics are as follows: 10 bunches cost N1,000 and produce 20 liters of red palm oil. The cost of pressing and packaging is no more that N500, total cost to the women is N1,500, which they sell in the market for between N2,000 and N2,500. Profit N500 to N1,000 ($3.70 to $7.40) per 20 liters. If a woman took a loan of N20,000 she could buy 200 bunches, produce 400 liters of red palm oil, sell the oil for N45,000, at the average price of N2,250, repay the loan plus N8,400 in interest (42% flat) leaving N16,600 to cover labor and processing cost of N10,000 and net N6,600 ($49).

Management information systems
Based on previous reports, FADU needs to computerize its zonal offices so it can produce accurate and timely management and accounting information. If FADU is going to become

sustainable or consider obtaining a microfinance license, it needs to develop standard accounting and portfolio management and reporting procedures.

Non-financial Services

BDS – provides accounting training, business registration, identification of business opportunities, linking producers up with sellers

Health – with a focus on hygiene, family planning, response to epidemics

Environmental – links to the MAP program (mixed agricultural program), and conducts agro-forestry and tree farming workshops

Many other programs are included in the program plan document. FADU also funds organizations in other states that will provide the same lending services as FADU, but under their own names. They pay the salary of the director, provide initial seed money and welcome the new institution, after three years, into the "FADU network" sharing information, BDS services, etc.

Organization

FADU has offices in 29 states, each headed by a state manager. All staff are volunteers except Zonal office staff and headquarters. The states are divided into 31 zones run by credit officers. In principal, each credit officer can have up to 25 groups of 10 totaling 250 members on average. Depending on the concentration of clients in the area, a credit office could handle up to 500 members. Thus with 9,500 groups, FADU should have some 380 credit officers, or 12 per zone. We were not able to verify these numbers.

Groups loans are organized in the following way.

Group	(5 people)	Each group elects a leader and a deputy
Society	(2 groups)	Each society has a management committee consisting of all the leaders and deputies from the groups, that meets once a week
District	(10 societies)	Each society elects 2 representatives for the district assembly, which meets once a month
Zone	(min. 2 districts)	District assembly elects reps for zonal assembly. Total 31 Zones.
State		Political/administrative area of country headed by a state manager.

Financial Performance

Capital Adequacy
Capitalized grants provide 95% of the capital. Over the last two years, accumulated operating deficits have reduced retained earnings to N14.6 million ($101,731) out of N269 million in total reported capital. The debt to equity ratio is a very low 0.19:1 because there is no bank or commercial debt supporting the assets. Client savings make up 14% of total liabilities and 22% of gross loans. Thus the loan portfolio is funded by client savings and grants. While the capitalized grants exceed the minimum level of capital required under the new CBN regulations (N50 million), whether grants can be used to capitalize a regulated MFI remains in question.

Savings total N44 million, which corresponds with the minimum of 25% required in mandatory savings before a loan can be made. No deposit withdrawls are permitted while a loan is outstanding. FADU pays interest on the deposits at the rate banks pay and then on-lends to its own member-clients the amount in savings less 12% reserves. Thus FADU is intermediating member savings as permitted under the proposed new CBN microfinance regulations for member only MFIs.

Asset quality
The gross loan portfolio is N200 million ($1.4 million). Net loans increased during the period 21% while interest on loans dropped 61%, reflected in the drop of portfolio yield from 38% to 13%. Normally such a drop would indicate a significant increase in non-performing loans, and indeed the loan loss provision was increased 121%.

Management reports that the average repayment rate is 98%. However, the jump in the loan loss provision would indicate that the non-performing loans are greater than 2%. The loan loss reserve is 17% of gross loans, which if loan losses are under 5% is adequate. However, if the annual provision is based on expected losses, then only 83% of the portfolio is performing. Again accurate aging information on past due loans and the write-off and loan rescheduling practices are required.

FINANCIAL RATIOS	31-Dec-02	31-Dec-03
Capital Adequacy		
Debt / Equity	26.9%	19.3%
Asset Quality		
Portfolio at Risk / Gross Loan Portfolio	n/a	n/a
Write-offs / Average gross portfolio	n/a	n/a
Loan loss reserves / Portfolio at Risk	n/a	n/a
Loan loss provision exp. / Average gross portfolio	18.5%	16.9%
Management		
Operating Expense / Average Gross Loans	42.7%	34.2%
Number of Clients / Credit Officer	1,316	1,316
Number of borrowers per credit officer	237	250
Earnings		
Net income / Average equity	-7.2%	-16.5%
Net income / Average assets	-5.6%	-13.8%
Portfolio Yield	38.3%	12.8%
Cost of borrowed funds	23.3%	15.4%
Liquidity		
Current Ratio (Current Assets/Current Liabilities)	4.6	3.4
Official Ending Exchange Rates - PRISMS	131	143

Management
FADU is a rural development organization formed, owned, directed, governed, and financed by about 500,000 rural Nigerians who are its members. FADU is headquartered in Ibadan and has a permanent core of development professionals with extensive experience in designing and managing community targeted development programs. Resident skills include agriculture, business, finance, community development, rural sociology, and food technology. As of 1999, FADU could draw on 346 program employees, consultants and volunteers across Nigeria.

Through its grassroots involvement approach, FADU has facilitated the role of the rural poor in project design, implementation, project cost recovery and management, enabling the members to have greater control of project resources. In three states, Oyo, Ogun and Osun where the Union has the highest concentration of members, about 58%, FADU has reportedly been able to cover the operational cost of its program. However, challenges of scale face the organization in the other 25 states.

Little information is available about the governing structure of FADU. An ambitious five-year plan was developed in 1999 to upgrade its financial and non-financial services. Paramount was the separation of the microfinance activities into a "self accounting service unit managed by commercial banking professionals that are sufficiently biased along micro-enterprise promotions." The unit was incorporate in the organization as FADU Investment Support Services (FISS). The community development arm, Community Development and Mobilization Services (CDMS) was to be a specialized extension unit providing much improved capacity building support services to FADU formations to run community based enterprises, health, literacy, and environmental projects. CDMS was also to transfer development program and project skills to other NGOs and CBOs in Nigeria. Finally, Commercial Services (CS) was to have been re-capitalized to support input supply and marketing services to the rural micro-producers in FADU operating states.

This vast range of basic community development services, all donor funded, point up the lack of essential federal and local state government programs that this NGO has been covering. While information is not available to determine whether FADU met most of its five year goals, financially speaking it has had difficulties. Outside of the loan portfolio, which is funded by grants and member savings, the major asset is a new office building (also funded by grants), totaling N120 million ($888,768). As noted, the banks will not accept this building as collateral for a loan, limiting the organization's ability to leverage its resources.

Earnings
Operational sustainability dropped from 76% in 2002 to 34% in 2003 largely due to a 61% drop in interest income on loans to members. Additional information is needed to determine the reason for this serious drop in income from the microfinance side of the operations. Whatever the cause, management's goal of reaching operational sustainability in 2004 is not realistic. The cost of operating in the rural areas is reported to be more stable than in urban areas because there is a low consumption of electricity. They are working to further minimize costs for fuel, staff and other variables.

Liquidity
FADU experienced a significant liquidity crunch in 2003 as cash dropped from N39.9 million to just N4 million. This N29 million use of funds basically covered the N30 million increase in net loans. The high current ratio of current assets to current liabilities at 3.4:1 is misleading because most of the current assets are tied up in the loan portfolio. A better measure of liquidity is the quick ratio of cash on hand to current liabilities. That ration was .94:1 in 2002 and fell to a dangerously low .08:1 in 2003. It means FADU can not pay out any of its clients' savings without decreasing its loan portfolio. A N17 million decrease in total liabilities, mainly a deferred grant, was off-set in part by new capital grants. In short, the liquidity situation is very tight.

FADU is trying to link-up with banks for low interest loans. They did receive a new N6.9 million ($51,450) overdraft in 2003 that helped cover some of the dramatic drop in liquidity, but that is a costly and ultimately unsupportable long-term strategy. FADU had a N10 million loan from Guarantee Trust, which was repaid in June 2002. It was reported that the bank would not renew the loan. FADU also found that the cost of the loan did not leave a sufficient spread on their internal interest rate to clients, and thus the bank financing was not cost effective at market rates.

They are successful (so far) in obtaining donor funding to cover operational shortfalls, and reportedly management has not been eager to take on more commercial funding. We learned FADU has been trying to get local commercial banks in Ibadan to extend credit, but has met resistance due to the lack of bankable collateral, despite pledging its new building in downtown Ibadan. Until FADU changes it corporate structure and becomes operationally sustainable, it will remain uncomfortably dependent on donor funding.

UNADJUSTED BALANCE SHEET (Naira '000)	31-Dec-02	31-Dec-03
ASSETS		
Cash and Banks	34,861,954	4,028,640
Temporary Investments	4,000,000	
Net Loans	137,045,738	166,974,738
Gross Loans	168,114,493	200,923,493
Performing Loans		
Portfolio at Risk	-	-
Loan Loss Reserve	(31,068,755)	(33,948,755)
Interest Receivables		
Other Current Assets	16,234,751	5,234,751
Current Assets	**192,142,443**	**176,238,129**
Equipment	11,453,043	24,153,282
Property	119,983,675	119,983,675
Other Long Term Assets	-	
Total Assets	**323,579,161**	**320,375,086**
LIABILITIES		
Client Savings	40,714,001	44,107,533
Short Term Time Deposits	-	-
Short Term Funding Liabilities	-	6,948,067
Other Short Term Liabilities	698,308	698,308
Current Liabilities	**41,412,309**	**51,753,908**
Long Term Time Deposits	-	-
Long Term Funding Liabilities		
Quasi-Capital Accounts	27,112,308	-
Other Long Term Liabilities	-	-
Total Liabilities	**68,524,617**	**51,753,908**
EQUITY		
Capital Grants Brought Forward	133,200,000	196,203,868
New Capital Grants	63,003,868	57,839,141
Retained Earnings	58,850,676	14,578,169
Retained Earnings Brought Forward	77,128,254	58,850,676
Earnings (Losses) Period	(18,277,578)	(44,272,507)
Total Equity	**255,054,544**	**268,621,178**
Total Liabilities & Equity	**323,579,161**	**320,375,086**
Source of Financial Statements	Management Reports	Management Reports
Official Ending Exchange Rates - PRISMS	130.62	143.3

FARMERS DEVELOPMENT UNION

UNADJUSTED INCOME STATEMENT (Nira '000)	31-Dec-02	31-Dec-03
Interest and Fee Income	52,534,323	21,412,020
Cash Interest and Fee Income	*52,534,323*	*21,412,020*
Accruals (Int.. Receivables)		
Interest and Fee Expense	(4,210,192)	(4,824,748)
Net Interest Income	**48,324,131**	**16,587,272**
Provision for Loan Loss	(1,320,000)	(2,880,000)
Net Interest Income After Provisions	**47,004,131**	**13,707,272**
Operating Expense	71,741,705	63,048,524
Personnel	*30,204,093*	*26,728,781*
Other Administrative Expense	*41,537,612*	*36,319,743*
Net Operating Income	**(24,737,574)**	**(49,341,252)**
Other Income	6,459,966	5,068,745
Investment Income		
Other Non-Extraordinary Income	*6,459,966*	*5,068,745*
Other Expenses	-	-
MFI's Inflation Adjustment (if any)	-	-
Other Non-Extraordinary Expenses	-	-
Net Not-Operating Income	**(18,277,608)**	**(44,272,507)**
Extraordinary Items	-	-
Extraordinary Income-Operating Grants		
Extraordinary Expense		
Net Income Before Taxes	**(18,277,608)**	**(44,272,507)**
Taxes	-	-
Net Income	**(18,277,608)**	**(44,272,507)**
Source of Financial Statements	Management Reports	Management Reports
Official Ending Exchange Rates - PRISMS	130.62	143.3

SUPPLEMENTAL ANNEX 4

Demand for Microfinance by MSMEs

A. Methodology

The demand assessment team investigating non-farm financial services visited commercial banks, a cooperative development bank, cooperative societies, large and small NGO MFIs, a money-lending outfit and women's associations. The type and distribution of the institutions by state is described in Table 1 below.

Table: No. and Type of Organization by State and No. of Staff Interviewed by Organizational Type

Organization	No. of Staff Interviewed	FTC	Plateau	Bauchi	Cross Rivers	Totals
Formal	**8**					**4**
Community Bank (2)	3	2				2
Coop. Dev. Bk. (1)	1				1	1
Cooperative Finance Agency (1)	4			1		1
Semi-formal	**26**					**9**
NGO MFI Lg. (2)	10		1	1		2
NGO MFI Sm. (3)	6		1	2		3
Cooperative Societies (2)	8		1	1		2
NGO Youth Service Org. (2)	2				2	2
Informal	**2**					**3**
Women's Associations (2)	(counted as clients)			1	1	2
Investment Co. (Money-lenders) (1)	2				1	1
Totals	**36**					**16**

The institutions were selected to obtain information from a range of microfinance services clients in rural and urban areas including men, women and youth. In general, the formal banks serve urban areas. The NGOs and NGO MFIs serve both rural and urban clients, with two of the NGOs focused largely on urban areas. One youth NGO serves primarily men in rural areas and the other women in urban areas. Cooperative societies are widespread in the rural areas.

The team met initially with the staff of the organizations to collect data on the number and type of clients served, products and services, and institutional perspectives on client demand. We met with approximately 34 staff. The meetings were usually followed by a meeting with a group of clients or individual interviews with clients. The data collection tools included three participatory rapid appraisal (PRA) tools developed by Microsave: Financial Sector Trend, Seasonal Calendar of Income, Expenditures, Loans and Savings, and the Life Cycle Analysis Tool.[28] The financial sector trend analysis helps clients to identify the sources of financial services and rank them according to their popularity and use this year, last year, five years ago and ten years ago. The seasonality calendar obtains a ranking by month or season on the degree to which there are income, expenditures, savings and borrowing which permit an assessment of cash flow and financial requirements. The life cycle tool elicits the key life cycle events that create financial pressures for lump sums of money and ranks the degree of pressure associated with each event. This tool also permits the identification of opportunities for financial products.

We completed three seasonal calendar, three life cycle and two financial sector trend PRAs. The AIMS[29] loan use tool was used with four clients and one AIMS savings use interview was held. For all the tools we attempted to obtain a sample of rural and urban clients, as well as men and women. (See Annex D for questionnaires used for the assessment.) Where it was not possible to carry out a PRA or individual interview, the team completed simple focus group discussions.

The institutions selected the interviewees based on our interest in achieving a representative number of rural and urban clients, as well as men, women and youth. Unfortunately, in the time period allowed, we were unable to interview youth directly. The table below presents the profile of those interviewed.

Table: Clients Interviewed By State, Gender and Location (urban or rural)

	FTC	Plateau	Bauchi	Cross Rivers	Total
Women	9	8	21	6	**44 (65%)**
Men	1	6	7	10	**24 (35%)**
Urban	10	8	17	9	**24 (35%)**
Rural	0	6	11	7	**44 (65%)**
Total	**10 (15%)**	**14 (21%)**	**28 (41%)**	**16 (24%)**	**68 (100%)**

B. Sources, Terms and Prevalence of Credit Services

Formal and Semi-formal. The financial landscape for credit services offered by “formal” and “semi-formal” institutions is presented in the table starting on the following page. The services are presented by organizational type. The larger MFIs, COWAN and DEC are presented separately.

The largest MFI in terms of both number of clients and volume of loans is the Cooperative Financing Agency (CFA) in Bauchi. The organization serves as an apex institution to thousands of cooperative societies to provide agricultural loans to farmers for animal traction, fertilizer and raising small ruminants. CFA estimates that 75% of the members are men. The cooperative societies and the small

[28] MicroSave—Africa, Participatory Rapid Appraisal for Microfinance—A Tool Kit, Assembled and developed by Graham A. N. Wright, Shahnaz Ahmed and Leonard Mutesasira with help from Stuart Rutherford, Monique Cohen and Jennifer Sebstad, May 2002.
[29] Nelson, Candace, Editor, Learning From Clients, Assessment Tools for Microfinance Practitioners, The SEEP Network, 2001.

NGOs, on the other hand, reach less than 3,000 persons. They provide loans for petty trading and agriculture and primarily serve women. The community banks and cooperative development bank largely serve salaried workers, especially civil servants from the cities and towns where they are located. Community banks reach lower economic groups than the cooperative development agency. The larger MFIs mainly serve rural poor women, although they have clients from urban areas.

Informal. The use of small NGOs, adashis (ROSCAs), esusus (ROSCA in the south, piggy bank in the north), workplace associations, clubs, supplier credit, moneylenders, loans from friends and family, and pawning is very common. The widespread use of informal mechanisms tells an important story about demand for financial services. In an environment where there is little trust, small groups from the same workplace or community who know one another well form to save and lend. Some men interviewed in Jos told us "*Nowadays people don't trust each other so we depend mostly on the community or NGOs like this one.* The small community organizations permit an individual to obtain a loan quickly and easily, for business, consumption or emergencies with little or no paper work. Loans may take a day, a few weeks or many months, but if the need is great, the groups are usually ready to respond. The poorest use the adashis and esusus. In recent times, there have been youth associations and clubs for youth and the non-poor. The community bank in Calabar has promoted workplace cooperative societies to mobilize savings and expand its reach. They have been successful helping members access loans from N20,000 ($145) up to 200,000 ($1445).

B1. Rural Clients (women, men, youth)

Rural clients rely largely on NGOs, semi-formal or informal cooperative societies, adashis, piggy banks and friends and relations for loans. The main reason for this is ease of access. The formal banks require large amounts of collateral, paper work, valuation reports and lengthy application processes. In many cases, they are too far away from the community to be accessible.

Loan products from NGOs and cooperative societies mainly include agricultural loans and loans for petty trading. Of all the institutions we interviewed, the cooperative societies appear to have structured the loan products to best meet client demand. Agricultural loans are generally eight months to one year in duration. There is a grace period followed by quarterly repayments. Petty trading loans are made for three to six months with weekly or monthly repayments. The highest loan amount to an individual is N10,000 ($72). Annual interest rates charged are approximately 40% flat. The effective interest rate is 65.67%, not including additional fees or mandatory savings which can significantly increase the cost of borrowing. Adashis and piggy banks are widespread and important to address shortages in loan capital from the institutions, and pay for household necessities and emergencies.

Input suppliers are an important source of capitalization in rural areas. Suppliers lend products such as seeds and other agricultural inputs on credit before the planting season and permit in-kind repayment. Repayments are two to three times the value of the borrowed input.

Women. Women in rural areas depend on cooperative societies, NGOs, friends and relations for loans for farming and petty trading. The women of DASS Women Multipurpose Cooperative in Bauchi say they have *"never"* tried getting loans from banks because they do not think it is possible, although they do save with the banks. The fixed and/or capital assets required by the banks are beyond the means of most women. Women in Toro Salam mentioned a strong dependence on supplier loans to obtain in-kind inputs for their economic activities, indicating a lack of adequate financing from other sources. The loan amounts from the cooperative societies range from under

N1000 ($7.22) to N10,000 ($72) for between six months and a year with N5,000 ($36) a common loan amount. The Rahama Women's Development Program in Bauchi makes N5,000 to N10,000 loans to individuals through groups of about ten women each. The annual nominal interest rate is 35% flat with monthly repayments. Formerly, the organization required repayment every two months but the repayment rate was dismal. It has improved since monthly payments were instituted but there is a long way to go at 70% loan recovery.

In Cross Rivers, a women's cooperative society is financed through the Susan Ohio Investment Company's "linkage person," who is a local pastor. The society prefers his loans because the nearest bank is twenty-three kilometers away and it costs of N100 ($ .72) transport and requires a N100 savings balance minimum in a bank account—amounts that are unaffordable to them. Loan amounts range from N10,000 to N50,000 ($361) to fit the business cycle for palm oil processing. The pastor claims he charges 20% interest on a six-month loan. The Northern Cross River State Women Association reaches eleven local government areas (LGAs). Members collect savings and on-lend to one another loans of N2,000 to N10,000 in rural areas. They say a N5,000 loan is *"plenty"* in the village. Although only $36, this is understandable. Consider that the price of a bus ticket from Abuja to Jos, approximately 4 hours away is N200 or $1.45.

Men. Men in rural areas are largely engaged in farming rice, cassava, soybeans, maize and other primary crops. Cocoa is produced in the south. They also obtain loans from cooperative societies. Loans are usually larger, such as the N85,000 ($614) provided by CFA for animal traction. Loan terms range from one to three years. CFA is not a direct lender, rather it works through thousands of cooperative societies that act as intermediaries. In Calabar, the Susan Ohio Investment Company with its "formalized" network of moneylenders, provides loans to mixed groups for processing palm oil, groundnuts, beneseed, beans and gari, and for rice farming and trading. The farmers and food processors are willing to repay double the amount of the loans in grain, and 10% to 20% on a three-month cash loan or nominal interest of 40% to 80% per annum. Most do not use the banks because the amounts they want are too small, the banks are far, and the formalities inconvenient.

Table: Financial Landscape for Formal and Semi-formal Credit Services

	Coop. Dev't Bank, Calabar Branch	Community Banks (3)	DEC NGO MFI	COWAN Jos Branch	Coop. Societies DASS, Toro Salam, etc.	NGOs (small) Urban Ministries, Rahama	Cooperative Financing Agency
Number of Clients	3,000	Calabar: 6,000 Garki: 6,192 Gwagwalada: 1,500	11,517 borrowers 100% women	6,000 clients	DASS: 520 borrowers (est.) Toro Salam: 75	Urban Ministries: 1,320 Rahama: 3,255	100,000 members (incl. thousands of cooperative societies)
Type of Clients	60% (M) 40% (F) Civil servants, students, traders, manufacturers, service sector, business sector	40-70% (M) 30-60% (F) 40% + civil servants		5% (M) 90% (F) 5% youth 70% rural 20% urban poor	Rural farmers and petty traders	Farmers, traders, small shops, food processing	
Socio-economic status of clients	Comfortable: 40% Middle: 30% Very poor: 30%	Traders, civil servants, lower to middle class "below the banking class"	25% literate	Urban: unemployed, Traders Rural: farming and some trading	Comfortable: 10% (3 meals/day) Moderate: 30% (2 meals/day) Very poor: 60% (1 meal/day) Also based on type of housing/amount of livestock	Illiteracy high Target very poor in urban and rural areas	75% men farmers
Loan Portfolio (as reported by org.)	N400 million ($2.9 million)	Calabar: N35 million ($253,000) *N15 million business loans, N10 million overdrafts* Garki: N10 million ($72,000)	N100 million ($720,000)	N10 million ($72,000)	DASS: N1.8 million ($13,000) Toro Salam: N7 million ($50,600)	*Urban Ministries:* *N6 million ($43,350)* Rahama: N 8 million ($57,800)	N220 million ($1.59 million)

	Coop. Dev't Bank, Calabar Branch	Community Banks (3)	DEC NGO MFI	COWAN Jos Branch	Coop. Societies DASS, Toro Salam, etc.	NGOs (small) Urban Ministries, Rahama	Cooperative Financing Agency
Average Loan Size	N133,000 ($961)	Calabar: N35,000 ($253) *Garki: N50,000 ($361)* Gwagwalada: $1100 agriculture N30,000-50,000 ($217-$361) trading	N8,674 ($63)	N1,667-5,000 ($12-36)	*DASS: N2,000-3,000 ($14-22)* Toro Salam: N9,000 ($65)	Urban Ministries: N4,500 ($33) Rahama: N2,458 ($18)	N5,000 ($36) crops N85,000 ($614) animal traction N25,000 ($181) small ruminants
Loan Use	Large businesses, traders, manufacturers 40% loan volume for trading	Cocoa sales, palm oil, groundnuts, traders, commerce, transportation, farming, fishing, food processing, small manufacturing (beauty creams, soaps)	Agriculture (crops, fisheries, livestock), trading, ready made clothes, grains, bean and rice cakes, noodles	Petty trading, processing groundnuts to oil and cakes, poultry	farming here (by women, as well as men), especially rice, also corn and other crops, agro processing (rice), honey extraction, local magi, weaving, soap, petty trading	Rural: Rice, soya bean, sweet potatoes, poultry, petty trading, bean cakes Urban: Trading, farm labor, gari making, groundnut oil and cakes, corn flour processing, beans, rice, fish, tomatoes	Ox plows and oxen, fertilizer, small ruminants (by women)
Products and Services	Local purchase order: used by 10% of clients Overdraft 2-4 months Term Loan – 1 year		ASA methodology (loans to individuals in groups of 5, groups of 5 members of an association of 25–30) Separate department for business and health training, other projects	Group-guarantee (5) Market women's loan Individual loans Youth loans Project loans POP (poverty) loans HIV/AIDS awareness, reproductive health, water, sanitation Savings	Agricultural loans Loans for petty trading, water and sanitation, TBA training, maternities Sales of subsidized ag. inputs	Group loans (25-30) and on-lending to individual members	Loans for animal traction, fertilizer, small ruminants Training: financial mgmt, product marketing, savings management, input sales and use, storage

	Coop. Dev't Bank, Calabar Branch	Community Banks (3)	DEC NGO MFI	COWAN Jos Branch	Coop. Societies DASS, Toro Salam, etc.	NGOs (small) Urban Ministries, Rahama	Cooperative Financing Agency
Product (Design)			Loans to "apexes" or local cooperative societies that on-lend to their members (not counted in DECs numbers)	Groups (5) guarantee one another's loans. Loan size directly proportional to savings. Leverage ratios vary on savings to loan from 1:3 (POP) , 1:6 (groups), 1:10 (new market women loan) Young people's loans: first, vocational training (carpentry, welding, etc.); then, place as apprentices. Loan N50,000 Also Hunger Project loans to 25 community women, N150,000 for farming food processing (only 4 groups)	Loans to groups of 25-40 members	Group loans with on-lending to individual members, group guarantee	Loans to agricultural producers through local cooperative societies combined with training, financial mgmt, product marketing, savings management, input sales and use, storage In-kind loans
Application to Disbursement Time	Says 5-6 days. Locals interviewed claimed 3-6 months. All loans must be approved at the head office in Lagos.	Can be reasonably fast. Sometimes one day, sometimes one to two months.	First group of 5 gets loan, starts repayment, if repayment is good next group and so on.	Same day as finished training, which may only last a day.	Very fast	Depends on availability of funds	In time for season/planting
Collateral/ Guarantees	Salaries, savings, assets, valuation reports	Salaries, assets	Group guarantee	Group guarantee, savings	Group guarantee, savings	Group guarantee	100% coop payment N5,000 share capital per cooperative In-kind, CFA staff must pay for input selected
Duration of loan	1 year, varies	variable	1 year	4 months, 6 months, 1 year	1 year – agriculture 3 months - petty trading	6 months – urban 1 year – urban and rural	1 year, 3 years

	Coop. Dev't Bank, Calabar Branch	Community Banks (3)	DEC NGO MFI	COWAN Jos Branch	Coop. Societies DASS, Toro Salam, etc.	NGOs (small) Urban Ministries, Rahama	Cooperative Financing Agency
Repayment Periodicity	Monthly deduction from salary, weekly, daily, varies	Monthly, taking 30% of salary for a 6-month, N60,000 loan	Weekly	Weekly, monthly	Quarterly interest payment- ag. Monthly payments, equal principal and interest - traders	Monthly	Weekly after grace period
Grace Period			6 weeks (44 payments on 1 year loan)		2-3 month grace period for ag.	No	6 months
Loan Size	N100,000 max. to traders N40,000 average to women (few) N1 million/year to others	Calabar: N100,000 max. for civil servants can be approved by mgr. Higher must be approved by Board. Frequent demand for loans of N20,000-40,000 Garki: N20,000-500,000 "small loans" N1.5 million, farming N5 million, cooperative Gwagwalada: N30,000-50,000, trading N1.5 million -- farming	N5,000 to N15,000 for individual in groups N100,000 for equipment loans N500,000 to cooperatives societies and NGOs	N2,000 max. first loan for groups (5) POP N5,000, market women **Other individual loans: 4-6 mos. or 1 year flexible, i.e. N5,000-6000** N50,000, equipment	N50,000–N100,000 per group Maximum individual loan N10,000	N5,000-N15,000 Urban Ministries: highest loan N50,000 Rahama: N10,000 highest loan	N5,000, crops N85,000, animal traction N25,000, small ruminants

Access Requirements	See above: difficult, application process, collateral, valuation report, review by head office	**Loans tied to savings amounts, collateral assets** Women must have consent of husband except public servants	Member of group; group members pay their loans, savings of N600 achieved and regular required savings deposits	Savings, group membership and performance of group	Tied to savings 1-5 ratio, regular group meetings	Tied to savings and group membership, usually pre-loan training required	Registration with cooperative, cooperative share payment
Interest Rate	26% p.a.	35%/month 17% 2 weeks on salary overdraft 12-13% 3 mo. loan (48%/p.a.) Depends on bargaining power Pay 10 equal installments + 35% interest	32% p.a. 15% to coop. societies	36% p.a. project loans at 30%	40% p.a. flat	Urban Ministries: 10% - 6 mo start-ups 20% - 6 mo. more established Rahama: 35% p.a. Flat rates	15% p.a. 13% for animal traction and cattle fattening
Other Fees		Xmas account “almost compulsory for salary earners”		Mandatory savings	N5,000 admin. fee per group per quarter, registration fees, monthly dues	Mandatory savings	3% admin. fee
Source of Funds	Savings	Savings	Microstart, past funds from Ford, Germans, D&P, ICA	Interchurch Organization for Development. ADF, individual contributors (civil servants NOT politicians)	ADF, Partner for Development, IFDC-Daimina, DFID, VSO	Grants	NACRBD with state government guarantee

Youth. It is all too common to find unemployed young men in rural areas who are paid by politicians to incite conflicts and riots. In Cross River, moneylenders lend to youth to engage in cocoa, rice and other crop production. The Young People's Initiative works with young men to provide skills training, and creates youth associations to assist members to save and access productive employment.

B1a. Uses of Loans

Although the purpose of the assessment was to focus on non-farm financial services, the clients in both rural and urban areas use loans for agricultural production, and farm-related commerce and food processing, as well as small manufacturing and services. As is often the case in microcredit, loan use is more diversified than the stated purpose would indicate, largely dependent on the day-to-day requirements of the borrower. That said, rural clients obtain loans primarily for agricultural production (crops, fisheries, livestock, animal traction) and petty trading. The primary uses of men, women and youth are described below.

Women. Women in rural areas generally use loans for agriculture, poultry and small ruminants, vegetable gardens and petty trading of agricultural produce and condiments. In DASS Women Multipurpose Cooperative Society, where the population is primarily Christian and many people have migrated from other areas due to religious conflicts between Muslims and Christians, women are active in rice growing, as well as maize, beans, groundnuts and other crops. The seasonality calendar completed by members of the cooperative society illustrates cash flow in the area and financial requirements. Credit needs are highest in April when families are preparing to plant. In January, women take loans for petty trading. This is an important source of income at a time when most of the proceeds from the harvest have been spent or are in storage for the rainy season when food is scarce and prices are high. Emergency loans are taken in June and July from friends and relations to pay medical costs, primarily because malaria, measles, typhoid and cholera are widespread at this time. By November, credit is taken to purchase grain and to buy clothes and other requirements for the festivals and marriages that go on in November and December. The chart on the following page indicates rural women's cash flow, including pattern of use of credit and savings.

Palm and Groundnut Oil

Julie (not her real name) is a widow who takes care of her grandchildren. She has a loan of N30,000 ($217) to trade red palm and groundnut oil. This is her fifth loan from COWAN. At first she was a member of a group and had a smaller loan of about N3,000. Her loan repayment performance was excellent and now she can take a loan as an individual.

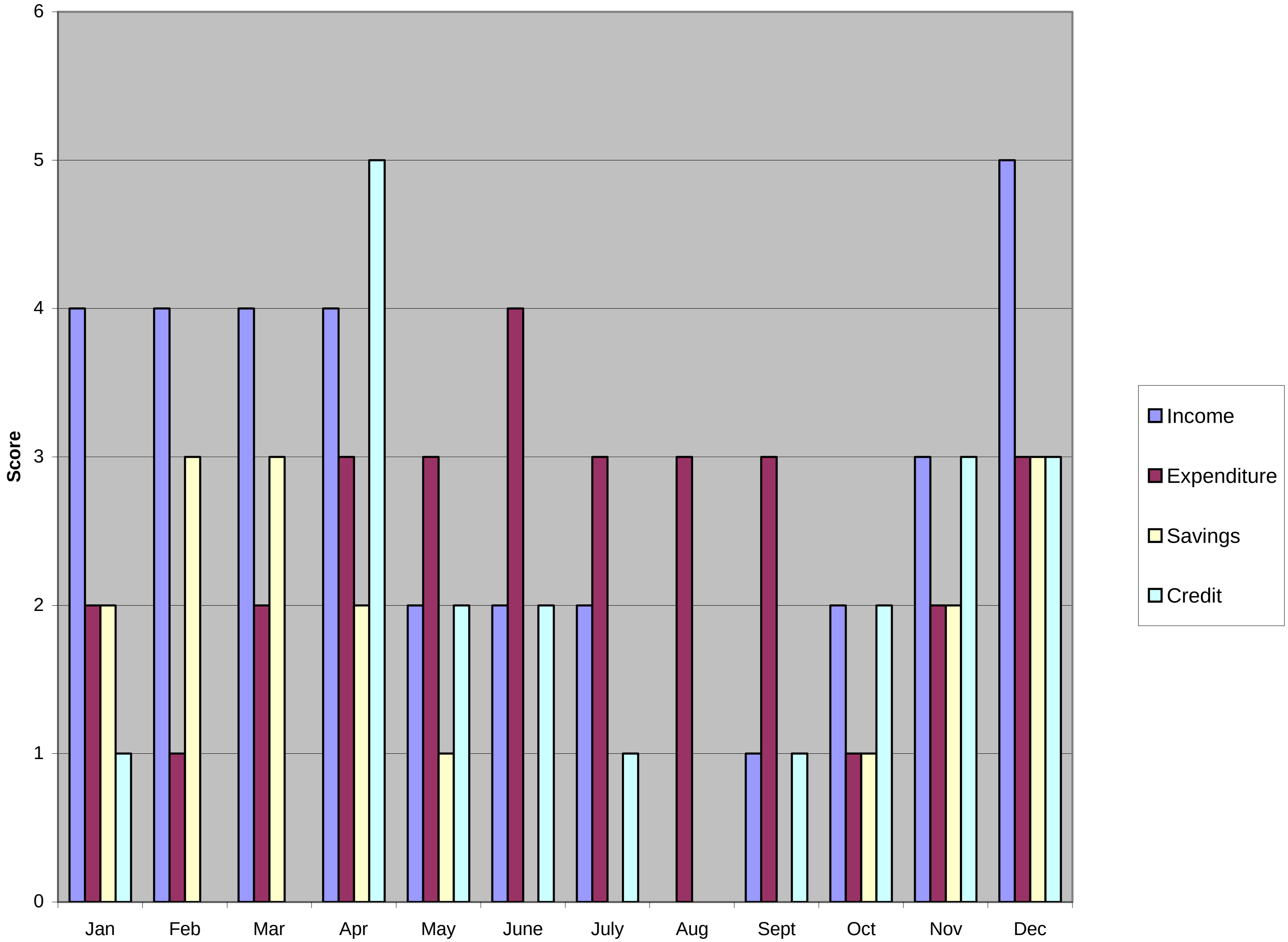
She purchases groundnuts and gives them to processors. These are four women that she engages regularly. Julie sells the processed product. The business is profitable as she is able to put aside between N1,200 to N3,000 per month. She also pays people to work on her farm and sell vegetables. This is a seasonal activity. It is the oil business that brings in more income.

With the profits, she buys food, clothes and pays school fees for her three grandchildren who are ages 25, 18 and 12. They are all in school. Another one of her grandchildren came to her from Kaduna because she was ill. She recently died. Some of the loan proceeds paid for her medical expenses.

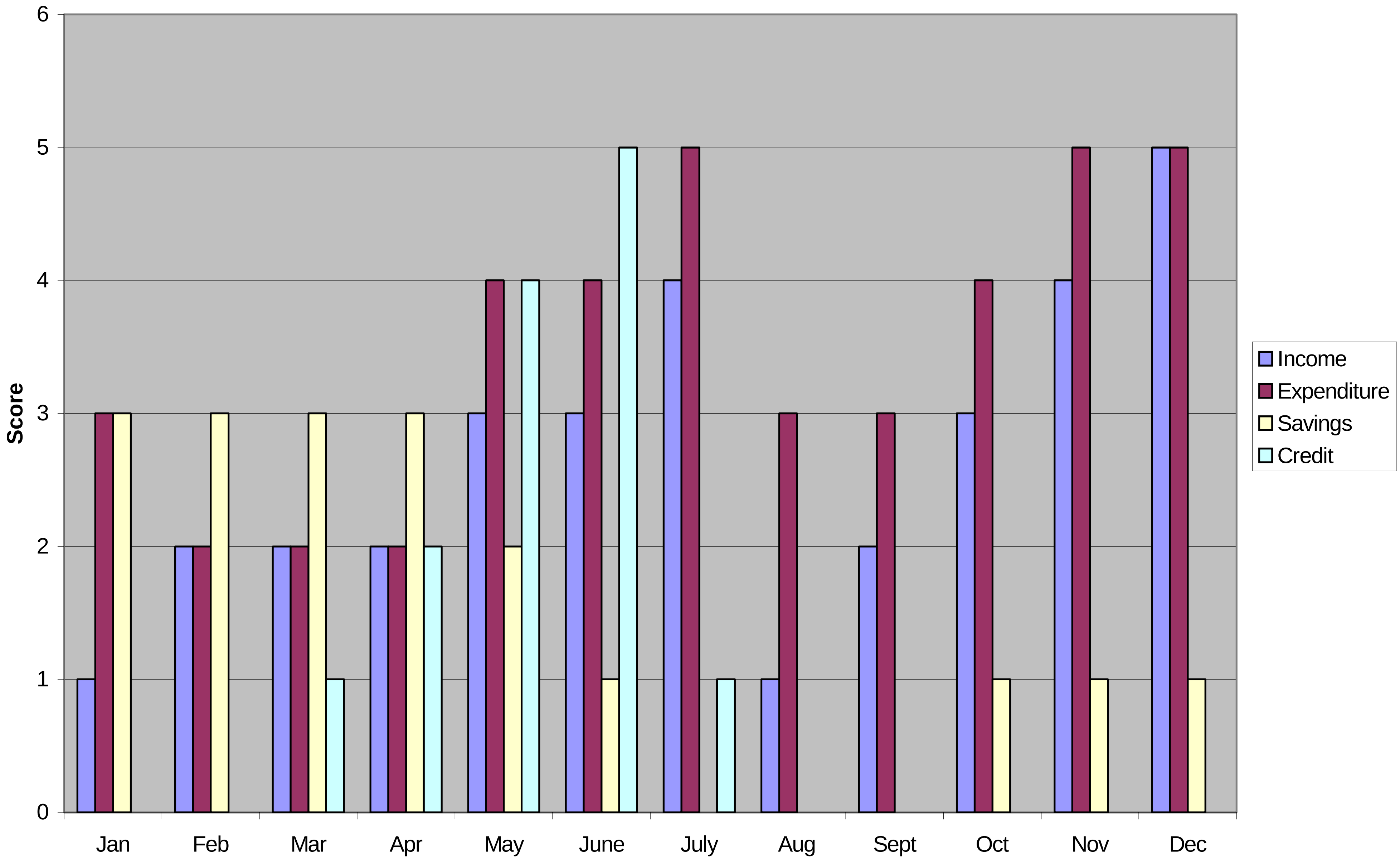
The business is growing slowly, although not as fast as she would like, because of inflation. She now has one employee as a result of the loans. When she did not have the loan, she had to buy groundnuts on credit and repay after processing and oil sales. This is expensive because suppliers charge high interest.

Source: Assessment PRISMS Team Field Visit, 2004

DASS Multipurpose Cooperative Union - 8 Women (Rural)
Seasonality Calendar of Income, Expenditure, Savings and Credit



Bauchi Cooperative Financing Agency - 7 Men (Rural and Urban Mix)
Seasonality Calendar of Income, Expenditure, Savings and Credit



Men. The majority of agricultural loans are for men. Men use CFA loans, in particular for ox plows and fertilizer. Other uses of agricultural loans include pesticides, seed, labor, bags for storage and transportation. The seasonality calendar (on the previous page) completed by rural and urban men in Bauchi shows a different picture from the women in Dass. Men in Bauchi borrow in May and June for cattle fattening and animal traction. Men say credit is accessible to them from banks, NACRDB, cooperatives, commercial banks, adashis and business men. They may borrow in-kind in July to feed their families.

Youth. Youth who are unemployed use loans for farming, trade and setting up small businesses. Where they are lucky enough to be enrolled in vocational training, they may receive loans to start up their carpentry, barber shop, tailoring, hairdressing, trading, computer, or repair shop businesses. Their financial requirements average about N50,000 depending on the type of business.

The Young People's Initiative, a small NGO in Calabar, seeks to address the problems of 70% of unemployed and low-educated boys and young men. A key issue is the use of these young people by politicians to incite conflicts and disrupt democratic processes, especially during elections. The young men from rural areas are taught to farm crops such as cocoa and rice using sustainable agricultural techniques.

Because of daily pressures to meet basic life requirements, it is not uncommon that loans are diverted for personal use, often to pay for school fees and health care. (See Financial Pressures section below.)

"Modern" Moneylending in Calabar:
The Demand for Microfinance Services

The largest microfinance organization in Calabar, Cross Rivers State, was regarded by locals to be the Susan Ohio Investment Company (SOIC). The organization grew out of Susan Ohio Foundation, once financed by Pathfunder and vaious health programs under USAID initiatives. When funding was discontinued, the director started a microfinance program and separated it from the foundation into an investment company. Financing, he says, came from a group of NGOs who also lost out when funds dried up, as well as local business men. He has hired 12 "link" persons, who are capitalized by SOIC in amounts ranging from $1,500-$3,000 over a period of 1-6 months. SOIC made $23,000 in loans in 2002. These (primarily) men, are free to find and lend to any customers they like on any terms they like. They include a village chief, pastor, owner of Diamond Investment Company, and other business men. SOIC charges about 40% per annum and the "links" charge on average 80% per annum and pocket the difference, according to the SOIC director.

Many work in rural areas. One lender financed rice farmers, both men and women, in his home community giving loans ranging from $220-$370 for periods of one to six months. Another financed a cooperative whose members used loans for trading, intra-city transport and buying and storing food to sell at the time of the peak price. Another lent money to members of a cooperative of groundnut and beneseed producers and yet another financed palm oil producers.

Diamond Investment is a "pure lending" business located in Calabar. It's owner finances "anybody" who needs a loan, from the working class people, to business men, traders and students. His clients number from 60-200 at any one time. Loan amounts range from N5,000-N300,000, with the most common loans between N10,000-N50,000. The interest rate charged is 30% per month. Sixty percent of the loans are for urban dwellers; 80% are for men. Seventy percent of the loans are for business and 30% are for "family problems," like illness, rent, and school fees. During our interview this moneylender said about his business: *"the demand is so much I run away from my office; I can't contain them."* His total capital is currently N1.5 million ($11,000). He says business is very good, *"People will pay anything if they really need the money."*

Business is also good for Susan Ohio. They pay their investors 10% quarterly and the company has been able to use the proceeds to start a trucking company and construct an apartment building.

Source: PRISMS Assessment Team Field Visit, 2004.

B2. Urban Clients

Community Banks. The team interviewed staff at three community banks in Abuja (Garki), Gwagwalada and Calabar. Many in urban areas are civil servants and have access to loans from the bank when they have their salaries automatically deposited into an account at the bank each month.[30] Using salaries to determine loan amounts and

[30] Or whenever the government pays. Salaries are commonly late by one to three months for civil servants.

deducting payments from client accounts is a low risk strategy used by the banks to manage loan default. For example, the Calabar Community Bank will give a N60,000 ($434) loan for six months to a salaried worker who earns N30,000 ($217) a month requiring a N10,000 ($72) automatic repayment monthly to the bank for six months on the salary plus interest. Interest rates are steep at this bank—35% for a six-month loan. The Calabar community bank manager can approve up to a N100,000 ($722) loan without going to the board. The lower class civil servants primarily use the community banks because the loans are easier to get than from commercial banks or the cooperative development bank. Traders and producers have a much harder time getting loans from the banks, even community banks, because they lack the capacity to meet paperwork and collateral requirements. Despite the risk management mechanisms, the default rate on loans was about 30% at Calabar.

The Garki Community Bank in Abuja makes loans at 26% per annum with a 2% loan processing fee. The smallest loan amount is N20,000 ($144) and the highest individual loan is N500,000 ($3,612). The bank had given a N5 million ($36,122) loan to a cooperative society. The median loan amount to "small" borrowers is about N50,000. Although the number of loans of between N20,000 and N500,000 to low-income traders and shop keepers was very low, the repayment on these was *"perfect"* according to the manager. Default on the larger loans was 23%. All the community bank capital comes from client savings.

Gwagwalada Community Bank provides three-month short-term loans from N10,000 to N100,000. Reportedly interest was 10% per quarter. The manager said that all 1,500 borrowers had large six-month agricultural loans of about N1.5 million at 2% interest per month. Many clients have both trading and agricultural loans. Three-quarters of clients are salaried workers. This community bank makes loans to petty traders who already have an established business. "*Women make better customers*" according to the bank manager, as they use loans for the stated purposes. *"Men use loans to pay off debts, get married, build homes and get drunk."* All the community banks complained that there is far more demand than they can meet, showing us hundreds of unfulfilled applications.

The Cooperative Development Agency is particularly inaccessible to microenterprise clients. People claim it can take up to six months to get a loan. All loan applications require substantial guarantees with a valuation report required to assess asset worth. All applications must also be sent to Lagos for approval. The acting bank manager in Calabar also said *"no loans for women; they can't get collateral."*

The people of Calabar interviewed said: *"[We] don't use the bank, it's rigorous." "Going to the bank, you pass through so many processes and at the end you won't get money."* They also told us that the community bank is better because one can get loans faster, but they cited that the interest is much higher.

Moneylenders, esusu/adashi groups and clubs are important sources of loans for the urban poor given the inaccessibility of bank loans.

B2a. Uses of Loans

Urban clients also use loans for trading and agricultural production. Although many are civil servants, they have farms and fisheries, cattle, poultry and small ruminants. They do business in transportation, food processing and small-scale manufacturing, as well as investing in small shops.

Women. Women have plots of land and commonly grow vegetables seasonally. They also buy and process palm nuts and groundnuts into oil for sale. Urban women also run small shops, make beauty creams, raise poultry, filter honey, and have hairdressing and seamstress businesses. Many engage in petty trading.

Men. Men in cities use loans for motorcycle taxi businesses, barbershops, repair shops, mechanics, carpentry, to run provisions shops and sell petrol. Men do other forms of commerce like selling telephone cards and hawking products ranging from watches to razor blades. Besides this, men use money for their farms. Many also feel pressured to borrow to pay for rent and transportation of their products. Some also borrow to pay for children's schooling.

B3. Sources, Terms, and Prevalence of Savings Services

The sources and terms of savings services are described in the table on the following page.

The Honey Seller

Laurentia is a member of Northern Cross River State Women Association. She was also once a primary school teacher. Her subgroup of 350 women in Calabar meets monthly to save and lend to the members. Laurentia produces honey in her home. She has built up her business, through the support of the association, to N100,000 ($722) in working capital. She uses family members to help her filter and bottle the honey which she sells by the gallon, bottle and in small measures to hospitals, schools and individuals. She even gets help from the local media to advertise her product.

There is a big honey factory in Calabar that bottles honey for exports. Laurentia would love to grow her business to supply the factory. But she cannot obtain enough working capital. She says she would have to have N300,000 ($2167) for this. No bank will give her a loan because she does not have the kind of collateral they want. If she had a big enough loan, she would buy the equipment and pay workers to help her to produce a large quantity of honey. Then she could sell to the honey bottling factory and really increase her profits. Unfortunately, Laurentia is part of the "missing middle" whose loan requirements exceed the ability of her association to finance, and who also cannot meet the stringent bank requirements to access a large enough loan to meet the capital needs to grow her business.

Source: PRISMS Assessment Team Field Visit

Table: Savings Sources and Terms

	Coop. Dev't Bank, Calabar Branch	Community Banks (3)	MFIs	COWAN	Cooperative Societies	ROSCAS, ASCAS	Piggy Banks	Grain Storage Informal Lending
Types of Deposit and Interest Rates	Current accounts: no interest On-call account: 8-13% Short-term (30, 60, 90 days): 10-17% Fixed deposits (1 year): 10.5-16.5%	Current accounts: No interest Regular passbook Savings: 5% On-call account: 6% Short term (90 days): 8% Fixed deposits: 10%- 17% (Garki) 3-9% (Calabar) X-mas Account : 10% Double interest account: 20% or double gov't bank	Mandatory savings: N20/ week up to N100/month: 2-5% or bank rate (group or MFI account) Voluntary savings: same as mandatory rate Loan amount may be tied to savings	Trust fund: COWAN bank account: 3-5% Long-term (1 year): add 1%	Loan amount based on savings Terms vary by cooperative May be dividends	Group-based voluntary savings Weekly or monthly contribution	Home-based voluntary savings	Buy grains, produce during harvest and sell when price is high Can obtain 3x in a good harvest year or up to 4x in years where there is higher scarcity Lend money at high rates
Access		Current and regular at any time Term and fixed after period	Mandatory: Withdraw after loan repaid Voluntary: withdraw at any time					

More poor people use banks for savings than for loans. They like the banks for the perceived security they provide and the interest they can earn. Most of the poor that use banks, use current accounts because day-to-day cash flow pressures do not permit them to tie up their savings.

Cooperative societies, small NGOs, COWAN and DEC require mandatory savings to guarantee the loan. This savings is an additional cost of borrowing, and most often is not perceived as savings. COWAN requires savings for two to three months prior to providing a loan. DEC requires clients to save N600 to become eligible for a loan. The savings are usually tied up for the duration of the loan, although some organizations make exceptions for emergencies. The organizations keep savings on deposit in the bank and pass on the banks' savings interest rates to their clients.

Voluntary savings are available and can be withdrawn any time. In many institutions, the amount of the loan is tied to the amount of savings. COWAN offers 1% additional interest on savings kept on deposit for 1 year. At Rahama Women Development Program, managers said they offered a voluntary savings for health and education but that no one is using it. They did not offer a better interest rate on this savings product than the 5% they pay on regular savings.

The cooperative societies likely offer the best returns on savings. Usually they lend out most of the member savings. Many pay dividends to the members based on the amount of their savings and the interest earned by the group on lending the savings.

Men, women and youth rely on adashis/esusus and piggy banks as their main means of saving small amounts of money. People say they have to use the group or piggy bank because the banks will not accept such tiny amounts. Some men admitted burying their savings in the ground. It is likely that there are huge sums of untapped savings in Nigeria.

The formal banks have fairly standard savings products including current accounts, regular savings, short and long-term fixed deposits. The community banks have some innovative products. The Calabar Community Bank offers a "Xmas Account" to encourage people to save for the holiday and a "Double Interest Account" for those who save for a year.

B3a. Uses of Savings

More than any other purpose, the people interviewed mentioned saving for education. Men were more likely to save for housing and women for illnesses, but school was an important issue for both genders. Some indicated saving to buy a house, and for marriage and childbirth.

Many people spend a considerable amount of their income and savings during the harvest season on marriages and festivals, so they have nothing left by the first quarter of the year and must again resort to borrowing to meet basic needs. Often we were told that it is very profitable to use any surplus to buy and sell grain which can earn them returns far higher than any long-term savings account. Many are able to triple or quadruple their investment.

B4. Other Services

The community bank in Abuja offered funds transfers and safe custody of valuables services. The community banks also engage closely with their clients, establishing personal relationships and trust. At Garki Community Bank, staff provide financial and business education, and advice to their clients. Clients said that because of the bank's advice they have been more productive and improved their cash flow management. At the Calabar Community Bank, the staff promote workplace cooperative societies as a means to mobilize more savings. Their clients appreciate this and it has been a successful project of the bank.

B5. Client Satisfaction and Demand for Improvements

B5a. Credit

What clients like and why. Client preferences for loan services in the four states we visited reflect client preferences among people around the world. They want simple application procedures, a short time period between the loan request and disbursement, timely loan disbursement to match the business cycle, loan amounts tied to the working capital or investment needs of the business, personal relationships and personal service from the lenders, availability of capital and reliability of services, little or no collateral requirements, and rapid access to small loans in times of need.

One cooperative society manager said they do not worry about determining loan amounts because they "*know the amount of land the member has*." DASS Women's Multipurpose Cooperative, Toro Salam Women's Cooperative, COWAN and CFA provide the type of loan product that clients perceive to be best suited for agriculture. The loans are generally made through groups of 5 – 40, six months to a year in duration depending on the product, with monthly or quarterly repayments. Collateral is in the form of joint and several liability of the groups and mandatory savings. Average loan amounts range from N5,000 for crop production N25,000 for small ruminants and N85,000 for animal traction.

COWAN has just initiated a "market women's loan" for individuals for N5,000 for four months repayable in weekly installments of N500 including the equivalent of a 40% annual flat interest charge. The clients can obtain the loan on the same day it is requested. The women greatly prefer this loan to the former product for which there was a lump sum payment at the end of the four-month loan period. The DEC loans based on the ASA methodology that provide a one year loan, six week grace period and 44 equal weekly repayments at 32% per annum flat interest work well for those with high turnover activities.

What improvements they want and why. A disturbing finding is the impact of DEC's ASA methodology on the need for loans to match the farming cycle. Because the methodology is so rigid, requiring weekly repayment, people who need loans for agricultural production are dropping out. ASA is gradually withdrawing from making loans to farmers, but is struggling because the organization recognizes that most clients engage in some agriculture, especially the rural poor, which is their target group. Clients in a number of organizations complained about the inadequate duration of the four-to-six month loans for farming activities.

The clients' major complaint was lack of adequate capital to meet their microenterprise needs. One urban client who had access to N30,000 to process palm oil and groundnuts wanted to raise poultry. She had enough land, but lacked the N60,000 in capital she needed for chicken coops, chicks and feed. The men using loans from CFA wanted more capital for chemicals and fertilizer and would prefer to rent tractors than using animal traction for farming. Some complained about the interest rates, but not as many as the literature on Nigerian microenterprise lending would indicate. Moneylenders for agricultural production in Cross Rivers state said "*the sky is the limit*" when it comes to demand for loans.

At the Garki Community Bank, clients interviewed said that although the bank is well run and provides personal service, because of the lack of computerized information systems, service is slow and the bank is always crowded. "*Often it takes two-three hours to make one withdrawal,*" said one client. The same client said the bank needs new accounting software and more MIS training, as well as more capital for lending. At Gwagwalada Community Bank, clients wanted a lower interest rate, saying they would prefer to pay 2-3% a month to the current 10%. (We were unclear in speaking with the bank manager whether interest on short-term loans was 10% per month or per quarter, but the terms and conditions for financial products at the bank seemed to be quite fluid.) Clients also request "better monitoring and evaluation" to allow them to get longer-term loans to purchase assets (like generators, electronics, milling machines, and refrigerators).

At Calabar Cooperative Development Agency branch, the operations manager said, *"Clients want soft loans."* Soft loans were defined as those with no collateral. The average amount that the poor clients want, she said, is around N40,000 ($289) , but they only give a few of those loans because they are considered too small.

The rural clients also seek larger loans for longer terms for agriculture. Many wanted business or agricultural technical assistance and training. The members of Rahama in Bauchi belonged to a women's grain processing society and specifically requested business assistance.

B5b. Savings

What clients like and why. Where they are accessible, many will use banks to save because they view them as safe. Community banks are used by the poorer or *"those who keep their money in their socks"* rather than commercial or cooperative banks. They see these banks as catering more to their class and more concerned about them.

Clients interviewed did not seem to mind mandatory savings. They say it makes them disciplined and makes loan repayment easier. Clients like saving with cooperative societies where they have a close relationship with other members and participate in decision-making about the use of funds. Where they use banks, current accounts are most popular for ease of withdrawal.

What improvements they want and why. Clients express the need for ease of access and security. Because they are so vulnerable to external events, people are less likely to tie up their savings for long periods of time. Earning interest on savings is less important than access or security. Clients say they do not have "big money" so they cannot use the banks. In part, because of this, adashis and piggy banks are very, very popular savings mechanisms for the poor.

B6. Financial Pressures and Coping Mechanisms

In addition to the pressures of meeting the day-to-day basic needs of the family, it was striking how important both men and women believe it is to pay for children's education costs. The government does not provide free education. Also, many prefer to send their children to one of thousands of private schools that have been established as a counter to the inadequacy of the public education system. People see school as a critical way out of poverty for their children. People also say *"If you learn to read and write, you won't get cheated."* The chart on the following page illustrates the life cycle financial pressures identified by men and women in FTC, Plateau and Bauchi States.

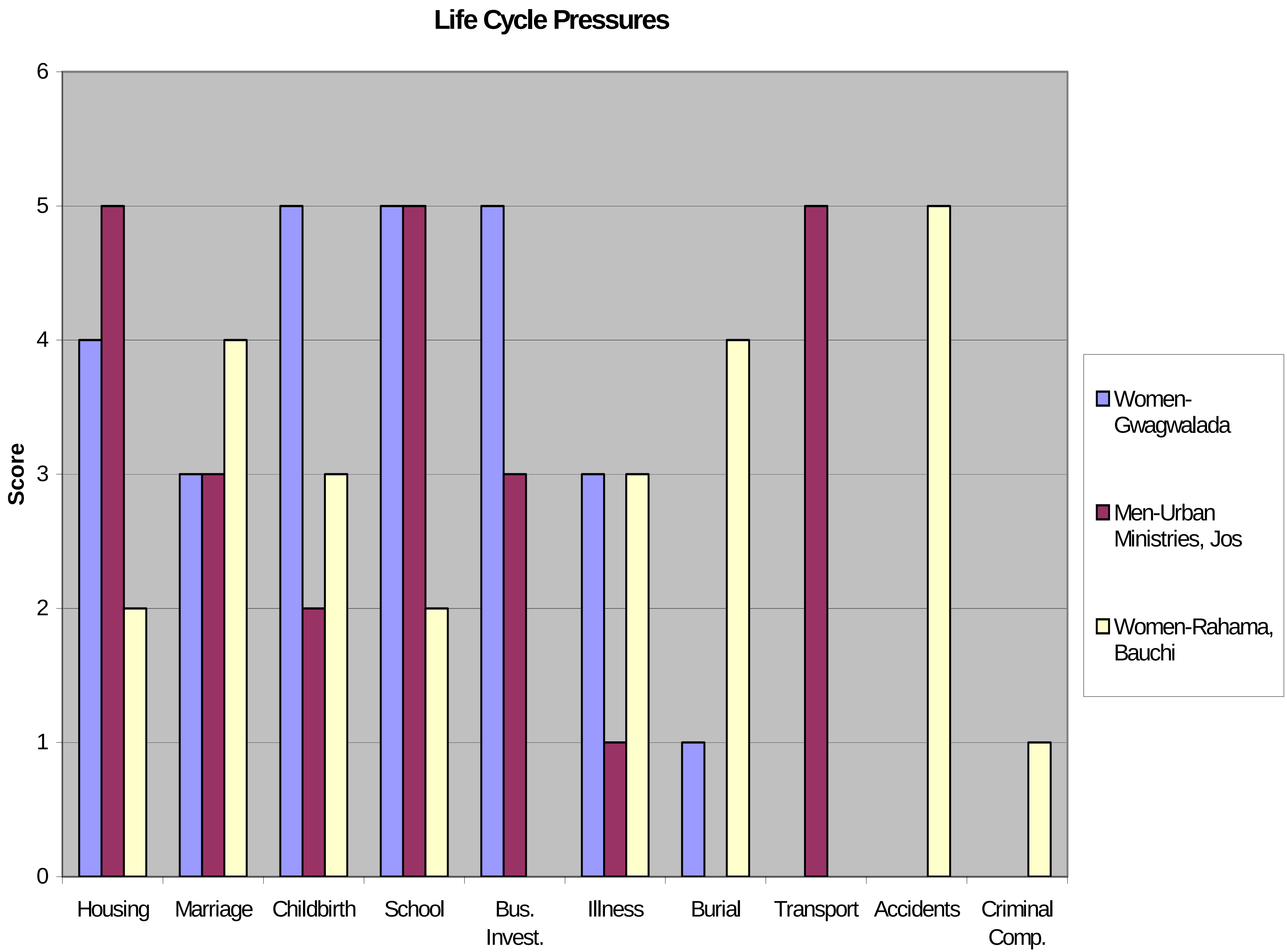
B6a. Rural

Women. As would be expected, people are largely preoccupied with obtaining timely investments for agricultural production. Agricultural loans in Bauchi must come in April for crops such as rice and maize. Women are also very concerned about health issues. In the rural women's cooperative discussion of the seasonality of cash flow, women mentioned malaria, typhoid, cholera and measles as important causes of expenditures during the rainy season after basic necessities and school fees.

Men. Men need money in May and June for animal traction and cattle fattening. Fertilizer and other farm inputs are also needed at this time. Some people even sell some of their property to get these inputs. Many generally experience hardship during the rainy season from June through September before the harvest begins. During this time, people resort to friends, families, their adashis, piggy banks and moneylenders to meet everyday needs.

B6b. Urban

Men. The Life Cycle tool used with male clients of Urban Ministries illustrates a strong preoccupation with housing, transportation and school. The pressures to pay for shelter, including rent and utilities, as well as building a house are large because landlords harass and evict tenants if they do not pay rent. Some cope with the costs of housing buy borrowing from friends or the adashi and forming work parties with friends for home construction. School fees and transportation also cause significant financial pressure. Men save to pay for school and their transportation needs, or they lend money. Some told us they can lend a sum at 10% *"for any time period."* Men, as well as women, mentioned marriage as requiring financing, but both say it is a lesser issue than housing, school and health because they have some control over when, who and how they marry.


Life Cycle Pressures
Score
0
1
2
3
4
5
6
Housing
Marriage
Childbirth
School
Bus. Invest.
Illness
Burial
Transport
Accidents
Criminal Comp.
Women-Gwagwalada
Men-Urban Ministries, Jos
Women-Rahama, Bauchi

Women. The women of Gwagwalada put school fees, childbirth and business investment as their top financial pressures. School costs of N5,000-10,000 are a big sum to them. Everywhere we went, a high priority was placed on putting children through school. School represents an opportunity to get out of poverty and have a secure future. The Muslim women seemed less concerned about sending their girls to school, and more inclined to marry them off if no money was available. School is the main expense for which people intentionally plan and save.

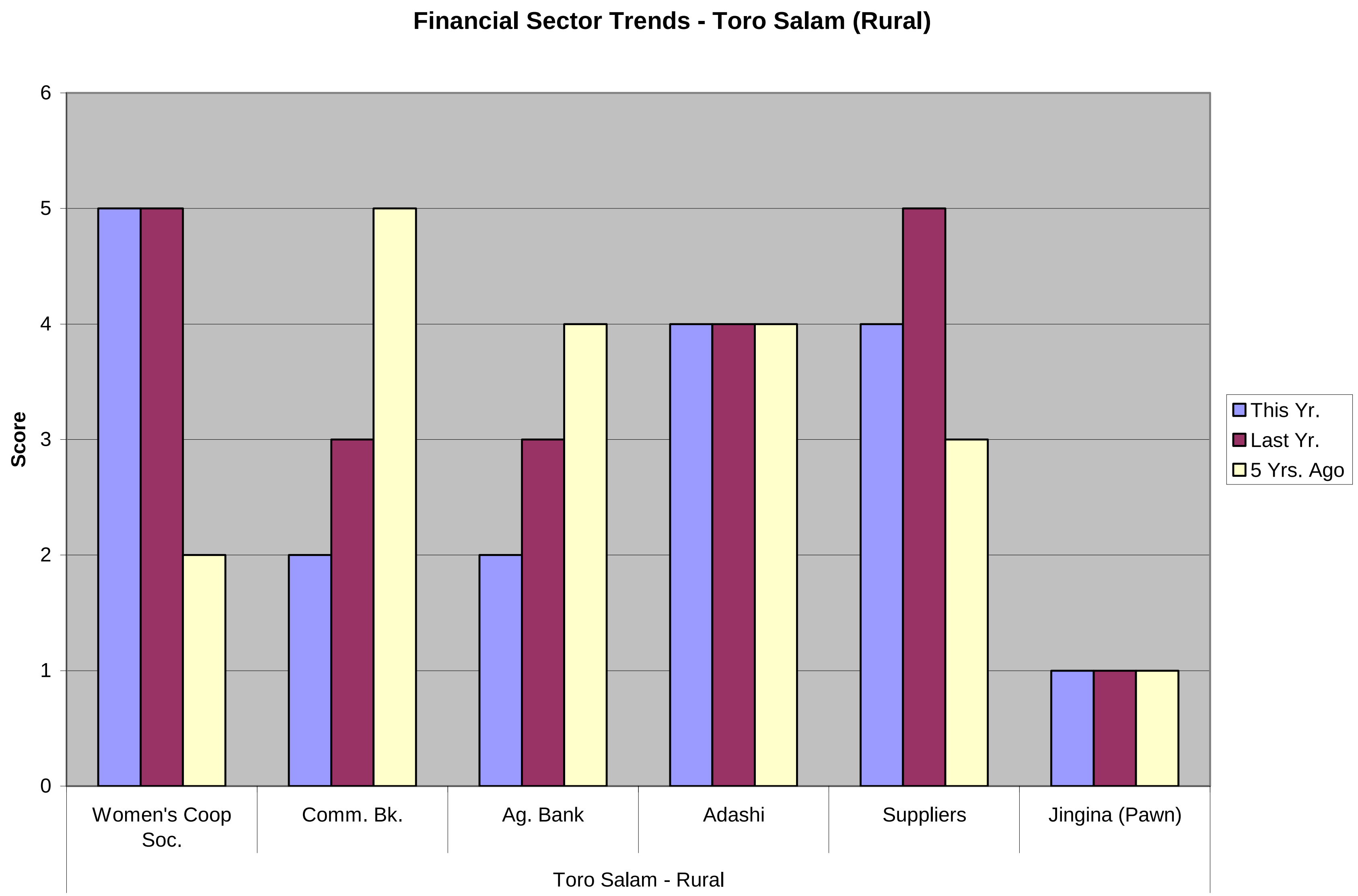
Women explained that childbirth becomes a big issue when there are complications and also because they lose income by staying at home for three months. At Rahama, the women interviewed were less well off than those in Gwagwalada. They identified accidents, especially automobile accidents, as a very high pressure, as well as marriage and burial, and to some extent childbirth and illnesses. A few felt some pressure for compensation of victims when a family member committed a crime.

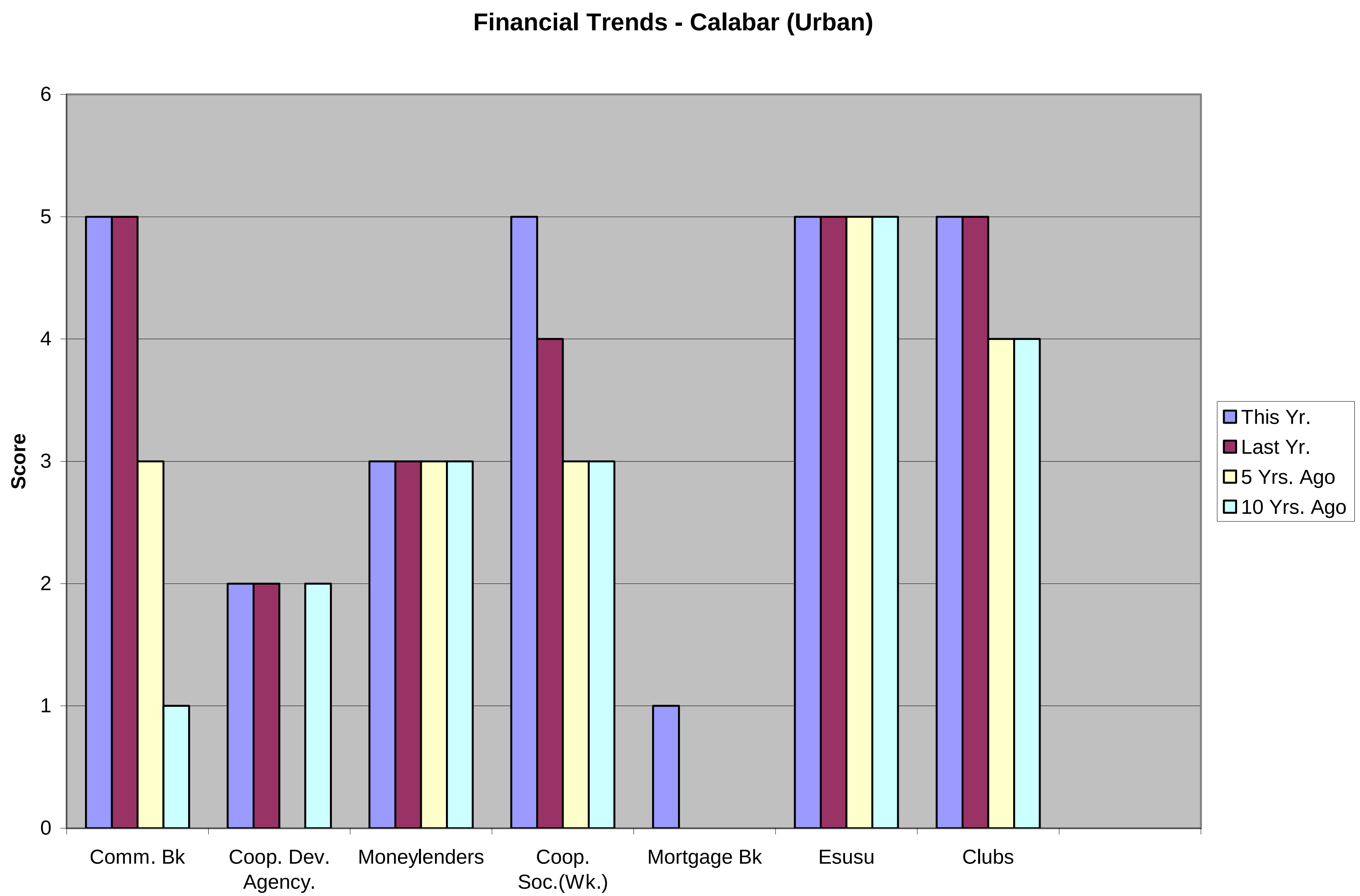
To meet financial pressures, men and women resort to borrowing, especially for medical expenses and to pay the rent. Most admitted that they use their loans to meet shortages and pay for emergencies. When asked how she used her loan in a time of crisis, one COWAN borrower responded: *"When one of my children was admitted to the university and the second was in secondary school."*

B7. Assessment of Use of Financial Services Over Time (financial sector trend analysis)

The assessment team completed two financial sector trend PRAs, one with rural women and the other with a mixed group of men and women in urban areas. (See charts on the following pages.) Cooperative societies and community banks were the most popular organized source of services in both areas. ROSCAs in both rural and urban areas and supplier credit in rural areas were also very popular.

In the rural community, the community bank was the main source of services five years ago followed closely by the agricultural bank. One reason the community bank was attractive at that time was that the government ran a subsidized loan program through it called FEAP (Family Economic Advancement Program) which charged 10% per annum interest. The agricultural bank remains an important source of capital for farming for both men and women, although it, too has declined in importance since the cooperative society began. When the cooperative women's society organized three years ago, women began using its services. It is closer, has easier access, and provides reasonable sums of money. People like the frequency of loans and they know one another. Neither the community bank nor the cooperative society provides enough loans to meet client demand. ROSCAs are the "most used" because they are "small, easy to get a loan, and the most affordable". The popularity of the ROSCAs has remained steadily high. The input suppliers provide an indispensable service, but it is expensive to borrow from them.


Financial Sector Trends - Toro Salam (Rural)
Score
0
1
2
3
4
5
6
Women's Coop Soc.
Comm. Bk.
Ag. Bank
Adashi
Suppliers
Jingina (Pawn)
Toro Salam - Rural
This Yr.
Last Yr.
5 Yrs. Ago


Financial Trends - Calabar (Urban)
Score
0
1
2
3
4
5
6
Comm. Bk
Coop. Dev. Agency.
Moneylenders
Coop. Soc.(Wk.)
Mortgage Bk
Esusu
Clubs
This Yr.
Last Yr.
5 Yrs. Ago
10 Yrs. Ago

The Calabar clients (accountant, caterer, cleaner, technician for Nigeria Telecom) represented low-income urban financial services users. The woman participant also ran a small shop in town. Before the community bank started ten or so years ago, ROSCAs were the primary source of financial services. They still remain as highly used now as they were before. Cooperative societies were also important five to ten years ago. They appear to be increasing in importance. One reason is that the Calabar Community Bank is promoting cooperative societies in the workplace. Also, people like the cooperatives, because they get a dividend at the end of a cycle based on the amount of their savings. The dividend may represent as much as 20% of savings. Clubs are a bit different from esusus as they have weekly meetings, a constitution, take roll call and charge fines for being late. In the club you may get a loan faster than the esusu which requires waiting your turn, although there is lots of room for negotiation in the latter group. The community bank has gained popularity in the past few years among wage-earners and market women with collateral assets. It has reduced the need to borrow from friends and relations. Moneylenders are a steady source of capital over the years for those who do not have collateral, as are ROSCAs. The Cooperative Development Agency has never been popular and five years ago it actually “kicked out” low-income earners, but brought some of them back in later. Very few people can afford to get a mortgage.

C. Gap Analysis, Opportunities for Innovation and Improvements

Our investigation indicates that both rural and urban poor families lack access to adequate credit and savings services. Where services are available, capital is inadequate and effective interest rates are high. Opportunities and incentives for savings to build assets and pay for education, health care and housing are particularly lacking.

For the rural and urban poor, the most attractive source of “formal” financial services is the community bank. But community banks, although more accessible than commercial banks, have more processes and collateral requirements than the poor are able to fulfill. Often, a loan for N5,000 –10,000, or even less, is all a trader needs to carry out her business but the bank cannot afford to make such tiny transactions following traditional banking practices.

The “missing middle” has particular difficulty accessing loans. Where the smallest businesses requiring less than N30,000 ($217) may access funds from their cooperative society or NGO, a food processor or small manufacturer has few or no options. A N30,000 ($217) loan can support an oil processing business and a N60,000 ($433) loan, a good sized poultry business. An urban microentrepreneur with a shop or stall in the market, or carpentry business may need N50,000 ($361) to N100,000 ($722) or more to capitalize the business. Yet, the bank will not talk with them because their collateral is inadequate. Additionally, many potential bank clients are illiterate and do not understand the banking system, yet they have the capacity to produce and repay.

Cooperative societies, producer and processor associations, ROSCAs, and even HIV/AIDS self-help groups perform an important financial intermediation role for those that cannot access more formal bank services. They may have as few as 10-15 members or hundreds of members. They mobilize capital through shares, membership fees, regular contributions and savings. Sometimes they borrow from formal financial institutions such as the thousands of cooperatives that are members of the cooperative financing agency in Bauchi. Many do not have this opportunity and may take costly loans from moneylenders, such as the rice producing multipurpose society in Cross Rivers that pays up to 20% a month.

An opportunity exists to assist community banks to develop products and services that meet the needs of microentrepreneur and producers. The banks need tools and processes to design loan, savings, insurance and other products suitable for a lower income clientele. Market research tools such as those used for this assessment can be adapted for use by the banks to help them design appropriate products. Banks will also need assistance in pricing and promotion of new products to a new clientele. Bank staff will need training in the use of these tools--not only their implementation--but how to translate findings into a product and delivery system that operates profitably. Banks can also benefit from client satisfaction tools to assist them to monitor the continuing appropriateness of their services.

To lower the costs of providing the small loans that microentrepreneurs need, community banks could work with cooperative societies and other self-help groups. It is well-understood that to effectively serve the poor in rural areas, services must be provided to them in the community. They must be regular, reliable and adapted to the types of economic activities people do. Cooperative societies, producers' groups and other self-help groups are close to their clients and can respond to them well, if given the opportunity. The groups would bundle loan requests from their members, apply to and receive one loan from the bank and on lend to their individual members. Bank staff would be hired and trained to strengthen the groups' management of loans and savings, and to access bank services.

Banks will require dedicated staff to deliver these products. The new staff will need training to organize and train the groups. They will need technical assistance for appropriate management and supervision of these staff, including the development of incentive systems to ensure timely and honest service. These staff will need to monitor the groups' management of financial services to their members.

Complementary Services. The assessment team discovered that a number of banks believe it is necessary to provide basic advice and training to their clients on cash flow management and business practices. They report that the clients are more likely to succeed in business, repay the loans and use subsequent higher loan amounts. The cordial business relationships that result enhance banker-consumer relations. Financial education also helps clients interact more successfully with financial institutions. A financial education service, provided that the income/expenses associated with training and technical assistance as accounted for separately, can be a powerful means to achieve better performance and consumer loyalty and should be considered as part of the PRISMS approach. Financial education can include referrals to business services providers, where they are available.

C1. Credit

Lending practices of the banks need to change to meet the demands of microentrepreneurs. Simpler procedures, smaller loans, fewer collateral requirements, acceptance of joint and several liability and a culture geared to reaching poorer clients is needed. The community banks already manage frequent repayments, have reasonably short intervals between loan applications and disbursement, and have the know-how to work with less educated customers. They can learn much from the successful strategies of NGOs and cooperative societies and design these into their loan products. Deepening their outreach has the potential to meet an enormous unmet demand for credit. Some loan products with existing high demand that emerged from the assessment are summarized below. Most of these are tried and true products that have worked well with successful MFIs in Africa. More market research is required by the MFIs to design the product features that will be most relevant to their clients and to develop marketing strategies.

Working Capital Loans. Short-term loans of three to six months with weekly or monthly repayments appear to be the most popular for clients with rapid turnover activities. Mandatory savings and peer group guarantees work well. Banks will need to be comfortable to accept the group's decision and not require individual analyses of each loan request, which is costly for the size and types of loans uses involved.

Agricultural production loans. Longer-term loans from eight months to a year tied to the agricultural cycle with periodic repayments have been successful. Mandatory savings and peer guarantees also work well. Management of the risk of crop failure through diversification, technical assistance referrals, and so on is important.

Grain Storage Loans**.** Loans to buy and sell grain have good potential to cash in on a widespread practice. Technical information and access to pesticides to ensure appropriate storage techniques will add value.

Fixed Asset Loans. Larger loans to small manufacturers with a good track record of working capital loans can particularly help the missing middle. Banks need to become innovative about the type of collateral they require. Leasing could be a possibility in some cases.

Youth Loans. Where youth have had access to vocational training, banks can be encouraged to make loans to them to get set up in business or farming. This could be an important contribution to the deterrence of conflict incitement and aid efforts to build civil society and ensure legitimacy of elections at the grassroots level.

Consumption Loans**.** Why talk about consumption loans in a microenterprise program? The fact is that many microenterprise loans are diverted for major life cycle events and unanticipated emergencies. One way to deal with this is to investigate the potential to provide loan products to meet these needs.

Housing Loans to respond to the high demand for paying rent, utilities and building new homes.

Education Loans to pay for children's education for which people currently appear to go into debt through informal lenders.

Emergency Loans for illnesses, accidents and other unanticipated events. This type of loan would probably require higher interest.

From Group-based to Individual Lending. Successful MFIs recognize that some clients' loan needs grow larger than their peers are able to guarantee. When clients have developed a track record of creditworthiness, they can become eligible for individual loans with new collateral mechanisms, such as selected guarantors or different types of assets.

C2. Savings Services

Although microentrepreneurs save, the opportunities for saving with formal banks are limited since they do not accept small deposits and may require written applications for withdrawals. People also lack the knowledge, skills and attitudes to plan for future capital needs. Nevertheless, there is a tremendous demand for savings, as demonstrated by the widespread use of ROSCAs and cooperative societies, as well as piggy banks.

Opportunities exist to develop savings products linked to specific goals such as education, health, housing and childbirth. Opportunities for savers to save tiny amounts will be important. One means to make this feasible is to encourage savings through community groups and allow them to open group savings accounts. The groups could keep the records for individuals at their own level. In all cases, some flexibility might be built into the products that allow withdrawal in the case of emergencies.

Education savings. Term deposits could be encouraged from the time of the birth of a child. They should offer attractive returns.

Housing savings. This could be another term product geared to those needing lump sums for rent or building a home. Even rent is a significant expense because of the amount of advance required.

Childbirth savings. Childbirth savings could be a short-term savings product for three to six months available as soon as a family learns they are expecting.

Health savings. This would be another contract savings product for which a client would determine how much, how often and how long she wants to deposit savings to mitigate the risk of illness or accidents.

It is important that MFIs distinguish between the savings that provides a guarantee for loans and other savings. When clients understand that the savings will be used to pay off the loans, it can be a disincentive for saving with the organization. It is best to establish separate voluntary savings, whether they are regular, term or contract savings accounts for those who want to save for important life cycle events.

Savings promotion will be an important part of financial education and service marketing by the banks. Clients need to understand the tradeoffs between borrowing to meet life cycle needs and saving ahead of time. More encouragement to be proactive rather than reactive in building savings will be advantageous to both the clients and the banks.

D1. Gender Issues

Poverty is widespread in Nigeria and although Nigeria has a wealth of human and natural resources, it falls below the average for sub-Saharan Africa on many poverty indicators. At least 66% of the Nigerian population is poor and lives at less than a dollar a day. Women and children are disproportionately represented among the poor to the extent that poverty is both an economic and a gender issue. It is the poverty state of women that links it with microfinance. The issue of gender equity in microfinance is potentially complicated and difficult but lessons learned from microfinance best practices around the world have led to preferential targeting of women clients in most MFIs in Nigeria. The study of microfinance institutions and their beneficiaries in Abuja, Plateau, Bauchi and Cross-River States, found more that than 95% of clients are women. Most MFIs deliberately exclude clients that are men because they have proven to be bad borrowers who prefer individual to group loans. The idea of operating in groups poses a challenge to men’s participation and they prefer asset loans which are bigger, while women want working capital loans which are comparatively smaller.

But the strongest argument given in favor of women is that they cause fewer problems and use their business profits to benefit members of the family.

For example, Lift Above Poverty Organization (LAPO) and Justice, Peace and Development Commission (JPDC) have shifted their gender portfolio of micro-credit loans to target more women. The poor generally have difficulty in accessing loans but women have a harder time than men do in accessing bank loans due to prevailing cultural and religious practices. Land, homes and property are in husbands' name precluding their use as collateral by women even if both paid for these assets. In many commercial and community bank in Nigeria, a written consent of the husband is needed for women to secure credit. There are gender variations in acceptance of business development services as valuable services. Women clients are more eager to receive training and are willing to pay greater part of the cost than men.

The gender issues involved in staffing of microfinance institutions presents another contradiction. Whereas in many institutions, a hundred percent of clients are women, the leaders of such institutions, on the other hand, are men. Very few microfinance institutions are headed by women. This problem becomes clear as one move from south to north where there are religious and cultural complications affecting the relationship between men and women. Male credit officers in the North have a problem in reaching Muslim women especially those in Purdah.

A proactive focus on gender issues in PRISMS will be essential to ensure the success of the intervention.

E. Impact of HIV/AIDS on Demand for Financial Services and Non-financial Services

E1. HIV/AIDS Prevention, Care and Treatment, Knowledge and Practices

Synergetic efforts have been employed in addressing issues of prevention, treatment, knowledge and practices in Nigeria. The government of Nigeria after years of denial has put in place institutional mechanism such as the National Action Committee on HIV/AIDS (NACA) to deal with policy implementation relating to prevention and care. The Civil Society Consultative Group on HIV/AIDS in Nigeria (CiSCGHAN) made up of NGOs, and CBOs is involved in all aspects including awareness creation, treatment, care and behavioral change. The Nigerian AIDS Research Network (NARAN), Network of People Living with AIDS in Nigeria (NEPWAN) along with the Federal Ministry of Health, and Development Partners like USAID, DFID, CIDA and UN agencies have provided synergy needed in the prevention and care of HIV/AIDS in Nigeria.

Those who are not aware of HIV/AIDS still engage in risky practices and behaviors. Practices such as prostitution, promiscuity, exchange of sharp piercing objects and transmission from mother to child remain main means of HIV infection in Nigeria. Women are particularly vulnerable because of the gender and power relations which place a woman at a disadvantage. Husbands who test positive often will not disclose their status to wives. Voluntary counseling and testing (VCT) is rarely practiced, and the problem of stigmatization remains a challenge to PLWHA Nigeria.

E1a. Availability and Access to HIV/AIDS Prevention, Management and Treatment services

Access of the general population to prevention, management and treatment services for HIV/AIDS, especially in urban areas, has increased, but a larger part of the population is yet to be reached. Campaigns have been concentrated in the urban areas and the middle class is targeted. There is a need to focus preventive messages at youths and older people in rural areas. Urban poor are yet to be adequately reached with HIV prevention messages and programs. Management of HIV/AIDS in Nigeria remains backward because of the paucity of counseling and testing outlets. Condoms are not easily accessible, and are expensive where available. Cultural and religious attitudes tend to complicate care because of myths and misconceptions associated with the condition. Some PLWHA are abandoned or isolated by relations fearing that they may be infected in the process of providing care. Others yet attribute the condition to gods and will not associate themselves with PLWHA fearing that such care may annoy the gods and lead to unpleasant consequences. Then there are avalanche of healers, herbalists, quacks and spiritualists providing treatment to people sick with AIDS. The other side of the coin is the dearth of anti-retroviral (ARV) drugs. The government of Nigeria ordered only 10,000 doses of ARV drugs at a time it had over 3.7 million people that were HIV-positive and needed treatment. Access to ARV remains very difficult especially to women, youths and the poor who find it difficult to know where to get the drugs and who can not afford the money to buy when they do locate the services. The contribution of NGOs, support groups, and development partners is trying to fill the gaps, but a lot more needs to be accomplished in this area.

The Story of Emeka:

How AIDS Affects Financial Services

Emeka (not real name) was a 35-year-old man married with five children and was a petty trader in automobile spare parts in Ogoja, Cross River state. To expand his small business he sourced and obtained a loan in the sum of N100,000 from a local cooperative society operating micro- credit in his town. He did not have any collateral but was given the credit because of his integrity and business. The profit he made was not enough to cover food and the school fees for his five children. Unknown to the cooperative society, Emeka was HIV positive and almost at the stage of full brown AIDS at the time he got the loan. He had to invest in business, hospital bills and school fees for his children and also commenced repayment of loans before he finally died of AIDS.

At his death, the wife was sick, the children were starved and had no school fees. Emeka had no relations financially strong enough to pay the N45,000 balance of the loan. The local cooperative society also makes very little profit and cannot absolve the N45,000 liability. The tragic death of Emeka from AIDS has destabilized that cooperative. If one more case of an unpaid loan from AIDS-related mortality occurs there, the cooperative society will collapse.

Source: PRISMS Assessment Team Field Visit, 2004

E2. Financial Services Requirements for Those Vulnerable/Affected by HIV/AIDS

The challenge faced by PLWHA is how to access credit and invest in business. In the first place, financial services are not easily accessible to the poor and being HIV positive makes it even more difficult. A few PLWHA we spoke to have experienced the difficulty and were able to get credit only from family and relations. Many of the PLWHA, like most of the poor, do not have access to any credit and do not have information about where they can go for credit. Commercial banks are normally inaccessible to the poor and women because of collateral and other requirements. Cooperatives and community banks have small capital bases and can not give credits to even half of those who need it. Additionally, community banks prefer to give credit to civil servants whose salaries are paid in their accounts with the bank.

Many PLWHA do not even save for health care, because they do not have regular income to support their savings. Even those who are salaried people require good education for care and support so that they can think of savings, insurance to cover health costs, and loan default that may be due to periods of illness. Education for care and support and vocational education are very necessary non-financial services required by microfinance clients but especially those living with HIV/AIDS because this will link them to health services and will initiate and sustain the culture of services for PLWHA.

There are several existing obstacles that deny PLWHA access to credit. MFIs fear financial losses in giving credit facilities to them. On the part of PLWHA, many do not have information about financial services. A special intervention in the area will clear the obstacles and also serve other purposes.

E2a. Opportunities for Linking HIV/AIDS Interventions and MFIs

Linking micro-credit services with HIV/AIDS will be an appropriate incentive for promoting VCT in Nigeria. Many Nigerians who know their HIV status did not do so through VCT, but were sick and needed a medical test, or one spouse was sick and required tests, or during routine tests associated with child delivery. One lender said, "*Disclosure of the HIV status is the fundamental problem.*" If those suspecting they might have HIV/AIDS know they can become eligible for education and financial services if they are tested, it may be an incentive to do so. The following are some intervention ideas proposed to link microfinance and HIV/AIDS.

> Regarding lending to those afflicted with HIV/AIDS the moneylenders from Calabar said:
>
> *"We would not deny them, we would give them priority so they can get drugs and do business."*
>
> Source: PRISMS Assessment Team Field Visit, 2004.

MFI and Client Education. First, MFI staff require education about HIV/AIDS to change misperceptions and attitudes about the disease. Many HIV/AIDS afflicted people can be very productive members of society for many, many years. Their potential to be good financial institution clients can be as good as any other Nigerian. For those that become sick, risk mitigation strategies can be put in place.

Client/community education about HIV/AIDS prevention, care and support, stigma, treatment should be provided to reduce the incidence of infection, increase the demand for VCT testing and other medical services, such as the use of ARVs, and to improve and extend the capacity for a productive life for PLWHA. Microfinance institutions could be powerful networks for reaching hundreds of thousands of clients with vital information and referrals to achieve these goals.

There are local providers in Nigeria, such as Intergender, who are experienced in HIV/AIDS education, but they lack knowledge about microfinance institutions and understanding about best practices required to ensure their profitable operations. PRISMS could potentially work with a number of these institutions, selected strategically for their potential capacity and location around the microfinance institutions targeted by the project, to provide capacity building and training to MFIs, working with them to develop and deliver training to their staff on the basics of HIV/AIDS prevention, care and treatment. This intervention could help MFIs become comfortable serving HIV/AIDS afflicted persons and assist them to design products and services to mitigate the risks associated with full-blown AIDS.

HIV/AIDS technical providers could also provide training of trainers to MFI staff so that they, in turn, may educate their clients and promote linkages for them to HIV/AIDS testing services, support groups and medical services. PRISMS would coordinate with USAID and other donors working to strengthen the HIV/AIDS testing and other medical services. Referrals to HIV/AIDS medical services can only work where they exist and are of sufficient quality. If some of the MFIs selected by PRISMS are in the same areas where quality medical services are being installed, good synergy could be established between these MFIs and the service providers and effective referral services put in place.

For example, MFI loan officers hired to train and monitor financial services provision through groups, could be provided with simple educational tools, materials and referral information to share with groups at the regular group meetings they attend. Groups can also be encouraged to include and provide financial services to HIV/AIDS afflicted people. This education and information “rides” the financial services delivery system so there is little or no additional cost.

Opportunities for financial services, education and referral for HIV/AIDS afflicted persons are presented below.

***Drug Funds*.** Many who suspect they have HIV/AIDS do not get tested because, if positive, anti-retroviral (ARVs) drugs will not be available or affordable to them. If financial services groups are willing to save for a drug fund, or use their own retained earnings (through fees and income earned from extra interest they place on the loan), this could be an incentive for people to get tested and obtain treatment.

***Death Funds*.** Use a fee mechanism on loans to create a fund which will pay the remaining balance for people no longer able to work or who are dying from AIDS. Banks might even contribute to such a fund, through voluntary contributions obtained from healthy clients, or a small percentage of profits at the end of the year.

Loan Guarantors. The person with HIV can designate an “heir” or “apprentice” to the business and this person signs an agreement to pay the balance of the loan (eldest child, sibling, self-help group member). There could be two signature providers: one to continue the business and pay off the loan and one who guarantees that that person will do so.

***Community Insurance*.** Similar to above, except that a contribution of savings by all members of the group is made, or an added interest charge on the loan to create a fund to pay for the costs associated with HIV/AIDS (drugs, transportation, medical services, loan repayments, burial costs).

***Commitment to Serve People Living With HIV/AIDS (PLWHA*).** Provide education for banks and financial intermediaries about HIV/AIDS including the causes, treatment, care and support needs and dealing with stigma. The education would be for the purposes of obtaining a commitment on the part of the MFI to provide services to those afflicted with the disease.

Coordination with USAID’s HIV/AIDS Initiative. USAID’s program will largely be based on the President’s Emergency Plan for AIDS Relief (PEPFAR) directed by the Office of the Global AIDS Coordinator. Nigeria is one of 14 target countries and will likely receive $200 million for this program. The program aims primarily to support medical services, ARVs and Voluntary Counseling and Testing (VCT). PRISMS could target MFIs located in areas where PEPFAR services will be active so that they can refer needy clients to these services.