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Department

The banking sector recorded a number of developments during the first and second quarters of 2015. Some of these developments included Implementation of Two Factor Authentication for Internal Banking Processes, N300 Billion Real Sector Support Facility (RSSF) Guidelines, and Guidelines on the Governance of Financial Regulation Advisory Council of Experts for Non-Interest (Islamic) Financial Institutions in Nigeria, Terms and Conditions for Participation by Deposit Money Banks (DMB's) in the implementation and Execution of Nigeria Electricity Market Stabilization facility ("CBN-NEMSF") and New policy on Dormant Accounts. Details of these and other developments are contained in this report.

Financial Condition and Performance of Insured Banks in First and Second Quarter 2015, By Research, Policy & International Relations and Insurance & Surveillance Departments

During the period under review, the Nigeria's banking industry witnessed a mixed performance during the two quarters under review. The first quarter shows some stability in most of the financial indices. However, in the second quarter, there were declines in many parameters, especially in Total Assets, Deposits and Assets

Quality. The decline was largely attributable to the fall in the price of crude oil (the main revenue earner for Nigeria) and sliding exchange rate which had impacted negatively on the banks with high exposure to the Oil and Gas sector of the economy. Despite the decline, most of the indices are well above the regulatory threshold

FINANCIAL MARKET INTEGRATION AND ECONOMIC GROWTH: AN EXPERIENCE FROM NIGERIA

By

OYENIRAN, I. W. And Maryam, W. T Department of Economics, Al-Hikmah University, Ilorin Kwara State

This study examines the effect of financial integration on economic growth in Nigeria. Using time series data from 1981 and 2012, the study employs autoregressive distributed lag (ARDL) bounds testing approach proposed by Pesaran et al., (2001) to estimate the long run and short run effect of financial integration and development on economic growth. The result from cointegration test showed presence of long run relationship between dependent and all explanatory variables. The regression results show that, while financial integration has no short run effect on economic growth, its long run effect on growth is negative and significant. Financial development was found to have both short run and long run positive effect on economic growth in Nigeria. Hence, for Nigeria to benefit from financial integration, the government has to increase the level of competition, improve the quality of financial information and reduce corruption in the financial system.

A SYNTHESIS OF GRAMEEN MICROFINANCE MODEL: LESSONS FOR NIGERIA

BY

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AND

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In this study, the authors highlighted the contribution of the microfinance banking sector in economic development of countries due to its capacity in employment generation, increase in household income and as a poverty reduction and financial inclusion strategy. Because of these critical roles, various countries are taking measures to harness its potential in order to achieve the desired developmental goal. The challenge however, has been the best and most effective model or strategy to adopt. The Grameen (GB) microfinance banking model of Professor Mohammed Yunus has achieved success in Bangladesh in poverty reduction, financial inclusion and sustainable economic development. It is being replicated and adapted by many countries. The paper analyzed the GB model, noted its critical success factors and juxtaposed it with the microfinance banking practice in Nigeria using the CBN 2005 and 2011 microfinance frameworks. It was observed that microfinance banking in Nigeria has not been successful due to wrong design, inappropriate methodology and other challenges. The paper further noted that some useful lessons can be learnt from the success achieved by the GB model to make microfinance banking achieve its objective in Nigeria. Finally, some recommendations were made to the regulatory authorities and operators to remodel microfinance practice in Nigeria so as to achieve the desired benefits.

REVIEW OF DEVELOPMENTS IN BANKING AND FINANCE IN THE FIRST AND SECOND QUARTER 2015

1.0 INTRODUCTION

The banking sector recorded a number of developments during the first and second quarters of 2015. Some of these developments were by products of the Central Bank of Nigeria (CBN) Monetary Policy Committee Meetings

2.0 CBN MONETARY POLICY COMMITTEE MEETINGS

The CBN Monetary Policy Committee (MPC) met during the period to review conditions and challenges that confronted the domestic economy, reassess short-to-medium term risks to inflation and challenges from the harsh external environment.

There were (3) three MPC meetings in the first and second quarters. The first held on the 19th and 20th January, the second on the 23rd and 24th of March, while the third and final meeting for the first and second Quarter held on the 18th and 19th May 2015.

3.0 EXTERNAL ECONOMY

During the period under review the pace of global economic recovery ranged between tepid to moderate. Low commodity prices weighed heavily on the growth of output. In addition, expectations of a rise in US short term interest rates continue to fuel capital outflows and currency weaknesses in emerging markets and developing economies against the backdrop of sustained weakness within the Euro zone.

During the first quarter 2015, the United States provided the global growth impetus as consumer demand strengthened on the heels of falling oil prices and accommodative monetary policy. In contrast the Euro zone still faced continued output decline resulting in the European Central Bank introducing a massive €1.1 trillion asset purchase programme which commenced in March 2015. The programme though open-ended, is expected to last until September 2016. Global growth continued to be constrained by a number of factors including high debt, rising unemployment, geopolitical tensions and conflicts, weak external demand and the exit of the US Federal Reserve Bank from quantitative easing which triggered sharp corrections in the financial markets.

The International Monetary Fund (IMF) has projected a marginal increase in global output from 3.4 percent in 2014 to 3.5 percent in 2015 with variations across regions and major economies. Stronger currencies in both the United states and the United kingdom may likely moderate net exports and the asset purchase programme introduced by the UK and Japan indicate the divergent monetary policy stances amongst key advanced economies with the attendant widening of long-term interest rate differentials.

In china, growth is expected to decline below the long run target of 7.0 percent in 2015 owing to financial market vulnerabilities, declining productivity, excess capacity and weakening domestic demand. Developing economies continued to show relative resilience with growth projected at 4.8 percent for 2015 from 4.4 percent in 2014.

4.0 DOMESTIC ECONOMY

The slowdown in growth which surfaced in the third quarter of 2014 intensified in the first quarter of 2015 as a result of declining crude oil prices. The National bureau of Statistics (NBS) estimated Real GDP growth at 3.96 percent in the first quarter of 2015 which is significantly lower than the 5.94 percent and 6.21 percent in the preceding quarter and the corresponding period in 2014.

The non-oil sector continued to drive the growth in the first quarter of 2015, recorded at 5.59 percent. Services, trade and agriculture contributed 2.82, 1.27 and 1.05 percentage points respectively as key growth drivers. Modest recorded increments in the oil sector in the fourth quarter of 2014 appear to have been eroded as oil GDP fell by 8.5 percent in the first quarter of 2015 compared with the increase of 1.2 percent in the preceding quarter.

Overall, concerns about continued weakening economic momentum as a feature prevalent in virtually all oil exporting countries further substantiate the need to accelerate initiatives and reforms aimed at diversifying the economic base of the country. Also, the successful conclusion of the 2015 general elections and renewed thrust against insurgency suggest that the pace of economic progress would pick up in the near term.

5.0 MONEY SUPPLY

Broad Money Supply (M2) declined by 1.70 percent in February 2015 over the level at the end-December 2014. This translated to an annualized decline of 10.23 percent when compared with the provisional growth benchmark of

15.24 percent for fiscal 2015. This decline reflects the contraction of 18.14 percent and 8.22 percent in Net Foreign Assets (NFA) and other assets (net) respectively during the period. The fall in NFA is attributable to the combined effects of weakening oil prices and reversal of portfolio capital flows. Net Domestic Credit (NDC) grew by 9.89 percent in February 2015, annualized to a growth rate of 59.31 percent, compared with a growth rate of 7.89 percent recorded in the corresponding period of 2014 and an indicative benchmark of 29.3 percent for 2015.

Interest rates in all segments of the money market trended upwards between 26th November 2014 and 13th January 2015. The interbank call rate opened at 8.98 percent on 26th November 2014 and closed at 26.15 percent on 16th January 2015. Similarly the OBB and 30 day NIBOR increased from 10.2 and 11.38 to 23.46 and 11.63 percent respectively. These increments particularly for interbank and OBB were primarily as a result of tightening measures introduced at the November 2014 meeting of the Monetary Policy Committee (MPC).

Broad money supply (M2) increased by 1.80 per cent in April 2015 over the level at end-December 2014 a figure transformed to an annualized increase by 5.39 per cent which was lower than the growth benchmark of 15.24 percent for fiscal 2015. The modest increase in money supply reflected the growth in the net domestic credit (NDC) of 9.66 per cent.

Annualized, net domestic credit grew by 28.98% over the end-December, 2014 level, which was within the provisional benchmark of 29.3% for 2015. The significant growth in aggregate credit was traced mainly to Federal Government borrowing which increased by 177.26 per cent in April 2015 or 531.78 per cent on annualized basis.

6.0 SUSTAINING MACROECONOMIC GAINS

To sustain the macroeconomic gains, the Central Bank of Nigeria (CBN) at its first MPC meeting for the year, noted with satisfaction the growth performance of the economy as well as the year-end inflation outcome. It did however also observe that its decisions of November 2014 needed sometime to crystallize thus its decisions to retain the status quo;

- i. MPR to be retained at 13percent;
- ii. CRR on private sector deposits at 20 percent;
- iii. Retain CRR on public sector deposits at 75 percent;
- iv. Retain Liquidity Ratio at 30 percent.

This would be applied on all Federal, State, Local Government and MDA deposits. For non-public sector deposits, the CRR would be retained at 20 percent. Deposits from the following institutions are regarded as public sector deposits;

- i. NNPC Joint Venture (JV) Accounts;
- ii. Sovereign Investment Funds;
- iii. Government MDA's/Companies Collection Accounts such as: Customs, FIRS etc.
- iv. Pilgrim Welfare Boards; and
- v. All accounts belonging to Government Universities.

The CBN on the backdrop of the successful completion of the 2015 General election and its attendant benefit on the macroeconomic environment (given other prevailing realities within the economic space), noted that monetary policy was gradually approaching its tightening limits and thus needed to be synchronised with complementary fiscal and structural policies. It also noted that in order to reduce the opportunity for the occurrence of moral hazard, the discriminatory effect of the variance in public and private sector CRR which has constrained the policy space would need to be reviewed.

This led to the decision by the MPC in its May 2015 meeting to merge the CRR of both the public sector deposits and private sector deposits at 31 percent in its circular referenced BSD/DIR/GEN/LAB/08/024. It also noted that maintenance period would be weekly and that the CRR rate would be applied on the average adjusted deposits for the preceding maintenance period and not on the incremental deposits. Computed Cash Reserve would be maintained for the subsequent period. It also decided that the;

- i. MPR to be retained at 13percent with a corridor of +/- 200 basis points around the midpoint; and
- ii. Retain Liquidity Ratio at 30 percent.

The CBN recognized that while additional tightening measures may not be appropriate to prevent the overheating of the economy, the harmonization of the CRR was imperative in order to achieve the twin objectives of curbing abuses and improving the efficacy of monetary policy.

7.0 CIRCULARS AND GUIDELINES ISSUED BY CBN

The following are the circulars and Guidelines issued by the Central Bank of Nigeria (CBN) during the period under review.

7.1 Utilization of rDAS and Interbank Funds/Review of the Foreign Exchange Trading positions of Banks

In the circular ref. TED/FEM/FPC/GEN/01/002 dated January 21, 2015, the CBN informed authorized dealers of its continuing attempt to review developments in the foreign exchange market and to curb speculative demand in the market as well. The CBN instructed that both rDAS and interbank funds be henceforth used strictly for funding of Letters of Credit, Bills for Collection and other invisible transactions. It also has restricted the sale of rDAS and Interbank Funds to BDC's and other authorized buyers.

7.2 Implementation of Two Factor Authentication for Internal Banking Processes

The CBN issued a circular referenced BPS/DIR/GEN/CIR/06/001 dated January 19, 2015 to all deposit money banks (DMBs) on the increased insider abuse involving identity theft and abuse of authorization procedures. The circular directed all DMBs as follows:

- i. Implement a Maker/Checker control structure for all payment platforms, including account and database system maintenances on core banking systems. DMBs are expected to comply by December 31, 2015.
- ii. Implement Two Factor Authentications at login points for applications driving Transfers, Withdrawal, Deposit, Standing Order, Account Maintenance and System Maintenance processes. The DMBs are expected to submit their implementation to the CBN by January 30, 2015 while the deadline for full implementation is December 31, 2015, failing which defaulting banks would incur a penalty of N50,000.00 daily.

- iii. All payment processing Gateways and Third Party Processors should implement Fraud-Monitoring Tools to check transfers from an account to multiple bank accounts by December 31, 2015.

7.3 Circular to all Banks, Discount Houses and Other Financial Institutions on compliance with the United States of America's Foreign Accounts Tax Compliance Act (FATCA) 2010

In the circular ref. FPR/DIR/GEN/CIR/04/004 DATED January 22, 2015, refers to the Hiring Incentive to Restore Employment (HIRE) Act, otherwise referred to as Foreign Accounts Tax Compliance Act (FATCA) enacted in the United States (US). The Act seeks to broaden tax coverage to foreign financial assets (FFA), including offshore accounts of US "persons" which is defined to include US tax payers or foreign business where a US tax payer holds substantial ownership interest.

The US Internal revenue Service (IRS) essentially requires certain categories of Foreign Financial Institutions (FFI's) including banks, discount houses and other financial institutions to enter into agreement with it in order to provide periodic information on US persons' accounts with them to the IRS.

7.4 N300 Billion Real Sector Support Facility (RSSF) Guidelines

The Central Bank of Nigeria (CBN), in its bid to further unlock the potential of the real sector to engender output growth, value added productivity and job creation has released a guideline in its attempt to establish a N300 billion Real Sector Support Facility (RSSF). It is intended that this facility shall provide much needed support to large enterprises for start-ups and expansion financing needs of N500million up to a maximum of N10 billion. The sectors of

particular interest include Manufacturing, Agricultural value chain and selected Service sub-sectors.

7.5 Re-Prohibition from Borrowing to Capitalize Banks

In the letter ref. BSD/DIR/GEN/LAB/08/008, the Central Bank of Nigeria (CBN), reminds financial institutions that in a previous circular dated November 2000, Prohibits borrowing within the banking system as a source of funds geared towards the recapitalization of banks. Where such funds are borrowed outside the banking system, they must be of the type and nature that qualify as part of capital in accordance with Guidance Notes on the Calculation of Regulatory capital and are still subject to the verification by the CBN.

7.6 Exposure Draft on the Guidelines for Banking Operations in the Free Trade Zones in Nigeria.

In the letter ref. BPS/DIR/GEN/CIR/02/004, dated February 6, 2015, In furtherance of its mandate for the development of banking operations in Nigeria, the Central Bank of Nigeria (CBN), released the Exposure Draft on the Guidelines for Banking Operations in the Free Trade Zones in Nigeria for review and comments.

7.7 Guidelines on the Governance of Financial Regulation Advisory Council of Experts for Non-Interest (Islamic) Financial Institutions in Nigeria.

Section 9.1 of the Central Bank of Nigeria (CBN) Guidelines for the regulation and Supervision of Institutions offering Non-Interest Financial Institutions provides for the establishment of an advisory body at the CBN on Islamic Banking and finance. The body, to be referred as Financial Regulation Advisory Council of Experts (FRACE), shall advise the CBN on matters relating to Islamic commercial jurisprudence for the effective regulation and supervision of Non-Interest (Islamic) Financial Institutions (NIFIs) in Nigeria. The Guidelines sets out the membership, composition, qualification, duties and responsibilities of the FRACE among others.

7.8 Terms and Conditions for Participation by Deposit Money Banks (DMB's) in the implementation and Execution of Nigeria Electricity Market Stabilization facility ("CBN-NEMSF")

In the circular ref. FPR/DIR/GEN/CIR/01/004, DATED March 4, 2015, the Central Bank of Nigeria (CBN) released the terms and conditions for the participation of Deposit Money Banks (DMBs) in the implementation and execution of the Nigeria Electricity Market Stabilization Facility ("CBN-NEMSF").

7.9 New Policy on Dormant Accounts

The CBN introduced new guidelines for the treatment and management of dormant account balances by deposit-taking financial institutions. This is contained in a circular referenced FPR/DIR/CIR/GEN/01/003 dated 16th February, 2015, to all deposit taking financial institutions and stakeholders in the financial services industry.

Among the objectives of the policy is to ensure that dormant account funds are identified and channeled through appropriate institutions to make them more productive to the economy and eliminate the possibility of banks converting dormant account balances to income. The policy is also intended to

curb possible abuse in the operation of dormant accounts as well as set operational standards for banks and other financial institutions in line with best practice.

7.10 Closure of Retail, Wholesale Dutch Auction Windows

The CBN on 18th February, 2015 closed the Retail Dutch Auction System (RDAS) and Wholesale Dutch Auction System (WDAS) Foreign Exchange windows in bid to stabilize the naira.

Consequently, all demand for foreign exchange should be channelled to the Interbank Foreign Exchange Market. The policy was as a result of a widening margin between the rates in the interbank and the rDAS window, reinforced by undesirable practices including round-tripping, speculative demand, rent-seeking, spurious demand, and inefficient use of scarce foreign exchange resources by economic agents.

7.11 CBN Slashes Spending Limit on Naira Debit Cards to \$50,000 Per Annum

The CBN in a circular referenced No: TED/FEM/FPC/GEN/01/009 dated 13th April, 2015, cut down the spending limit on Naira Debit Cards for transactions abroad from \$150,000 per person annually, to \$50,000 per person annually. The daily cash withdrawal limit on the card was also fixed at \$300 per person.

7.12 Appointment of New CBN Deputy Governor

The appointment of Dr. Okwu Joseph Nnanna as a Deputy Governor of the Central Bank of Nigeria representing the South-East geo-political zone was confirmed by the Senate on 13th April, 2015.

7.13 AMCON Sold Two (2) Bridged Banks to New Owners

The AMCON had transferred the ownership of Mainstreet Bank Limited and Enterprise Bank Limited to their new owners, Skye Bank Plc and Heritage Bank Limited, respectively. This was announced at the divestment ceremony held in Lagos on 27th January, 2015.

The Governor of the CBN, Mr. Godwin Emefiele, warned against a reoccurrence of the factors which led to the takeover of the three bridged banks. He observed that if the Bridge bank option had not been adopted the systemic crisis in the banking sector would have been unprecedented and costly in terms of its effects on other banks.

7.14 Skye Banks Appoints Four (4) Executive Directors

The Board of Directors of Skye Bank Plc announced the elevation and appointments of four new executive directors. The list of the new executive directors include; Mr. Bayo Sanni, Executive Director, Lagos Commercial Banking; Mr. Idris Yakubu, Executive Director, Abuja and Northern Region; Mrs. Markie Idowu, Executive Director, Technology and Service Delivery Channels and Mrs. Abimbola Izu, Executive Director, Corporate services.

The bank described the development as “part of the overall efforts to uphold the very high standards and tradition of professionalism which have become the bank’s driving force for service excellence and leadership.”

8.0 EXTERNAL SECTOR DEVELOPMENTS

The Gross official reserves stood at US\$34.49 billion on the 5th of January 2015. The Gross external reserves figure declined for the months of February and March concurrently and then tapered somewhat for the months April, May and June respectively.

Nigeria’s gross Foreign Reserve (FR) dipped by \$4.55billion in Q1 of 2015, this is going by the gross Foreign Reserve movements as published by Central Bank of Nigeria as at March 25, 2015. The gross foreign reserve was impacted by price volatility in the global oil market. While its Year on Year analysis revealed that the gross FR went down, Money Market Analysts are of the opinion that the CBN must begin to look for ways of managing the foreign reserve with a view to reduce or avoid regular depletion of the nation’s reserve base.

The macroeconomic concept that draws from a combination of strong fiscal policies post 2015 general election is expected to strongly resist regular depletion of the foreign reserve to meet international trade payments or to at least ensure that there is a commensurate trade-off between draw down and asset inflows into Nigeria Foreign Reserve. Nigeria’s quest for a strong foreign reserve position might be extremely difficult in the medium to long term without achieving the twin goals of eradicating fuel subsidy and significantly improving local refining capacity.

The movement in the foreign reserve from January to June 2015 is shown in Table 1, below:

TABLE 1: Movement in the Foreign Reserves (US\$)

| DATE | GROSS | LIQUID | BLOCKED |
|-------------|----------------|----------------|----------------|
| 6/5/2015 | 29,306,866,312 | 28,436,379,045 | 870,487,267 |
| 5/5/2015 | 29,630,776,490 | 28,747,136,083 | 883,640,407 |
| 4/7/2015 | 29,614,491,474 | 28,714,925,463 | 899,566,012 |
| 3/5/2015 | 30,815,858,935 | 29,885,977,881 | 929,881,055 |
| 2/5/2015 | 33,872,897,637 | 32,922,997,908 | 949,899,729 |
| 1/5/2015 | 34,493,455,664 | 33,518,455,053 | 975,000,611 |

SOURCE: CBN WEBSITE**9.0 INFLATION**

The headline inflation progressively increased from 8.2% in January to 9.2% in June 2015, due largely to food importation as well as other core components. Core Inflation rose to 8.4% in June from 6.8% in January 2015 while food inflation also rose from 9.2% in January 2015 to 10% June 2015.

TABLE 1

| DATE | HEADLINE INFLATION (%) | FOOD INFLATION (%) | CORE INFLATION (%) |
|-----------------|-------------------------------|---------------------------|---------------------------|
| Jan-2015 | 8.2 | 9.2 | 6.8 |
| Feb-2015 | 8.4 | 9.4 | 7.0 |
| Mar-2015 | 8.5 | 9.4 | 7.5 |

| | | | |
|-----------------|------------|------------|------------|
| Apr-2015 | 8.7 | 9.5 | 7.7 |
| May-2015 | 9 | 9.8 | 8.3 |
| Jun-2015 | 9.2 | 10 | 8.4 |

Source: CBN

10.0 CAPITAL MARKET

The bearish conditions in the capital market continued as indicators trended downwards in the review period. The All-Share Index (ASI) declined by 16.1 percent from 41,329.19 to 34,657.15 between December 31, 2013 and December 31, 2014. This trend was carried into January 2015, eventually levelling out in February 2015.

Modest improvements were subsequently recorded as the year progressed as recorded, the All Share Index (ASI) rose by 9.3 per cent from 31,744.82 on March 31, 2015 to 34,708.11 on April 30, 2015. Market Capitalization also increased by 10.0 per cent from ₦10.72 trillion to ₦11.79 trillion during the review period.

11.0 NAIRA EXCHANGE RATE

During the period under review, the closure of RDAS returned some level of stability to the foreign exchange market checking the depletion of the forex account balance and round-tripping. The naira exchange rate opened at N197.80./US\$ and closed at N197.00/US\$ between March and May 2015, with a daily average of N197.04/US\$. This represented an appreciation of N0.80k for the period. At the same period, the Bureau-de-Change segment also opened at N225.00/US\$ and closed at N217.50/US\$, with a daily average of N216.75/US\$. This represented an appreciation of N7.50k for the period.

**FINANCIAL CONDITION AND PERFORMANCE OF INSURED BANKS IN
THE FIRST AND SECOND QUARTERS OF 2015**

BY

RESEARCH, POLICY & INTERNATIONAL RELATIONS AND INSURANCE & SURVEILLANCE DEPARTMENTS

1.0 INTRODUCTION

During the period under review, the Nigeria's banking industry witnessed a mixed performance during the two quarters under review. The first quarter shows some stability in most of the financial indices. However, in the second quarter, there were declines in many parameters, especially in Total Assets, Deposits and Assets Quality. The decline was largely attributable to the fall in the price of crude oil (the main revenue earner for Nigeria) and sliding exchange rate which had impacted negatively on the banks with high exposure to the Oil and Gas sector of the economy.

Total Assets of the industry declined marginally by 1.01% from ₦27.329 trillion as at March 31, 2015 to ₦27.055 trillion as at June 30th, 2015. Similarly, Total Deposits decreased by 0.4% from ₦18.163 trillion as at the end of March 2015 to ₦18.098 trillion as at the end of June 2015.

Asset Quality as represented by the ratio of Non-Performing Loans (NPL) to Total Credits (TC) worsened as the ratio increased from 4.06% as at March 2015 to 9.79% as at June 2015 which was above the maximum 5% benchmark.

The Industry had a liquidity ratio of 42.83% as at June 2015 which depicted a significant fall from 72.39% recorded as at March 31st 2015.

The banks' profitability measured in absolute terms by Profit before Tax (PBT) increased significantly by 14.45% to ₦191.704 billion as at June, 2015 as against ₦167.500 billion recorded in March 2015.

The Industry average Capital Adequacy Ratio (CAR) at 17.38% showed a marginal increase compared to a CAR of 16.82% recorded as at March 2015.

Despite the marginal increment in the CAR of the industry, three (3) deposit money banks (DMBs) out of twenty three (23) in March 2015 and twenty two

(22) in June 2015 failed to meet the minimum prudential Capital Adequacy Ratio of 10%.

Apart from this Introduction, the rest of this paper comprises of three sections. Section Two presents the Structure of Assets and Liabilities; Section Three assesses the financial condition of insured banks, while Section Four concludes.

2.0 STRUCTURE OF ASSETS AND LIABILITIES

During the period under review, The Total Assets of the industry decreased by 1.01% from ₦27.329 trillion as at March 31st, 2015 (1st Quarter) to ₦27.055 trillion as at 30th, June (2nd Quarter). The structure of the industry's total assets and liabilities at 30th June 2015 are presented in Table 1 and Charts 1A and 1B below.

TABLE 1

Structure of Banks' Assets and Liabilities for first and second Quarters of 2015

| Assets (%) | 30th June 2015 | 31st March 2015 | Liabilities (%) | 30th June 2015 | 31st March 2015 |
|---|----------------------------------|-----------------------------------|---|----------------------------------|-----------------------------------|
| Cash Balances | 2.18 | 1.90 | Deposit From Banks | 3.26 | 3.79 |
| Balances with Banks & Central Bank | 21.80 | 22.21 | Deposit From Customers | 66.89 | 66.46 |
| Loans & Advances to Banks | 2.02 | 2.71 | Financial Liabilities Held For Trading | 0.09 | 0.10 |
| Loans & Advances to | 45.71 | 45.03 | Borrowings | 6.17 | 5.92 |

| | | | | | |
|--|--------|--------|-------------------------------|--------|--------|
| Customers | | | | | |
| Financial Assets Held for Trading | 2.56 | 1.92 | Debt Instrument | 2.74 | 2.78 |
| Investment Securities: Available for Sale | 8.86 | 8.71 | Other Liabilities | 8.49 | 8.49 |
| Investment Securities: Held to Maturity | 7.15 | 8.09 | Shareholders' Fund | 12.35 | 12.46 |
| Assets Pledged as Collateral | 1.50 | 1.42 | TOTAL LIABILITIES | 100.00 | 100 |
| Investment in Subsidiaries & Associates | 1.09 | 1.06 | CONTINGENT LIABILITIES | 16.86 | 17.59 |
| Property Plant and Equipments | 2.79 | 2.76 | - | - | - |
| Other Asset | 4.21 | 4.08 | - | - | - |
| Asset Classified as Held for Sale & Discontinued Operations | 0.12 | 0.11 | - | - | - |
| Total | 100.00 | 100.00 | Total | 100.00 | 100.00 |

Source: Banks Returns

NOTE: TOTAL ASSETS (N Trillion) 1st Quarter 2015 = 27.329 & 2nd Quarter 2015 = 27.055

Chart 1A: Structure of Banks' Assets for the 1st and 2nd Quarters of 2015

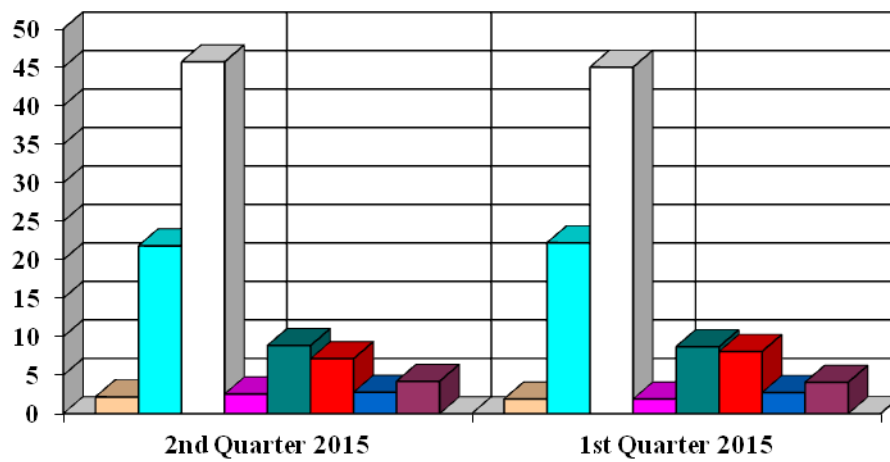
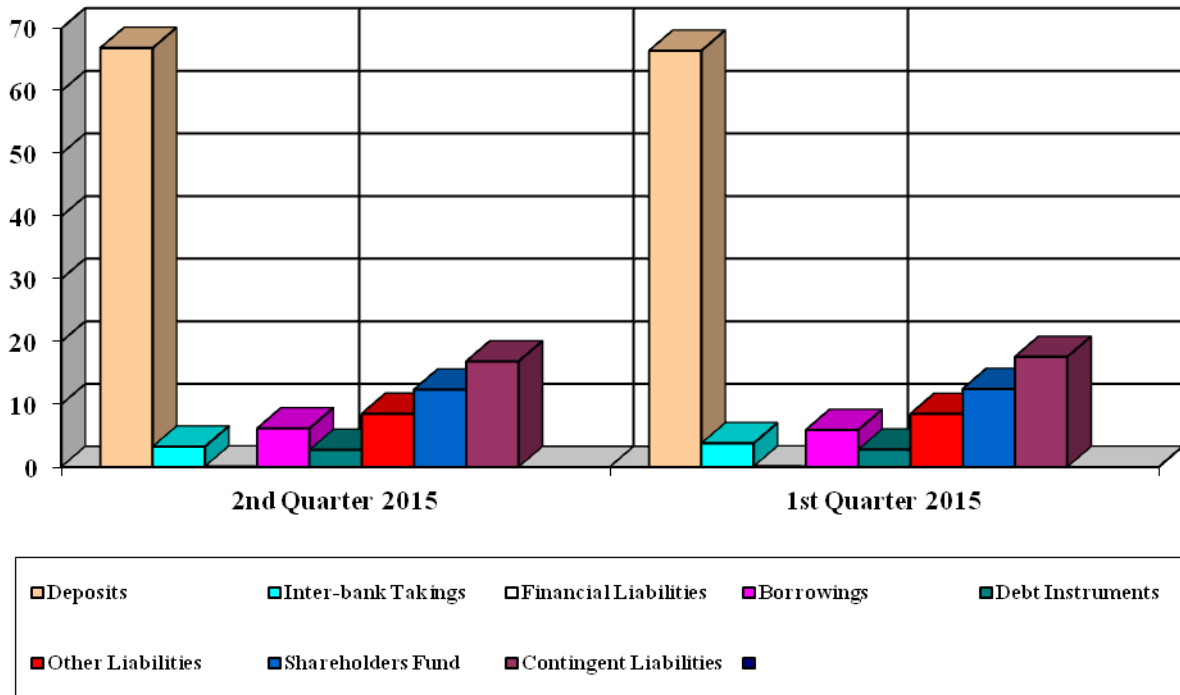


Chart 1A: Structure of Banks' Liabilities for the 1st and 2nd Quarters of 2015



Total Loans and Advances increased by ₦68.658 billion or 0.511% from ₦13.433 trillion as at 31st March, 2015, to ₦13.501 trillion as at 30th June, 2015. This was followed by Balances with Banks & Central Bank of ₦5.897 trillion which accounted for 21.80% of the Total Industry Assets as against the sum of ₦6.070 trillion as at 31st March, 2015. Investment Securities (Available for Sale) accounted for ₦2.397trillion or 8.86% of Total Industry Assets. Similarly, Investment Securities (Held to Maturity) also decreased from ₦2.209 trillion as at 31st March, 2015 to ₦1.935 trillion as at 30th June, 2015 or contributed 7.15% of the Total Assets while Other Assets which contributed ₦1.116trillion or 4.21% of the total Industry Assets as at 30th June, 2015.

As shown in Table 1 and Charts 1A and 1B, Loans and Advances have the highest component of the Total Assets of the Banking industry during the first two quarters of 2015. Its components accounted for 45.71 % and 45.03% in the two quarters respectively. In the second position was Balances with Banks and Central Bank, which stood at 21.80% and 22.21%. Investment Securities

available for sale followed suit with 8.86% and 8.71 % while Investment Securities held at maturity stood at 7.15% and 8.09% as at June 2015. For the other components of the Industry's total assets; Loans and Advances to Banks decreased from 2.71% as at 31st March, 2015 to 2.02% as at June 30th 2015. Other Assets also increased to 4.21% as at 30th June, 2015 from 4.08% in March 2015.

On the liabilities side of the balance sheet, Deposits remained the largest with a slight increment from 66.46% in March 2015 to 66.89% in June 2015. Shareholders' Funds contributed 12.35% of the Total Industry Liabilities as at 30th June, 2015. This signifies a slight decline of 0.89% compared to the 12.46% recorded as at 31st March, 2015. Deposits from Banks contributed 3.26% of Total Industry liabilities. This also signifies a decline of -13% compared to 3.79% recorded in March 2015. Other Liabilities and Borrowings, contributed 8.49%, 6.17% and 8.49%, 6.17% to the Total Industry liabilities during the First and Second quarters, respectively.

3.0 ASSESMENT OF THE FINANCIAL CONDITION OF INSURED BANKS

3.1 Asset Quality

The Banking Industry Asset Quality deteriorated during the period under review as revealed by the increased non-performing loans (NPL) during the quarters under review. Total industry Non-Performing Credits increased by ₦775.816 billion or 142% from ₦546.016 billion as at March 2015 to ₦1.321 trillion as at June 30th, 2015. Thus, the Industry Non-performing Credits to Total Credits Ratio worsened from 4.06% as at 31st March, 2015 to 9.7% as at 30th June, 2015. However, this was still well above the statutory maximum threshold of 5%.

The Banking Industry Total Credit increased by ₦0.068 trillion or 0.50% from ₦13.433 trillion as at 31st March, 2015 to ₦13.501 trillion as at 30th June, 2015 which represented about 50% of the Industry Total Assets of ₦27.055 trillion as at June 2015.

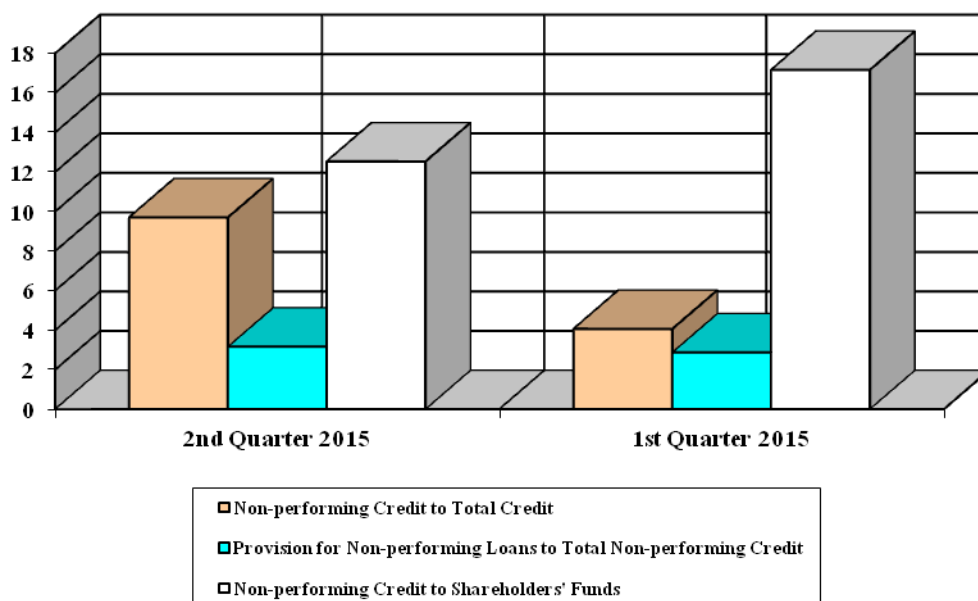
Table 2 and Chart 2 present the indicators of insured banks Asset Quality for the first and second quarters of 2015.

TABLE 2

| Asset Quality Indicator (%) | Industry | |
|---|----------------------------------|-----------------------------------|
| | 30th June 2015 | 31st March 2015 |
| Non-performing Credit to Total Credit | 9.7% | 4.06% |
| Provision for Non-performing Loans to Total Non-performing Credit | 3.16 | 2.87 |
| Non-performing Credit to Shareholders' Funds | 12.53 | 17.16 |

Source: Banks Returns

Chart 2: Indicators of Insured Banks' Asset Quality for 1st and 2nd Quarters of 2015



3.2 Earnings and Profitability

During the period under review, the banks' profitability measured in absolute terms by Profit before Tax (PBT) increased significantly by 14.45% to ₦191.704 billion as at June, 2015 as against ₦167.500 billion recorded in March 2015

This increment is highly attributed to the 22.17% increment in interest income. Net-Interest Income had also increased by 29.75% from ₦330.145 billion as at March 2015 to ₦428.383 billion at the end June, 2015. Interest Expense had increased by 30.40% from ₦249.906 billion as at March 2015 to ₦280.304 billion as at the end of June, 2015. However, Non-Interest income decreased by 74.71% from ₦319.555 billion as at March 2015 to ₦182.902 billion as at the end of 30th June, 2015. The banking industry Operating Expenses on the other hand, declined by 30.61% from ₦561.576 billion as at 31st March, 2015, to ₦429.956 billion as at 30th June, 2015.

The Banking Industry Return on Assets (ROA) increased from 0.63% as at March 2015 to 0.71% as at June 2015. Return on Equity (ROE) also increased from 4.94% in March 2015 to 5.72% as at June 2015. Net Interest Margin

also increased from 1.86% in March 2015 to 2.90% in June 2015. However, Yield on Earning Assets decreased from 3.27% as at 31st March, 2015 to 2.57% as at 30th June, 2015.

Table 3 and Chart 3 presents' selected financial indicators of earnings and profitability for the first and second quarters of 2015

TABLE 3

Insured Banks' Earnings and Profitability Indicators for first and second quarters of 2015

| Earnings/Profitability Indicator | Industry | |
|---|------------------|-------------------|
| | June 2015 | March 2015 |
| Return on Assets (%) | 0.71% | 0.62% |
| Return on Equity (%) | 5.75% | 2.48% |
| Net Interest Margin | 2.89% | 1.86% |
| Yield on Earning Assets (%) | 1.32% | 1.43% |
| Profit Before Tax (N' billion) | 191,704 | 167,500 |
| Interest Income (N' billion) | 428,383 | 330,145 |
| Operating Expenses (N' billion) | 429,956 | 561,576 |
| Non-Interest Income (N' billion) | 182,902 | 319,555 |

| | 1st Quarter 2016 | 2nd Quarter 2015 |
|-----------------------------|------------------|------------------|
| Return on Assets (%) | 0.71 | 0.62 |
| Return on Equity (%) | 5.75 | 2.48 |
| Net Interest Margin | 2.89 | 1.86 |
| Yield on Earning Assets (%) | 1.32 | 1.43 |
| Profit before Tax | 191,704 | 167,500 |
| Interest Income | 428,383 | 330,145 |
| operating Expenses | 429,956 | 561,576 |
| Non interest income | 182,902 | 319,555 |

3.3 Liquidity Profile

The Banking industry liquidity decreased significantly as depicted by the relevant indices. The average liquidity ratio decreased from 75.71% as at March 2015 to 42.84% as at June 2015. Individually, all the DMBs in the industry had liquidity ratio in excess of the minimum regulatory requirement of 30%, hence, as at end the two quarters under review, all DMBs were sufficiently liquid. Also, Deposits from Banks decreased by 24.60% from ₦1.099 trillion in March 2015 to ₦882.739 billion as at June 2015. However, borrowings by Banks grew by 3.26% or ₦1 5.08 billion.

The Industry recorded a Net Credit of ₦13.501 trillion as at June 30, 2015 representing an increase of 0.51% over ₦13.432 trillion recorded in March 2015. The Net Credit to Deposits Ratio also increased slightly by 0.65% from 73.95% as at 31st March, 2015 to 74.60% as at June, 2015.

The Banking Industry Volatile Liabilities to Total Assets Ratio increased by 0.04% from 66.93% in March 2015 to 66.89% as at June 2015.

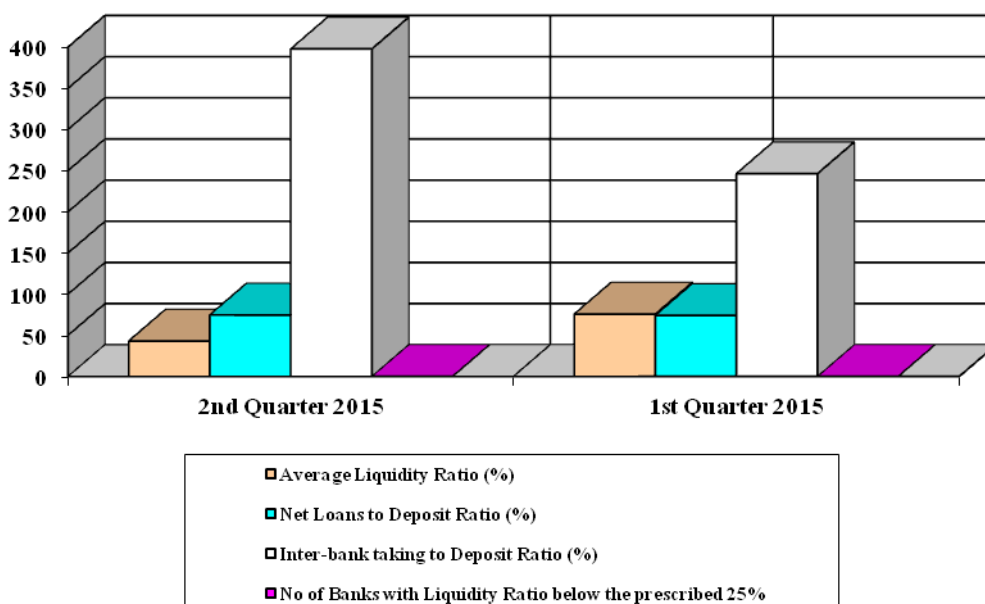
TABLE 4**Indicators of Insured Banks' Liquidity Profile For first and second Quarters of 2015**

| Liquidity | Period | |
|---|----------------------|-----------------------|
| | June 2015 | March 2015 |
| Average Liquidity Ratio (%) | 42.84 | 75.71 |
| Net Loans to Deposit Ratio (%) | 74.60 | 73.95 |
| Inter-bank taking to Deposit Ratio (%) | 397.70 | 246.17 |
| No of Banks with Liquidity Ratio below the prescribed minimum | 0 | 0 |

Source: Bank Returns

Chart 4**Indicators of Insured Banks Liquidity Profile for the 1st and 2nd Quarters Of 2015**

Chart 4: Indicators of Insured Banks' Liquidity Profile for the 1st and 2nd Quarters of 2015



3.4 Capital Adequacy

The banking industry capital base remained strong during the year under review. The Banking Industry Capital to Risk Weighted Assets Ratio (CAR) increased from 16.82% as at 31st March, 2015 to 17.38% by 30th June, 2015.

The Banking Industry Capital to Total Assets Ratio increased from 11.63% to 12.12% while the Adjusted Capital Ratio increased from 20.43% as at 31st March, 2015 to 21.66% as at 30th June, 2015.

The Total Qualifying Capital of the Banking Industry decreased by ₦0.03 trillion or 0.95% from ₦3.179 trillion as at March 2015 to ₦3.149 trillion as at June 2015. The Total Risk Weighted Assets also decreased slightly by ₦0.789 trillion or 4.18% from ₦18.901 trillion as at 31st March, 2015 to ₦18.112 trillion as at 30th June, 2015, resulting in Banking Industry Capital Adequacy Ratio of 17.38% in June 2015. However, during the two quarters under review, three (3) banks out of twenty three (23) failed to meet the minimum

prudential CAR of 10% as at March 2015. Similarly, three (3) banks out of twenty two banks failed to meet the minimum CAR of 10% as at June 2015.

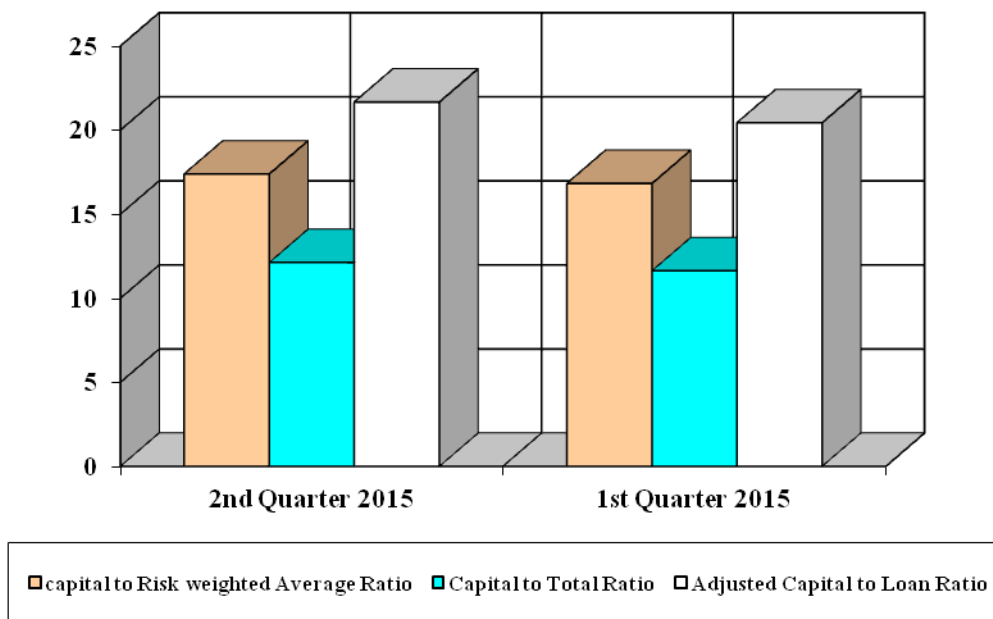
Table 5 and Chart 5 depict the capital adequacy position of the industry for the period under consideration.

TABLE 5

Indicators of Insured Banks' Capital Adequacy Position for the first and second quarters of 2015

| Capital Adequacy Indicator | Period | |
|--|-----------|------------|
| | June 2015 | March 2015 |
| Capital to Risk weighted Average Ratio (%) | 17.38 | 16.82 |
| Capital to Total Asset Ratio (%) | 12.12 | 11.63 |
| Adjusted Capital Ratio (%) | 21.66 | 20.43 |

Chart 5: Insured Bank's Capital Adequacy for the 1st and 2nd Quarters of 2015



3.0 CONCLUSION

The financial indices depicted in the paper shows the financial condition and performance of the banking industry as at June 30th 2015 and 31st March 2015. However, the June report was based on the performance of 22 banks as against 23 banks in March 2015.

The paper shows a decline in Total Assets of the industry by 1.01% from ₦27.329 trillion as at 31st March, 2015 to ₦27.055 trillion as at 30th June, 2015. Similarly, Total Deposits decreased by 0.4% from ₦18.163 trillion as at the end of March 2015 to ₦18.098 trillion as at the end of June 2015. Also, Asset Quality as represented by the ratio of Non-Performing Loans (NPL) to Total Credits (TC) worsened as the ratio increased from 4.06% as at March 2015 to 9.79% as at June 2015 which was above the maximum 5% benchmark. The Average Liquidity Ratio (ALR) of the Banking Industry without the two Merchant Banks was 42.83%. The liquidity ratios for all the 20 banks were above the 30% prudential minimum with the exception of Skye bank and Fidelity bank plc with 27.66% and 29.78% respectively. The liquidity ratio of 42.84% as at June, 2015 declined from 72.39% recorded as at 31st March, 2015. The banks' profitability measured in absolute terms by Profit before Tax (PBT) increased significantly by 14.45% to ₦191.704billion as at June 2015 as against ₦167.500 billion recorded in March 2015.

FINANCIAL MARKET INTEGRATION AND ECONOMIC GROWTH: AN EXPERIENCE FROM NIGERIA

Abstract

This study examines the effect of financial integration on economic growth in Nigeria. Using time series data from 1981 and 2012, the study employs autoregressive distributed lag (ARDL) bounds testing approach proposed by Pesaran et al., (2001) to estimate the long run and short run effect of financial integration and development on economic growth. The result from cointegration test showed presence of long run relationship between dependent and all explanatory variables. The regression results show that, while financial integration has no short run effect on economic growth, its long run effect on growth is negative and significant. Financial development was found to have both short run and long run positive effect on economic growth in Nigeria. Hence, for Nigeria to benefit from financial integration, the government has to increase the level of competition, improve the quality of financial information and reduce corruption in the financial system.

Keywords: Integration, liberalization, unit root, Autoregressive, economic growth

Introduction

The advancement in information and communication technology coupled with growing financial deregulation and liberalization in international capital markets has made financial markets throughout the world steadily become more open to foreign investors. This development has also made a number of

countries, including Nigeria, initiate reforms to foster financial market development and attract foreign portfolio flows.

One of the most enduring debates in finance during the last decade is whether financial market integration causes economic growth. This issue had been widely studied by scholars (see Akdogan, 1995; Levine, 2001; Emiris, 2002; Klein and Olivei, 2006; Armanious, 2007). Financial market integration is believed to affect the real economy through at least two broad channels. First, the size of the financial sector and the volume of available credit are seen as a proxy indicator for how effectively the sector manages to collect savings and allocate them to productive investments. This transfer of funds not only raises productive capacity but should also enhance the efficiency of the economy by reallocating funds from least to most productive investments. A second channel relates to the capacity of the financial sector to absorb shocks. An effective financial sector will raise the possibilities for households and enterprises to hedge against risks and systemic shocks (Bloch and Tang, 2003).

Notwithstanding these theoretical benefits of financial integration for trend growth and inequality, empirical studies have so far produced mixed evidence, particularly regarding the impact of financial market integration on financial development and economic growth in developing countries. The dismal condition of the financial system in the developing countries post financial globalization has also received a great attention since the last quarter of 20th century. Authors such as Rodrik (1998) and Stiglitz (2002) argue that financial integration has remained a curse to developing countries since it is a major cause of financial crises. However, Mishkin (2005) contends that financial integration promotes growth but it is the bad policies of these developing countries that hinder the promotional effect of financial globalization. It was also contended that financial market integration entails several risks in terms of capital flight which could lead to balance of payment disequilibrium through

currency fluctuations and high inflation rates which engender current account deficit and unemployment (Boyle, 2009).

Several reasons have been put forward as the causes of lack of significant impact of financial market integration and financial development on economic growth in developing countries. According to Stulz (2005), financial market integration remain ineffective in developing countries due to lack of strong property rights, weak legal system, corruption, lack of quality financial information, poor corporate governance, and government overbearing interference with the financial sector. Although, most developing countries have liberalized their financial sector, there are still some elements of financial repression in their financial sector. For instance in Nigeria, having liberalized her financial sector in 1986, government still intervened in the determination of exchange rate. The central bank was controlled by the government especially during the military regime. Some banks have the majority of the deposits from federal, state or local government and its parastatals (Nnana, 2001).

In summary, part of the difficulty in finding a definite relationship between financial market integration and growth may lie in the fact that financial market openness interacts with the overall regulatory environment in any particular country. A supporting business environment with efficient governance, productive industrial relations and predictable labour regulation helps foreign investors to identify business opportunities quickly and channel funds towards their most productive use.

Capital market integration could be made effective if developing countries could develop strong property rights, strengthen the legal system, reduce corruption, improve the quality of financial information, improve corporate governance, and get the government out of the business of directing credit.

To our knowledge, there is paucity of studies on the effect of financial market integration on economic growth in Nigeria. Most of the studies in this area focus on the importance of financial market development. This study, therefore, fills this gap by empirically providing evidence of the effect of financial market integration on economic growth in Nigeria between 1981 and 2012.

Concept of Financial Integration

The concept of financial integration has been perceived differently by various authors. Financial integration is said to encompass domestic financial market deregulation and capital account liberalization (McKinnon, 1973). Financial integration is defined as the integration of a country's local financial system with international financial markets. It usually requires liberalization of domestic financial sector and the capital account. Financial integration, thus, entails increase in cross-country capital movement, which involves an active participation of local borrowers and lenders in international markets and a widespread use of international financial intermediaries and instruments (Bussiere, 2004).

Emiris (2002) argues that assets with similar risk characteristics will have the same price if financial markets in the world are completely integrated even if these assets are traded on different markets. To him, "in completely integrated financial markets, investors face common and country-specific or idiosyncratic risk, but price only common risk factors, because country-specific risk is fully diversifiable. When markets are partially integrated, investors face both common and idiosyncratic risks and price them both. However, if markets are completely segmented, investors face and price only country-specific sources of risk".

Theoretically, financial integration promotes development of the financial system and economic growth (McKinnon and Pill, 1997). Financial integration

advances the working of the financial system through two main channels. First, financial integration increases the flows of funds and enhances financial infrastructure through reduced asymmetric information which, consequently, decreases adverse selection and moral hazard and enhances the availability of credit (Unite and Sullivan, 2003 and Mishkin, 2006). Secondly, financial integration leads to more comprehensive, stable, and effective financial markets and, as a result, increases economic growth and development (Levine, 2001).

Financial integration improves macroeconomic policy-making and encourages the implementation of pro-growth reforms by imposing discipline on governments (Goldberg, 2004). It strengthens corporate governance through a more competitive market for corporate control (Unite and Sullivan, 2003 and Goldberg, 2004); improves country risk-sharing (Boyle, 2009); enhances product market competition through the inflow of new, internationally operating enterprise and portfolio diversification (Armanious, 2007 and Boyle, 2009) and directs capital flows to the most efficient and productive use and ensure that executives are performing at their best (Akdogan, 1995 and Mishkin, 2003).

Through financial integration, foreign financial institutions bring to domestic financial markets best corporate practices and experiences that which are likely to encourage technology transfer to domestic financial institutions (Goldberg, 2004). Entry of foreign financial institutions helps improve domestic prudential supervision because supervisors are now able to see what risk management practices are successfully used in foreign institutions and insist that they be adopted by domestic institutions (Mishkin, 2003).

However, despite its notable advantages, financial integration has been claimed to expose a country to capital flight and financial crisis and financial malpractices (Boyle, 2009). Rogoff *et. al.*, (2006) note that financial market integration can heighten a country's vulnerability to macroeconomic instability

and financial crisis if a country's financial market is imperfect. The imperfections in financial market can generate speculative attacks' bubbles, and herding behavior among others. Imperfections in international financial markets may also lead to financial crises even in countries with sound fundamentals. It was also pointed out that inadequate financial infrastructure during the process of integration can weaken the health of the local financial market and increase its vulnerability (Obstfeld, 1998; Demirguc-kunt and Detragiache 1999 and Lane and Milesi-ferretti 2006).

Hence, for countries to benefit from financial integration, Mishkin (2006) points out some prerequisites which include: developing strong property rights, strengthening the legal system, reducing corruption, improving the quality of financial information, improving corporate governance, and getting the government out of the business of directing credit.

Empirical Review on the Effect of Financial Integration on Economic Growth

There are several studies on the role and importance of financial market integration in economic development. Bekaert *et al.*, (2005) using a sample that covers 95 countries over the period 1980–97, conclude that financial market integration increases GDP growth by about 1 percentage point. Using a longer sample with different methodology, Li (2003) finds that such integrations lead to a 0.6 percentage increase in GDP growth. Hammel (2006) reveals that industries that are more dependent on external finance grow faster in countries with relatively higher stock market capitalization rates.

Chinn and Ito (2005) focus on the links between financial market integration, legal and institutional development, and financial development. In their panel data analysis encompassing 108 countries and time span from 1980 to 2000, they found that a higher level of financial integration contributes to the development of stock markets only if a threshold level of general legal

systems and institutions is attained and that trade openness is a precondition for financial market integration. They also found that in developing economies a higher level of institutional framework, effective law and order, as well as the lower levels of financial corruption increase the impact of financial integration on the development of stock markets”.

Klein and Olivei (2001) examine a cross-section of 87 industrialized and less developed countries between 1976 and 1995. In their study, financial integration was proxied by capital account. They found a positive relationship between capital account liberalization and financial development. However, the identified positive relationship is only associated entirely with developed countries, while there is no detectable relationship between financial integration and development for the less developed countries

Using firm-level data in a sample of 11 emerging market countries, Chari and Henry (2005) find that financial market integration reduces the cost of capital and increases investment. They also find that financial integration reduces the systematic risk associated with holding equities in developing countries. Using a sample of 12 developing countries and an event study approach, Henry (2000) shows that, on average, equity price indexes register a substantial increase in the months preceding capital market liberalizations, implying that these liberalizations are associated with a fall in the cost of equity capital. Also, using industry-level panel data from the manufacturing sectors of 31 emerging market economies over the period 1981– 98, Gupta and Yuan (2005) conclude that, in capially integrated economies, industries that are technologically more dependent on external finance experience higher growth.

In other studies, Levine and Zervos (1998) find that financial integration and liquidity rates in stock markets are positive and significantly correlated with present and future rates of economic growth, capital accumulation and an increase of productivity growth. Milton (2006) finds that firms with stocks that are open to foreign investors register higher levels of returns on investment, higher efficiency and lower leverage ratios. Alfaro and Hammel (2006) find

that financial market integration boost imports of machinery going into domestic equipment investment. Edison *et al.*, (2004) confirmed the positive association between financial market integration and output growth but they find that this relationship disappears when a measure of government reputation was introduced as a regressor.

Model Specification

The transmission mechanism from financial intermediation to economic growth is an open question in the literature. In this study, the neoclassical growth model was employed to build a model that gives financial market a role in economic growth. The standard neoclassical growth model seeks to explain the growth rate of aggregate output from various factors, such as labour, capita and technological progress also known as the Solow residual. The standard neoclassical model relating these factors to output is given as follows:

$$Y(t) = A(t) f [K(t), L(t)] \quad (1)$$

where $Y(t)$ represents output in time (t) , $K(t)$ capital input in time (t) and $L(t)$ labor input in time (t) . $A(t)$ denotes the technology level in the economy or its stock of knowledge and total factor productivity.

Given the significance of technological factors in economic growth, measures of financial development and integration were introduced into equation (1) to capture the effect of technological change on economic growth. Since, according to Schumpeter (1911), well-functioning financial system boosts technological innovation by funding entrepreneurs with the best chances of successful innovation and technological breakthrough. Exchange rate and interest rate were also introduced into equation (1) to serve as control variables.

Hence, based on the argument above, equation is rewritten as follows;

$$Y_t = \alpha_0 + \alpha_1 K_t + \alpha_2 L_t + \alpha_3 FIN_t + \alpha_4 CI_t + \alpha_5 EXR_t + \alpha_6 INT_t + \mu_t \dots\dots\dots 2$$

Where:

Y= log of industrial value added

FIN= measure of financial deepening (ratio of money supply (M2) to GDP)

CI= measure of Financial integration

EXR= exchange rate

INT= interest rate

K= log of capital

L= log of labour force

α_i and μ are parameters and error term respectively.

Data Source and Measurement

Secondary data are used for this study spanning 1981 to 2012. All variables are sourced from Central Bank statistical bulletin 2013. Financial integration is represented by ratio of capital account to GDP (Glick *et al.*, 2004 and Hernán, 2007). Financial development is represented by ratio of broad money supply to GDP. Capital and labour are captured by gross fixed capital formation and total labour force respectively. Interest rate and exchange rate are represented by lending rate and effective US to naira exchange rate. Income is represented by industrial value added instead of GDP since it is used in the computation of financial development and financial integration.

Method of Analysis

To empirically estimate the long-run and short-run impact of financial integration on economic growth in Nigeria, equation (2) was estimated using

the bounds testing (or autoregressive distributed lag (ARDL)) cointegration procedure, developed by Pesaran *et al.*, (2001). The ARDL procedure can be used when the regressors are integrated of order zero or one unlike the strict requirement of Johansen approach which required all variables to be purely integrated of order one, that is, stationary at first difference (Fosu and Magnus, 2006). The ARDL procedure is also relatively more efficient in small or finite sample data sizes as is the case in this study (Kakar *et al.*, 2010). The ARDL, however, is not efficient in the presence of variables that are stationary at second difference.

The ARDL cointegration procedure involves several stages. In the first stage, the stationary properties of time series variables in equation (2) were examined by implementing unit root test. All variables were tested in levels and in the first difference using the Augmented Dickey-Fuller (ADF) Test and Phillip Perron unit root test.

The second stage involves testing for the existence of a long-run relationship between economic growth, financial integration and all other regressors within a univariate framework. Following Pesaran *et al.*, (2001), the bounds test procedure was adopted by modeling the long-run of equation 3 as a general vector autoregressive (VAR) model of order p as follows:

$$\Delta Y_t = C_0 + \beta_1 Y_{t-1} + \beta_2 K_{t-1} + \beta_3 L_{t-1} + \beta_4 FIN_{t-1} + \beta_5 CI_{t-1} + \beta_6 EXR_{t-1} + \beta_7 INT_{t-1} + \sum_{i=1}^p \phi_1 \Delta Y_{t-1} + \sum_{i=1}^p \phi_2 \Delta K_{t-1} + \sum_{i=1}^p \phi_3 \Delta L_{t-1} + \sum_{i=1}^p \phi_4 \Delta FIN_{t-1} + \sum_{i=1}^p \phi_5 \Delta CI_{t-1} + \sum_{i=1}^p \phi_6 \Delta EXR_{t-1} + \sum_{i=1}^p \phi_7 \Delta INT_{t-1} + \mu_t \dots \dots \dots 3$$

where β_i and ϕ are the long run and short-run multipliers respectively, C_0 is the drift and μ_t are white noise errors.

In ARDL procedure, equation (3) is estimated by ordinary least squares (OLS) in order to test for the existence of cointegration or long-run relation among the variables by conducting an F-test for the joint significance of the coefficients of the lagged levels of the variables, i.e

$$H_0: \beta_1 = \beta_2 = \beta_3 = \beta_4 = \beta_5 = \beta_6 = \beta_7 = 0 \text{ (There exist no long run relationship)}$$

$$H_1: \beta_1 \neq \beta_2 \neq \beta_3 \neq \beta_4 \neq \beta_5 \neq \beta_6 \neq \beta_7 \neq 0$$

The calculated F-statistic from equation (3) is compared with the critical value tabulated by Pesaran *et al.*, (2001). If the calculated F-statistic exceeds the upper critical value, the null hypothesis of no long-run relationship can be rejected regardless of whether the underlying order of integration of the variables is zero or one (Pesaran *et al.*, 2001).

Once cointegration is established the conditional ARDL ($p_1, q_1, q_2, q_3, q_4, q_5, q_6$) long-run model for equation (2) can be estimated as:

$$Y_t = C_0 + \sum_{i=1}^p \beta_1 Y_{t-1} + \sum_{i=0}^{q_1} \beta_2 K_{t-1} + \sum_{i=0}^{q_2} \beta_3 L_{t-1} + \sum_{i=0}^{q_3} \beta_4 FIN_{t-1} + \sum_{i=0}^{q_4} \beta_5 CI_{t-1} + \sum_{i=0}^{q_5} \beta_6 EXR_{t-1} + \sum_{i=0}^{q_5} \beta_7 INT_{t-1} + \mu_t \dots \dots \dots 4$$

Where, all variables are as previously defined. This involves selecting the orders of the ARDL ($p_1, q_1, q_2, q_3, q_4, q_5$) model in the six variables using Akaike information criteria (AIC).

The last and final step of an ARDL bound procedure is to obtain the short-run dynamic parameters by estimating an error correction model associated with the long-run estimates. This is specified as follows:

$$\Delta Y_t = \lambda_0 + \sum_{i=1}^p \phi_1 \Delta Y_{t-1} + \sum_{i=1}^p \phi_2 \Delta K_{t-1} + \sum_{i=1}^p \phi_3 \Delta L_{t-1} + \sum_{i=1}^p \phi_4 \Delta FIN_{t-1} + \sum_{i=1}^p \phi_5 \Delta CI_{t-1} + \sum_{i=1}^p \phi_6 \Delta EXR_{t-1} + \sum_{i=1}^p \phi_7 \Delta INT_{t-1} + \delta_8 ECM_{-1} + \mu_t \dots \dots \dots 5$$

Where ϕ is short –run dynamic coefficients of the model, δ indicates the speed of the adjustment which restores equilibrium in the dynamic model.

Empirical Result

In this section, the impact of financial integration on economic growth is estimated using the Autoregressive Distributed lag model (ARDL) over the period 1981 to 2012. Before proceeding to the ARDL bounds test, unit root test of the time series variables used in this study were conducted and the

result presented in Table 1. This was to ensure that the variables in our model are not $I(2)$, that is, not stationary at second difference, so as to avoid spurious results. According to Ouattara (2004) in the presence of $I(2)$ variables the computed F-statistics provided by ARDL procedure are not valid because the bounds test is based on the assumption that the variables are $I(0)$ or $I(1)$.

Table 1: Unit root tests

| Variable | Augmented Dickey Fuller Test | | Phillip Perron Test | |
|----------|------------------------------|------------------|---------------------|------------------|
| | Level | First difference | level | First difference |
| Y | -3.640315* | -5.087816** | -3.640315* | -5.102278** |
| K | -3.775140* | -3.777678* | -3.596300* | -3.571732* |
| L | -3.673604* | -13.16627** | -4.650099** | -12.41712** |
| FIN | -0.013920 | -4.496688** | -0.080887 | -4.388133** |
| CI | -3.952330** | -8.236770** | -3.952330** | -11.68681** |
| EXR | -2.090197 | -5.306837** | -2.090197 | -5.306770** |
| INT | -3.011616* | -5.509372** | -2.942210* | -8.901823** |

Notes: * and ** denote significance at 1% and 5%, respectively.

The ADF and PP unit root tests results for the variables are reported in Table 1. In the results, all variables are integrated of $I(0)$ based on Phillip Perron test and Augmented Dickey Fuller test except for financial development and exchange rate both of which are stationary at first difference. These results, thereby, justify the use of ARDL method.

Bounds tests for cointegration

The results of bounds testing approach for co-integration long run relationship for equation 2 is presented in table 2. The calculated F-statistic of the model is statistically significant, implying that the null hypothesis of no co-integration

cannot be accepted and, thus, it is concluded that there is indeed a co-integration relationship among the variables used.

Table 2: Cointegration test

| Dependent var. | AIC | lagF-statistic | Prob.outcome | |
|----------------|-----|----------------|--------------|------------------------|
| Y | 1 | 3.827123 | 0.0000 | there is cointegration |

Having found the existence of long run relationship between financial integration, economic growth and other selected variables, the ARDL method was applied to estimate the long run parameters of equation 2. Table 3 presents the estimated long-run coefficients of equation 2. The lag length of long run model was selected on basis of Akaike Info Criteria (AIC). The R-squared and adjusted R squared of the model are about 0.97, signifying that about 97 percent of variations in economic growth is explained by all the included independent variables. The F-statistic value of the long-run model is also significant and implies that all the independents variables include in the model are jointly significant. The Durbin Watson test statistic shows an absence of autocorrelation in the model.

Table 3: Estimated long run coefficients using the ARDL approach

| Dependent variable: Y | | |
|------------------------------|--------------------|------------------------|
| Independent variables | Coefficient | T-ratio (prob.) |
| Y(-1) | 0.410166 | 2.709615 (0.0125) |
| K(-1) | 0.069242 | 3.121440 (0.0019) |
| L (-1) | 0.108862 | 0.632642 (0.5332) |
| FIN (-1) | 0.011826 | 2.765668 (0.0095) |
| C1 (-1) | -0.007955 | -3.597233 (0.0003) |
| EXR (-1) | 0.001365 | 2.449363 (0.0223) |
| INT (-1) | -0.000640 | -0.126792 (0.9002) |

| | | |
|-------------------------|-------------------|--|
| R ² | 0.977884 | |
| Adjusted R ² | 0.971153 | |
| F-statistics (P-value) | 145.2835 (0.0000) | |
| DW | 2.157172 | |

The long-run result shows that past income level, capital investment, financial development and exchange rate have significant positive effect on economic growth in Nigeria, while economic labour force and interest rate have an insignificant effect on economic growth in the long run. In the result, financial integration has a significant negative effect on Nigeria. The implication of this finding is that the Nigerian economy has been hindered by financial market integration. This is expected since the country's financial system is still underdeveloped relatively to the world standard. The capital account has been negative for most the periods under review which indicates that capital flight out the country is still substantial.

However, financial development, measured as ratio of broad money supply to GDP, has a significant positive impact on Nigerian economy. This result implies financial intermediation facilitates increased economic activities. This finding is consistent with that of McKinnon (1973), Nnana (2001) and Hernán (2007).

Table 4: Short run result for the selected ARDL model

| Dependent variable: Y | | |
|------------------------------|--------------------|------------------------|
| Independent variables | Coefficient | T-ratio (prob.) |
| Y | 0.838226 | 4.621383 (0.0001) |
| K | 0.086381 | 2.246171 (0.0318) |
| L | 0.034339 | 0.336129 (0.7401) |
| FIN | 0.067806 | 2.986181 (0.0131) |
| CI | 0.004305 | 0.954060(0.3509) |

| | | |
|-------------------------|-------------------|--------------------|
| EXR | 0.000301 | 0.498701 (0.6232) |
| INT | 0.008831 | 4.362874 (0.0003) |
| ECM(-1) | -0.871618 | -3.316924 (0.0017) |
| R ² | 0.727922 | |
| Adjusted R ² | 0.624274 | |
| F-statistics (P-value) | 7.022979 (0.0001) | |
| DW | 1.982721 | |

The results of the short-run coefficients of the relationships between financial integration and economic growth are given in Table 4. As in the long-run model, the lag length of short run model is selected on basis of Akaike Info Criteria (AIC). The signs of the short-run estimates are similar to that of long – run model, except financial integration which has a positive sign and is insignificant at 5 percent critical level and interest rate which is positively related to economic growth. The result shows that there is no significant positive relationship between financial integration and economic growth in short-run. This result is consistent with that of Klein and Olivei (2001) who find no detectable relationship between financial integration and development for the less developed countries.

Previous income level, capital investment, financial development and interest rate have significant positive impact on economic growth in Nigeria. Also the error correction parameter is statistically insignificant at 5 percent critical level. This indicates the existence of stable long run relationship. Also, the coefficient of determination (R-squared) of the model is 72 percent, indicating the about 72 percent of the variations in economic growth is explained by variations in all the independent variables. The F-statistic value of the long-run model is also significant and implies that all the independents variables include in the model are jointly significant. The Durbin Watson test statistic shows an absence of autocorrelation in the model.

Conclusion

This study examines the effect of financial integration on economic growth in Nigeria between 1981 and 2012. Financial integration, measured as ratio of capital account to GDP, was found to have a significant negative impact on economic growth in Nigeria. The sign of coefficient of financial integration, however, raised concern. Opening Nigeria's financial system to the world ordinarily would have led to improvement in the functioning of the financial system through increased competition and funds, enhanced financial infrastructure and capital inflows. However, the situation in Nigeria might be different due to underdeveloped and imperfect nature of her financial market. Financial integration, as Boyle (2009) put it, has exposed Nigeria's financial system to capital flight and imported credit crunches, and has also increased corruption incentives in country. Lack of financial infrastructure in the country has also increased the vulnerability of financial system to global financial crisis as evidenced in 2007. Hence, for Nigeria to benefit from financial integration, it is necessary to increase the level of competition in the financial sector, improve the quality of financial information and corporate governance and reduce corruption in the financial system.

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A SYNTHESIS OF GRAMEEN MICROFINANCE MODEL: LESSONS FOR NIGERIA

BY

DR. T.W.O. ALASIA AND MARYAM ISAH

Abstract

Economic literature had acknowledged the contribution of the microfinance banking sector in economic development of countries due to its capacity in employment generation, increase in household income and as a poverty reduction and financial inclusion strategy. Because of these critical roles, various countries are taking measures to harness its potential in order to achieve the desired developmental goal. The challenge however, has been the best and most effective model or strategy to adopt. The Grameen (GB) microfinance banking model of Professor Mohammed Yunus has achieved success in Bangladesh in poverty reduction, financial inclusion and sustainable economic development. It is being replicated and adapted by many countries. The paper analyzed the GB model, noted its critical success factors and juxtaposed it with the microfinance banking practice in Nigeria using the CBN 2005 and 2011 microfinance frameworks. It was observed that microfinance banking in Nigeria has not been successful due to wrong design, inappropriate methodology and other challenges. The paper further noted that some useful lessons can be learnt from the success achieved by the GB model to make microfinance banking achieve its objective in Nigeria. Finally, some recommendations were made to the regulatory authorities and operators to remodel microfinance practice in Nigeria so as to achieve the desired benefits.

1.0 INTRODUCTION

There are numerous debates and arguments in contemporary economic literature on the contribution of microfinance in poverty eradication, financial inclusion and economic development in different countries. (See Raham and Nie(2011); Grunewald and Baron (2011); Komolafe(2011); Iganiga(2008); Aigbokhan and Asemota(2011). At the centre of most of these academic discourse is the reference to the microfinance model of Grameen Bank of Bangladesh in South Asia. According to Agene(2011), microfinance is the provision of full range of financial services comprising micro credit, micro savings, insurance and funds transfer to low income (poor) clients including consumers and self-employed, who traditionally lack access to deposit money banks and related financial services to help them grow micro-enterprises or engage in other productive economic activities. Microfinance is based on the premise that the poor are economically active but are constrained by access to finance and are therefore excluded in the financial intermediation chain. It is believed that enabling access to these classes of economic agents will promote financial inclusion and also pull them out of grinding poverty to which some of them have been subjected to for a long time. This is because the process will enable the active or working poor to become more self-sufficient and improve their lives and those of family members, the community and the society at large.

Over the years, microfinancing has emerged as an effective poverty alleviation strategy across developing countries. One of such developing countries with a successful history of microfinancing is Bangladesh where the operations of Grameen bank had become a reference point. Grameen bank was incorporated in 1983 by Professor Mohammad Yunus for the provision of micro-finance services to remove the credit constraints of the rural poor in Bangladesh which are very active economically. Yunus started his experimentation in the 1970s. Apart from being the dominant microfinance institution in Bangladesh in outreach, outstanding loan, savings mobilization and efficient service delivery, it provides microcredit to 13 million poor

households with cumulative recovery rate of 98% (Raham and Nie, 2011). The Grameen bank has been able to demonstrate the effectiveness of microfinance programs towards sustainable development for the rural poor in Bangladesh culminating into Professor Yunus being awarded the Nobel Peace Prize in 2006. The Grameen model has been adopted or adapted by many countries in addressing poverty reduction and as a financial inclusion strategy. What lessons can Nigeria also learn from the Grameen microfinance model? What are the success factors of this model? How can these be adapted in Nigeria's microfinance strategy as encapsulated in the CBN microfinance policy framework and operation?

In Nigeria though microfinance has been in existence for decades, the formalization by the monetary authorities commenced in 2005 by the release of the "Microfinance Policy, Regulation and Supervisory Framework" by the Central Bank Nigeria (CBN). The objectives, justifications and strategic targets of the framework stated the emphasis it places on poverty alleviation, encouraging participation of the economically active poor, elimination of gender disparity in the access to financial services, and also increasing the percentage of microcredit to both GDP and total credit in the Nigerian economy. Five years into its practice revealed some gaps in the implementation which made the achievement of the objectives/targets far from realization. Obe(2011)stated that the current microfinance banking framework in Nigeria cannot work, nor achieve the cardinal objective of poverty alleviation. Babajide(2011)in support of this view, submitted that the framework for microfinance banking in Nigeria is faulty and cannot achieve its objectives based on identified gaps in procedure and implementation by both operators and regulators.The CBN revised the framework in 2011, in which it observed that a huge gap still exists in outreach of financial services to the poor. The success rate is therefore mixed.

In 2011, Professor Mohammad Yunus after a careful assessment of microfinance practice in Nigeria concluded that what is practiced is not microfinance but micro commercial banking.⁴This statement asserts to the fact that the implementation of the microfinance policy in Nigeria is faulty. Therefore, the question arises: what success factors can we learn from the Grameen model to transform microfinance operation in Nigeria? The drive to identify and harness these issues informs the need to carry out this study.

The objective of the study is to identify the basic methodology and critical success factors of the Grameen microfinance model with a view to deriving possible applicable lessons for Nigeria. In doing this, the specific objectives of the study are:

- I. Examine the Grameen microfinance model with the view to bringing out the success factors;
- II. Identify impediments/weaknesses of microfinance practice in Nigeria, juxtapose its operation with the Grameen bank model, and;
- III. Recommend some useful lessons from the GB model for enhanced microfinance practice in Nigeria.

In order to achieve the stated objectives, the following research questions are investigated:

- I. What are the basic features of microfinance bank operation in Nigeria?
- II. What are the impediments to formal micro-financial participation by the low income earners and the poor in Nigeria?
- III. What are the key success factors of the Grameen microfinance model?
- IV. Does the Grameen model have any useful lesson for microfinance banking in Nigeria?

¹ Professor Muhammad Yunus visited Nigeria in September 2011 to attend the maiden edition of the First Bank of Nigeria Plc. International Conference with the theme: "Micro-Financing as a Tool for Poverty Eradication and Economic Growth," held in Lagos. He delivered the key-note address at the event.

The study will adopt a thematic literary approach to analyse the work. The structure of the remainder of the paper is as follows: The first section is the introduction; the second section presents the theoretical concept; conceptual issues and review of some empirical studies. The third section discusses the Grameen Microfinance model. In the section, the socio-economic environment, emergence of the bank, its ownership, operational mechanism and critical success factors were discussed. Nigeria's microfinance model is discussed in the fourth section by a review of the 2005 and 2011 microfinance regulatory frameworks which were analysed and juxtaposed with GB model. In section five, the paper drew some useful lessons from the GB model while section six contains the recommendations and conclusions of the paper.

2.0 LITERATURE REVIEW

2.1 THEORETICAL CONCEPTS

The contribution of the banking industry in facilitating economic development of nations, due to its link with key sectors of the economy has been widely acknowledged by economic literature. Tiel (2001) suggested that a well-developed banking system support economies to reach their potential because they enable firms which have successfully identified profitable opportunities to exploit them by channelling investment funds from those in the economy who are willing to defer their consumption plans into the future. One important function of the banking system is its role of financial intermediation. In the performance of this role of financial intermediation, banks also promote economic development, through capital accumulation, investment through credit creation and output. Iganiga (2008) argued that robust economic growth cannot be achieved without putting in place well focused programmes to reduce poverty through empowering the people by increasing their access to factors of production, especially credit. Iweala (2005) further posited that through such process, the latent capacity of the poor can be significantly enhanced by the provision of micro-finance services. It will also enable them

engage in economic activities and be more self-reliant, increase employment opportunities, enhance household income, and create wealth.

It was further observed that in the performance of this intermediation role over the years, these financial institutions (commercial banks/deposit money banks) important as they are in economic development, do not meet the needs of some segments of the economy. This is because of the class of customers they service, pricing methods and instruments used. The type of customers they deal with and loans they grant are sophisticated in nature and very large. As a result, a significant population of the active economic agents of the society are either excluded or under served. The need arose therefore to include the financially excluded segments into the formal financial intermediation process by creating a micro-financing corridor. The call for the inclusion of micro-credit and micro-finance in banking therefore, became very loud.

Mirero (2004) defined microfinance as the provision of very small loan that are repayable within short periods. He submitted that clients of microfinance institutions (MFIs) are basically low-income individuals and households with minimal assets that can be used as collateral and includes financial products and services targeted at the poor. Zeller and Sharma (1998) supported this school of thought when they posited that microfinance can help to establish or expand family enterprises, potentially making a difference between grinding poverty and an economically secure life. Hulme (1998) concluded from his studies of 13 MFIs in seven developing countries that access to microfinance could increase income and improve the asset holding position.

Agene (2011) viewed microfinance as the provision of a full range of financial services comprising micro-credit (including micro-leasing), micro-saving, insurance, and fund transfers to low-income (poor) clients, including consumers and the self-employed, who traditionally lack access to deposit money banks and related financial services, to help them grow micro-enterprises or engage in other productive economic activities. Aigbokhan and Asemota (2011) argued that access to credit affects welfare outcomes by

alleviating the capital constraints on poor households for their agricultural and micro and small scale non-agricultural enterprises. They further asserted that access to credit also increases the poor household's risk-bearing and risk-coping abilities and enables consumption smoothing over time.

One inference that can be drawn from the above arguments is that microfinance means integrating the financial needs of the poor and low-income into a country's mainstream financial system. This is based on the assumption that they are economically active and can empower themselves if they have access to credit.

2.2 CONCEPTUAL ISSUES

The concept of microfinance is not new but may be as old as human commercial existence. Agene (2011) posited that the origin of microfinance was traced to the era of the Franciscan monks who founded the community-oriented pawnshops of the 15th century as well as to the founders of the European credit union movement in the 19th century. Seibel (2004) stated that Microfinance is not a recent development as it is not just a contemporary solution for poverty in developing nations. According to Ehigiamusoe (2011) this was because, for many years, there have been institutional arrangements in formal and informal form that delivered financial services to the low income people. He further argued that these early initiatives might differ from modern microfinance in some service delivery approaches but the objectives are similar. He believed that generally, the evolution of microfinance or microcredit has been due to the needs of the underprivileged, poor and low income to pull themselves out of poverty and exploitation.

Apart from Europe, there are evidence which suggest the existence of informal microfinance and microcredit institutional arrangements that serve similar financial delivery to the poor, facilitated trade and empowered the low income and financially excluded from the mainstream financial economy in Asia, the Americas, Africa and others. Hugon (1990) was of the view that such informal

financial arrangements existed before the modern medium of exchange and existed to serve social and economic goals. Aryeety (1995) and Alasia (2005) identified two main variants of such informal arrangements to be purely savings, and savings and credit. Chandavarkar (1985) and Akanji (1998) submitted that the two types involve in-cash transaction and are common in Africa. The two types are commonly called Rotating Savings and Credit Associations (ROSCAs) have various local names. For example, according to Alasia (2005), in Africa, it is called 'Gamiayah,' in Egypt, 'Susu' in Ghana, 'Tortines,' in Niger, Ivory Coast, Burkina Faso and Cameroun, in Nigeria 'Susu' in Igbos, 'Osusu' in Efik, 'Oku' in Kalabari, 'Adashie' in Hausa, 'Dashi' in Nupe, 'Esusu' in Yoruba. In Bolivia it is called 'Pasnaku' and 'Tanda' in Mexico. In Asia, it is called 'Ko,' in Japan, 'Hui' in China, 'Arisan' in Indonesia, 'Chitfund' in India and 'Paluwagan' in the Philippines.

Ehigiamusoe (2011) further argued that the provision of financial services to the low income persons has evolved through phases across the world and identified four broad models of microfinance. These are the; African indigenous microfinance model; Cooperative thrift and Joan model; Asian pro-poor model and Commercial microfinance of latin American model. The African indigenous microfinance model is basically traditional, characterized by huge savings mobilization, group delivery approach, flexible and existed in an informal form. Savings and credit or loan features make up the model. The Cooperative thrift and Joan model applies basic principles of co-operative enterprise to savings and loan transaction as in the African model. However, the thrift and credit groups are organized on the basis of the core co-operative principle of volunteerism, democratic control and equality. The Asian pro-poor model has features which include; exclusive focus on low income persons or the poor and group delivery methodology. Loan sizes are usually small; clients are organized into self-selecting groups, regular loan receipts, installment loan repayments and deposits. In some institutions, non-financial services such as health, education and others are delivered to group members. The Grameen Bank Model is atypical example. The Commercial

microfinance of Latin American model emphasizes individual methodology. Proponents of this model advocate for the integration of microfinance into the mainstream financial sector in order to use microfinance as a poverty alleviation tool using the huge national resource.

From the above, we see that although the concept of microfinance or microcredit is not new, it has however undergone several developmental phases. In all these, the rationale of its practice in the different jurisdictions is the same; to provide financial services to the poor or low-income persons and small entrepreneurs and businesses deprived access to the mainstream financial system. In that regard, Akinyooye (2010) observed that Economics Professor Mohammad Yunus of Bangladesh may not have invented the word 'Micro-credit' but appears to have simply put the two age-old words together to describe his lending in 1976 of the Bangladeshi Taka, equivalent to of US \$ 27 to 42 very poor landless women in the rural village of Jobra to make bamboo furniture.

The modern concept of microfinance is attributed to Mohammad Yunus who pioneered the microcredit revolution in the 1970s. His microfinance model was built on institutional design for risk management, incorporated social mission; group participation, included birth control, sanitation concerns and made financial services to be provided to the door steps of the poor. The success of this model was acknowledged when in 2006 he won the prestigious Noble Peace Prize. The model has been copied and adapted by many countries as financial inclusion, poverty eradication and economic growth strategy.

EMPIRICAL STUDIES

Grunewald and Baron (2011) carried out a comparative study of Grameen Bank of Bangladesh and SKS Microfinance of India with the objective of examining their method of operation, ownership and the sustainability of future survival. They used a descriptive approach and relied on secondary sources of information. The study found, among other things, the following:

SKS Microfinance is the largest microfinance bank in India and the world's fastest growing MFB, while Grameen bank is the largest MFB in Bangladesh operating from 2,562 branches. They found that the two banks involved in social banking using microfinance as a tool. They also found that the two banks had similar objective of enabling people in poverty and small enterprises to obtain small loans, by providing access to money and credit. The study examined the similarities and differences of the banks by analyzing the objectives, the Chairmen of board of the banks, ownership, organizational structure, governance and related matters, outreach, socio-economic environment and operational mechanisms as the focal point of the study and raised the question of long term viability of their mission.

The study made the following conclusions. Both institutions have similar objective of poverty eradication. Although both institutions had provided access to credit to the poor, made collateral-free loans to the poor for creating income and had diversified the types of loans, the two differ in raising capital and their future strategies. They observed that while the SKS Microfinance – (founded by Mr. Vikra Akula), was founded to attract commercial financing which had better prospect of raising large capital and longevity, its social banking objective may be compromised. This is because; investors' excess emphasis on profit maximization may deemphasize non-profit dimensions and is inconsistent with the original mission.

On the contrary, the Grameen Bank they posited may not be self sustaining if it depended on donor funds. Therefore, to continue the performance in the future, it must be aggressive, gain greater visibility in global capital market and must transcend the boundaries of Bangladesh for financial support. The study also found that Grameen bank had a 98 % loan repayment rate which makes the achievement of its social mission easy. Furthermore, while the SKS MFB is owned by the founder and other investors, GB is owned by majority of its borrowing members.

In another study, Rahman and Nie (2011) examined the microfinance approaches of the Grameen Bank in Bangladesh. They also adopted a

descriptive methodology in their analysis and also relied on secondary sources of information. The study examined the background to the emergence of the bank, its organizational structure, ownership and outreach, operational mechanism, products and service delivery procedures amongst other factors against how the bank met their client's needs, developed relatively low cost delivery mechanism and generated resources. The study found fifteen (15) critical success factors of the bank that made it unique. These include the following;

- i.) Lending mechanism: The bank offers individual loan along with group lending with individual and group responsibility.
- ii.) Accountability: The sincerity of the field officers as well as the borrowers; particularly the women.
- iii.) Hearing Women's Voice: Provided market suggested products after hearing from the women who are the majority clients.
- iv.) Focused Target: The bank developed programmes that targeted the 'Ultra poor' or the poorest of the poor which refers to those at the very bottom of the social ladder.
- v.) Trustworthiness: The bank established a personal relationship with the borrowers, through a certain degree of faith to the community.
- vi.) Prominence to Women: The contribution of women to increasing family income through participation in entrepreneurship and business activities was recognized and given attention.
- vii.) Screening Procedure: 'Bad' clients were screened out through client's involvement in group selection.
- viii.) Collateral: The bank adopted a collateral free and simple loan approval process.
- ix.) Monitoring for Repayment: There was intensive supervision of borrowers by field staff. This is supported by peer group monitoring which ensures repayment.

- x.) Use of Group Pattern: Through the formation of groups in the form of cooperatives, the villagers and clients key into the progamme without difficulties.
- xi.) Diversified Products: Product diversification has contributed to economies of scale.
- xii.) Partnering: Through partnering with donor agencies and other bodies, the bank was able to secure soft loans to support its financial self-sufficiency of the huge number of clients.
- xiii.) Administrative Efficiency: Through the development of good human relationship, the transfer of administrative and transaction costs to clients were greatly reduced.
- xiv.) Maintaining Friendly Relationship with Government: The bank had gained government reliance by its hard work, appropriate structure, assurance to improving the lives of the poor, particularly women.
- xv.) Decentralization: The bank's decentralization policy combined with widespread information communication system and the organizational structure makes good management and promoted transparency.

Based on their findings, Rahman and Nie (2011), suggested that, "Poverty" and "Poverty Alleviation" are common terminology and frequently heard words; and micro-credit programs have a strong relationship with poverty alleviation. They further conceived that it is not a simple task to improve the livelihood of the poor people. Haan and Michele (1998) on their own part opined that, the geographical location of the poorest and the environment of the border in which they operate also makes it more difficult to help them. They further submitted that while the poorest can be found in urban areas, most of the poor are concentrated in rural areas where basic physical infrastructure is highly inadequate. The study concluded further that, because the GB offers small loans to the poor using the group structure which did not have any physical collateral and deprived of access to credit offered by regular commercial banks, it created social pressure and solidarity which made

repayment successful. The institution of a transparent organizational structure made its cost of operation to be low. Rahman and Nie (2011), further observed that due to the introduction of diverse products and honesty of both officers and borrowers, the GB model has achieved a huge success and had been replicated and applied in many developing and developed countries such as China, India, Pakistan, Sri Lanka, USA, Canada, Germany and some African countries.

Nigeria can also replicate or adapt the GB model, in such a manner as will suit our environment and address our peculiar needs.

Jegade et al (2011), in their study of the 'Impact of Microfinance on Poverty Alleviation in Nigeria' had the following objectives in mind: i) to examine the roles of Microfinance in reducing poverty, ii) to assess the level of Microfinance operations in nation building through poverty alleviation and iii) to make recommendation for effective and efficient realization of the scheme. They used a descriptive survey method for the study. The method was found ideal for the study because it involved collecting data from rural communities' members of microfinance institutions with a view to determining whether or not microfinance contribute to poverty reduction by increasing their income and welfare. The population used comprised all rural communities' member MFI and non-members in Lagos State. Out of the 80 copies of the questionnaire administered, 68 were returned and used for the analysis. Chi-square, regression analysis and Analysis of Variance (ANOVA) were computed using Statistical Package for Social Science (SPSS). The study found that there was an empirical relationship between microfinance loan disbursement and poverty alleviation, employing chi-square test, F-test and T-test. The study further found that: (i) there was a significant difference in income between those who used microfinance institutions and those who do not use them; (ii) There is a significant effect of microfinance institutions in alleviating poverty by increasing income and changing economic status of those who patronized MFIs. Based on these findings, the study concluded that microfinancing is a potent strategy of poverty reduction and a viable tool for conveying credit to

the poor. They however observed that for the MFIs to play that role of a viable tool for sustainable poverty alleviation, more effort is required on the programme's outreach and depth compared with the present status quo.

The conclusions drawn from the review of the various studies above are that; first, the poor and low income people are economically active if they have access to finance or credit. Second, microfinance and microcredit is a tool to reach the poor and low income. Third, there is a positive and significant relationship between microfinance and poverty reduction, employment generation and asset ownership. Fourth, microfinance can be used as a potent financial inclusion strategy and by extension facilitate economic development. Fifth, the inclusion of social mission as is the case of the Grameen Bank has more impact in pulling the poorest of the poor from grinding poverty, increase household incomes and raise their standard of living. Finally, the Grameen model of microfinance which has achieved success the world over is being replicated, applied and adapted to suit different economies in solving poverty, financial inclusion and development dilemmas.

3.0 REVIEW OF GRAMEEN MICROFINANCE MODEL

Socio-Economic Environment/Background of Bangladesh

Bangladesh, a country with 162 million people in south Asia (the 7th most populated in the world) gained her independence in 1971 from Pakistan. Majority of its population live on subsistence farming and reside in the rural areas with high poverty rate. Its currency is Taka. According to a 2007 UNICEF report on Women and Girls in Bangladesh, girls are fed last and less than their brothers. Girls are given into marriage as early as 15 years and according to tradition, their families pay heavy dowries in giving out their daughters for marriage (unlike Nigeria where the men pay dowry on women) which further impoverished them. Girls are therefore very vulnerable to trafficking, sexual abuse, child labour and prostitution, rape, acid attack and other societal denials.

According to Akinyooye (2010), a high percentage of women lack freedom to go alone to hospital, health center or outside their villages, towns or cities. More than half of adolescent girls in Bangladesh become mothers at 19 years with half of them malnourished. The country has the worst maternal mortality rates in South Asia at 320 deaths per 100,000 births. Girl child education is not a priority. Men decide for their wives including what they wear, make purchases for them including foodstuff and spends even their own money. Men entitled to pocket incomes from their wives in the name of 'tea and cigarette allowance'. Female headed households face even more serious poverty challenges. It was these socio-cultural practices in the society which provoked the Professor Mohammed Yunus who was then an economics lecturer to start a socio-cultural revolution through his research. His work helped to bring self confidence to women and indeed reduced the traditional/cultural exploitation of women by men.

Emergence of Grameen Bank

The establishment of what is today known as Grameen Bank (GB) started as a pilot research by its founder, a Professor of Economics, Mohammad Yunus in 1976 in Bangladesh when he saw the dire need for finance by rural bamboo stool makers in the district of Jobra. According to Dowla and Barua (2006), these rural bamboo stool makers could not access credit offered by the money lenders due to high interest rates and other conditions. He observed that their businesses were economically viable and they could repay loans if given to them. He therefore, experimented by lending his US \$27 to 42 poor rural women in the village of Jobra near Chittagong University, Bangladesh where he was the head of Economics Departments. His US \$27 was fully repaid which strengthened his believe that the poor are indeed capable of been trusted financially and has the capacity to repay loans. The successful Grameen project officially became the Grameen Bank in 1983 – a self regulating member owned bank for the poor. Today the GB is owned by the rural poor whom it serves (Rahman and Nie (2011). Mohammad Yunus was worried about the high level of poverty and some socio-cultural factors

contributing to this circle of poverty. He then decided to embark on a social and cultural revolution by combining microfinance with socio-cultural change, and environmental advocacy.

He advocated the reduction of the family size, stoppage of dowry payment and receipt and encouraged income generating ventures by women. He then advocated better health care and environmental sanitation by drinking good water, planting and eating vegetables and digging of pit toilets amongst others. These resolutions are recited compulsorily at all meeting to ensure unity of purpose and acceptance. These resolutions/points were codified into what is called the 16 Decisions of Grameen Bank which are as follows: i.) We shall advance the four principles of the GB, which are; Discipline, Unity, Courage and Hard work - in all walks of our lives. ii.) Prosperity we shall bring to our families. iii.) We shall not live in dilapidated houses. We shall repair our houses and work towards constructing new houses at the earliest. iv.) We shall grow vegetables all the year round. We shall eat plenty of them and sell the surplus. v.) During the planting season, we shall plant seedlings as possible. vi.) We shall plan to keep our families small. We shall minimize our expenditures. We shall look after our health. vii.) We shall educate our children and ensure that they can earn to pay for their education. viii.) We shall always keep our children and environment clean. ix.) We shall build and use pit latrines. x.) We shall drink water from tube wells. If it is not available, we shall boil water or use alum. xi.) We shall not take any dowry at our son's weddings; neither shall we give any dowry at our daughter's weddings. We shall keep our center free from curse of dowry. We shall not practice child marriage. xii.) We shall not inflict any injustice on anyone; neither shall we allow anyone to do so. xiii.) We shall collectively undertake bigger investments for higher incomes. xiv.) We shall always be ready to help each other. If anyone is in difficulty, we shall all help him or her. xv.) If we come to know of any breach of discipline in any center, we shall help to restore discipline. xvi.) We shall take part in all social activities collectively.

Ownership and Organizational Structure

According to Casuga(2002), borrowers of the bank own 95% of its shares while the remaining 5% is owned by the government. The bank is regulated by government ordinance of 1983 and governed by a board of governors. The board consists of 13 members made up of the Managing Director, three persons including the Chairman of the corporation appointed by the Government, and nine members elected from the borrower shareholders. According to Rahman and Nie (2011), since 1986, all the nine members were selected from the borrower-shareholders from a thirteen member board of the bank. Grunewald and Baron (2011) stated that although the bank is technically a for profit business, it is exempted from tax payments. The bank operates 2,562 branches with over 13million customers. According to Latifee(2008), the bank has a decentralized, pyramidal operating structure in its administration, lending units, centers, branches, areas and zonal offices including the head office in Dhaka. This makes loan approval easy and fast as the functions of the management and decision making processes have been delegated to lower levels. The bank focused on women as its core clients.

Operational Mechanism

The establishment of the GB was premised on the concept that the poor have underutilized skills and the potential to be successful if they have access to money and credit. This is based on the experience of the founder who observed that, the rural poor face a significant shortage of capital, and traditional financial institutions, with their impossible loan conditions, inaccessibility and bureaucracy, ignore the poorest of the poor (Yunus, 2007). The bank's operational mechanism is therefore anchored on this philosophy.

Branch set up

Majority of the GB branches are set up in the rural areas where the poor reside. Officers of the bank are picked or recruited from the village or

environment and given some training after which they mobilize individuals into organizing themselves into forming small solidarity group of five. Men and women who share common social and cultural affiliation in accordance with socio-cultural norms of the community form different groups. These groups are inducted and lectured on the principles, philosophy and entrepreneurial initiatives of the bank. The bank delivers credit to the door steps of the clients instead of the clients going to the bank's offices. The bank therefore has a large outreach in terms of number of customers and geographical coverage. Rahman and Nie (2011) posited that bank has extended services to 83,458 villages, with 2,562 branch offices spread across the country, serving 8.32 million borrowers (cumulative number as at end of July, 2010).

Administration

The bank operates a decentralized administrative policy. The decentralization policy combined with widespread information communication system and organizational structure makes for good management and promotes transparency. Latifee (2008), submitted that, the bank has a decentralized, pyramidal operating structure in its administration, lending units, centers, branch, area and zonal offices including the head office in Dhaka. This makes loan approval easy and fast as the functions of the management and decision making processes have been delegated to lower levels. The bank maintained a small office structure. It also established a personal relationship with the borrowers through a certain degree of faith to the community which promoted trustworthiness. Furthermore, through the development of good human relationship, administrative and the transfer of transaction costs to clients were greatly reduced.

Target Group

The target groups of the bank were the poor rural women. This is because it is believed that women as care takers were capable proper money management and had good repayment histories (Rahman and Nie(2011)). The Bangladeshi society restricts women's interaction with men and their mobility. Furthermore, Holmes and Jones (2010) posited that the cultural behavior

restricts women's mobility to go to the market, leaving them dependent on men to put their income-generating skills and knowledge into practice in terms of income generation from their assets. As a result of these cultural inhibitions, the rural women are placed in a helpless position which leads to their being malnourished, less educated and less important than their male counterparts.

Furthermore, Rahman and Nie (2011) posited that there was a growing number of female-headed households due to divorce, (which leave them impoverished) deaths of a male income earners, cases of desertion and male migration. Based on all these factors, the GB targeted rural women as their focal clients. The bank developed programmes that targeted the 'Ultra poor' or the poorest of the poor rural women which refers to those at the very bottom of the social ladder. The bank recorded a 97% active women borrower base as a fall out of its commitment to women economic and social empowerment.

Products of the Bank

The bank had a variety of loan and savings products based on market research. This is done after hearing from the women who are the majority clients. Loan products developed include; micro enterprise, education loan, village phone loan, basic loan, housing loan, insurance products, education loan – to build schools, loan for irrigation pump, transportation vehicle, river craft for transportation and fishing. Loan Product diversification has contributed to economies of scale. Examples of savings products include; compulsory savings, children welfare fund and pension savings.

Loan Administration

The bank's policy had been group lending. However, in line with the GB model, it offers individual loan along with group lending with individual and group responsibility. However, the bank uses group based approach in its loan administration. The method relies on peer pressure within the group to ensure that loan agreements are followed. Through the formation of groups in the form of cooperatives and peer socio-cultural affinity, the villagers and clients key into the programme without difficulties. Formation of like-minded

group is a prerequisite for loan approval as it ensure group solidarity. Through such procedure, 'Bad' clients were screened out through client's involvement in group selection.

Thereafter, group members are educated about the rules and regulations of the bank during which members are told that not all members can get initial loan at the same time. According to GB (2010), two members obtain loan first, begin to repay principal plus interest for over six weeks before two others become eligible for loan. Loans are disbursed in small amounts while most loan durations were under one year. Maximum loan disbursement was in the range of US \$ 388.49. Some of the loans have some weeks or months moratorium before payment. Interest rates are fixed and were not more than 10% for most loan types. Clients do not require any collateral. Through the development of good human relationship, administrative and the transfer of transaction costs to clients were greatly reduced.

Loan Monitoring and Repayment

The loan officers/bank workers who are familiar with the group members and mainly from the environment attend all the meetings, participated in the discussion, disburses and receives money. All transactions are openly carried out and members take effective roles in both individual and group progress and challenges. The accountability regime in the bank anchored by the sincerity of the field officers as well as the borrowers; particularly the women made loan repayment easy. The "sixteen decisions" are recited at all meetings to show commitment (which includes; the eating of vegetables, education for children, planting trees, reduction of family size, non-payment and receipt of dowry etc.).

Through effective screening procedure, 'bad' clients were screened out through client's involvement in group selection. The active involvement of loan officers in the weekly meeting makes monitoring for repayment easy. Furthermore, the intensive supervision of borrowers by field staff which is supported by peer group monitoring further ensures successful repayment.

Grameen bank had a 98 % loan repayment rate which makes the achievement of its social mission easy.

Monitoring the effect of the Loan

The bank apart from monitoring the application of the loan on members for purposes of repayment also has a mechanism to evaluate the effect of the loan on the personal lives of members. The bank has developed ten (10) Indicators to ensure this. This is based on its philosophy of enabling the economically active poor to move out of poverty by measuring improved standard of living of borrowing members. The 10 indicators are; i.) The family now lives in a house worth Taka 25,000 minimum or a house with tin roof and each family member sleeps on bed instead of on the floor. ii.) Family members drink pure water of tube-wells, boiled or purified water with alum, arsenic-free purifying tablets or pitcher filters. iii.) All children in the family over six years are all going to school or finished primary school. iv.) Minimum weekly loan installment of the borrowers is Taka 200 or more. v.) Family uses sanitary latrine. vi.) Family members have adequate clothing for everyday use such as warm clothing for winter – sweaters, shawls blankets, and for mosquitoes. vii.) Family has additional sources of income, such as vegetable gardens, fruit-bearing trees etc that they can fall back on in terms of emergency. viii.) The borrowing maintains an average annual balance of Taka 5,000 in the savings account. ix.) Family experiences no difficulty in having three square meals daily throughout the year. x.) Family can take care of the health of its members through adequate healthcare.

The success of the GB is anchored on its focus and mode of operation coupled with its monitoring and evaluation methodology.

4.0 MICROFINANCE IN NIGERIA

There was no conscious effort of a formalized micro-financing scheme in Nigeria until the introduction of Community Banks in 1992. Okoye(2011) states that though a plethora of microcredit initiatives in Nigeria in the past (Peoples

Bank, FEAP, FSP, SME, NERFUND, etc) appears on the surface to be good attempt but were largely politically motivated and so did not serve the interest of the society at large. A number of the multi-sectoral programmes established were not microcredit or microfinancing in nature, objectives, approach, features and operation. For example, the rural banking schemes of the CBN were predicated on the profit orientation of commercial banking. The small-scale entrepreneurs they were meant to serve were priced out by the lending policies employed by the lending institutions in terms of interest rates charges, collateral requirements, product design, and loan administration amongst others. The focus of some of these schemes such as the National Economic Reconstruction Fund (NERFUND), Nigeria Bank for Commerce and **Industry** (NBCI) and the Nigerian Agricultural Insurance Company (NAIC) were not targeted at micro-credit customers but for micro-commercial bank customers hence the success recorded from their implementation was low. The scheme which had a success rate closest to the desired level was the NAPEP financial support and money transfer.

Typical microcredit or finance customers have the following characteristics;

Business Ownership: They own their business, finance it and work themselves or mostly employ family members. The nature of their businesses is usually small, simple and unsophisticated.

Occupation: They are usually self employed engaged in small income generating activities. They include artisans involved in unsophisticated business such as motor and bicycle mechanics, carpentry, bricklayers, vulcanizers, plumbers, barbing, hair weaving/dressing salons, painters, printers, operators of grinding business, fridge, air conditioners and heating equipment and GSM technicians, welders, etc. They are also engaged in small scale farming, fish, poultry farming, patent medicine and chemists, manufacturers of pure water, toilet roll, bread, provision stores, distribution, food sellers (cooked and raw), laundry business, etc.

Asset: They usually do not own asset required for collateral by banks.

Capital: They have limited access to capital. They are mostly self or family financing. They also require small capital.

Level of Education: Most of them do not have tertiary education, but have primary, secondary and diploma education.

Income Level: Most of them fall within the poverty line.

One would readily observe from the above characteristics of microfinance customers that previous efforts of reaching these segment of the society was not meaningful because, the amount of loans given were far above their needs, collaterals and other conditions, high interest rates charged and other requirements were more than what they can afford. The results has been that, though huge amounts of money and loans were disbursed, but not for these micro-credit customers. The first formal microfinance effort that tend to target the poor and the low income who were economically active but denied access to credit came in December, 2005 when the CBN introduced the Microfinance Policy, Regulation and Supervisory Framework for Nigeria.

THE CBN MICRO-FINANCE FRAMEWORK

The CBN introduced the Microfinance Policy, Regulation and Supervisory Framework for Nigeria in 2005 with the following five specific objectives.

- i. Make financial services accessible to a large segment of the potentially productive Nigerian population which otherwise would have little or no access to financial services;
- ii. Promote synergy and mainstreaming of the informal sub-sector into the national financial system;
- iii. Enhance service delivery by microfinance institutions to micro, small and medium entrepreneurs;
- iv. Contribute to rural transformation and
- v. Promote linkage programmes between universal/development banks, specialized institutions and microfinance banks.

Some of the policy targets of the framework include; cover majority of the poor but economically active population by 2020 thereby creating millions of jobs and reducing poverty; increase the share of credit as a percentage of total credit to the economy from 0.9% in 2005 to 20% in 2020; eliminate gender disparity by improving women's access to financial services by 5% annually; improve linkages among universal, development, specialized finance institutions and microfinance banks by 10% annually and increase state and local government participation in credit financing by 2015.

The CBN revised the policy framework in 2011 with the following objectives:

- i. Provision of timely, diversified, affordable and dependable financial services to the economically active poor;
- ii. Creation of employment opportunities and increase the productivity and household income of the active poor in the country, thereby enhancing their standard of living;
- iii. Promotion of synergy and mainstreaming of the informal Microfinance sub-sector into the formal financial system;
- iv. Enhancement of service delivery to micro, small and medium enterprises (MSMEs);
- v. Mobilization of savings for intermediation and rural transformation;
- vi. Promotion of linkage programmes between microfinance institutions (MFIs), Deposit Money Banks (DMBs), Development Finance Institutions (DFIs) and specialized funding institutions;
- vii. Provision of dependable avenues for the administration of the microcredit programmes of government and high net worth individuals on a non-recourse basis; and
- viii. Promotion of a platform for microfinance service providers to network and exchange views and share experiences.

In broad terms, the policy targets and strategies of the 2005 and 2011 policy frameworks are similar except that the 2011 framework stipulated a 10% annual access to financial services of the economically active poor as a policy

target. An analysis of the implementation of the framework and operation of microfinance banks in Nigeria since 2005 show the following;

- i. Wrong concept of microfinance: It does appear that the concept and practice of microfinance banking has been misunderstood by both regulators and operators. Microfinance institutions are operated as micro-commercial or micro-deposit money bank whose focus and objectives are quite different from those of microfinance.
- ii. Poor outreach: Most of the offices/branches of microfinance banks are in the urban and semi-urban centers. Majority of the economically active but poor and financially excluded live in the rural areas which were not reached. The CBN stated that outreach of formal financial institutions barely increased from 35.0% to 36.3% since 2005. This is attributed to the urban bias of microfinance banks. Instead of the banks finding or going to the prospective customers, the customers find the banks at a cost.
- iii. High interest rates: The microfinance institutions charge high interest rates on loans. Sometimes, their interest rates are even higher than deposit money banks as some charge up to 4% and 10%, per month. Calculated on an annual basis gives you between 48% and 120% per annum.
- iv. Poor funding: Micro financing in Nigeria is a private driven business. They are poorly funded by the government. There had been plans to create a pool of funds to enable customers easily access, but this arrangement lofty as they are had been in the pipeline for quite some time.
- v. High cost of operation: Because of the set up, operation and concept of microfinance, microfinance banks compete with Deposit Money Banks which result in high operational cost. The category of personnel specified by the regulatory authorities to work in such institutions, the acquisition of tastefully furnished offices and vehicles further escalate the cost of operation.

- vi. Wrong regulation: Due to the wrong concept and philosophy of microfinance by the government, the authorities lack understanding of what they are regulating. An analysis of the regulatory and supervisory guidelines for microfinance banks in Nigeria show similar supervision as those of deposit money banks. MFIs are examined annually.
- vii. Limited Products: There is no variety of products for microfinance clients. This could be due to the wrong concept and lack of market research by both the regulators and the operators.
- viii. Lack of focus on target clients: Although the framework mentioned the poor and low income, there is no definite or clear definition of these set of people to whom micro-credits are to be administered. Therefore, one finds it difficult to see a lot of credit going to them. Most credits approved in these banks are beyond the need of the low income. They are micro-commercial in nature mostly requiring collateral security.
- ix. Collateral: Some microfinance operators still insist on the provision of collateral as a requirement for loan disbursement. The element of trust and honesty is lacking.
- x. There is high loan default rate because of wrong lending policy.
- xi. Poor corporate governance practice and dishonesty of operators and borrowers.

Based on the challenges in the operation microfinance banking in Nigeria, it has not been able to make significant achievement. The CBN (2011) after a careful analysis of its microfinance policy framework and implementation since 2005 observed; there exists a huge untapped potential for financial services at the micro level of the Nigerian economy. Attempts by Government in the past to fill this gap did not achieve the desired result. Achievements recorded in the subsector since 2005 have been mixed. While outreach by formal financial institutions increased from 35.0% to 36.3% (1.3%), the institutions have been confronted with numerous challenges including, poor corporate

governance and asset quality, weak internal control and risk management, amongst others. It concluded that as a result, the revised microfinance policy framework provides that MFBs would be adequately capitalized, better managed, run on low cost structure and be operated in a safe and sound manner.

In 2010 the operating license of 103 MFBs were revoked while some others voluntarily closed their banks. Majority of these MFIs were located in the cities and urban centers. The major cause of their poor performance was due to high non-performing loans and poor corporate governance.

Compared to the GB model, the Nigerian model has not recorded appreciable success. Although, the socio-cultural environment of Bangladesh and Nigeria may not be exactly the same, some similarities exist between the two countries. For example, while denial of the girl child in education, early marriage and other gender discriminatory policies exist in some parts of Nigeria, they are not overwhelming as it was in Bangladesh. However, the prevalence of high poverty rate, constraints of access to financial resources and financial exclusion of the poor but economically active people are common in the two countries. Furthermore, because both countries are in the bracket of developing countries it will be useful to draw some lesson from the GB model to redesign the Nigerian model.

5.0 LESSONS FOR NIGERIA

While the critical success factors of the GB model were anchored on the bank's philosophy, branch outreach, target clients, loan administration, collateral free lending, new business development, low overhead, trust and honesty of field officers and borrowers, low interest charges, loan monitoring and repayment among others, which led to a huge success been recorded in the Grameen Microfinance model, the same could not be said of the microfinance model in Nigeria. What are the factors responsible for this, and what useful lessons can Nigeria learn from the Grameen model. A critical

analysis of the two models shows that the following lessons can be drawn and applied in Nigeria from the Grameen model.

- i. Appropriate conceptualization of Microfinance banks: Unlike the GB model that appropriately conceptualized and defined the business of microfinance in theory and practice, the Nigerian model did not. That had led to the application of commercial banking laws and regulation in MFIs. For example, the location of urban branches is not allowed in the enabling law of the GB model.
- ii. Definition of clients: The Nigerian model must define its clients in simple and clear terms as is the case of the GB model. First, microfinance is for the poor, the poorest poor and low income. They have no asset and must be looked for.
- iii. Rural Location: While majority of MFIs are located in the rural areas in Bangladesh, a sharp contrast exist in Nigeria. Majority of MFIs are urban based thereby excluding the poor and low income majority who live in the rural areas from access to banking services.
- iv. Funding: While the GB enjoys a lot of funding from governments and donor agencies, the Nigerian MFIs hardly enjoy such patronage.
- v. Collateral requirement: While the GB model does not insist on collateral, the Nigerian model is not strict. Some of them insist on production of collateral as a condition for lending even when contravening the statute. Since most microfinance clients do not own assets, the insistence automatically excludes them.
- vi. Mode of operation: While the GB model adopt individual and group lending, but emphasis on group lending, the Nigerian model emphasis on individual lending. Secondly, while the GB model goes to the clients, the Nigerian model waits for the clients as a business strategy. Thirdly, while the GB model disburses small amounts with fixed and low interest rates, the Nigerian model disburses amounts for micro-commercial businesses using high and floating interest rates.

- vii. Business strategy: While staff of the Grameen bank are involved in business development, group meeting etc of their clients in the GB model, the Nigerian model adopts a strategy of pure commercial business strategy of non-participation and interference in clients business. Furthermore, while new business was an attraction to the GB model, such was not an attraction to the Nigerian model which instead preferred existing business.
- viii. Target Group: While the GB model had its target group as women whom it identified as economically active, the Nigerian model even though mentioned gender in the framework did not apply gender consideration in credit approvals. It considers ability to pay principal and interest as a primary factor.
- ix. High cost of operation: While the GB has a low cost of operation due its simple office, furniture and personnel, the Nigerian model has a high operational cost due to its high overhead in paying for its personnel, expensive and tastily furnished offices and other running costs. As a result, the high operational cost is transferred to customers in Nigeria.
- x. Limited Products: While the GB model has a variety of both saving and loan products that covers the need of its clients, the same is not the case of Nigeria. Microfinance products are limited in Nigeria.
- xi. Super Profit Orientation: The Nigerian MFIs have a profit orientation as a cardinal objective of their establishment while the GB model was founded on the social concept and objective of solving/reducing poverty.
- xii. Ownership of MFIs: MFIs in Nigeria are owned by very few rich people. This is facilitated by the regulatory requirement which put minimum capital base at N20 million. The same is not the case at the GB model where the bank is owned and managed by the poor-borrowing customers.

xiii. Social Mission: While the GB model incorporates social mission in its philosophy, the Nigerian model does not and is run on purely economic enterprise.

6.0 RECOMMENDATIONS AND CONCLUSION

6.1 Recommendations

Based on the observations made and the useful lessons drawn from the GB model in the preceding section, we make the following recommendations:

- i. **Appropriate conceptualization of Microfinance banks:** There is need to appropriately conceptualize microfinance in Nigeria. Such conceptualization will define the end or target clients, ownership and the target problem it is expected to solve in concrete terms. For example, the urban bias in its location and other operational modalities should be well defined.
- ii. **Funding:** The governments at the various levels should play more visible role in providing funding for onward lending as a soft loan to clients. For example, 0.5 % of pretax profits of companies can be set aside to have pool of capital for lending.
- iii. **Collateral:** MFIs should not insist on collateral security as a requirement for lending. Since most microfinance clients do not own assets, the insistence would automatically exclude them.
- iv. **Mode of operation:** A clear distinction should be made in terms of lending amounts, interest rate charges etc between deposit money banks and MFIs.
- v. **Business strategy:** Field officers of MFIs in Nigeria should be well trained and orientated by the regulatory authorities on the concept and operation of microfinance. They should be made to look for the clients, be involved in their business development and build trust with them.

- vi. Target Group: While the GB model had its target group as women whom it identified as economically active, the Nigerian model even though mentioned gender in the framework did not apply gender consideration in credit approvals. It considers ability to pay principal and interest as a primary factor.
- vii. Availability of Product Variety: Both the regulatory authorities and the MFIs should ensure the availability of variety of products. This can be done through market research in consultation with the clients.
- viii. Simplification of Account opening Requirement: Personal Identification and other Legal requirements should be simplified. For example, tradition/community leaders rulers and religious leaders should be part of identification process where MFB clients do not have identity cards. Similarly, KYC procedures should also be simplified to ensure less sophistication and ease for target customers to maintain account.
- ix. Super Profit Orientation: The Nigerian MFIs should de-emphasize profit orientation as a cardinal objective of their establishment. Social Mission orientation should be incorporated into its philosophy.
- x. Simplification of operations: Both the regulatory authorities and the MFIs should emphasize low cost of operation. Maintenance of simple office, furniture and personnel. This would require redesigning ownership and other operational mechanism to incorporate the concept and objective of poverty reduction and financial inclusion, reduction of over-heads, simplification of business models, lowering of credit management system and collateral requirements.
- xi. Consideration to Locality: MFIs should be located only in their villages or locality so that they can cater to locals on a higher trust levels and simplified requirements for customers and borrowers.
- xii. Enlightenment: A continuous massive public enlightenment programmes should be carried to sensitize the public on microfinance activities and the need for their cooperation and

participation. Churches, Mosques, NGOs and Community Unions can be used as a launching pad.

xiii. Literacy rate: Literacy rate in the country should be stepped up to enable active participation of a wider clientele.

xiv. Re-classification of MFBs: The current classification MFBs into national, State and Unit should be reconsidered with a view to separating micro-credit functions of MFIs from the current "micro-commercial" situation. This could be achieved by scrapping the National MFIs and keeping the services of that middle segment of the market under the purview of Deposit Money Banks. The State and Unit MFBs can be then retained solely to cater for the MF sub-sectors.

xv. Enabling environment: The government at all levels should provide the necessary economic and infrastructural environment for microfinance to thrive.

6.2 Conclusion

The study has attempted to provide some extant information on the purpose, development and operation of microfinance. Relevant studies on microfinance in Nigeria, the Grameen bank model and its operation were reviewed and examined thereby revealing the factors impeding the effectiveness of MFIs in Nigeria. The study further identified the success factors of the GB model and drew some useful lessons for Nigeria. The analysis had shown that microfinance can successfully empower the economically active poor and thus reduce poverty. Furthermore, it came to the fore that microfinance is a veritable financial inclusion strategy, as well as a poverty reduction tool with possible positive contribution to sustainable development in Nigeria.

Based on the above we therefore conclude that microfinance has the potential to reduce poverty, close the gender gap in economic empowerment and facilitate economic development. It is our firm believe that this potential will be adequately harnessed if these lessons drawn from the success of the

Grameen model as elucidated here are incorporated into the on-going reform process in the sub-sector while situating them within the realities of our financial climate.

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