Partnerships that Work: Alleviating Poverty in Nigeria through Microfinance

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Executive Summary

In just five years, the Lift Above Poverty Organization (LAPO), a Nigerian microfinance institution (MFI), grew exponentially from 26,982 clients served by 28 branches to more than 243,056 clients served by 226 branches, including expansion to Sierra Leone. This paper illustrates how strategic partnerships formed among policy makers, donors, commercial banks (local and international), and Nigerian MFIs made this growth possible and how LAPO has distinguished itself as a leader among Nigerian MFIs. Lessons learned from LAPO's experience are paired with concrete recommendations for strengthening Nigeria's microfinance sector.

To better understand LAPO's growth and challenges it has faced, this paper provides a quick snapshot of the Nigerian economy followed by an overview of the Nigerian banking and microfinance sectors. Nigeria is Africa's second largest economy, with an average gross national income per capita (PPP) of roughly US$1,940 and an estimated GDP of US$293.10 billion.[1] Despite this, seventy percent of its population is poor and more than sixty-five percent live below the poverty line. About ninety percent of Nigeria's businesses are considered micro-enterprises. A major constraint to the growth and expansion of their activities is lack of access to commercial capital. The commercial banking sector suffers from low consumer confidence, high collateral requirements, and an inability to extend financial services to an estimated ninety million Nigerians who are currently unbanked. Despite commercial banks having the funds to reach the poor they do not have the outreach or methodology needed to reach the poor at the base of the pyramid. Conversely, MFIs have the methodology and approaches need to reach the poor, but do not have the funds. The Central Bank of Nigeria (CBN) carried out extensive banking reforms in 2005 and implemented a new microfinance policy in 2008.

In an effort to combat the extreme poverty faced by many Nigerians, the United States Agency for International Development (USAID) in Nigeria provided support to develop a strong, viable microfinance sector in Nigeria. USAID's support to the microfinance sector came in the form of two development assistance projects: Promoting Improved Sustainable MSME Financial Services (PRISMS) and Maximizing Agricultural Revenues and Key Enterprises in Targeted Sites (MARKETS). Both projects focused on cultivating partnerships between donors and the government for regulatory reform, and between commercial banks, international microfinance funding organizations and other donors to extend commercial capital to the microfinance sector. Two types of partnerships emerged: those that support regulatory reform and those that increase the flow of commercial capital to Nigerian MFIs. Through the cultivation of strategic partnerships LAPO, USAID/Nigeria and the Grameen Foundation USA (GFUSA) demonstrated the commercial viability of microfinance to the Nigerian financial sector.

There are at least three ongoing challenges faced by the Nigerian microfinance sector. First, microfinance institutions must reach a greater number of the poor. Less than one million people

[1] Source: World Bank, World Development Indicators database, September 2009.

out of forty million people needing microfinance services have been reached. The banking sector's inability to deliver financial services on the required scale continues to constrain the growth and development of Nigeria's microfinance industry. Second, expertise in the microfinance management is lacking. Managers within MFBs lack the requisite skills needed to properly manage them. Third, microfinance banks are numerous. Many are undercapitalized and in danger of becoming insolvent. Too many bank licenses were given out to pseudo microfinance banks started by commercial bankers but masquerading as microfinance banks.

Despite the challenges facing Nigeria's microfinance sector, LAPO's growth from a small, informal provider of micro-credit to the leading Nigerian microfinance bank highlights the fact that broader access to finance can be provided through microfinance. Lessons learned from LAPO's experience and recommendations for moving forward are included for donors, policy makers and microfinance providers. LAPO's experience shows that donors must work together to achieve a common goal. The coordinated efforts of USAID PRISMS and GFUSA in facilitating commercial finance for LAPO demonstrates what can be achieved when organizations work together. Without the effective collaborations of these two donors, the Central Bank and LAPO, it is doubtful that LAPO would be where it is today. Likewise the demonstration effects resulting from LAPO's successes across the Nigerian microfinance industry would not have happened. While donors are encouraged to withdraw their support in the form of cash grants to MFIs, these resources should be redirected to strengthen MFIs' capacity to manage large commercial funds with the appropriate control mechanisms in place. Donors should direct resources to build the capacity of microfinance bank staff and commercial bank staff through targeted training on core competencies such as risk management, internal control mechanisms, and portfolio management. An industry-led certification program for microfinance professionals is recommended.

On the policy front, the drafting and eventual implementation of the microfinance policy was critical. Without this policy, organizations such as LAPO would not have been able to convert to microfinance banks, reach more clients, and provide broader financial services to their clients. Recommendations include updating the microfinance policy with broad stakeholder input and encouraging the Central Bank of Nigeria to consider putting in place incentives to encourage commercial banks to lend to the sector, especially through wholesale loans to MFBs for on-lending to MSMEs. Government supported guarantee schemes are not recommended.

For MFIs to transform from grant-based organizations to commercially viable organizations they must have clear vision and focus, openness and transparency, and strong internal controls and procedures. Recommendations include strengthening and maintaining openness and transparency in all of their operations and building the capacity of MFI staff through the provision of technical trainings on regulatory compliance, international standards for MFIs, internal controls and procedures, portfolio management, product development, outreach, and best practices for sourcing wholesale loans for on-lending to MSMEs.

While the challenges currently facing the microfinance industry in Nigeria are serious, this paper shows the pioneering successes of a thriving Nigerian microfinance bank which has motivated other MFIs to follow in its footsteps. Without the formation of the strategic partnerships between donors, the government, and private sector, Nigerian microfinance would not be where it is today.

Between 2005 - 2009, LAPO's growth soared from nearly 27,000 clients served by 28 branches to more than 243,000 clients. Strategic partnerships formed among policy makers, donors, commercial banks (local and international), and Nigerian MFIs to support regulatory reform and broker on-lending to the Nigerian microfinance sector made LAPO's growth possible and enabled LAPO to distinguish itself as a leader among Nigerian MFIs.

Snapshot of the Nigerian economy. Nigeria is Africa's second largest economy, with an average gross national income per capita (PPP) of roughly US$1,940 and an estimated GDP of US$293.10 billion.[2] By the late 1960s, oil had replaced cocoa, peanuts, and palm products as the country's largest foreign exchange earner providing twenty percent of GDP, ninety-five percent of foreign exchange earnings, and about sixty-five percent of budgetary revenues.[3] Despite the wealth created by the discovery of oil, seventy percent of Nigeria's population is poor. More than sixty-five percent live below the poverty line and approximately three-fifths of those living below the poverty line live in rural areas. The majority of these people in the rural areas are engaged in subsistence agriculture while those in the urban and peri-urban areas are engaged in informal sector activities. The real standard of living for Nigerians has been declining due in large part to political instability, mismanagement, and corruption. With all the wealth that it 'should' have, Nigeria is still considered a third-world country[4]

Overview of Banking and Microfinance sectors. Nigeria has a long history of community finance and microfinance to provide financial services to the unbanked population. However, performance has been poor. A recent Finscope Survey conducted in Nigeria concluded that 74% of adults have never been banked, only 15% of women have bank accounts and 86% of rural adults are currently unbanked. The percentage of population with access to formal financial services in Nigeria is among the lowest of African Countries[5].

Before the 2005 banking reforms, the industry was composed of numerous small banks with low capitalization (less than US$10 million). Lending to microfinance institutions was rare. The top ten banks controlled over 50 percent of the total assets and deposits. Despite this, only two out of 89 banks had a capital base of US$167 million before July 2004. [6] As a result of the reforms, commercial banks were required to raise their capital base to more than $13 million. The total number of commercial banks declined to 25 and banking supervision was increased. The resulting banking system enabled banks to offer a wide range of services covering core banking areas such as lending, trade finance, private banking and financial advisory services. Yet millions of Nigerians still lack access to bank accounts and credit and the microfinance sector continues to struggle for funds.

The use of microfinance (MF) as powerful poverty alleviation tool is a well-known strategy in Nigeria. A recent news article in Nigeria's "The Nation" argues "[t]he war on poverty cannot be

[2] Source: World Bank, World Development Indicators database, September 2009.
[3] www.countryfacts.com/nigeria/economy
[4] United Nations Development Programme's Human Development Report "Human Development Indices - A statistical update 2008"
[5] Enhancing Financial Innovation and Access (EFiNa); 2008

[6] Central Bank of Nigeria (CBN)

won when credit remains inaccessible to over 60 percent of the population."[7] About ninety percent of Nigeria's businesses are considered micro-enterprises. These farm and non-farm activities serve as the primary income source for the majority of the labour force. A major constraint to the growth and expansion of Nigeria's micro-enterprises is lack of access to commercial capital. Commercial banks were challenged as to how they could provide access to finance to micro, small and medium enterprises on a wide scale. Meanwhile, non-bank financial institutions such as community credit groups and microfinance institutions were struggling with how to continue providing services to clients as well as scale up their activities to reach more people while direct donor funding for microfinance was drying up. Despite commercial banks having the resources to provide funds to reach the poor they did not have the outreach or methodology needed to reach the poor at the base of the pyramid. Conversely, MFIs did not have the funds to reach the poor but had the methodology and approaches need to reach them. It was at this point that the microfinance policy was being drafted by the CBN and donors to regulate the activities of the sector in 2005.

The Central Bank of Nigeria estimates that more than 40 million unbanked Nigerians could benefit from access to microfinance.[8] As part of its commitment to alleviating poverty, USAID/Nigeria pledged to support the development of a strong, viable Nigerian microfinance sector. USAID's support to the microfinance sector came in the form of two development assistance projects: Promoting Improved Sustainable MSME Financial Services (PRISMS) and Maximizing Agricultural Revenues and Key Enterprises in Targeted Sites (MARKETS). The PRISMS project was a two-year project (2004- 2006) which focused on increasing the capacity of the financial sector to provide appropriate services to MSMEs, while MARKETS is a five year project (2005 -2010) focused on strengthening agricultural competitiveness and food security. PRISMS and MARKETS' finance component focused on cultivating strategic partnerships between donors and the government for regulatory reform, and between commercial banks, international microfinance funding organizations and other donors to extend commercial capital to the microfinance sector.

Partnerships to support regulatory reform. Under the PRISMS project, USAID/Nigeria provided support to the Government of Nigeria's efforts to clearly define the regulatory environment for MFIs, including the CBN's requirements for MFIs' transformation to microfinance banks (MFBs). The PRISMS project coordinated the donor community's review of the draft microfinance policy and subsequent recommendations. As the donor representative on the newly established Microfinance Advisory Board, USAID/Nigeria through PRISMS and MARKETS, met regularly with the donor community, including the UNDP, DFID, WB, and GTZ, to discuss issues of concern and formulate policy recommendations on behalf of the donor community to be shared with the broader Microfinance Advisory Board. Passage of the microfinance policy by the CBN[9] cleared the way for MFIs to transform into MFBs that were

[7] Ayodele, Thompson and Olusegun Sotola, "Rethinking microfinance bank strategies", June 30, 2010, The Nation. Retrieved June 30,2010 at: http://thenationonline.net/web3/columnist/4035.

[8] Central Bank of Nigeria, 2004.

[9] In 2005, the Central Bank of Nigeria (CBN) exercised its powers under Section 28 Subsection (1) (b) of the CBN Act No 24 of 1991 (as amended) and in pursuance of the provisions of section 56 -60A of the Banks and Other Financial Institutions Act (BOFIA) N0. 25 of 1991 (as amended), designed the Microfinance Policy Regulatory and Supervisory Framework. The policy which was launched on December 15, 2005 became operational on January 1, 2008 on the issuance of licences to qualified microfinance banks by the apex bank.

able to increase the number of Nigerians with access to financial services and provide expanded financial services to their clients. After the passage of the policy, the Microfinance Advisory Board continued to play an important role in supporting the CBN's efforts to implement the policy and encourage MFIs, community banks and commercial banks to apply for Micro Finance Banking (MFB) licenses. PRISMS also supported the CBN's efforts to introduce internationally accepted risk-based supervision in place of the outdated compliance-based system. PRISMS also helped build the capacity of CBN staff in risk-based supervision.

Partnerships to increase the flow of commercial capital to Nigerian MFIs. The second type of strategic partnership that USAID/Nigeria developed increased the flow of commercial capital to Nigerian MFIs. These partnerships took a variety of forms including collaboration between USAID/Nigeria, international microfinance funding organizations and Nigerian microfinance institutions such as LAPO, and collaboration between international commercial banks and Nigerian MFIs with support from guarantee funds. Examples of both of these types of strategic partnerships are discussed in detail under the section on LAPO.

USAID/Nigeria's PRISMS project provided support for these partnerships in multiple ways. On the MFI side, PRISMS provided training to build the capacity of MFI staff to prepare commercially-oriented business plans, improve transparency of their operations, and strengthen their internal management controls. PRISMS worked with MFI's to help them source hard currency loans from specialized microfinance funds and donors, which served as collateral to obtain loans from Nigerian commercial banks. PRISMS also collaborated with GFUSA to secure a partial loan guarantee to encourage more banks to lend to microfinance banks. Specific examples of the loan guarantee and hard currency loans are discussed in greater detail under the LAPO section of this paper. On the commercial bank-side, PRISMS developed a NBFI risk assessment tool for commercial banks to assess MFIs and non-bank financial institutions for wholesale loans. PRISMS also worked to build the capacity of bank managers to better understand the commercial viability of microfinance and how to manage their risk when providing a wholesale loan to a microfinance institution or bank for on-lending to MSMEs. PRISMS worked to broker internationally backed hard currency loans and a guarantee by specialized international microfinance funds and donors on behalf of Nigerian MFIs such as LAPO. The partial loan guarantee reduced commercial banks' risks. Brokering these hard currency loans proved to be an essential bridge to secure wholesale commercial loans from Nigerian banks which otherwise would not have been made available.

In 2006, USAID re-scoped the PRISMS project into the MARKETS project which focused on strengthening agricultural competitiveness and food security in Nigeria. At the time of the merger, the MARKETS project was already working to increase access to credit for smallholder farmers and agribusinesses. MARKETS incorporated PRISMS' objectives of leveraging credit for MSMEs, facilitating wholesale loans from commercial banks to microfinance institutions for on-lending to the MSME sector, and leading donor coordination efforts for improving the enabling environment for the MSME sector as well as working with the Central Bank. As part of the transition process, MARKETS signed memoranda of understanding to continue working with two of the original four MFIs supported under PRISMS. One of the two supported MFIs, LAPO, is highlighted below. Under PRISMS and MARKETS, LAPO benefited from a wide array of technical assistance which has helped to facilitate its ascension as the premier MFI in Nigeria and an internationally recognized microfinance bank.

LIFT ABOVE POVERTY ORGANIZATION

LAPO is the leading microfinance institution in Nigeria today. It is based in Benin City of Edo State. Founded in 1987 by social entrepreneur Godwin Ehigiamusoe, LAPO began in a small village in Delta state with 300 naira, approximately US$2, given to three women as a loan of 100 naira each (US$0.67). LAPO's history, growth and success provide a useful lens through which to view how the various strategic partnerships discussed earlier in this paper laid the foundation for LAPO and other microfinance institutions to succeed. This section details LAPO's progress from a small, informal provider of micro-credit to an internationally recognized provider of financial services to MSMEs. It also discusses the strategic partnerships formed by LAPO which supported its transition to become the leading microfinance provider in Nigeria.

At its founding, LAPO sought to reduce poverty for low income Nigerians, especially women, through the provision of financial services to MSMEs with affordable terms. LAPO's vision was to be a first choice MFI, delivering responsive financial services while meeting the expectations of its stakeholders on a sustainable basis. During its formative years, LAPO's contact with the GFUSA in the 1990s had tremendous influence on the features and pace of development of the organization. At the outset, LAPO depended significantly on grants from the donor community. This dependence on donors dictated the limit to which LAPO could grow as well as the number of clients it could reach to improve livelihoods. As grants from donors began to dry up, LAPO stayed laser-focused on its vision of being the top microfinance organization able to address the economic powerlessness of large numbers of Nigerians. LAPO understood that if it was to continue providing financial services and increasing its client base, it had to seek sustainable funding through commercial credit. Seeking commercial credit, however, was a herculean task as the organization did not have the required collateral to seek loans from commercial banks.

In November 2004, USAID's PRISMS project met with the CBN and UNDP regarding LAPO. UNDP, who had been supporting LAPO in the process of expanding its operations through the Microstart program, acknowledged the fact that loan funds for the organization were inadequate. LAPO requested PRISMS' assistance to source commercial credit. At this time, LAPO had previously accessed two small loans of US$12,333 from Peoples' Bank and US$40,000 from United Bank for Africa UBA (through the Growing Businesses Foundation) which they utilized and fully repaid with interest. Between 1987 and 2004, LAPO's outreach grew slowly but steadily each year. During this 17 year period LAPO's client base grew from three clients served by a single branch to 26,982 clients served by 28 branches in December 2004. With PRISMS and MARKETS support, LAPO sourced more than US$20 million in wholesale loans between 2005 and 2009. In just five years, LAPO's client base expanded to 243,056 clients served by 226 branches. LAPO's support from donors such as GFUSA, UNDP and the Growing Business Foundation, coupled with the hard work and vision of LAPO's Executive Director and management staff laid the foundation for LAPO's transition from a relatively small, grants-based institution to a commercially viable, market-led MFI, able to dramatically increase its outreach and impact on its customers.

PRISMS met with LAPO management in December 2004 to develop a plan to move forward. LAPO needed an acceptable, commercial business plan, as the original one developed by them was designed for an organization seeking grants from donors. PRISMS assisted LAPO to review and improve the business plan so that LAPO could satisfy the requirements laid out by Nigerian commercial banks. From the outset, it was very clear that LAPO's objective to source commercial capital would be a difficult task. LAPO's Executive Director, Godwin Ehigiamusoe, described the process as difficult. He argued, "It will be easier to get water out of a rock than to get Nigerian commercial banks to provide loans to MFIs". With support from PRISMS, LAPO marketed its business plan to eleven commercial banks in Nigeria in January 2005. Only one bank expressed interest in reviewing the proposal. It would take over two years for this bank to eventually approve the loan. Commercial banks' lack of interest in the microfinance sector is largely due to the banking sector's orientation toward financing the highly profitable oil and gas sectors which dominate the Nigerian economy. Understanding the microfinance sector is an additional hurdle for commercial banks, most of which believe that MFIs cannot operate profitably. Banks also perceive MFIs to be lacking in good governance and have weak internal control procedures. Finally, there are no incentives for the commercial banks to shift focus from the oil and gas sector to serve the poor through microfinance. While established guarantee mechanisms have been promoted in other countries to stimulate lending to MFIs on a large scale, guarantees in Nigeria for other sectors, like agriculture, have been underutilized.

The Key to LAPO's Success: Strategic Partnerships

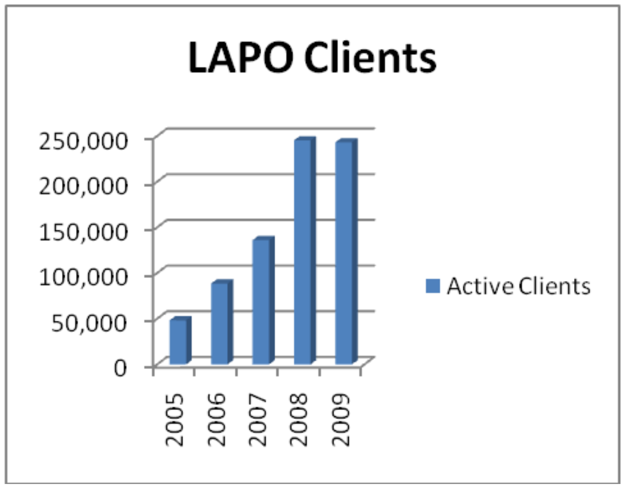
Grameen Foundation USA: Provided the 50% loan guarantee which encouraged other lenders to extend loans to LAPO.
Oxfam Novib: Dutch affiliate of the international Oxfam organization, provided the 1st parallel hard currency loan to LAPO. This €400,000 loan was used to collateralize the Zenith Bank loan.
Incofin: An international microfinance funding organization, provided the 2nd parallel hard currency loan of €250,000 to LAPO.
CORDAID: A Dutch international development organization, provided the 3rd parallel hard currency loan of €500,000 to LAPO.
Zenith Bank: First Nigerian commercial bank to provide loans to LAPO.
Citibank Nigeria: Loaned LAPO US$1 million under the GFUSA partial loan guarantee.
Standard Charter: Loan LAPO US$4 million in 2008 and again in 2009.
USAID/Nigeria: Provided technical assistance to secure commercial financing, upgrade operations, and enhance control mechanisms through PRISMS and MARKETS projects.

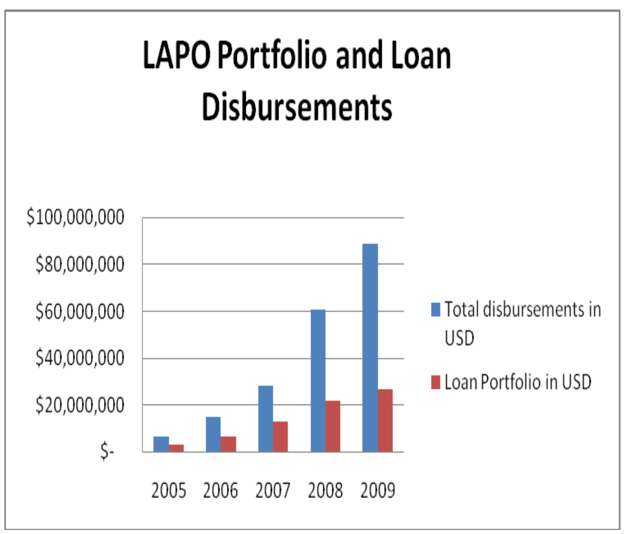
Despite these challenges, LAPO remained dedicated and focused on sourcing commercial credit. With PRISMS's encouragement LAPO focused on maintaining openness and transparency with its potential commercial funders. It welcomed due diligence assessments as well as international rating agencies[10] to examine its business operations and portfolio. LAPO also focused on strengthening its internal controls and procedures in anticipation of its expansion with commercial credit.

LAPO's strategic partnerships. LAPO had a strong ally in GFUSA. Having satisfied GFUSA's review of LAPO's operations and management structures, GFUSA provided a much needed fifty percent loan guarantee and link to donors such as Oxfam Novib[11] and specialized international

[10] Microrate assessment in 2007; Planet Rating assessment in 2009.
[11] Founded in 1956, Novib (Nederlandse Organisatie Voor Internationale Bijstand) is the Dutch organization for international aid. In 1994 Novib became an affiliate of Oxfam. It formally changed its name to Oxfam Novib in March of 2006.

microfinance funding organizations such as Incofin and Cordaid. PRISMS and MARKETS, on LAPO's behalf, brokered the first set of hard currency loans from these three organizations. The loans were used as collateral to secure loans from Nigerian commercial banks (see text box). By the end of 2005, LAPO obtained a €400,000 loan (~US$487,892) from Oxfam Novib which was used to collateralize the commercial loan from Zenith Bank. When Zenith Bank saw that LAPO was making a profit and paying on time, other commercial banks began lending to MFIs using internationally backed loans. In 2006, LAPO won the Global Excellence Award for Microfinance by GFUSA. These initial loans enabled LAPO to prove it was creditworthy and thus opened the door to obtain subsequent commercial loans, both foreign and local. By 2007, Citibank Nigeria lent LAPO US$1 million under a partial guarantee scheme with GFUSA. Following closely on its heels, LAPO received a 600 million naira loan (US$4 million) from Standard Chartered Bank in 2008 and another 600 million naira loan (US $4 million) in 2009. With increased credit available and strong management structures in place, LAPO was able to quickly scale up its lending to large numbers of MSMEs throughout Nigeria.





LAPO's growth. By the end of 2004 LAPO had a client base of 26,982 clients served by 28 branches. By 2009, with MARKETS' support, LAPO had leveraged its strategic partnerships and had succeeded in sourcing over US$20 million as wholesale loans from commercial banks and other international microfinance funding institutions. With commercial credit secured, LAPO's clients and number of branches increased sevenfold from 2005 to 243,056 clients served by 226 branches in 2009. LAPO even established an international subsidiary—LAPO Microfinance Company in Sierra Leone by April of 2008.[12] Within one year of beginning operations, the Sierra Leone branch had established eleven branches, reached 18,596 clients and had a loan portfolio of US$1.4 million. See Annex A for additional information.

To manage and support LAPO's growth from 2005 to 2009, LAPO concentrated on building the capacity of its staff to manage its expanding portfolio and to maintain strict management controls. LAPO increased its credit officers tenfold from 114 to 1,262. During the same period LAPO's loan portfolio jumped 16-fold from US$1.3 million to US$26.7 million. In 2009 alone, over US$86.6

[12] See Annex A for a list of LAPO's six subsidiaries, including the LAPO African Regional Initiative, which houses the LAPO Microfinance Company in Sierra Leone.

million was disbursed as loan to clients, while over $US4 million was realized as net surplus during the same period. LAPO continually focused on expanding its services and products to better meet its clients' needs.[13] One of LAPO's new products, Credit for Shares[14], won the prestigious Pro-Poor Innovation Challenge given by the Consultative Group to Assist the Poor (CGAP). The pioneering successes recorded by LAPO have motivated other MFIs in Nigeria to seek commercial loans for their lending operations and diversify their product offerings to clients. The Development Exchange Centre (DEC) in Bauchi and the Self Reliance Economic Advancement Programme (SEAP) in Ilorin are excellent examples of MFIs that have followed in LAPO's footprints. Although LAPO's initial approach to backing loans with international loans was not a long-term solution, it gave the Nigerian microfinance industry the jump-start it needed to prove to Nigerian commercial banks that microfinance was both a profitable and a dependable investment. Working together, LAPO, PRISMS, and GFUSA demonstrated the commercial viability of microfinance to the Nigerian financial sector.

Challenges for Nigerian Microfinance

The Nigerian microfinance industry has come a long way. With support from PRISMS, the first microfinance policy was drafted and launched by the CBN in December of 2005. The policy became operational in January 2008. Prior to the release of this policy, there was no governmental policy regulating microfinance institutions. The policy set standards for the provision of MFB licenses and increased bank supervision to include oversight over MFBs. Today there are more than 900 microfinance banks operating within Nigeria. Commercial banks have begun wholesale lending to some of these MFBs for on-lending to MSMEs. Commercial banks are also learning more about the viability of the MF industry and how to mitigate risk when lending to the industry through risk-based assessments. Despite these advancements, several challenges remain.

MFIs must reach a greater number of the poor. The CBN reports that the existing microfinance sector in Nigeria is serving less than one million people out of forty million potential people needing microfinance services.[15] Aggregate micro-credit facilities in Nigeria account for about 0.2 percent of GDP and less than one percent of total credit to the economy. A large proportion of microfinance lending is channeled to the commercial sector to the disadvantage of the agriculture and manufacturing sectors. MF services are concentrated in the South while the majority of the poor reside in the North and lack access to services. The lack of adequate capacity to deliver financial services on the required scale has continued to constrain the growth and development of Nigeria's microfinance industry.

Expertise in the microfinance sector is lacking. A widespread criticism of microfinance banks is the lack of experienced staff to properly manage the microfinance banks. Many managers and directors transferred over from commercial banks to newly-formed MFBs without the knowledge needed to properly run and manage a MFB. Without proper management structures and internal controls in place, it is difficult for MFBs to remain solvent and meet the needs of their clients.

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[13] LAPO's products and services are presented in Annex B at the end of this document.
[14] Discussed in Annex B.
[15] Central Bank of Nigeria (CBN, 2005)

Microfinance banks are numerous and weak. While the formation and implementation of the microfinance policy was a positive step forward for the Nigerian microfinance industry, many critics have argued that too many microfinance bank licenses were given and that "not enough audit was undertaken except ensuring they met the minimum capital requirement".[16] As mentioned above, many of the managers and directors for the new MFBs transferred directly to the microfinance industry without the requisite management expertise needed. In addition, the capital requirement set for MFBs under the microfinance policy, 20 million Naira ($US 133,333), is too low. This has resulted in a high numbers of under-capitalized MFBs that are in danger of becoming insolvent.

Lessons Learned and Recommendations

Despite the serious challenges facing the Nigeria's microfinance sector, LAPO's growth from a small, informal provider of micro-credit to the leading Nigerian microfinance bank within this challenging environment highlights the fact that progress can and should be made to provide broader access to finance can be provided in Nigeria through the provision of microfinance products and services.

Below is a summary of lessons learned through LAPO's experience and the partnerships described in this paper. Also summarized below are recommendations for taking Nigerian microfinance to the next level whereby a smaller number of more efficient microfinance banks are able to reach a larger portion of Nigeria's population. The lessons learned and recommendations are grouped under the following sub-headings: donors, policy makers, microfinance providers.

Donors. Donors must work together to achieve a common goal. The coordinated efforts of PRISMS and GFUSA in facilitating commercial finance for LAPO demonstrates what can be achieved when organizations work together to achieve common goals. PRISMS supported LAPO's efforts to develop a commercial business plan and market the document to several Nigerian commercial banks. This raised commercial banks' awareness of MFIs' needs for wholesale loans. GFUSA played a key role in identifying international microfinance funding institutions and provided the critical loan guarantee which led to LAPO's first sizable wholesale loans. If donors could work together as in this case, more successes would be recorded and the ultimate beneficiaries will be the millions of micro entrepreneurs who gain access to much needed finance. Without the effective collaboration of these two donors, as well as the CBN and LAPO, it is doubtful that LAPO would be where it is today. Likewise the demonstration effects resulting from LAPO's successes across the Nigerian microfinance industry would not have happened.

<u>Recommendation</u>. Donors should work together to address the training needs of microfinance bank staff and commercial bank staff with regard to microfinance. Most officials of commercial banks have limited knowledge about microfinance and harbour false perceptions of the risks involved in lending to the sector. Donor support is needed to increase awareness among commercial banks on the enormous opportunities that abound in the microfinance sector.

[16] Graham Orodje, "The State of Microfinance in Nigeria", posted on Microfinance Africa, March 26, 2010, retrieved on May 28, 2010 at: http://microfinanceafrica.net/news/central-bank-of-nigeria

Similarly, donors should work together to build capacity within commercial banks to properly assess the risks associated with microfinance lending. This support would go a long way in stimulating the interest of commercial banks in providing much needed wholesale finance to MFIs for on-lending to MSMEs.

Recommendation. Also, while it is a welcome development for donors to withdraw their support in form of cash grants to MFIs, such support should be redirected to strengthening MFIs' capacity to manage huge commercial funds with the appropriate control mechanisms in place. Donors should collaborate to provide capacity building support to strengthen MFI boards, management, internal controls, policies and procedures, and management information systems.

Other stakeholders are equally expected to play their own part in addressing the challenges of capacity gaps. In particular, the government at various levels should invest in appropriate infrastructure that could enable the microfinance institutions to conduct their businesses in a profitable manner, as well as provide training support where necessary.

Policy makers. Coordinated support by the donor community to policy makers within the CBN played a critical role in the drafting and eventual implementation of the microfinance policy. Without this policy, organizations such as LAPO would not have been able to convert to microfinance banks, reach more clients, and provide broader financial services to their clients. The creation of the Microfinance Advisory Board was also an important step in ensuring that policy formulation takes into consideration the advice and experience of all stakeholders (government, MFBs, commercial banks, and the donor community). It also ensures that pertinent information is shared with all stakeholders. Having this structure in place will help to ensure that future legislation takes into consideration input from multiple stakeholders.

Recommendation. The current microfinance policy needs to be updated. The Microfinance Advisory Board should seek broad stakeholder input regarding needed changes for the policy. Some items to be considered should include raising the minimum capital base required for MFBs and reviewing and revising the regulatory requirements for current and future MFBs to ensure that all MFBs have the adequate capacity (both human capacity and capital capacity) required to serve MSMEs. Input should be gathered regarding requirements for asset and portfolio quality, internal controls, board management, and credit ratings.

Recommendation. LAPO's and PRISMS' efforts to mobilize commercial credit directly from the commercial banking sector for on-lending to MSMEs was very difficult due to the lack of understanding by the commercial banking sector of the microfinance sector. The CBN should consider putting in place incentives to encourage commercial banks to lend to the sector, especially through wholesale loans to MFBs for on-lending to MSMEs. Given the numerous guarantee schemes which already exist for agricultural financing and are underutilized by commercial banks, the CBN should seek input directly from commercial banks and donors as to the types of incentives, such as tax rebates, that would encourage commercial banks to invest in the microfinance sector.

Microfinance Institutions. LAPO's ability to transform from a small grant-based organization to the leading microfinance institution was greatly supported by LAPO's clear vision and focus on being the top microfinance organization. LAPO understood that if it was to continue providing financial services and increasing its client base, it had to seek sustainable funding through commercial credit. In addition, LAPO's commitment to maintaining openness and transparency and strengthening its internal controls helped it to attract internationally backed guarantee funds as well as hard currency loans which ultimately led to wholesale loans from international and local commercial banks.

<u>Recommendation.</u> MFIs must have a clear vision of where they want to be and must focus on how to get there. MFIs must understand that there is limited growth with grants from donors. If MFIs are interested in expansion, commercial funding is the path to follow. Like LAPO, MFIs must stay focused and look for partners who share their vision.

<u>Recommendation</u>. MFIs that want to attract commercial finance must maintain openness and transparency and should regularly review their performance against clearly defined performance standards and criteria. Local and international banks, as well as donor agencies will conduct due diligence assessments before entering into new partnerships. Some will even request a rating by reputable international rating agencies. LAPO successfully went through all these and gained the trust of its new partners.

<u>Recommendation.</u> MFIs which are interested in sourcing commercial funding must be prepared to effectively manage their expansion. MFIs must strengthen their board, management, internal controls, policies and procedures, and IT platforms. Had LAPO failed to complete any of these steps, it would not have been able to manage the exponential growth it has recorded over the last five years.

<u>Recommendation.</u> An industry association of microfinance banks should provide technical trainings for its member MFIs' staff on regulatory compliance, international standards for MFIs, internal controls and procedures, portfolio management, product development, outreach, and best practices for sourcing wholesale loans for on-lending to MSMEs. This association should also develop a professional certification program for staff of microfinance institutions. This will help to build the capacity of MFI staff.

While the challenges currently facing the microfinance industry in Nigeria are serious, LAPO's story provides an example of a thriving microfinance institution which, through strategic partnerships fostered with donor assistance, has been able to expand its client base and deliver much needed microfinance services to MSMEs in Nigeria. The lessons learned and recommendations contained here are not exhaustive but do offer a few concrete examples of changes stakeholders within the Nigerian microfinance industry can make to improve the sector as a whole.

Annex A. LAPO's subsidiaries

LAPO's Subsidiaries

LAPO acknowledges the fact that poverty manifests not only through economic or financial indicators but interacts with both social and economic forces to obstruct healthy living of poor people. Therefore, the organization embarks on poverty reduction through six different subsidiaries.

LAPO Development Foundation (LDF) which focuses on gender inequality, injustice, women's low self-esteem, poor nutrition and some socio-cultural practices that affect women's social status.

Academy for Microfinance Enterprise Development (AMEND) provides enterprise development training for clients, formulation of microfinance business plans, monitoring and evaluation of microfinance programmes as well as providing training to microfinance bank staff.

LAPO Agricultural and Rural Development Initiative (LARDI) was established to specifically improve the quality of life of rural dwellers through the provision of extension services. In the long run, the subsidiary is expected to enhance the current farming system through aggressive extension services.

Micro Investment Support Services (MISS) as an addition to LAPO financial services was set up to provide small and medium scale enterprises with scale-up funds as well as insurance services to mitigate business risks for clients.

Lift Microfinance Bank emerged to empower LAPO active clients whose business growth and experience require over N200,000 and whose savings ability requires a regulated institution.

LAPO African Regional Initiative – LAPO started exploratory activities to begin operations in Sierra Leone in 2008 which resulted to the incorporation and eventual take off of its international subsidiary—LAPO Microfinance Company in Sierra Leone—under the Companies Act (Chapter 249) of the Republic of Sierra Leone. It was established in December 2008. The international subsidiary of LAPO has equally grown in terms of branches, number of clients and loan portfolio. It has eleven branches, 18,596 clients and a loan portfolio of $1.1 million all within one year of its operations.

Annex B. LAPO's Products and Services

LAPO Savings Products

Festival Business Savings enables clients to build capital that is used to support their business and personal experience during festive periods.
Golden savings enables clients to deposit substantial money for a minimum of 6 months.
Rural savings enables clients to make weekly deposits into their savings account at group meetings.

LAPO Credit Products

Asset loans given to active borrowers to acquire income-generating assets at market rate.
Business loans with an 8 month duration.
Credit for shares* allows LAPO clients to acquire shares in profitable companies.
Enterprise loans meet the needs of low income earners, who for personal reasons are unable to attend group meetings.
Farming loans target LAPO clients in rural areas whose primary occupation is farming.
Festival loans enable clients to boost their businesses during festive periods.
*LAPO won the Pro-Poor Innovation Challenge award of the Consultative Group to Assist the Poor (CGAP)