

## Legal Alert ? January 2007 ? **Micro Finance In Nigeria**

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Business Quote.

"If we were meant to talk more than listen, we would have Two Mouths and One Ear" ? By Mark Twain

Legal Alert - January 2007 - Microfinance in Nigeria

Introduction.

Modern economies rely on small and medium scale industries to serve as the foundation for the continuing growth of their economies. In Nigeria, small and medium scale industries have been unable to grow as a result of the non availability of affordable credit facilities from existing financial institutions, and lack of minimum public utilities and infrastructure like regular power supply, roads, certainty in tax liabilities and collection, security of lives and properties, health care delivery, etc.

The effort of the regulatory Bank in Nigeria to remedy the above credit problem by having Nigerian banks mandatorily contribute a portion of their profits to fund small and medium scale industries have equally failed because of:

- a. Lack of appropriate institutional framework and documentation for micro finance businesses.
- b. Lack of confidence between the formal Banks and the informal small and medium scale proprietors (SME).
- c. Absolute ownership culture by SME owners which discourages venture capital entrepreneurs and commercial Banks entering into short term partnerships with SMEs.
- d. High interest rates due to short term money market.
- e. Allegation of insider dealings by Banks under the Small & Medium Enterprises Equity

Investment Scheme as a result of the problems enumerated in items (a) to (d) above.

The failure of the SMEEIS (Small and Medium Enterprises Equity Investment Scheme) has led the Central Bank of Nigeria (CBN) to introduce and regulate the establishment of Micro Finance Banks in Nigeria in a further effort to remedy some of the problems enumerated above.

What is Micro Finance?

Micro Finance is the process of extending small and short term collateral-free loans and other financial services to small business owners that are unable to access these same services from the formal financial lending institutions.

What is a Micro Finance Bank?

A Micro Finance Bank (MFB) is described by the Micro Finance guidelines issued by the CBN as any company licensed by the Central Bank of Nigeria to carry on and provide financial services such as opening and maintaining savings accounts, granting short term collateral-free loans, offering domestic money transfer services, and providing other financial services to small income earners, small and medium scale entrepreneurs, etc.

Types of Micro Finance Banks in Nigeria

1. Micro Finance Banks licensed to operate within a local government area and restricted to that area. This type of Micro Finance Bank must have a capital base of N20Million.
2. Micro Finance Bank licensed to operate in a State with branches only in that State. This type of Micro Finance Bank must have a capital base of N1Billion.

A MFB must obtain an additional licence in order for it to be able to operate in another Local Government Area or State not designated in the original licence of the MFB.

Maximum Credit & Tenor of Credit

Presently, the maximum amount that a MFB can extend to a client is N500,000 (Five Hundred Thousand Naira). The maximum tenure of a Micro Finance loan is 180 days or 6 months. For agricultural crops, the maximum tenor for repayment is 12months.

Prohibited Businesses of a MFB

- a. Dealing in land for speculative purposes and real estate business that is not for the MFB's office accommodation.
- b. Credit facilities for speculative purposes.
- c. Direct cheque clearing activities.
- d. Foreign exchange and International commercial activities.
- e. Corporate finance.
- f. Any commercial activity that involves speculation in its dealing.

Tax Treatment of MFBs

The guidelines regulating Micro Finance Banks provides for exemption from companies income tax, of the profits of a MFB, if and only if the MFB does not distribute its net surplus among its shareholders but reinvest the profits by extending them as credit to its Customers.

#### Advantages of MFBs

1. Collateral-free loans to small scale entrepreneurs.
2. Networking opportunities for business counseling, mentoring and advise.
3. Peer support among members of a MFB, in good times and bad times.
4. Client friendliness and simplicity of operation of MFBs.
5. Deposits with MFBs are covered by insurance provided by the National Deposit Insurance Corporation (NDIC).

#### Possible Disadvantages of MFBs

1. High Interest Rates because of their collateral-free and short term nature.
2. Poor repayment culture to credit facilities by SME entrepreneurs; some SME operators may misunderstand MFBs loans to be their share of the national treasury.
3. Insufficient education among operators of MFBs on the differentiation between MFBs and regular Commercial Banks.
4. Lack of a credit bureau/data Bank to monitor small business owners with poor credit ratings and abuse of credit from MFBs.

#### Conclusion

The successes of Micro Finance Institutions in Nigeria without equal advancements in energy/power supply, roads, education, health care, security, etc. would not eradicate or reduce poverty. Equally disturbing is the high profile of the operators of MFBs who perceive their institutions as secondary players to the larger commercial Banks.

It is expected that continuing enlightenment support and enforcement by the regulator, CBN, on what MFBs are meant to do and achieve, and unreserved punishment for violators of MFBs guidelines would improve the medium to long term conditions of MFBs in Nigeria.

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