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Assessment of Community Banks in Nigeria

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Note:
This study is a follow-up to Working Paper 1994-2. The author is a former staff member of the Development Research Center (AEF) of the University of Cologne. He is now on the staff of the Food and Agriculture Organization of the United Nations in Rome. The views expressed in this paper are those of the author and not of the organizations which supported the study.

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FEDERAL REPUBLIC OF NIGERIA

ASSESSMENT OF COMMUNITY BANKS

FOOD AND AGRICULTURE ORGANIZATION OF THE UNITED NATIONS – ROME
INVESTMENT CENTRE DIVISION

WORLD BANK

IFAD - INTERNATIONAL FUND FOR AGRICULTURAL DEVELOPMENT OF THE UNITED NATIONS – ROME

With the participation of:

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DEPARTMENT FOR INTERNATIONAL DEVELOPMENT – ABUJA

FEDERAL REPUBLIC OF NIGERIA

ASSESSMENT OF COMMUNITY BANKS

Table of Contents

Currency Equivalents

(2004)

US$1.00 = NGN 132.60
NGN 1.00 = US$0.00754

Abbreviations

ACGS(F)	Agricultural Credit Guarantee Scheme (Fund)
ADP	Agricultural Development Project
AfDB	African Development Bank
AFRACA	African Rural and Agricultural Credit Association
AGM	Annual General Meeting
Av	Average
BDP	Bad debt provisions
BOFIA	Bank and Other Financial Institutions Act
CB	Community Bank
CBARD	Community-Based Agricultural and Rural Development
CBN	Central Bank of Nigeria
CDA	Community Development Association
CFA	Cooperative Financing Agency
CIDA	Canadian International Development Agency
COT	Commission on turnover
DFD	Development Finance Department (of the CBN)
DFID	Department for International Development (U.K.)
EIU	European Intelligence Unit
FAO	Food and Agriculture Organization of the United Nations
FF	Ford Foundation
FGN	Federal Government of Nigeria
FMARD	Federal Ministry of Agriculture and Rural Development
GTZ	Deutsche Gesellschaft für Technische Zusammenarbeit
IFAD	International Fund for Agricultural Development
LAPO	Lift Above Poverty Organisation
LGA	Local Government Area
LGC	Local Government Council
MFI	Microfinance Institution
MIS	Management Information System
NGN	Naira
N	Number (of cases)
NACOB	Nigeria Association of Community Banks
NACRDB	Nigerian Agricultural, Cooperative and Rural Development Bank

NAICOM	National Insurance Commission
NBCB	National Board for Community Banks
NDIC	Nigerian Deposit Insurance Corporation
NGN	Nigerian Naira
OFID	Other Financial Institutions Department (of the CBN)
PBN	People's Bank of Nigeria
PMB	Primary Mortgage Banks
SEC	Securities and Exchange Commission
SMIEIS	Small and Medium Industries Equity Investment Scheme
SWOT	Strengths, Weaknesses, Opportunities and Threats
UNDP	United Nations Development Programme
USAID	United States Agency for International Development
WB	World Bank

EXECUTIVE SUMMARY

(i) This study on community banks in Nigeria was undertaken in June 2004 by the FAO Investment Centre, with financial support from the Canadian International Development Agency (CIDA), the Department for International Development (DFID), the International Fund for Agricultural Development (IFAD), the Ford Foundation (FF), the United Nations Development Programme (UNDP) and the World Bank (WB), and in collaboration with the Central Bank of Nigeria (CBN). The objective of the study was to assess the past and present performance of community banks, in particular rural-based banks, and to propose a first framework for their support.

(ii) The enabling Community Bank Decree intended to permit rural communities to own and manage their financial institutions and thereby enhance their access to simple financial services. Instead of mandating the CBN to regulate and supervise these banks, a special parastatal, the National Board for Community Banks (NBCB,) was created. The original legal and supportive framework had many deficiencies, among them a lack of vision to develop the originality of community banks, inadequate institutional support, insufficient orientation towards professionalism and profitability and insufficient depth of on-site inspection. This led to the creation of mini-commercial banks, low levels of market penetration, poor credit recovery performance, low degrees of financial intermediation and a concentration on clients without risks. As the NBCB did not introduce and enforce provisioning for bad debts, a superficial view of the balance sheets and income statements showed satisfactory performance.

(iii) Within five years, the number of banks increased to 1355 but then started to decline. At present, there are about 775 surviving banks with a license from the NBCB, of which only 532 had a valid license from the CBN. It is estimated that about 750 community banks will actually survive. Poor loan appraisal, loans granted to persons without the intention of repaying them, loans to friends and relatives, embezzlement and other malpractice were the causes of the insolvency of the banks that closed their doors. The effects of these closures are that public confidence in the community banks is low, as it is regarding the entire banking system, and that many thousands of depositors and shareholders lost their money.

(iv) In 2000, the CBN was vested with the mandate to regulate and supervise all financial institutions in Nigeria, including the community banks. The CBN changed some of the regulations that did not work (e.g. the ceiling on a single shareholder of 5 percent of the share capital), increased the minimum share capital to NGN 5 million and started to enforce bad debt provisioning in line with standard banking practice. In addition, the CBN required all banks to apply for a new banking license and demanded a special audit of all banks that applied for it. These activities led to fresh capital injections from shareholders and slowly improving banking practices and performance, as indicated by higher levels of lending, higher deposits and higher profits.

(v) Much of the poor performance of many banks can be attributed to the poor design of the community banks right from inception, the rather unprofessional supervision by the NBCB, the insufficient financial endowment of the NBCB and the lack of attention by policy makers to this segment of the formal financial system during the last years of the military regime. No donor agency has systematically supported the system since inception.

(vi) With a total number of about one million clients and about one sixth of all banking counters in Nigeria (which already has a comparatively low banking density), community banks represent an enormous potential to enhance access to financial services for the rural population. They are an indispensable element of Nigeria's strategy to accelerate growth in rural areas and to alleviate the widespread poverty that has reached about 70 percent of the total population. This is even the more important as commercial banks have slowed down lending to rural areas since the liberalisation of the financial markets, and as the state-owned agricultural development bank NACRDB is not yet in a position to fully serve farmers in Nigeria. The comparative advantage that community banks have is their spatial proximity to their clients; their intimate knowledge of local cultures, habits, opportunities and constraints; and a concentration on simple banking functions. Despite low levels of lending and relatively high bad debt provisions, the average bank has satisfactory levels of profit. Improved performance and competition could thus lead to higher profitability, higher deposit interest rates or lower loan interest rates.

(vii) In order to develop this comparative advantage and turn it into a competitive advantage, a number of measures are required. These include three priority areas: (i) addressing the governance problem in community banks, (ii) improving the lending activities, and (iii) improving regulation and supervision. Concrete measures to improve the performance of the system and to lift the credibility of the community banks should therefore comprise:

- *Some regulatory changes related to accounting and auditing standards, the expansion of community banks through cash centres and branches, prudential guidelines, board supervision, trading activities and prevention of fraud, bad lending and other malpractice,*
- *An improved supervisory framework and more frequent on-site inspections,*
- *An improved reporting and data analysis system,*
- *The computerisation of banking transactions and accounting, coupled with an improved reporting system,*
- *Improved loan appraisal and recovery systems, which are geared to and tailor-made for local entrepreneurs, in particular farmers, craftsmen, petty traders and other service sectors,*
- *Training for management, staff and directors of community banks on almost all areas of planning, management and financial analysis,*
- *Elaboration of a comprehensive operational system adapted to the different local cultures and value systems, comprising manuals, banking products, financial analysis, planning, management and supervision approaches,*
- *Public awareness to enable depositors and shareholders to exercise their control functions,*
- *Institution building support to the umbrella organisation of community banks (NACOB), to enable this institution to provide peer support to members and the gradual transfer of some supervisory functions to it on the basis of merit and performance,*
- *Innovations research, documentation and publishing,*
- *Facilitating access to refinance facilities from commercial banks under the SMIEIS through a scoring or rating system,*
- *Facilitating institutional linkages between community banks and rural clients, who are already assisted by development projects, and with micro finance institutions,*

commercial banks, input suppliers and marketing agencies, in order to improve credit performance by the banks and outreach to the rural population.

Community banks at a glance[1]

Share of community banks in the financial system assets	*0.6%*
Total number of clients	*1 million, among which about 70,000 borrowers*
Share in total banking sector outlets	*19%*
Highest regional concentrations of community banks	*Anambra, Ogun, Oyo, Lagos, Imo, Enugu, Delta, Edo States*
Staff in rural areas	*11*
Share-holding	*Individuals: 61%* *CDAs: 28%* *Groups, mutual associations: 11%*
Major sources of funds	*Placements: 39%* *Loans and advances: 35%* *Fixed assets: 9%* *Investments: 8%*
Major uses of funds	*Deposits: 63%* *Shareholder funds: 24%*
Major clients served	*Salary earners, pensioners, traders*
Average number of depositors	*1430*
Number of active borrowers	*106*
Deposit services	*Current, savings and time deposits, occasionally other target savings products*
Credit services	*Advances for salary earners (1-6 months), loans (3-18 months)*
Interest rates on deposits	*Call deposits: 0%* *Savings deposits: 4%* *Time deposits: 9%*
Interest rates on loans	*10-60% in most cases; average: 26%*
Bad debt provisions	*15% of loans outstanding*
Profitability	*Pre-tax profits/paid-up capital: 29%*

1 Data as at December 2003. Data on community banks referred to are mean amounts.

1. INTRODUCTION

A. BACKGROUND OF THE STUDY

1.1 In 1999, the Federal Government of Nigeria and a number of donor agencies started discussions on a programme to strengthen the capabilities of rural financial institutions in Nigeria. The donor agencies comprised the African Development Bank (AfDB), the International Fund for Agricultural Development (IFAD) and the World Bank (WB). A number of missions followed these in 2000 and 2001, to assess the rural financial landscape and identify its potential and constraints. Institutions that had been identified to benefit from an eventual support programme comprised the Nigerian Agricultural, Cooperative and Rural Development Bank (NACRDB), the Nigerian Agricultural Insurance Corporation (NAIC), community banks, commercial banks, non-licensed microfinance institutions and the Central Bank of Nigeria (CBN) as a regulatory body. Design and pre-formulation missions undertaken by the Department for International Development (DFID), IFAD and the United States Agency for International Development (USAID) confirmed the intention of donors to strengthen the community banks.

1.1 There is a paucity of consolidated data and up-to-date knowledge on the community banks. While the most recent data of the National Board for Community Banks (NBCB), dated October 2003, indicate a rather poor performance of the approximately 250 community banks covered up until mid-2003, a comparison of the 2002 and 2003 data of the CBN (OFID) indicates a rather good performance of another set of 564 banks. So far, more than 500 community banks have received their final banking license from CBN, and about another 250 may receive theirs before mid-2005. It is generally feared that many community banks ultimately face closure due to lack of compliance with CBN requirements, and that such banks would be primarily located in rural areas, thus leading to a further decline of access to banking outlets for rural clients.

1.2 Upon request of some donor agencies, the FAO Investment Centre Division carried out a mission in Nigeria to assess the current state of community banks[2]. The donor agencies involved comprise the Canadian International Development Agency (CIDA), the Department for International Development (DFID), the International Fund for Agricultural Development (IFAD), the Ford Foundation (FF), the United Nations Development Programme (UNDP) and the World Bank (WB). The study was undertaken in collaboration with the Other Financial Institutions Department (OFID) of the CBN.

1.3 The study comprised two separate activities, an analysis of aggregated key financial data obtained from CBN and NBCB, as well as a field trip to selected community banks.

1.4 The field mission took place from 6 to 28 June 2004. After a briefing session in Abuja, the mission split into two field teams. One team visited the Cross River, Abia and Benue States, while the other team visited Bauchi, Borno and Ekiti States. In addition, the financial analyst undertaking the data analysis visited two community banks in Lagos State. Against earlier

[2] Dr Michael Marx, Rural Finance Officer, FAO/TCIW, led the mission. Other mission members comprised Mr Samuel Ansong, Rural Bank Manager, Mr Kabir Busari, Manager, CBN, OFID, Prof. Liza Cook, Economist, Prof. Anthony Ikpi, Agricultural Economist, Mr Thierry Mahieux, Financial Analyst, and Mr John Ofori, Rural Bank Manager.

plans, the visit of Enugu State could not take place due to security reasons. In addition, the mission had decided to substitute Niger State by Ekiti State, in order to obtain a more equitable coverage of the different regions of Nigeria[3]. On 28 June, the mission presented a summary of the first findings and conclusions to representatives of the Federal Ministry of Agriculture and Rural Development (FMARD), CBN and some donor agencies. The itinerary of the mission, which also contains the community banks visited, is presented in Annex 2 of this report.

B. TERMS OF REFERENCE

1.5 The mission was to undertake a comprehensive assessment of the performance of community banks, with special emphasis on rural based banks. Particular aspects to be covered by the mission comprised: (i) genesis, evolution and current status; (ii) regulatory and supervisory framework; (iii) current status and share of the markets; (iv) set-up, ownership, staffing and outreach; (v) clientele and their perceptions; (vi) products, services, linkages and innovations; (vii) financial performance and profitability; (viii) accounting, the Management Information System (MIS) and audit systems; and (ix) development strategies and support services required. Other issues to be addressed included regulation and supervision. Based upon a SWOT[4] analysis, the mission was to make detailed proposals on the support needed to strengthen the capacity of rural community banks. The detailed Terms of Reference are presented in Annex 1 of this report.

C. METHODOLOGY AND APPROACHES

1.6 The mission selected the states to be visited with a view to obtain as broad as possible coverage of the different regions of Nigeria. Borno and Bauchi States, which are essentially rural and thinly populated, were selected because of the interest of donor agencies to assess the possibilities of linking farmer groups with the community banks. The Cross River State was selected as one state in the Delta, in which one donor agency is already funding an agricultural and community-based rural development programme; the interest here was to explore the possibilities of linking the economically active groups with the financial sector. Abia State was selected as one state in the Eastern Zone, which is very densely populated and has intense industrial activities, as well as an active farming sector. Benue State was selected as one of the states in the Middle Belt of Nigeria with a very intense farming sector. Ekiti State was selected as one of the states in the Western Zone, which is largely dominated by farming as the most important economic sector in a mixed and diverse economy. Finally, one team member used the opportunity to visit two metropolitan community banks in Lagos, the commercial centre of Nigeria, to obtain an idea on the performance of community banks in a highly competitive environment.

1.7 In all cases, interviews had not been announced prior to the visit, and all banks fully cooperated with the mission. Interviews, which took somewhere between three and five hours, were mostly held with the manager and some staff of the bank, which usually comprised the accountant, credit officer or other officers. In some cases, the mission also interviewed board members, either in the bank premises or outside. In a few cases, other local dignitaries such as chiefs or members of the Local Government Council (LGC) were also interviewed to cross-check

[3] In addition to this concern for a broad based distribution, prior hand information on community banks in Niger State indicated that these were not very much different from those visited in Bauchi and Borno States.

[4] Strengths, Weaknesses, Opportunities and Threats.

some of the information or obtain their view on the performance of the community bank or other issues. Where possible, the teams also interviewed clients and the general public about their views and perception of the community banks. As much as possible, the mission tried to obtain a fairly representative coverage of the community banks in one state. In Borno and Bauchi States, all existing community banks were covered. In Cross River, Abia and Ekiti States, the mission selected community banks in a way to obtain a spectrum view of rural and urban community banks, but with emphasis on rural based banks, and of licensed and unlicensed banks. In Benue State, only two selected banks were interviewed. All community banks provided all the required information as far as it was available. All financial data were obtained from the books and records of the banks, and from their monthly and quarterly returns to either the CBN or the NBCB. Other data were obtained from the other records of the banks, e.g. on numbers of accounts. Where possible, the activities of Nigerian Associations of Community Banks (NACOB) were also discussed during the interviews, and in one case, a specific meeting with NACOB representatives held in Lagos.

1.8 Table 1 below classifies the community banks visited during the mission according to the preponderance of their urban/rural activities. A community bank was classified as 'rural' if it was located in a community with a predominantly rural economy and environment in which agriculture played an important role, and that did not have a population above approximately 50 000 inhabitants.

Table 1: Number of Community Banks Visited by States According to Demographic Categories

State	Mostly Rural Activities	Mainly Urban Activities	Mixture of Rural and Urban Activities	Total no. of community banks visited	Total no. of licensed community banks	
					NBCB license	CBN license
Abia	3	2	1	6	33	19
Bauchi	4	1	0	5	10	6
Benue	0	2	0	2	21	7
Borno	3	2	0	5	5	2
Cross River	3	5	1	9	24	14
Ekiti	5	0	0	5	27	18
Lagos	0	2	0	2	67	39
Total	**18**	**14**	**2**	**34**	**881**	**532**

1.9 The mission used a combination of data and information to elaborate this report. These sources include the aggregate data on community banks as kept by the NBCB (1994-2002) and the CBN (2001 and onwards). Where the data level permitted, a breakdown of some of these aggregated records by a number of variables was undertaken. The interviews with the 34 community banks in the field were made along a questionnaire that served as guidance for the interviews. Interviewers deepened single issues where this was appropriate. The financial, operational and other records of the 34 banks visited in the field and the information provided by staff and directors, as well as other publicly available information on the industry, were therefore additional sources of information. It was intended that the data bases, which provided a useful overview of the entire sector, in combination with the field work, would permit a comprehensive and holistic view. While a maximum of care was exercised to obtain a broad spectrum of community banks, this report is indicative, but not necessarily representative of all community banks in Nigeria.

1.10 In order to respect the view of some of our discussion partners for discretion, names of individual banks and staff are not provided in this report. In general terms, the report is generic in the sense that it presents community banks with the variation as they were found. In addition, a few selected banks are portrayed in text boxes to show their performance or weakness, as the case may be. As the interest in this assessment was to elaborate support programmes on the basis of an assessment of the current performance of the community banks, it is natural that their weaknesses were more emphasised than their achievements. This should, however, not be interpreted as a sign that all community banks are weak and poorly performing.

D. OUTLINE OF THE REPORT

1.11 This report begins with a brief overview of the financial landscape in Nigeria in Chapter 2. This section briefly describes the main types of formal financial institutions intervening in rural finance, as well as the informal financial sector, and concludes with a summary of the main government policies and institutions geared at enhancing access to financial services. Chapter 3 presents the main results of the study along the topics as prescribed in the Terms of Reference, including the evolution, regulatory framework, set-up, clientele, operations and services, linkages with other institutions, management, control and supervision, profitability and development strategies and plans of the community banks. This chapter ends with a summary of the main points. Chapter 4 contains a one-page SWOT analysis to capture the main results in a short form. Chapter 5 presents its recommendations regarding the direct and indirect support of community banks. Annex 3 contains the working paper of the financial analyst on the performance of community banks and Annex 4 the questionnaire used in the field. Annex 5 shows the distribution of licensed community banks over states. Source of data, unless stated otherwise, is the field survey on community banks.

E. ACKNOWLEDGEMENT OF THANKS

1.12 The mission wishes to express its sincere gratitude and appreciation to the CBN for the excellent partnership and assistance provided; to CBN and NBCB for permitting access to their data bases on community banks; to the boards, management and staff of the community banks visited in the seven States of the Federation for their time and frank views about their banks and the environment in which they operate; to the clients of community banks for their views about the banks; to Mr Kwapong, Managing Director of the ARB APEX Bank, Ghana, for the assistance in selecting experienced rural bank managers from Ghana; to Dr. Adebayo Oduwole, Chairman, Lagos branch of NACOB, for his kind arrangements to meet NACOB delegates; and of course to CIDA, DFID, FF, IFAD, UNDP and the WB for the financial support and to CIDA, FAO and CBN for the logistical support to the study.

2. RURAL FINANCE IN NIGERIA

A. THE NIGERIAN FINANCIAL SYSTEM

2.1 **Overview**. Nigeria has a complex and rather well developed financial system[5], but it is fraught with many constraints and ultimately does not correspond adequately to the needs of the country and its citizens. At its helm is the Central Bank of Nigeria (CBN). The CBN is in charge of the formulation of monetary, credit and exchange rate policies. It supervises all financial institutions, including those owned solely by the Government, and regulates the sector in all instances unless such regulations require an act of parliament. Other regulatory bodies comprise the National Deposit Insurance Corporation (NDIC), the Securities and Exchange Commission (SEC), the Federal Ministry of Finance (FMF), the National Insurance Commission (NAICOM) and the Financial Services Regulatory Coordination Committee. The formal financial sector is dominated by 89 commercial banks, including eight merchant banks. In addition, there are about 774 community banks, 81 primary mortgage banks, 104 finance companies, 5 discount houses and 85 bureaux de change. The sector further comprises six Government-owned development finance institutions, leasing companies, insurance companies, venture capital companies and about 80 known microfinance institutions. Outside the formal sector, there are several tens of thousands of cooperative societies. Finally, Nigeria has a very dynamic informal financial sector, which is certainly among the most dynamic ones on the African continent.

2.2 **Density of outlets**. Despite this complexity, the outreach of the banking sector is rather low. By the end of 2003, there were a total of 3 247 branches of commercial banks, 774 single-unit community banks and 200 branches of the NACRDB, which also receives deposits, thus 4 221 outlets accessible to the public. If one assumes a population of 126 million by the end of 2003[6], the average population per banking outlet would be around 30 000; this would increase to about 34 000 under the assumption of a higher population figure[7].

2.3 **Interest rates** in the private sector are usually determined by the financial institutions along business parameters. However, informal requests in the past by the Government and CBN to the commercial or the community banks to bring down interest rates have often been adhered to, in order to avoid conflicts or being seen as non compliant[8]. Interest rates are constantly fluctuating. During the period from May 2003 to April 2004, average monthly interest rates paid by commercial banks on savings deposits were in the range of 3.2-5.8 percent, with an average of 4.2 percent. Average monthly prime interest rates charged fluctuated from 19.1-21.1 percent, with an average of 20.0 percent, while the inter-bank rate fluctuated between a low of 12.1 percent and a high of 23.2 percent. Over the same period, the composite consumer price index rose by 17.0 percent[9], indicating largely negative returns for all savers[10]. Over the same period, the margin

[5] Data used in this section refer to 2002 and 2003 as published in the CBN Annual Reports for the respective years.

[6] This is based on the linear increase of the 1991 population census figures by 3.0 or 3.1 percent per year, and which is one of the lowest estimates.

[7] The EIU assumes a population of 143.6 million for the end of 2002. EIU 2003:9.

[8] See for example the CBN Circular BSD/2/2004 dated 23 April 2004. Several community banks visited in the field also revealed that the CBN inspectors had ‘advised’ them to reduce the interest rate.

[9] Period covered May 2003 to April 2004. The inflation rate for urban areas was 24.8 percent and 11.4 percent for rural areas. Source: Federal Office of Statistics, cited in CBN, Monthly Report April 2004, pp. 9-10.

between average savings deposit and the maximum lending rates was 15.4 percent points, while the spread between the weighted average deposits and maximum lending rates was 10.8 percent points[11].

2.4 **Central Bank of Nigeria**. The CBN intervenes on the basis of two pieces of legislation, i.e. the Central Bank of Nigeria Act 24 of 1991 and the Banks and Other Financial Institutions Act 25 of 1991, which superseded the previous CBN Act of 1958 and the Banking Decree of 1969. The CBN is mandated to retain macroeconomic stability (inflation and exchange rate management) and to secure the integrity and healthiness of the entire financial sector. The bank defines entry, operational and exit rules for financial institutions, supervises all financial institutions and enforces compliance with legal provisions within the entire financial sector. Although all financial institutions are to report to the CBN, not all institutions actually do so. The CBN is the sole institution for the licensing and regulation of the commercial banking sector, but it legally shares this responsibility as far as community banks are concerned with the NBCB[12].

2.5 **Commercial banks**. The financial sector is dominated by 89 commercial banks, which account for more than 90 percent of total sector assets excluding the CBN[13]. Commercial banks are universal banks since the former distinction between commercial and merchant banks has been abandoned. The sector is largely oligopolistic. The ten biggest banks have a market share of above 50 percent[14], and the biggest three a share of about one third. Due to illegal operations and insolvency, the CBN has closed a number of banks over the past 15 years, where the private or public owners were unable to inject the necessary fresh capital. Up to the early 1990s, commercial banks were the biggest provider of agricultural finance, as they were subject to special regulations forcing them to invest a certain percentage of their portfolio in agriculture. Since the removal of these policies, the number of commercial banks lending to agriculture and the value of loans has been shrinking gradually. With the new prudential guidelines of the CBN, commercial banks are forced to make adequate bad debt provisions, and these consumed in some cases up to 45 percent of the interest received. On the other hand, there are some signs of change as new emerging and expanding banks enter the scene. Commercial banks have benefited since 1978 from the Agricultural Credit Guarantee Scheme Fund, operated by the CBN, which has kept six of the biggest banks in agricultural lending. Due to the high transaction costs, a lack of interest by an urban-based top management, inadequate procedures and training, and also high default rates, commercial banks have not been able to really penetrate rural areas. Commercial banks in Nigeria are not very active in lending; of the ten biggest banks, the loans outstanding were 24 percent of their total assets[15]. Most rural bank branches do not lend to rural clients at all. It is

[10] The rural Consumer Price Index increased annually (Jan.–Dec.) by 18.6 percent, 13.0 percent and 13.2 percent during the years 2001, 2002 and 2003 respectively. Over the same period, the urban index rose by 20.5 percent, 12.5 and 16.5 percent respectively. CBN Annual Report 2003, Tables 6.16 and 6.17.

[11] Data source: CBN Monthly Report April 2004.

[12] See Chapter 3 B below for details.

[13] At the end of 2003, commercial banks held 95.2 percent of total financial savings, compared with 94.0 percent at the end of 2002. CBN Annual Report 2003, p. 46.

[14] By December 2003, the ten biggest commercial banks accounted for 53.3 percent of total assets, 56.2 percent of total deposits and 44.3 percent of total loans of the financial system. CBN Annual Report 2003, p. 43.

[15] Banks ranked by assets as at March 2002. Source: EIU: Country Finance Nigeria. Release June 2003. Own calculation.

therefore not surprising that lack of access to finance has been listed among one of the three major business constraints in almost all surveys[16].

2.6 **Non-banking financial institutions in the public sector**. There are six state-owned non-bank financial institutions in Nigeria, including the Bank of Industry[17], the Nigerian Agricultural, Cooperative and Rural Development Bank[18], the Urban Development Bank, the Nigerian Export-Import Bank and the Federal Mortgage Bank. After long years of mismanagement, operations outside any professional supervision and without prudential guidelines, these public institutions have lost their market share and need serious rehabilitation and recapitalisation.

2.7 The **Nigerian Agricultural, Cooperative and Rural Development Bank** (NACRDB) has undergone some structural changes over the past 2-3 years. The Federal Government of Nigeria (FGN) is ready to sell up to 51 percent of the NACRDB shares to a core investor. Out of the 350 banking outlets taken over from the former Nigerian Agricultural and Cooperative Bank and the People's Bank of Nigeria (PBN), 150 have been closed, leaving the bank with 200 outlets. Many of these have since then been rehabilitated and upgraded. Similarly, out of the 4 608 staff of both banks at the time of the merger, the bank has retrenched about half of these, keeping a staff strength of 2 305. The FGN has injected an amount of NGN 9.1 billion as fresh capital, and the Ministry of Finance granted a loan of NGN 3 billion. Total deposits as at September 2003 amounted to NGN 3.3 billion. Total available resources are grossly inadequate to fulfil its mandate. According to its charter, the bank is entitled to take deposits, but it does not have a license yet for this as required by the banking act, nor are deposits insured under the otherwise compulsory deposit insurance. The bank is entitled to lend to all sorts of on- and off-farm income-generating activities. Lending resumed in May 2001, and by the end of 2003, the bank had disbursed cumulatively NGN 4.186 billion to 21 028 clients, including some financial intermediaries. According to the directives from the FGN, 70 percent of the loan portfolio must be granted to the poor ("micro loans") at single digit interest rates, and the remainder to other clients. Micro loans are loans below NGN 250 000, equivalent to about US$1 800. The bank calculated the repayment rate of the micro loans at 83 percent. Most of the term and macro loans were not yet due.

2.8 **Viability of NACRDB**. Interest rates charged by NACRDB range from 7.0-18.5 percent. About 10 percent of the disbursements went to cotton production at an interest rate of 7 percent, 43 percent to micro clients at 8 percent, 31 percent to micro clients through on-lending schemes at 8 percent, and the remaining 16 percent to macro clients at 16.5-18.5 percent per annum In addition, the bank charges up to 1.5 percent administrative, processing and legal fees, and requests a compulsory collateral deposit of 30 percent for micro loans and production loans of up to NGN 100 000, and 20 percent for all other loans. The bank usually pays an interest of up to 5 percent per annum on deposits. Even if the effective rate of interest increases to 11-12 percent per annum in the case of an annual micro loan, which is less than half of what commercial banks currently charge, it is evident that lending is not viable.

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16 For example in WB (Africa Region): Results of the Nigeria Firm Survey, Draft report 12 October 2001; 77 percent of the 311 manufacturing enterprises surveyed listed lack of finance as one of their main problems.

17 A merger of the former Nigerian Industrial Development Bank, the Nigerian Economic Reconstruction Fund and the Nigerian Bank for Commerce and Industry.

18 A merger of the former Nigerian Agricultural and Cooperative Bank, the People's Bank of Nigeria and the risk assets of the Family Economic Advancement Programme.

2.9 **Microfinance institutions**. The first microfinance institutions (MFIs) began operations in the very early 1980s. There are a handful of larger ones, about a dozen medium sized ones with more than a decade of experience, and about 70-80 smaller ones that have been created over the past five years or so. In addition, there are a few cooperative apex organisations capable to expand. MFIs predominantly use donor funds and collateral deposits of borrowers to grant short-term loans to clients, but some have gone beyond this. The Lift Above Poverty Organisation (LAPO), for example, has bought a defunct community bank, rehabilitated it and opened a new banking hall at a strategic place, and uses the bank to mobilise deposits and provide additional services to the communities it could not provide under the MFI status. While a few have been able to achieve satisfactory repayment rates, their transaction costs are still high due to relatively small loan portfolios. A few of them benefited much from the UNDP Micro Start Programme and performed reasonably well in terms of outreach and sustainability. Where MFIs obtained bank loans in the past under donor arrangements, both banks and MFIs were apparently not very satisfied with the results in some cases. Many MFIs have a weak management, and have hardly had access to innovative approaches. They are also cautious to incur higher risks, e.g. by borrowing from external sources. MFIs represent a vast potential to reach women, farmers and other rural entrepreneurs, but they would also need substantial technical assistance and access to loan funds to reach more clients and achieve higher degrees of sustainability.

2.10 **Cooperatives** have a 70 years history in Nigeria. For almost the same period, they have "benefited" from government support. There are many different types of cooperatives, and those providing financial services to clients include the single-purpose Cooperative Thrift and Credit Societies, which exclusively provide financial services to their members, as well as multi-purpose societies, which handle financial services in addition to others, such as input supply, marketing, processing, etc. The actual numbers of registered and functional cooperatives and their membership have always been unknown. There is evidence that many registered societies were actually defunct[19]. Despite years of promotion by government, public and private sector lending schemes to cooperatives and substantial donor support to the secondary and tertiary levels, the sector has lost almost all its credibility. With two exceptions, all State Cooperative Financing Agencies closed shops due to illiquidity. Very few commercial banks would consider lending to cooperatives because of the very bad track records. At present, cooperatives are not a significant player in the rural financial markets.

2.11 **Informal finance**. Nigeria has a very dynamic informal financial sector. The predominant institution is the rotating savings association without any funds, which is predominantly used in the Northern part of Nigeria, among salary earners, traders and market women. Many farmers, craftsmen and small entrepreneurs prefer a rotating savings and credit association, where part of the financial contribution of each member is used to establish a fund, which is mostly used to grant additional loans to members. In some cases, the fund may also be used to assist members in difficulties with a small grant. Farmers in the South and the Middle Belt regions often prefer the non-rotating savings and credit association, where members start saving in January and use the available fund for lending purposes. By the end of November, all loans are to be paid back, and the association refunds all the savings to members and shares or consumes the

[19] The number of societies has been cited between 10 000 and 100 000 by various reports and statistics. With the disappearance of the Family Economic Enhancement Programme (FEAP) from the landscape in 1999, under which many new societies had been created to get loans, the actual number may not exceed 15 000. Most of these are located in the Northern and South-western parts of Nigeria. The entire system needs a massive rehabilitation.

interest received. In most markets, deposit collectors collect daily deposits from traders on that market; after one month of collecting the uniform daily amounts, the collector refunds the total deposits minus one daily contribution, which is his/her remuneration. There are also moneylenders in all parts of Nigeria, which often charge rates of up to 1 800 percent per annum, but people tend to borrow from this source only if there is virtually no other alternative. Groups are usually quite formal, with written or oral by-laws, chairperson, secretary and treasurer; accounts are usually well kept, and often controlled by an internal auditor, especially in the South. Different estimations about the spread of the informal financial services indicate that at least one quarter of all active Nigerians use these frequently or constantly. The entire sector is quite effective in ensuring timely and full compliance with the internal regulations, and sanctions and means to enforce payment differ from one ethnic society to another.

B. COMMERCIAL BANKS IN RURAL FINANCE

2.12 Commercial banks have been active in agricultural lending as long as there were special regulations in place that requested commercial banks to lend 12 percent of the portfolio to agriculture, while merchant banks had to observe a quota of 8 percent. Where banks did not comply, the CBN transferred the respective shortfalls to former NACB without any interest. Since the removal of these regulations under the liberalisation programme, the number of banks lending to agriculture and the amounts lent have been declining, with the notable exception of six of the biggest commercial banks. Lending to rural areas outside agriculture, beyond overdrafts for salary earners, is virtually absent nowadays.

2.13 **Agricultural Credit Guarantee Scheme (ACGS)**. One of the Federal Government policies that kept the remaining commercial banks in agricultural lending is the ACGS, which was established in 1977. Through this scheme, the CBN extends a guarantee cover for all loans for agricultural purposes granted by commercial banks of up to 75 percent of the amount disbursed net of any borrower collateral and repayment. Alongside the increase of the capital of the fund from NGN 100 million to NGN 1 billion[20], the limits for loans guaranteed were also increased to NGN 5 million for companies and to NGN 0.5 million for individual borrowers. During the year 2003, the CBN had guaranteed a total of 24 303 loans worth NGN 1.20 billion, thus an average of NGN 49 400 per loan guaranteed. This represents about two times the numbers and four times the value of the loans guaranteed in 1999, the year prior to the change of the capitalisation and the change of the regulations.

Table 2: Number and Value of Loans Guaranteed by CBN/ACGSF (1996-2002)

1998		1999		2000		1978-2000		2002		2003		2003	
No.	Amt.	No.	Amt.	No.	Amt.	**No.**	**No.**	No.	Amt.	No.	Amt.	**No.**	**Amt.**
15	**216**	**13**	**246**	**14**	**361**	**294**	**2575**	**24**	**1051**	**24**	**1164**	**24**	**1200**

Note: No. in '000; Amounts in NGN million; Source: CBN Annual Reports 2000, 2002 and 2003.

2.14 Of the total loans guaranteed in 2003, 41 percent of the numbers and 17 percent of the value were for loans in the range of NGN 5 001 to 20 000, 33 percent of the numbers and 25 percent of the value were for loans in the range of NGN 20 001 to 50 000 and 20 percent of the

[20] By the end of 2003, the (authorized) share capital of the fund stood at N 2.25 billion, of which the FGN was yet to pay its own share of N 0.75 billion. CBN, Annual Report and Statement of Accounts 2003, p. 21.

numbers and 33 percent of the value were for loans in the range of NGN 50 001 to 100 000. Loans to individual farmers dominated the scheme, as they accounted for 95 percent of the value and 99 percent of the number of loans. This CBN guarantee has over the past few years been coupled with additional guarantees granted by special guarantee funds[21]. Some cases include the Micro Credit Scheme for Agricultural Development[22], the Green Card[23] and the Jigawa State Trust Fund for Agricultural Development, which cover the remaining 25 percent of the commercial bank loans. While the number of participating commercial banks was about 30 in the early 1990s, the number had declined to six in 2001 and 2002, but has slowly increased since then with the expansion of some new banks. Banks have in the past often complained that the procedures for payment on guarantee claims in case of default were very lengthy, and that they hardly received any payment from the CBN[24]. It appears that the CBN has since then changed some of the procedures and sped up the processing of claims. In January 2004, the CBN approved the entry of community banks to this service, but the scheme is not yet operational for them.

2.15 **Linkage programme**. In 1992, the CBN started promoting a programme "Self-Help Group Linking Banking", in close collaboration with the African Rural and Agricultural Credit Association (AFRACA) and the GTZ[25]. Key features of the programme were: (a) an institutional linkage between commercial banks using the ACGS on the one hand, and savings and credit associations, farmer groups and cooperatives on the other; (b) regular savings activities of the group; (c) a deposit of the group savings in their own bank account with their partner bank; and (d) a loan of up to four times the savings by the bank to the group. The CBN guaranteed these loans under the ACGS. In some years, several thousands of groups were served by the banks. The scheme led to widespread interest where banks actively promoted it, and to a higher collateral coverage of the loans. Banks started to request farmers to save 25 percent of the loans amount in a blocked savings account; these deposits plus the CBN guarantee cumulated in a near full collateral coverage of small scale lending, which substantially improved the risk situation of the bank and did not dent into the leverage capacity of the equity capital[26]. During the 1990, most of the banks involved in agricultural lending fully applied the minimum deposit requirement, but did not put much attention on the careful selection of groups, proper monitoring and a continuous savings process as propagated by AFRACA. While the programme faded out gradually with the liberalisation, the deposit requirements seem to remain in place.

C. FEDERAL GOVERNMENT POLICIES

2.16 **Past direct lending programmes**. Over a period of thirty years, the FGN has enacted and pursued numerous policies aiming at increasing lending to farmers. The FGN established the now defunct NACB, which was mandated to provide short, medium and long-term loans to farmers. Over many years, commercial and merchant banks were to grant 8-12 percent of their

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[21] On the Trust Fund Model, see also http://www.cenbank.org/devfinance/Innovation.htm..

[22] Operated by Shell Petroleum Development Corporation.

[23] Operated by the Nigerian Agip Oil Company.

[24] In 2002, the six lending banks filed 206 claims worth N 6.08 million. Of these, 124 claims valued at N 3.21 million were settled; CBN Annual Report 2002, p. 19.

[25] See http://www.cenbank.org/devfinance/Innovation.htm.

[26] Savings mobilised in 1998, the peak of the programme, amounted to NGN 25.3 million. At that time, 1 083 groups with 15 340 members joined the scheme. World Bank (Rural Development 2, Africa Region): Financing Nigeria's Rural Micro and Small-Scale Enterprises. Main Report No. 19973-UNI. Washington D.C., 11 May 2000, p. 33.

loan portfolio for agricultural purposes; this policy has been abolished. Other programmes aimed at creating cooperative societies, either single-purpose savings and credit societies or multi-purpose societies with financial functions, and opening access to bank loans for them. In addition, the FGN facilitated the creation of Cooperative Finance Agencies (CFAs) on a state basis, which received their lending funds from NACB and the state and federal governments. These linkage programmes have however failed, as the repayment rates were very low. With the exception of two CFAs[27], all other CFAs are now defunct. In other cases, the Agricultural Development Projects (ADPs), River Basin Development Authorities or State Ministries of Agriculture provided direct loans to farmers or farmer groups, which were appraised by the agricultural extension agents. All these programmes had in common that: (a) lending rates were below market rates and did not cover all costs and risks; (b) funds ultimately derived from government; (c) collateral requirements were waived and (d) saving was not integrated. All these supply-led lending schemes achieved their goals in terms of reaching a large numbers of borrowers and increasing the flow of loans to the rural population, but often failed in terms of use of loans for agricultural purposes and reaching low-income farmers, and totally failed in terms of repayment and sustainability. The rural population, whether farmers or not, regarded official statements as lip service and an invitation to help oneself. Consequently, there was always a 'rush' for these loans, and everybody made an effort to get one's share of the oil revenues or "national cake". With the advent of democracy, this has not changed very much, with the exception that the former "national cake" syndrome is now popularly referred to as the "democracy dividend" syndrome. All these programmes were sooner or later discontinued, and many of the institutions created for lending have disappeared from the landscape. The two exceptions from this are the ACGS of the CBN and to a certain extent the community banks.

2.17 **Present programmes**. The FGN continues to lay strong emphasis on low interest rates, as it presumes that small farmers are unable to afford high interest rates. The FGN has contributed to the lending capital of the NACRDB and has directed the bank to lend at rates much below market rates. However, it appears that since 1999, the FGN has no longer actively pursued the promotion of subsidised agricultural lending through any new scheme. In order to encourage medium and long term lending of commercial banks to agriculture and other sectors of the economy, the CBN had established a Rediscounting and Refinancing Facility for Term Lending[28]. This was in recognition of the term structure of commercial banks, which hardly mobilise any deposits maturing above 12 months. In 2002, the CBN granted two loans worth NGN 315 million under this facility[29].

2.18 In the arena of lending, the focus of the FGN appears to have shifted towards the support of small and medium scale entrepreneurs, as these are believed to be able to expand substantially and create employment. In 2001, the FGN urged commercial banks to invest 10 percent of their profit before taxation into small and medium industries **(Small and Medium Industries Equity Investment Scheme SMIEIS)**. As at April 2004, the 83 participating banks set aside an amount of NGN 22.3 billion (about US$161 million), of which 53 banks actually invested NGN 9.7 billion in 185 projects/companies in urban areas. The average amount per project was therefore NGN 52 million, way above what is usually lent to the rural sector. Due to operational and conceptual problems, banks have been reluctant to follow the directives, and they are now facing CBN sanctions regarding the shortfall. The CBN has already withdrawn an

[27] These are Bauchi and Gombe CFA. Both, however, derive their main income from non-financial activities.
[28] See http://www.cenbank.org/devfinance/Innovation.htm.
[29] Against four applications received worth N 819 million.

amount of NGN 2.2 billion from the banks and invested most of these funds in treasury bills; the interest is added to the capital, and not transferred to the respective banks. In recognition of these difficulties, the CBN has recently permitted the banks to utilise 10 percent of their SMIEIS funds to refinance other institutions that lend directly to small and medium entrepreneurs. Banks are now keen to find suitable intermediaries, in order to avoid being sanctioned by CBN. This window could become the prime source of funds for both MFIs and community banks, provided that the huge distance between the different institutions could be bridged. Under this premise, no external funding for lending capital would therefore be required.

3. COMMUNITY BANKS IN NIGERIA

A. ORIGIN AND EVOLUTION

3.1 **Origin**. The creation of the decree through which the community banks were established was founded under the conviction that commercial banks and the state-owned development banks were unable to satisfy the entire demand for financial services by the rural population. In addition, most of these banks were not meant to grant loans without collateral, and were spatially far from the rural population. It was further recognised that the rural population is widely using informal financial arrangements and is capable of organising itself and rural financial services. The Federal Military Government decided to take a different path from the supply-led credit approach that had dominated so far by enacting Decree 46 of 1992, which permitted the creation of community banks in both rural and urban areas. The advantage for the Government was also that the policy did not draw heavily on the budget, and that it reduced the pressure from people who wanted to establish a bank. At that time, the CBN had made it very clear that it would not grant any new banking license for commercial or merchant banks, and it was widely believed by the general public that banking was a very profitable investment. As a consequence, many investors who could not establish a 'real' bank went into community banking.

3.2 **Evolution**. The first community bank was launched in December 1990 in Kaduna. By the end of 1995, the National Board for Community Banks (NBCB) had granted a total of 1 355 operating licenses. This number had declined to 1 015 in 1997. By 2001 and 2002, the NBCB records showed 881 functioning community banks. In 2000, supervision of community banks was vested with the CBN, which demanded that all community banks needed a new and final banking license from the CBN in accordance with the banking laws, thus disregarding the NBCB 'operational' licenses granted earlier. Based on an assessment of CBN staff, auditors and consultants, the CBN granted 282 new licenses in 2001, two licenses in 2002 and another 248 in 2004. This brought the total number of licensed community banks to 532 as at 27 May 2004. In 2004, the CBN also withdrew the provisional NBCB licensees of 23 community banks[30]. The CBN estimated that at the end of 2003, there were 774 operational community banks, and that it might eventually grant an additional 200-240 licenses to community banks over the next year, provided that these would comply with the legal requirements. On the other hand, the CBN informed the public that it had withdrawn the provisional licenses of a number of community banks[31] and advised the public not to transact business with them. Annex 5 shows the distribution of licensed community banks over states.

3.3 **The average community bank** (OFID data for 2003) has total assets of NGN 50.9 million, total deposits of NGN 32.0 million, total equity of NGN 12.4 million and loans outstanding of NGN 17.7 million. The assets and liabilities of the average community bank are shown in the diagrams and table below.

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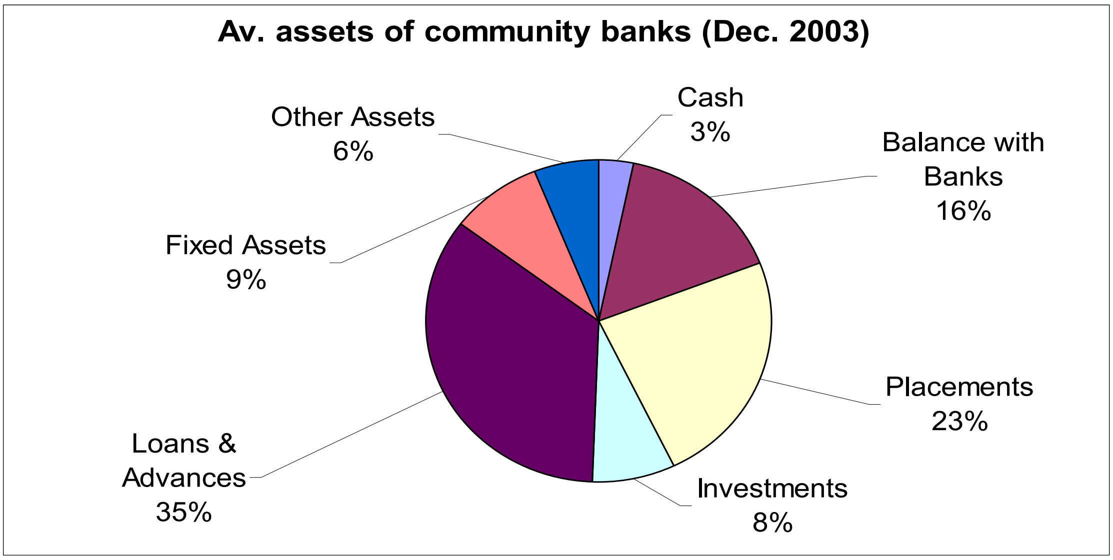
[30] OFID Circular 04-2004 dated 18 June 2004.

[31] See http://www.cenbank.org/OUT/CIRCULARS/OFID/2004/OFID-04-2004.PDF for the most recent OFID circular on 23 community banks.



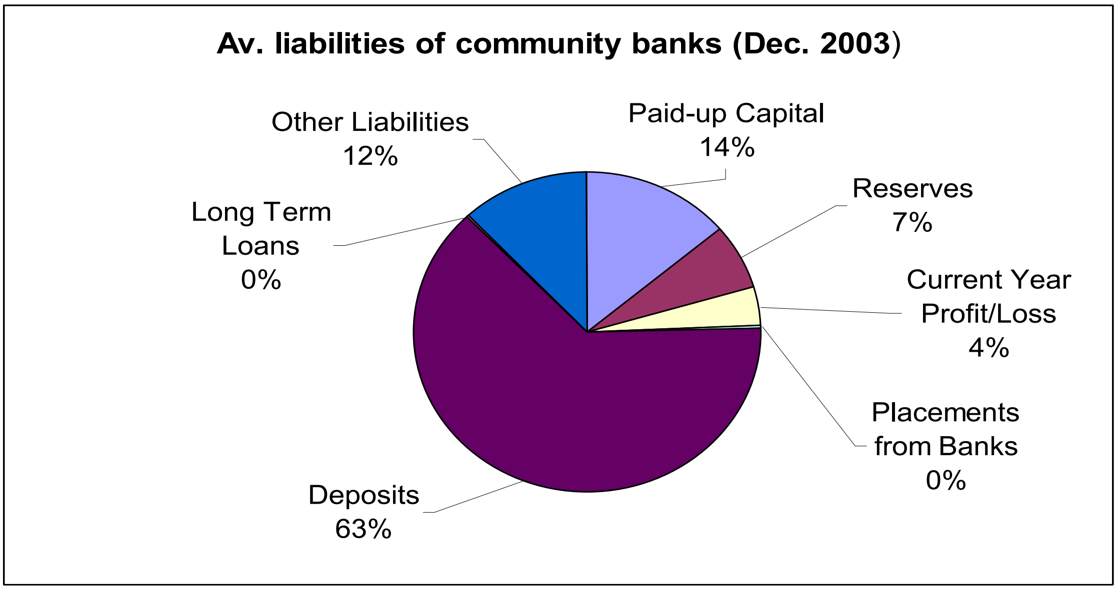


Table 3: Average Balance Sheet of Community Banks as at December 2003 (amounts in NGN millions)

ASSETS		**LIABILITIES**	
Cash	1.63	Paid-up Capital	7.02
Balance with Banks	8.18	Reserves	3.46
Placements	11.90	Current Year Profit/Loss	1.95
Investments	4.01	∑ of shareholders' Funds	12.43
Loans & Advances	17.65	Placements from Banks	0.21
Fixed Assets	4.42	Deposits	32.05
Other Assets	3.08	Long Term Loans	0.16
		Other Liabilities	6.02
TOTAL	**50.87**	**TOTAL**	**50.87**

3.4 **Importance of the community-banking sector**. Community banks account for only about 0.6 percent of the total assets of deposit taking banking institutions in Nigeria, a sector that is largely dominated by the commercial banks. Community banks have 0.94 percent of the assets, 0.54 percent of the loan portfolio and 2.27 percent of the deposits of commercial banks[32]. These figures, however, do not reflect their full potential and importance. In terms of banking counters, they accounted for 19.3 percent of all branches, counters and outlets in 2002, which indicates their importance to reach rural clients and serve a low and medium income clientele that is not directly targeted by the commercial banks. This is underscored by their number of clients served: by the end of 2003, 564 community banks served 804 605 depositors and 59 805 borrowers. The total number of clients served may therefore be safely estimated at around one million[33].

3.5 **Regional distribution**. About two thirds of all community banks are located in rural areas[34]. They are unevenly distributed over the Federation. The highest concentration is found in the Yoruba-speaking areas of the Southwest (six States), with 35 percent of all licensed banks, and in the Igbo-speaking areas of the Southeast (five States, 31 percent). The Middle Belt, the Delta and the Edo states account for 11 percent, 10 percent and 4 percent respectively of all licensed banks, while the 12 States of Northern Nigeria only comprise 9 percent of the total[35]. The highest numbers of community banks are found in Anambra (15.2 percent of all community banks), Ogun (8.1 percent), Oyo (7.9 percent), Lagos (7.3 percent), Imo (7.0 percent), Osun (4.9 percent), Kogi (4.3 percent), and Enugu and Delta states (4.1 percent each). The available data and the mission visits confirm that community banks in the rural North are relatively weak in terms of management, deposit and loan volumes and market penetration. Much of this may have to do with local perceptions of community development in general, the existence and functioning of Community Development Associations (CDAs)[36], the experience with the formal banking sector, the spread of formal education, indigenous savings patterns, the propensity to borrow and the notion of interest rates as a price for loans. It further appears that indigenous socio-cultural perceptions about participation, institutionalised checks and balances and control mechanisms and a culture of questioning of decisions, are a major condition for the success of community banks.

B. REGULATORY FRAMEWORK

3.6 **Legal background**. The Military Decree 46 of 1992[37], created the legal framework for the establishment of a community bank for the purpose of: (a) promoting rural development through the provision of finance and banking services; (b) enhancing the rapid development of

32 These figures are based on the 564 reporting banks only. If the estimated figures for the non-reporting community banks are added, the percentages chang by less than a decimal point.

33 This estimate is based on a number of assumptions: (a) 564 reporting banks with about 800 000 clients; (b) borrowers are not to be added to depositors as they are usually required to maintain a deposit account prior to borrowing; (c) the 205 non-reporting banks are smaller than the reporting banks; (d) non-reporting banks serve an average of 1 000 clients.

34 67 percent for 2002 as per the NBCB data. See details in Annex 3. A slightly different percentage was reported by FAO, 1996: p. 11 [FAO/Marketing and Rural Finance Service: A preliminary Examination of Community Banks in Nigeria. Rome, 1996, p. 8 (by Jackson O. Odonye)].

35 These percentage values are similar if based on the 881 community banks with a NBCB license as at the end of 2001.

36 See below under B.

37 According to Section 36, the Community Banks Decree of 1992 “shall be deemed to have come into force on 28 April 1992”.

productive activities especially in rural areas, and (c) improving the economic status of small-scale producers both in the rural and urban areas (Section 1). The Decree also made the start of operations subject to a license to be obtained from the NBCB. The Decree established the NBCB as a body corporate with perpetual succession and a common seal, which was allowed to sue and could be sued in its corporate name. Members of the NBCB comprised one representative each of the Federal Ministry of Finance, the Directorate of Foods, Roads and Rural Infrastructures[38] and the presidency and six other members, including the chairperson and the secretary, the latter to be appointed by the Military Head of State. The Banks and Other Financial Institutions Decree 25 of 1991 defines a community in Section 61 as a "bank whose business is restricted to a specified geographical area in Nigeria". Community banks are single unit banks so far without branches.

3.7 **Conditions for obtaining a license**. Investors who wanted to establish a community bank needed to comply with the following conditions:

- application in writing to the NBCB/CBN with full documentary evidence[39];
- adequate premises to transact business with the public;
- availability of some assets, such as a safe, a deed box, fire-proof cabinets and other necessary equipment, books and records;
- list of shareholders, directors and principal officers of the bank and their particulars; three types of shareholders had been envisaged, including: (a) Community Development Associations (CDAs); (b) trade associations such as cooperatives, farmer groups, occupational groups, women's guilds and associations, social clubs, age grades and savings and credit associations, and (c) individuals;
- minimum equity capital of NGN 250 000 fully paid up, of which at least 30 percent was to be held by a CDA[40] in accordance with some procedures; in addition, none of the other shareholders could hold more than 5 percent of the paid-up shares;
- linkages established with at least two correspondent banks; and
- payment of the prescribed application and licensing fees.

3.8 **Original vision of community banks**. The formal screening process by NBCB laid emphasis on compliance with the documentary requirements. The business prospects of the bank

[38] Created in 1986, and defunct since the end of the 1990s.

[39] Including the Draft Memorandum and Articles of Association, proposed name of the bank as cleared by the Corporate Affairs Commission, list of services to be provided, and proposed training programme for board and staff. Applications are today to be submitted to CBN only.

[40] CDA is a generic name for a variety of organizations of Nigerians. The Igbos and Yorubas, as well as other ethnic societies in the south have operated since decades their village, town or district "progressive" unions and associations. These promote the economic, social and cultural development of the area or kindred, collect levies and dues from members and indigenes for physical infrastructure, projects and support programmes, grant scholarships to the brightest students and engage in cultural activities and ceremonies, etc. Whereas in ordinary community development projects, financial contributions are decided by the council of elders (in segmentary societies) or the nobles, chiefs or kings (in hierarchical societies), town unions are headed by an elected committee. Persons living abroad are due to pay their contributions in the same way as residents. Town unions often have branches, and indigenes proudly cite the number of branches in the world as evidence of the spreading of the community over the world. While some of these CDAs registered under the Land (Perpetual Succession) Act, an old piece of colonial legislation for religious and cultural bodies, others have registered under more recent legislation or preferred to operate solely under customary law. Normally, CDAs in the north are of more recent origin, do not have the depth as in the south, do not embrace sons and daughters living outside the home area or abroad, and do not have branches.

were not an official part of the screening process. The entire set of documentation, appraisal procedures, prospectus, etc. of the NBCB, envisaged the community banks as a community development organisation in a special field, that of savings and credit, and did not reflect much of real world banking practices and requirements. Bad debt provisions were not made compulsory. This 'vision' had a number of important consequences, which prevail and have their bearing until today:

- Community banks do not always require full collateral coverage, but are often content with self-recognition, credit worthiness, personal guarantees and movable assets that do not cover the loan value[41]. This contributed to the high loan arrears.
- The NBCB emphasised the disbursement of loans, in line with its understanding of promoting the policy of the Military Government. Loan recovery was not much emphasised, and techniques of pursuing debtors not well known and established.
- Financial ratios being one of the major guides to maintain a healthy financial position have not been introduced, with the exception of a 30 percent minimum liquidity ratio and a maximum use of 70 percent of deposits for loans. This led to a poor financial management of many banks.
- Financial viability was never part of the screening process before a license was granted by NBCB; instead, the Board only inserted a clause at a later stage stating that earnings must be 'encouraging' and emphasised the improvement of the economic status of small producers. This led to an understanding that profits and payment of dividends were not one of the major objectives of the banks.
- Community banks were required to employ a minimum staff strength of 13[42], disregarding the actual workload and the earning capacity of a young bank. This led to over-staffing and high expenses on staff salaries and contributed to low earnings.
- The procedures for internal control were marginal[43]. As a consequence, most community banks did not have explicit internal control policies, frequently witnessed fraud of staff and other malpractice, did not employ an internal auditor and experienced losses.
- The constant drive for increasing the share capital was not made an official policy. As a consequence, most of the community banks were under-capitalised when the CBN took over control of the banks.

3.9 **Scope of business**. A community bank is entitled to undertake the following specific activities (Section 5):

- accept various deposits, including savings, time and target deposits;
- issue for the purpose of raising funds, redeemable debentures;
- receive or collect on behalf of its customers, moneys or proceeds of banking instruments;
- provide ancillary banking services, such as remittance of funds or safe deposit facilities;

[41] As per the NBCB Appraisal Manual, pp. 9-12.

[42] Including 1 manager, 1 accountant, 2 general service officers, 2 loan officers, 1 cashier, 1 secretary/typist, 1 ledger clerk, 1 cleaner/messenger, 3 security guards and 1 driver. NBCB, Operational Guidelines, December 1991, p. 9.

[43] These contained two small paragraphs with five very broad recommendations. NBCB, Operational Guidelines, December 1991, p. 57.

- maintain and operate various types of accounts with other banks in Nigeria;
- invest surplus funds in suitable instruments, including the deposit in correspondence banks or the purchase of treasury bills;
- provide credit facilities to its customers;
- receive refinancing or other funds from private or public sources;
- provide guarantee in favour of customers;
- operate equipment leasing facilities; and
- perform other non-banking functions to ensure access of customers to farm inputs.

3.10 **Restricted scope of business**. Community banks are not entitled to deal with foreign exchange. They are also barred from direct cheque clearing with the CBN, and must pass through any commercial bank of their choice. The same applies as regards the issue of drafts. They are also not entitled to engage in sophisticated banking services such as corporate finance and sale of international commercial papers or international electronic fund transfer. Community banks are requested to obtain prior approval from the CBN for a number of agreements or arrangements related to: (a) the change in the control of the bank, (b) the sale, disposal or transfer of the whole or any part of the business of the bank, (c) the amalgamation or merger of the bank with any other person or body, (d) the reconstruction of the bank, (e) opening or closing any cash office within its geographical area, (f) appointment of a new director or principal officer of the bank, (g) commercial, agricultural or industrial undertakings, and (h) granting of unsecured loans to staff or of loans to directors in excess of NGN 50 000.

3.11 **Supervision**. The original Decree vested supervision with the NBCB and regulation with both the CBN and the NBCB. During the initial period, the military rulers had made it clear to the CBN that the community banks were the prime affair of the NBCB, and that the CBN would have to remain outside. With the advent of democratic rule in 1999, the FGN confirmed that the CBN was now in charge of the entire financial sector, including banks and all other financial institutions. The CBN thus created the Other Financial Institutions Department (OFID) in 2000, which is in charge of all financial institutions other than the commercial and merchant banks. CBN and NBCB take their original mandate from military decrees, the Community Banks Decree of 1992, and the Banks and Other Financial Institutions Decree of 1991. Of these two, the Banks and Other Financial Institutions Decree has been amended various times and changed into an Act of Parliament, and most recently under democratic rule, whereas the Community Banks Decree has not. One may therefore argue that the most recent piece of legislation, the Bank and Other Financial Institutions Act (BOFIA), prevails over the older one, and that the supreme authority of a central bank prevails over that of a simple parastatal. However, neither has the NBCB been abolished, nor has the Community Banks Act been repealed, and the NBCB therefore continues to exist. Since 1994, funding to the board has been dwindling, leading to a financial crisis in 2001. Between 1994 and May 2003, the NBCB had no board, following the dissolution of the previous one. NBCB management hopes that the new board will help the repositioning of the NBCB in the system and give it more leverage, and help in attracting funding from the FGN in line with statutory regulations. The shortage of funds no longer permits the NBCB to perform its functions[44] and inspect banks[45]. The presidency has recently requested the two institutions to resolve the issue of dual supervision among themselves.

[44] NBCB was unable to fund the external audit of the board. Until 2001, this was performed by private chartered accountants. Training and field inspections have almost entirely stopped.

3.12 It is evident that the old supervision by NBCB had serious constraints, and that the Board is hardly in a position to provide adequate supervision. It further appears that the CBN supervision is also not as effective as it should be. This is related to the frequency of supervision, the omission of banks in remote areas, and the application of criteria to issue final licenses to some banks. In the view of the mission, the granting of licenses to some banks is questionable.

3.13 **Regulatory changes**. Since the CBN became in charge of supervision and regulation, it has changed a number of regulations[46], including the following:

- increase of the minimum share capital to NGN 3 million and then to NGN 5 million;
- removal of any stipulation related to the participation of share capital by a CDA; CDAs are entitled as before to invest in a community bank, but this is no longer a requirement;
- removal of the stipulation that no shareholder is entitled to hold more that 5 percent of the share capital;
- fixing the number of directors between three and seven, as against the former range of five to seven;
- abolishment of the minimum cash reserve requirement of 5 percent;
- increase of the minimum capital adequacy ratio from 8 to 10 percent;
- compulsory bad debt provisions of 1 percent on the total portfolio outstanding, 20 percent on past due loans above 90 days, 50 percent on past due loans above 180 days percent and 100 percent on past due loans above 360 days.

3.14 **Prudential requirements**. Community banks are to observe a number of prudential requirements, including:

- minimum liquidity ratio of 30 percent; cash deposits with the CBN do not constitute part of the liquid assets;
- minimum ratio of 10 percent between shareholder fund unimpaired by losses and net credits; and
- maximum exposure in all forms (loans, advances, guarantee or other liability) of 10 percent of shareholder funds to one single borrower.

3.15 **Submission of financial data**. Every community bank is obliged to submit returns on key financial and operational data to both the NBCB and CBN. While the NBCB, in accordance with the Decree, requested a monthly submission, the CBN changed this and asked for quarterly returns only. The two sets of forms differ widely and are not entirely compatible. While the rendition return to the NBCB was 60 percent in January 2000 and 52 percent in September 2001, it declined gradually since the CBN became the prime supervisory body. The rendition return to the CBN increased from 42 percent in December 2002 to 76 percent in 2003, in line with the issue of new banking licenses granted by the CBN. Many community banks complained about the

[45] In 2002 and 2003, the 31 visited banks from which data were available had received on average 1.2 and 1.0 visits respectively from the NBCB. During the first five months of 2004, this had decreased to an average of 0.1 visits per bank.

[46] The first Guidelines for the Operations of Community Banks in Nigeria was dated February 2000, and amended in May 2002.

different standards and sets of forms, and ceased to submit returns to the NBCB as they saw this as no longer necessary. This practice has the unfortunate consequence that the data from these two institutions are not comparable in all regards. Major items to be covered in the quarterly report to CBN comprise: (a) a balance sheet; (b) a report on interest rate; (c) a breakdown of major assets and liabilities; (d) a schedule of investments; (e) an income statement; (f) an analysis of loans and advances, including non-performing credits; (g) a structure of deposits; (h) loans outstanding to directors, principal shareholders and their related interests; and (i) reports on fraud and forgeries. In addition, banks are to send their audited annual financial statements to the CBN, and may also have to do so for the NDIC once they seek its insurance cover.

3.16 Managers and boards are fully aware of these reporting requirements, but even some licensed banks do not always comply fully. As regards reporting to the CBN, 71 percent of the banks visited in the field stated that they reported on a regular basis, 23 percent stated that they reported irregularly, and 6 percent did so only once over the past year. Reporting to the NBCB is less regular, with only 45 percent of the banks reporting on time and 26 percent reporting irregularly. About one out of three banks stated that they stopped reporting to the NBCB, as the CBN was apparently the only institution in control.

3.17 Community banks are required by the law to exhibit their balance sheet and income statement in their offices and to have their accounts audited by a qualified external auditor. However, few banks comply with this regulation, and very few on a regular basis[47].

3.18 **Recent changes**. In 2004, there has been one further modification of the regulations. Community banks are now permitted to participate under the ACGS and obtain CBN guarantees for agricultural loans. The CBN has been preparing circulars for community banks and has started to offer training on the scheme, but it is not yet operational in 2004. In addition, the CBN is currently holding discussions with the Nigerian Deposit Insurance Corporation (NDIC) to extend the coverage of NDIC to community banks and Primary Mortgage Banks (PMBs) as well[48]. NDIC guarantees deposits in the banking sector up to an amount of NGN 50 000 per account in the case of bankruptcy; banks pay 0.9375 percent of the total deposits to obtain this compulsory insurance cover. NDIC will start to examine community banks and PMBs in mid-2004.

3.19 **Urban community banks**. Community banks were designed to cater for rural communities, and some of the provisions were not compatible with metropolitan environments. Examples are the stipulations on the participation of CDAs[49] or societies, collateral requirements, promotion of farmers and agriculture, input supply, etc. NBCB tried to make the residence of shareholders in one suburb or neighbouring quarters a condition for a license, and put emphasis on associations of landlords or tenants. However, many community banks in urban areas may have been established "under various guises"[50] by people who just wanted to become bankers. Urban community banks are among the more prosperous banks, having succeeded in mobilising high

[47] Only two out of the 34 community bank visited actually displayed abridged versions of the audited financial statements in the banking hall.

[48] See http://www.cenbank.org/OUT/CIRCULARS/OFID/2004/OFID-03-2004.PDF.

[49] While town unions may have members in towns, people in Southern Nigeria trace their origin to the village from where they originate. As a consequence, there are hardly any indigenes from urban areas, and as a further consequence, hardly any CDAs.

[50] NBCB, Appraisal Manual, Abuja, not dated, p. 48.

deposits and differ in many regards from their rural sister organisations. The biggest community bank in Nigeria has been established by and for members of the Nigeria Police Force.

3.20 **Area of operations**. Each community bank is to operate in a defined geographical "catchment" area; no other community bank is entitled to operate in the same area as well. The NBCB had assumed that a rural population of at least 50 000 would generally suffice to allow a bank to operate profitably[51]. In actual practice, most clients in rural community banks come from the same locality, but some depositors keep accounts with different community banks if they operate in different locations, and some clients residing outside the catchment may also get loans[52].

3.21 **Matching loans**. The Decree mandated the NBCB to grant so-called matching loans to community banks up to an amount of NGN 0.5 million per bank. This was meant as a kick-start for the banks, assuming that clients would come in greater numbers if the bank could extend loans right from the beginning. In view of the limited amounts available and the large number of licensed banks, the Board reduced this amount to NGN 0.25 million[53]. By September 2003, the Board had disbursed matching loans worth NGN 119 million, which were to be repaid within 5.5 years[54]. By that date, NGN 58 million were still outstanding and overdue, and many defaulting community banks were already defunct.

C. SET-UP

3.22 **Organigram**. Community banks have a simple set-up, which is adequate for their size and operations. The supreme body is the Annual General Meeting (AGM) of the shareholders, which elects 3-7 directors into the board. The board is usually permitted to establish special committees, such as executive, credit or internal audit committees. Directors are not managers but only supervisors. In actual practice, many directors supervise the managers so closely that they could almost be regarded as the 'super-managers', but one needs to admit that the line to draw here is quite fine. The manager is the executive head of the bank and is in charge of all day-to-day affairs. He supervises all staff of the bank. The NBCB has provided for an organigram of the bank, comprising three divisions on Banking, General Service and Credit and Development. In actual fact, this is not very much applied, and the only visible hierarchy is the Deputy Manager below the Manager, who is often the Accountant.

3.23 **Staff**. Community banks visited in the field employ an average of 13 staff, and even rural based banks employ 11 staff on average. These figures are very close to the recommended staff strength of NBCB, and it is surprising to see that these recommendations, made 12 years ago, are still being largely followed, with the 'deviation' that the banks employ two accountants and one credit officer on average instead of one accountant and two credit officers, as the table below

51 NBCB, Appraisal Manual, p. 57. This number was expected to double in metropolitan areas.

52 The initial regulation that shareholders and clients should as much as possible be indigenes has left some negative traces, as many people may be indigenes of a place but reside elsewhere in a town. In one case, a community bank had 8 loans outstanding, of which 6 were granted to directors who resided in Lagos, beyond the reach of the manager.

53 Assuming that no community bank got more than N 250 000, 27 percent of all NBCB-licensed banks availed of this facility.

54 The loan was payable within 60 months after a moratorium of six months in ten half-yearly instalments. Community banks were not permitted to declare dividends until the loan has been repaid fully.

shows. Apart from the one Lagos-based bank, no other bank seemed to be in need of more than one credit officer, and nine banks did not even employ one.

Table 4: Evolution of Staff in Community Banks (1999-2004)

	Manager	Accountant	Credit Officer	Cashier	Other staff	Total Staff
Staff 5 years ago	33	67	32	45	209	397
Staff today	37	70	31	50	243	431
Change	4	3	-1	5	34	34
Change in percent	**12 %**	**4 %**	**-3 %**	**11 %**	**16 %**	**9 %**
Average today all banks	1.2	2.3	1.0	1.6	7.8	13.4
Rural + peri-urban banks only	1.0	1.9	0.8	1.3	5.7	10.7
NBCB recommendation	*1*	*1*	*2*	*1*	*8*	*13*

Note: N = 31.

3.24 It appears that many banks are overstaffed. Most of the staff are accountants, bookkeepers and account clerks (usually 4-6 in rural based banks). All banks visited outside the two Lagos-based ones kept their accounts manually, and only four out of 34 banks had functioning PCs, of which two (in Lagos) used a special software, while the other two used the PCs mainly for typing and calculation purposes. Most of the managers complain that even with such staff strength, they are not always able to comply with reporting requirements. The average number of daily transactions at the bank counters was estimated at 141 by the managers, which would be equivalent to 13 transactions per staff per day.

3.25 **Staff qualification**. For the normal and routine business, the lowly paid staff is adequately trained[55]. Problems emerge once more complex issues related to accounting, financial analysis, planning and projections. Not all bank managers have an adequate formal banking experience, and even a person who has worked some years in a commercial bank is not automatically a good community bank manager, as the skills required here are quite different from those in the highly specialised commercial banks. Managers lack access to information about alternatives to what they currently do and training in modern management tools. The credit officers met had had no training at all on their specific duties and were not familiar with even the most simple loan appraisal techniques.

3.26 **Staff turnover** is usually not a problem; on average, the banks visited in the field had an average staff turnover of six over the past five years, which indicates a normal situation and a desire of staff to remain in one's place of work.

[55] Apart from the manager and accountant, almost none of the other staff interviewed in the field had an educational qualification above secondary school level, and more than half of them did not even pass the examination General Certificate of Education Ordinary Level (GCE/OL). They, therefore, fall into the category of employees that are generally classified as *G4*, being those who have attempted class five in secondary school, but could not pass all the papers and so did not qualify for the award of the full secondary school ordinary level certificate.

Box 1: A community bank with a social mandate

A parish in South-eastern Nigeria thought it wise to add banking to establishment of schools, hospitals and charitable homes to help in evangelism. The idea was muted by the bishop of the diocese. Flotation of shares was announced in all parishes of the diocese. The campaign was well received and shares were subscribed. The bank started in 1994 with 100 shareholders, who were all members of the Church, raising a total capital of NGN 1.9 million, of which NGN 1.7 was held by a CDA and the rest by individuals. By May 2004, the paid-up capital had increased to NGN 8.7 million; all new shares after the initial share raising had been purchased by individuals. The bank has a good management and committed board, employs an internal auditor and has invested in the training of its staff. Clients met were quite satisfied with the services they received. Most of its financial data indicate a much above average performance in most regards. In 2003, returns on assets were 7.9 percent, returns on equity 262 percent, and the expenditure/income ratio was 44 percent.

The bank has excelled in mobilising savings; in May 2004, total deposits reached NGN 215 million, which were contributed by 10,800 savers. Deposits comprised between 74 and 87 percent of total assets, and the share of savings deposits in total deposits fluctuated between 72-86 percent over the past 4 years. The manager estimates the number of transactions at 8,000 per month or about 380 per day. On the lending side, the bank has been less successful. Is current portfolio amounts to NGN 34.9 million, of which NGN 12.5 or 36 percent were in arrears. In line with the CBN guidelines, the bank made its first loan loss provisions of NGN 10.8 million in 2003. The promoting parish is one of the defaulters.

3.27 **Shareholders**. Community banks have three different types of shareholders, i.e.: (a) Community Development Associations (CDAs), (b) trade associations[56] and (c) individuals. Two restrictive regulations have been removed, i.e. the ceilings for shareholding and the compulsory participation of CDAs. Some overall trends can be observed since these regulations, which were paralleled by the requirement to increase the share capital, came into force. The first observation is that – as expected – individuals[57] accounted for most of the fresh capital. Their share in the total share capital increased roughly by ten percent points in the community banks visited. This process was even more accentuated in the South East (Abia and Cross River States), where the relative share of individuals increased from 51 percent at start to 72 percent today. At the same time, the importance of CDAs has declined – as expected –, by about the same ten percent points in all zones. The interesting point here is not so much the decline of the share of CDAs, but that CDAs have participated in the fresh capital injection. On average, their shareholding was about five times higher at the time of the survey as compared with the start of operations. There are two further interesting observations here. The first is that the relative share of CDAs in the two Northern States of Bauchi and Borno was higher than in the two south-eastern States of Abia and Cross River, as against the difficulties that had been reported initially by NBCB to find sufficient numbers of CDAs in the Northern parts of Nigeria. The second one is that mutual associations have never been actively involved in community banks in the North, and

56 E.g. cooperatives, farmer groups, occupational groups, women's guilds and associations, social Clubs, age grades and savings and credit associations.
57 Staff did not hold shares of their community bank in those banks visited.

that their relative importance seems to have fallen even faster in the Southeast than in the entire sample[58]. The data are captured in the table below.

Table 5: Evolution of Shareholding by Type of Shareholder

	Start	Today	Start	Today	Start	Today
	All (N=34)		Bauchi & Borno (N=10)		Abia & Cross River (N=15)	
Av. no. of shareholders	153	210	210	124	91	147
Av. share capital in NGN '000	**1596**	**7606**	**1033**	**6784**	**727**	**5421**
• CDAs	633	2139	350	1653	210	1071
• Mutual Associations	144	799	16	89	147	472
• Individuals	819	4668	667	5042	370	3878
Av. share capital in %	**100 %**	**100 %**	**100 %**	**100 %**	**100 %**	**100 %**
• CDAs	40 %	28 %	34 %	24 %	29 %	20 %
• Mutual Associations	9 %	11 %	2 %	1 %	20 %	9 %
• Individuals	51 %	61 %	65 %	74 %	51 %	72 %

3.28 The average **number of shareholders** has not changed much since inception. While community banks visited in the field had on average 149 shareholders at the start, they had 207 in May 2004, an increase of 39 percent over eleven years[59]. This indicates that community banks have not been very successful to sell shares to new clients and are probably often a closed shop. None of the banks demanded from borrowers that they had to be a shareholder, or to have a minimum value of shares.

3.29 **Boards**. In principle, the voting rights of every shareholder are proportional to his/her contribution to the paid-up share capital of the bank (Section 10, BOFIA 1991). It appears that this clause is not very much adhered to in rural areas. Many banks have substituted this provision by some standard practices prevailing in rural areas, according to which boards and committees of any rural institution need to be broad based and comprise all the major streams, kindreds, quarters and segments of the local society, and which apply the "one man, one vote" principle. The NBCB also recommended having at least one female person on the board[60]. A consequence of this is that often, persons elected as directors are vocal leaders in their own right, determined to support local development and experienced to balance power, but are not necessarily the most qualified ones to steer a bank. One also needs to assume that with the decision to integrate the CDAs into the community banks, this local practice has found its entry into the community-banking sector. The consequence is that the community bank is treated as any normal rural development institution, and not as a bank that needs qualified supervisors and guides in order to survive on the market and achieve the goals it has set.

3.30 **Governance**. Community banks have a governance problem, and board supervision is probably the weakest aspect of community banking in Nigeria. However, this does not affect all banks. There are banks with experienced, professional bankers on the board, who know their

[58] One should add that in view of the relatively small number of banks visited, the results are not representative and should be treated cautiously. However, the issues may have to be deepened in the future.
[59] N = 28 banks, for which data were available.
[60] NBCB Appraisal Manual, p. 55.

communities, the economic environment and banking approaches. There are boards with very dedicated leaders, who are the good spirits behind the bank and keep the bank out of problems, link with the right persons, adequately supervise the managers and assist where the need arises. There are a few boards that laid down their code of ethics when the bank started, and that continued to apply it, especially as regards using the bank facilities, and especially as regards bank loans. Such boards, it appears, are the exception. With two exceptions, all banks visited[61] had had problems either with overdue loans by directors or with staff fraud and malpractice, which both point to a lack of adequate supervision and guidance by the board. Many board members are not qualified to supervise a bank manager, as their understanding of the issues at stake is low. Much of this may have to do with the involvement of CDAs and the selection of directors not on the basis of their shareholding. Over and above this issue of incompetence, board members decide on the loan interest rates applied in their own case as well, and usually set these rates as low as possible, sometimes as low as 2 percent per annum. They usually keep their bank accounts with commercial banks, and not with the community bank they pretend to patronise. Evidence from the field suggests that directors regard borrowing from the community bank they 'serve' as an optional facility, which they could avail of at any moment. As directors are able to protect themselves, they are hardly pushed by the manager to repay on time. As they hardly provide sufficient collateral, the bank has little to lean on in case of default. Under this corrupt practice, all directors borrow and default, so that none of them could ask for prompt and full repayment of the others. In the most obscene case studied, four directors had borrowed for their own purposes and for their associated businesses an amount of NGN 11.7 million, which was entirely in arrears. Directors' arrears in this case accounted for 93 percent of all arrears and for 107 percent of the total deposits[62]. Some board members are said to have threatened to sack the manager if he would pursue debt recovery against them, their indebted party followers, or any of their kinsmen. Managers in such cases are unable to do anything, unless they are prepared to look for another job.

3.31 **Annual General Meetings (AGM)**. Community banks are compelled by law to hold their AGM within six months after the end of the financial year. Discussions in the field revealed that only about half of the banks actually do so[63]. Some banks have held only two AGMs over eleven years of operations. This means that the financial records of the bank have not been transmitted to shareholders, and that the respective boards could not be regarded any longer as having a democratic mandate from the shareholders. The absence of regular AGMs coincided in almost all cases with serious loan default of the directors and the occurrence of other malpractice. One therefore needs to assume that these boards protect their own interests by not organising the AGM in accordance with the law, and that the shareholders, the CDAs or the community at large are unable or unwilling to enforce inviting for the AGM.

[61] This is equivalent to 92 percent of all cases, disregarding the two banks in Lagos, where this issue had not been raised.

[62] The CBN has intervened in this case by requesting bank management to stop lending until the arrears have been recovered. Clients are constantly pleading for new loans, but management is stuck between reluctant directors, the demanding clients and the ban of the CBN. This case illustrates that the current framework is not adequate to protect the banks.

[63] Out of the ten banks visited in Northern Nigeria, only one had held all AGMs regularly.

D. CLIENTELE

3.32 When community banks started, the promotional committees mobilised all sorts of people from the community, just in the way the propagators of the scheme wanted this to happen. As a consequence, community banks attracted a good mix of farmers, traders, contractors, craftsmen and artisans, and salary earners, and both men and women. As regards loans, there are until today some appreciable cases of community banks serving the market women to enable them buy their stock, the farmers to buy farm inputs or market their crops, and the craftsman to buy raw materials. This has, however, become the rare exception. A decade after their establishment, the salary earners and pensioners have become the main client group and dominate the minds of managers and directors. Apart from these and the loans given to staff and directors, community banks only serve a few traders. As regards deposits, community banks continue to be open for all clients that wish to open accounts. Their opening hours are often more conducive to people, as they open longer in the afternoon than commercial banks, and may even open their counters if the market day falls on a Saturday. Some community banks even go as far as targeting students through special savings products. While some banks receive most of their deposits from a few wealthy persons, there are others that are readily accessible to all those that look for a safe place for their excess liquidity. Most of this preference has to do with the high loan default of farmers and small-scale entrepreneurs, the inability to recover arrears from these, the high security that wage earners can provide and the high income realised from the commission on turnover (COT).

3.33 With this development, the community banks have abandoned their own mandate and vision, failed to achieve the objectives for which the Decree was set into force and are not an asset in rural development.

3.34 There are few data available on gender aspects. The mission observed that outside the LGC staff, women are an important group among the savers. Browsing through the credit records of some selected banks revealed that about one fifth of the borrowers were women. An FAO report states that some years ago, women accounted for 36 percent of the clients in four community banks surveyed[64].

E. CAPITALISATION

3.35 The **minimum share capital** has been set at NGN 5 million. By the end of 2002, a total of 300 community banks had the required amount, and this increased to 460 by the end of 2003. By mid-2004, all the 532 licensed banks had paid up the required share capital.

3.36 In 2002, the average value of shareholder funds were on average about twice the value of the paid-up share capital. While rural community banks had average shareholder funds of NGN 10 million[65], this value was 36 percent higher in urban-based banks. Interestingly, the average share of shareholder funds was equivalent to 23-25 percent of total assets/liabilities across all institutions in this year, as shown below.

[64] FAO/Marketing and Rural Finance Service: A preliminary Examination of Community Banks in Nigeria. Rome 1996, p. 17 (by Jackson O. Odonye).

[65] The average shareholder funds of 24 community banks visited in the field, from where data were obtained for all years, increased from N 6.63 million in 2001 to N 8.47 million in 2002, then declined to N 7.89 million in 2003, and increased to N 8.21 million in May 2004. The data for 2004 are of course preliminary figures only.

Table 6: Average Capitalisation (2002)

Item	Rural CBs	Urban CBs	All CBs	All CBs
Data source	NBCB	NBCB	NBCB	CBN
No. of banks	395	195	590	316
Total Paid-up Capital	5,574	7,180	6,105	6,720
Total Shareholders' Funds	10,074	13,656	11,258	12,106
Shareholder funds/Assets	23 %	24 %	24 %	25 %

Source: Annex 4, Table 2; Amounts in NGN '000

3.37 A more longitudinal view shows that the new CBN regulations pushed up the equity capital between 2000 and 2002. The average increase over a two-year period was 43 percent on the basis of the NBCB records, and 26 percent on the basis of the CBN records, as shown in the table below[66].

Table 7: Evolution of Equity (2000–2003)

Year	2000	2001		2002		2003	2000-2	2001-3
Indicator	Mean	Mean	Mean	Mean	Mean	Mean	percent Change	percent Change
Data source	NBCB	NBCB	CBN	NBCB	CBN	CBN	NBCB	CBN
Shareholder funds	5,571	8,926	8,085	11,258	12,106	12,431	43.2	26.2
Shareholder funds/assets	22 %	24 %	21 %	24 %	25 %	24 %		
No. of banks	654	579	128	590	316	564		

Note: Amounts in NGN '000. Source: Annex 4, Table 3

3.38 **Constraints**. With the threat to close banks, many banks tried to raise their share capital to the required level. Most banks had serious difficulties to attract additional share capital. Low income clients refused to buy shares as they could not get loans from the bank[67]. Potential investors did not see that the bank in question had paid out substantial dividends, which would make the investment into a community bank a risky and potentially non-profitable venture. Investors apparently buy shares from a community bank for motives other than getting a maximum rate of return. In many cases, community banks only have an authorised share capital close to the required minimum, and AGMs usually set the ceiling rather low[68]. This prevents banks from selling additional shares to clients as a normal routine practice. Lending is also not tied to the amount of shares held by an applicant[69]. Managers do not regard the selling of shares as one of their prime duties.

66 It is unfortunate that the data do not permit a further analysis by separating the additional capital injections by shareholders and the massive bad debt provisions that were made in 2003; see Chapter 3 G.

67 See Section 3 G.

68 As per the balance sheets of the community banks visited, the differences between authorised and paid up share capital was less than 10 percent on average.

69 It would for example be possible to raise shares by requesting all borrowers to hold shares worth 5 percent of the amount sought.

F. SAVINGS MOBILISATION

3.39 **Overview**. On average, deposits account for 63 percent of total liabilities[70]. In 2002, short-term assets[71] represented 84 percent of total deposits on average, which declined to an average of 68 percent in 2003. On average, total deposits comprise 55 percent of savings, around 30 percent demand and 15 percent time deposits. However, the importance of savings deposits in rural based institutions is much higher (65 percent) than in urban banks (44 percent). Rural banks also have a much lower share of time deposits than urban banks (9 percent compared to 23 percent) and lower demand deposits. Much of this may have to do with the improved knowledge of the different instruments and yield concerns by the urban population. The deposit structure of community banks is shown in the table below.

Table 8: Average Deposit Structure (2002)

Item	Rural CBs	Urban CBs	All CBs	All CBs
Data source	NBCB	NBCB	NBCB	CBN
No. of banks	395	195	590	316
	…. ....%			
• Demand deposits/total deposits	26	33	29	28
• Savings deposits/total deposits	65	44	56	55
• Time deposits/total deposits	9	23	16	17
Total deposits/total assets	58	65	60	63

Source: Annex 4, Table 2

3.40 Over the period from 2000 to 2002, NBCB records show very little fluctuation as regards the share of savings in total deposits (56-57 percent). CBN data for 2003 show an increased share of 60 percent; much of this may have to do with a larger number of reporting banks and the coverage of more rural based institutions in the CBN records for this year. The growth rate of savings mobilised by community banks has been higher than the rate of inflation over the past three years.

3.41 **Deposit volume and evolution**. By the end of 2003, total deposits held by all community banks should have exceeded NGN 20 billion. OFID data indicate total deposits of NGN 18.1 billion for the 564 reporting banks. The average deposit value per bank based on the OFID data was NGN 32.0 million in 2003 as compared with NGN 30.7 million one year earlier; representing a 4 percent increase. On the basis of NBCB and OFID records for the years 2000-2003, average deposits per bank increased from NGN 15.4 million in 2000 to NGN 32.0 million three years later. As these data are based on different sub-sets, the two-year growth rates of deposits were 38 percent for the NBCB records (2000-2002) and 12 percent for the CBN records (2001-2003), as shown in the table below.

[70] OFID data for 2002 and 2003. As NBCB and CBN records show similarities, one may assume that this ratio applies more or less to all community banks.

[71] Cash at hand, balances held with other banks and short term placements

Table 9: Evolution of Average Deposits (2000–2003)

Year	2000	2001		2002		2003	2000-2	2001-3
Indicator	Mean	Mean	Mean	Mean	Mean	Mean	% Change	% Change
Data source	NBCB	NBCB	CBN	NBCB	CBN	CBN	NBCB	CBN
Total Deposits	15,433	23,903	25,734	28,742	30,694	32,048	37.6	11.8
• Demand	4,830	7,156	na	8,243	11,635	8,448	31.7	na
• Savings	8,867	13,572	na	16,199	23,024	19,287	36.2	na
• Time	1,736	3,175	4,300	4,561	7,058	3,327	63.3	5.6
N	654	579	128	590	316	564		

Note: Amounts in ‘000; na = not available. Source: Annex 4, Table 2

3.42 **Deposits in rural banks**. As could be expected, rural based community banks have much lower deposits than urban banks. In 2002, average deposits in urban banks were NGN 36.4 million, which were NGN 11.5 million or 31 percent higher than in rural based banks.

Box 2: Growing without lending

A community bank in Western Nigeria started with a share capital of NGN 1 million, contributed by 197 shareholders. By June 2004, the number of shareholders had increased to 532, and the paid-up share capital to NGN 7.1 million. The bank has an active manager and board supervision is effective. Directors meet every 2 months, and all AGMs have been held since inception. The bank works out a yearly budget, controls any deviation from it, appraises staff regularly, uses an operational manual and effectively supervises and controls staff. None of the borrowing directors had ever been in arrears with his loans.

Apart from the usual call, savings and time deposits, the bank offers three other target savings products. These are related to Christian, Muslim and indigenous religious festive seasons, correspond with the interest of clients and bring a constant flow of target savings to the bank. Interest paid on savings is 3 percent, and interest on time deposits fluctuates between 7-10 percent per year. With these products and terms, the bank excels in savings mobilisation. Total deposits stood at NGN 47 million, equivalent to 78 percent of total assets.

The bank finds it difficult to find enough borrowers, although terms and conditions of loans are similar to what other community banks apply, and although the interest charged is on the lower side (25 percent). Only 6 percent of assets and 8 percent of deposits were used for loans, despite the frequent visits of the manager to clients and inviting them to take loans. As a consequence, most of the assets (76 percent) were placed with banks or in treasury bills, for which the bank earned 13.75 – 16.8 percent.

3.43 **Types of savings**. All community banks offer the same types of deposits as commercial banks do. These are call, savings and time deposits. The marked difference to commercial banks is that community banks keep very low entry barriers, but also apply much lower rates of interest as shown in the table below. This should be regarded as a definite policy to tap savings from all corners of the community, disregarding the amount of savings.

Table 10: Opening Balances and Interest Rates for Deposits

Item	Call Deposits	Savings Deposits	Time Deposits
Min. opening amount	100	100	5,000
Max. opening amount	5,000	2,000	100,000
Av. opening amount	1,129	663	64,667
Min. interest rate	0%	1%	8%
Max. interest rate	1%	4%	20%
Av. interest rate	0.0%	3.8%	9.2%

3.44 **Other savings products**. Over and above these standard banking services, only few banks offer additional savings products. Among the ten banks visited in the North, two banks offered "Hadj Savings" for persons desirous to undertake their pilgrimage to Mecca and Medina. These savings were usually for a period not exceeding nine months, the amounts were not significant as compared with the total deposits, and the service was obviously meant more for the wealthier classes. In Ekiti and Lagos States, community banks offered at least one additional product, and up to a maximum of three. These savings products were either special event savings, e.g. for Christian, Muslim or traditional or cultural festivals, or special target savings, e.g. for school fees. In cases where community banks offered three different religious/cultural savings, which occur at different periods of the year, the banks usually had good success with these products, and the amounts thus mobilised were substantial in terms of total deposits. Interest rates were usually somewhere between the rates offered for ordinary savings and time deposits. In addition, operating costs for these products were usually low, as similar procedures and books as regards savings could be used. Surprisingly, banks visited in Abia, Cross River and Benue States had no additional savings product other than the standard ones.

3.45 **Issues**. Except in the Western part, community banks seem a long way away from tapping the full savings potential of their market. Many bank managers are more concerned with the decision of the local government council to automatically transfer salary payments to the bank, and forget about the rest of the market. Only few, which are probably concentrated in the highly competitive West, have savings products that are targeted to specific clients. None of the banks had ever carried out a review of products, associated costs and benefits or profitability of savings mobilisation, and none of the banks had ever bothered to ask clients about their perception of the savings products.

G. LENDING

3.46 **Overview**. The total loan portfolio of banks reporting to the CBN amounted to NGN 9.95 billion at the end of 2003; the total loans of all banks may be estimated at around NGN 10.5 billion for the same time[72]. The average loan outstanding was NGN 166 454 for the end of 2003, which represents an increase of NGN 44 918 or 37 percent over the previous year. By the end of 2003, 59 805 borrowers had loans outstanding from a community bank. However, the average number of borrowers per bank of 106 is disappointing. Over the period 2000-2003, community banks employed 27-35 percent of their total assets for loans and advances, generally

[72] Assuming cautiously that the non-reporting banks have an average loan portfolio of about N 2.5 million.

with an increasing trend[73]. In terms of total deposits, loans accounted for 40-55 percent of the total deposits over the period 2000-2003. Both NBCB and CBN records show an increasing trend: from 47 percent in 2000 to 52 percent in 2002, according to the NBCB data and from 40 percent in 2000 to 55 percent in 2003, according to the CBN data. The data show no marked difference for urban and rural banks, except that rural community banks have a slightly lower intermediation ratio compared with urban ones[74]. However, such shares fall short of the ceiling of 70 percent permitted by the laws.

3.47 The **average loan portfolio** of a community bank was NGN 14-15 million by the end of 2002 and NGN 17.7 million by the end of 2003. CBN records for 316 banks give an average of NGN 13.6 million, while the NBCB records for 590 banks show an amount of NGN 15.1 million. The NBCB records reveal substantial differences between urban and rural banks. While rural based banks had a portfolio of NGN 13.1 million on average, their urban sisters had 19.0 million, which is 45 percent higher.

3.48 **Growth rates**. NBCB records for the period 2000 to 2002 show an increase of 45 percent of the average loan portfolio, while the CBN records for the period 2001-2003 show a growth of 31 percent.

3.49 **Loan products**. Community banks have very simple loan products. They offer an overdraft facility on current accounts for a duration of 1-12 months and short-term loans up for a duration of 3-18 months.

3.50 **Overdrafts** are primarily granted to salary earners, mainly the staff of the Local Government Councils, schools and hospitals. In some cases, loans are given up to a maximum of three times the net salary, which are then repayable over six months through deductions, but in other cases are as low as one third of the net salary, to be repaid with the next monthly salary transfer. Community banks demand the domiciliation of accounts or a letter of guarantee from the employer, making this activity a low-risk one. This product is usually profitable for the bank, and it permits the banks to use call deposits without overstretching their maturity. Most banks appear to pursue a risk diversification strategy of giving out many small overdraft loans instead of a few loans of larger amounts. Other beneficiaries include local contractors, who mainly provide goods and services to the Local Government Councils[75], and who are to cede their payment claims to the bank, in addition to other collateral. Most banks have experienced serious difficulties with this type of loan, as any new incoming administration tends to stop all payments due to contractors. Both contractor and bank often wait for more than a year for the payment, and the interest payable consumes any profit of the contractor. As a consequence, banks either have stopped to grant loans for such purposes, or are very cautious. Apart from salary earners, traders and contractors, only board members and staff appear to benefit from this facility.

3.51 **Business loans** are the exception in community bank lending. While banks may publicly provide the terms and conditions for this loan, they hardly grant such loans in actual

[73] NBCB records for 2000-2002 show a slow increase from 29 to 32 percent, while the CBN records show an increase from 27 to 35 percent for the period 2001-2003.

[74] In 2002, rural community banks employed 30 percent of their assets under the form of loans, while the ratio for urban ones was four percent points higher. The longitudinal analysis of 8 urban and 8 rural community banks over the period from 1995 to 2002, shows a loan-to-savings ratio that was on average 15 percent points higher in urban banks than in rural banks (see Annex 3, Table 6).

[75] Commonly referred to as Local Purchase Orders, or LPO.

practice. Managers try to avoid granting loans to avoid arrears; in many cases seen in the field, either boards or the CBN had suspended the granting of loans until the arrears had been recovered. In the Northern states visited, none of the banks granted agricultural loans to farmers; the only exception was one bank that granted farming loans to salary earners to help them reduce spending on food items. In the Southern States visited, agricultural loans are granted in principle for amounts between NGN 2 000 and NGN 500 000. Borrowers are to provide personal guarantees, liens on savings or landed property as collateral. Trading loans are granted for amounts in the range of NGN 20 000 to NGN 4 million. In general terms, bigger loans are only granted if substantial collateral can be provided in the form of deposits, land or movable property. In most cases, loans are to be repaid within relatively short periods not exceeding nine months. Only one Lagos-based bank permitted repayment over up to 18 months. The average loan duration as per the estimate of the bank managers was 7.5 months.

Box 3: Difficult revival

A community bank in Northern Nigeria collapsed in early 2002 after years of mismanagement and overdue loans. The granting of new loans had been suspended even before that for some time. During the 2 years before the collapse, no board meeting had taken place. In April 2002, a few months after the temporary closure, the chairman decided to revive the bank and injected fresh capital in cash (NGN 250 000) and in kind (fertilizer worth NGN 367 000). The number of staff was downsized to five to reduce expenses. By August 2002, the net value of the shareholders' funds was below NGN 0.3 million, far below the required minimum.

By June 2004, the bank had assets worth NGN 1.8 million, including cash in hand of 1.2 million and a time deposit in a commercial bank of 0.6 million. The bank practically lived on the interest charged on overdrafts advanced to staff of the LGC, for which it charged up to 5 percent per month. Total deposits were NGN 3.56 million, of which 94 percent were in the form of savings deposits. The bank paid only 1 percent interest on savings, as it wanted to reduce all expenditure. The bank practically only served salary earners. The bank had no strategy for a revival, and the terms and conditions of its meagre services were very unattractive. If the LGC would decide to pay salaries through another bank, this bank would most likely lose all remaining customers. If clients would start to withdraw their deposits, the bank would have to close immediately.

3.52 **Loan purposes**. According to the data obtained from the community banks visited in Abia, Cross River and Benue States, about 65 percent of the total loans went to salary earners, 20 percent to contractors and the remaining 15 percent to small enterprises, mainly agriculture, trading, transport[76] and other crafts. The compounded data for Bauchi, Borno and Ekiti states show an average of 59 percent going to salary earners, 20 percent to commerce, 7 percent to agriculture, 6 percent to manufacturing and 8 percent for other purposes. This contrasts with the sectoral aggregate analysis of OFID, which show that in 2003, 27 percent went to trade and commerce, 17 percent to transport and communication, 6 percent each to agriculture and real estate/construction, and one percent to mining/quarrying[77].

[76] These were "Okada" drivers, the Nigerian expression for motorcycle taxis.
[77] Author's calculation based on OFID data for 2002 and 2003. The residual category "other purposes" was substantial with 34 percent, which included loans to wage earners.

3.53 **Interest rates**. Community banks charge interest rates higher than those of commercial banks. Apart from one bank that charged only 5 percent per annum, but that ceased to lend, interest rates varied in most cases between a low of 10 percent and a high of 60 percent per annum. Two remarkable exceptions have been found. One was a one-week loan for market women, for which the bank charged 2 percent per week, which helped the women get new trading stocks from passing traders; this service was apparently very much appreciated by the women[78]. A negative example was an interest of 20 percent per month charged on overdrafts for salary earners[79]. The average lending rate of banks was 25.8 percent per annum Most banks (70 percent) apply the same interest rate across all lending products, but others vary by charging higher rates for overdrafts, consumption loans and loans with lesser guarantees, and by privileging agricultural loans.

3.54 **Loan processing and monitoring** are one of the big constraints of community banks. Few banks have elaborate manuals for loan processing. Bank managers do mostly have a lending authority, but this is usually rather low, sometimes as low as NGN 5 000 and thus requires the board approval for almost all loans. While banks employ one credit officer on average, there are a few urban banks that employ more, but about one quarter of all banks do not employ a credit officer at all. Moreover, credit officers in rural areas appear to be young and poorly trained and qualified, and none of them had received any special training on their assignments. Community banks finance between 50-100 percent of the total requirements, with an average of 81 percent. However, four out of ten banks visited in the field permit full project financing without a substantial contribution by the borrower. Standard ratios on portfolio in arrears, age analysis and portfolio at risk are not used in banks outside Lagos, which is not surprising as none of the banks outside Lagos had computers with adequate software programmes. Finally, community banks hardly engage in on-site visits during appraisal, post-disbursements visits and regular monitoring activities.

3.55 **Arrears and recovery**. Over and above a weak loan processing, loan recovery is very weak, making this issue one of the main constraints. On average, banks visited had 57 percent of their loans in default. Many banks do not even charge penalty rates for defaulters. Credit officers are mainly regarded as assistants of the managers, and hardly participate in loan recovery drives. Only one bank employed the services of a special debt collector - with remarkable success[80] -, while another bank was in the process of recruiting one. After years of supervision of the NBCB, during which bad debt provisions were not made compulsory, the CBN has imposed the same regulations as applied in the commercial banking sector to the community banks as well. Bad debt provisions in Nigeria are to be made as follows:

- General provision for all standard (performing) loans outstanding: 1 percent
- Provision for doubtful loans (in arrears of 91-180 days): 10 percent
- Provision for bad loans (in arrears of 181-360 days): 50 percent
- Provision for losses (in arrears of 91-180 days): 100 percent

78 Although the nominal interest rate was quite high in this case, the bank incurs higher than average handling charges for these loans, which were unsecured.

79 It appeared that this rate kept the lowly paid wage earners in a constant cycle of borrowing month after month. The community bank had the quasi-monopole for loans in the area.

80 Since the bank hired this debt collector, a retired military officer, loan recovery has been on the increase, and debts have declined. For his services, the debt collector gets 10 percent of the amount recovered, which is added to the debts of the defaulter.

3.56 In 2001 or 2002, most banks that hoped to get a license from CBN therefore started to make their provisions in accordance with the CBN regulations. However, there are still many banks that do not comply with this regulation, and there are still auditors who do not report such lack of compliance in annual reports. The share of bad debt provisions in gross earnings, loans outstanding and total assets among community banks visited in the field has gradually increased over the past three years, as shown in the table below.

Table 11: Summary of Bad Debt Provisioning (2001-2003)

Year	BDP/Gross Earnings	BDP/Loans	BDP/Assets	BDP/Shareholder Funds
	......................%			....
2001	5	5	1	7
2002	8	10	2	19
2003	29	19	6	34

Note: BDP = Bad debt provisions; N = 25

3.57 The compounded OFID data on community banks rendering returns also show that the total bad debt provisions accounted for 2 percent of the loan portfolio in 2002, but increased to 14 percent in 2003. On average, a community bank made provisions of NGN 0.26 million in 2002, but this increased by a factor of ten in 2003, when the average amount was NGN 2.55 million per bank. As at May 2004, the month prior to the mission, the amount of loans in arrears was equivalent to 59.5 percent of the loans outstanding.

3.58 These bad debt provisions compare well with what commercial banks in Nigeria provisioned when they were first obliged to apply the CBN regulations, as the table below shows.

Table 12: Loan Loss Provisions of Three Commercial Banks in Nigeria (1999 + 2000)[81]

Ratio	Three commercial banks in 1999-2000 (%)
Loan loss provisions/total assets	5.7
Loan loss provisions/loans	15.3
Loan loss provisions/interest received	71.7

3.59 With such a high incidence of default and bad debt provisions, banks lending at interest rates below 30 percent, which is what most banks do, could hardly draw a profit from their lending operations. Assuming an average lending rate of 26 percent, average cost of funds of about 3.5-4.0 percent, operational charges of about 10 percent[82], and bad debt provisions of 14-19 percent, lending is clearly a loss.

81 Source: African Rural and Agricultural Credit Association: The Role of Commercial Banks in Rural Finance. Case studies from Nigeria. Nairobi, October 2001 (Author: Michael Marx). The data are based on the annual reports for 1999 and 2000 of three major commercial banks and comprise the compounded amounts of the three banks in each category.

82 This is a very conservative estimate. The data sources do not permit such a calculation. Odonye 1996:18 reports that in 1996, total overheads of the banks were equivalent to 59 percent of the loans outstanding. In the sample of the banks visited in the field, the share of cumulated overheads for January 2001 to May 2004 in total loans at the end of the respective periods was 43 percent. However, this ratio could not indicate the

3.60 In addition, it appears that not all banks have made adequate bad debt provisions for loans in arrears in accordance with the regulations, and many banks will sooner or later be compelled to inject fresh equity in order to avoid falling below the required minimum equity capital. In some cases, the net equity after provisions has fallen below one quarter of the stipulated minimum. Where banks used a high portion of deposits for lending, which is mostly in arrears, they are likely to enter into a liquidity crisis sooner or later.

Box 4: Staying in business after mismanagement

Determination and belief in the business potential of both a community and the people moved local investors in one town of South-eastern Nigeria to establish and operate a community bank, although the semi-urban town had no functioning bank at the time. Seventy-four initial shareholders from the town, including civil servants, pensioners, a CDA, age-groups, schools and churches, established the community bank in June 1993. Their initial share-capital contribution was NGN 0.37 million, of which 30 percent came from the CDA, 27 percent from groups and 43 percent from individuals.

Seven years into the bank's operation, shareholders discovered that the directors and manager had made the bank bankrupt through carefully planned connivance to defraud and mismanage the bank to an extent that depositors could not draw from their accounts and the bank workers could not be paid their monthly salaries. The board members took loans without intention of ever paying back and spent bank funds as if it were their own. The manager gave out loans to friends and relatives, of which he usually kept half for himself. All these loans became bad and irrecoverable.

When the situation was reported to the town's traditional ruler, he arranged for an emergency AGM and requested all major shareholders (who happened to be civil servants living in faraway places) to rescue the bank from imminent collapse by taking over the board and appointing a new manager. He then appealed to depositors (especially the retirees and teachers living in the town) not to close their accounts and to well-to-do shareholders to increase their shareholdings to keep the bank afloat. His appeal worked: more accounts were opened and some individuals increased their shareholdings. With the support of regional NBCB office, the individual with the highest shareholding, who was known to be highly responsible and greatly respected in the community, was asked to become the chairman of the bank's board. Although this responsibility was deemed inconvenient since he lived far away, he accepted the invitation. Convinced of the great business potential of the bank, the new chairman blocked all loopholes that had been identified in the previous management. A new manager was appointed, and through the application of adroit business strategies, the new board attracted more funds to the bank.

Within two years, the bank was turned around and was able to increase the number of its shareholders to 198 and its paid-up share capital to NGN 5 million. Today, there are 233 shareholders and the bank's paid-up capital is NGN 6.2 million. The bank now owns an eight-apartment students' hostel and will soon complete another one for both generating a steady supplementary income and providing a service. It is the only surviving bank in the area, and serves towns and villages within a radius of over 25 kms in its local government area. The NBCB regional office frequently praised the bank for multi-ownership shareholdings and meaningful contribution to rural and community development.

extent of operational charges in total loans because the bank staff is engaged in many activities, and because lending is not necessarily a major activity everywhere.

3.61 Apart from the above-mentioned deficiencies on the side of the banks, all bank staff commented that default was in most cases wilful, and not caused by circumstances. In addition, they categorise the prime defaulters as being the wealthier persons belonging to the local elite, directors, traders and contractors, but add that farmers, market women and traders are also defaulting. As elsewhere in Nigeria, borrowers default where they see chances of escaping from their repayment obligation, and this applies to community banks as well. Borrowers default where they assume that the bank has no funds or is too weak to pursue them, that the directors protect them, that the realisation of collateral is too complicated or too expensive, or where they are related to a manager or a director.

H. OTHER OPERATIONS AND SERVICES

3.62 **Investments**. Apart from physical cash in the vault, community banks keep their excess liquidity in commercial banks in demand or time deposits or purchase treasury bills from the CBN. Apart from COT, the interest received on these deposits and on loans are the major sources of revenues. The rather stable loan-to-asset ratio of community banks over the past three years, a decline by about 5 percent points of the ratio between the total of cash, short-term funds and placements in commercial banks (see Annex 3, Table 3) and a decline of placements of 16 percent between 2002 and 2003, suggest that on an aggregate level, placements have not been made at the expense of lending. Regrettably, the aggregate data of NBCB and CBN do not permit a deeper analysis as regards both any eventual change of investment patterns in rural or urban banks over time. On the other hand, the field visits imply that many community banks in rural areas have stopped or considerably slowed down lending because of the high arrears and the ultimate losses incurred. As a consequence, they have used most of their liquid funds in time deposits and treasury bills.

3.63 The consequence of both the high general propensity to default and the inability to recover loans is that community banks stop lending where they can, and restrict lending to those groups that offer good collateral and easy recovery (salary earners). In addition, they use the excess liquidity to purchase treasury bills and place time deposits in commercial banks. This orientation is rational and protects the assets of the banks. On the other hand, they intermediate only deposits, increase the amounts mobilised by rural branches of commercial banks, which usually do not grant loans any longer, and thereby facilitate the outflow of funds from rural to urban areas. Through this, they no longer fulfil their own mandate. In addition, they do no longer fulfil the mandate for which shareholders bought shares, and for which the government created them.

3.64 Community banks are predominantly financial intermediators and they do not provide many other services. In accordance with their restricted scope of operations, they clear cheques from clients through correspondent banks, and use the same for the issue of drafts; this is a standard service provided by all banks. Since the commercialisation of the sale of school examination forms, community banks frequently also offer this service against a commission to the general public, even if buyers do not keep an account with the bank. A few banks that have spacious strong rooms also offer safe custody of valuables against a fee. Other financial services provided to clients include the purchasing of treasury bills, extension of guarantees to other financial institutions for clients, fund transfer to other accounts within Nigeria through the commercial banks, disbursement of FGN poverty alleviation funds, and the payment of school fees on behalf of clients. In two cases seen in the field, bank managers provide business advisory services to clients without any charges, in order to improve their performance and retain clients with the bank. In single cases, community banks sell cell phone cards or cement or visit schools to educate students on the need for savings. In two cases, a bank engaged in trading operations (beans, vegetables, rice) by using its own funds[83] or built market stalls and leased these out to the market women. The contribution of these services to the total revenues was unknown by all banks visited.

I. LINKAGES

3.65 Community banks keep four different types of linkages, including those with their corresponding bank(s), with other community banks and the umbrella organisation NACOB (Nigerian Association of Community Banks), with their Local Government Councils and finally with their communities.

3.66 The **relationship with commercial banks** can take different shapes. In some cases, commercial bank managers regard community banks as unnecessary competitors, and just provide ordinary services to them, such as the clearing of cheques, issue of drafts, fund transfers or receiving deposits. In such cases, the conditions applied are the same as to any other customer, and it has often happened that commercial banks delay the withdrawal of deposits, to the frustration of the community bank manager, and issue the dirtiest notes that they have in the coffers. On the other hand, there are also numerous cases where the managers of the commercial and the community bank understand each other, and where the community bank gets a preferential treatment as a prime customer[84]. Most of this may have to do with personalities and personal perceptions, rather than policies.

3.67 The **relationship with other community banks** also varies from state to state, and from bank to bank. There are those local chapters of NACOB where bank managers meet frequently, exchange views, experiences and insights (as they are not competitors), or organise local fora and expert meetings to increase their knowledge about crucial developments[85]. In a few cases, community banks also maintain accounts with other community banks for ease of payment to clients. In other places, community banks in one state may have nothing to do with others, or NACOB is not very active[86], and managers are not permitted to participate in NACOB activities, which are regarded as the exclusive domain of directors[87]. In the sample, 94 percent of the community banks were members of NACOB. Out of these, most of the bank managers were quite critical of the activities and achievements of NACOB over the past few years. While 59 percent of the managers mainly in the South-East cited no records and achievements, banks in the North and West listed some positive records, such as assistance in getting the CBN license, general lobbying and advocacy, regular meetings at state level with good exchange of information, and in one case direct technical assistance when the bank almost collapsed. In many cases, NACOB's drive for establishing a commercial apex bank for community banks is very much appreciated by members.

[83] There seems to be some ambiguity as regards trading activities under the bank's name. It is reported in the literature that some banks create loan accounts through which trading activities are channelled. See FAO/Marketing and Rural Finance Service: A preliminary Examination of Community Banks in Nigeria. Rome 1996, p. 8 (by Jackson O. Odonye).
[84] Such as lower COT (1%) and commissions and higher interest rates paid on time deposits.
[85] This emerged as a standard pattern in Ekiti and Lagos states.
[86] This prevailed in the Southeastern states visited.
[87] This was a rather uniform feature in the two Northern states visited.

3.68 **Links with the Local Government Council** vary by region. In the Northern States, it is quite common to see that LGCs assisted in the creation of the bank and helped mobilise people and resources for the bank. When the banks started in the early 1990s, there was often a shortage of qualified staff, especially of managers, accountants and clerks. Many LGCs therefore deployed some of their staff to the community banks, and this prevails until today[88]. In one case, a LGC paid for the basic salaries of four out of the nine staff of the bank[89]. In other cases, however, there are no such links, and this seems to prevail all over the Southern parts of Nigeria. In addition to the financial dependence, the mission often found a mental dependence on the side of the community banks. As salaried staff is the preferred clientele nowadays, community banks feel they depend on the support of the Council to make salary payments through the bank, without which they fear they would be unable to retain many of their preferred clients[90].

3.69 No clear pattern emerged regarding **linkages with the community**. There are those managers and directors that keep active ties with each and everybody, urge non-clients to become members, visit schools to arouse the interest of students in saving, participate actively for an outside the business scope, and try to be helpful where they can. In other cases, managers appear more as armchair bankers and do not move around to visit clients, and restrict business to what appears physically in the banking premises.

J. MANAGEMENT, CONTROL AND SUPERVISION

3.70 **Management** of community banks has often been found to be very weak, and this more frequently in rural areas. The aspiration and dream of community bank managers is the commercial bank manager, and many appear to be trying to copy their behaviour and approaches. However, they lack the depth that commercial banks have, and they have hardly any access to high-quality material and operational manuals. Out of the community banks visited in the field, only 26 percent had a basic written operational manual, which was in most cases the CBN one, 3 percent had a written management information system, 16 percent had a written manual for the supervision of the board, and 6 percent had a written risk assessment policy. Very few banks had introduced any changes over the past 3-5 years, with the exception of an adjustment of the interest rates applied. This indicates that the entire system is stable, complacent and un-dynamic, which may have much to do with the quasi-monopoly they enjoy.

3.71 **Internal administration** is another weak aspect of management. Even some basics of managing an office are frequently unknown, filing systems and the methods of keeping records are often appalling and banking halls dirty and untidy. All financial accounting of transactions and ledger entries are manually carried out and are often inadequate, inaccurate, time consuming and untimely. Many banks submitted their reports to CBN and NBCB between three to nine months delay. Generally accepted accounting standards are not followed and applied all the time, and auditors and

88 In addition to allocating plots for construction of the bank without charges.

89 In this case, the bank in question would not be able to make a profit without the LGC subsidy.

90 Many CBs complained about the lack of patronage from the LGC chairperson. If the chairperson recommends that LG staff open their account with a CB, the CB may be in business and get sufficient deposits, turnover and income from COT and interest on advances and loans. This high dependence on the LGC staff, and of the favourable attitude of the chairperson, also entails great risks. In case the former chairperson changes after elections, or is replaced due to mismanagement, and the new chairperson no longer patronises the bank, the CB may quickly witness a decline of business and profits, with little chances to find other types of clients.

inspection missions have not been able to address this weakness. Customer care has been anchored in none of the banks visited, and many banks do not even have adequate sitting facilities for waiting clients[91]. Regular staff assessments, annual budget drafts at the beginning of the financial year, budget variance analysis, and similar simple techniques to manage a complex business are mostly absent. Records are mostly kept manually[92], with all the associated propensity for errors. Accountants and managers often spend long hours in the bank after closing of doors to the public, to detect errors and balance accounts.

3.72 **Financial analysis skills.** Most banks apparently lack skills for adequate financial analysis. The previous and current system of reporting, accompanied by a lack of ratios to be calculated by the management, provide an inadequate framework to encourage managers and boards to assess their own financial performance[93]. Moreover, the manual record keeping and the lack of computers do not encourage managers to assess where the bank stands. While most managers are able to portray the current situation of their bank, they are unable to give any longitudinal analysis and from there draw lines into the future.

3.73 **Self-assessment**. However, and against the assessment of the mission, bank managers assessed their own capabilities and that of the staff as predominantly positive: 71 percent had a self-assessment “good” or “very good”, 25 percent “satisfactory”, “mediocre” or “average”, and 4 percent “weak”. Many of the banks visited had, in the view of the mission, poorly qualified staff, including sometimes, but not always, the manager. Apart from manager and accountant, all other staff was generally poorly qualified.

3.74 **Board supervision**. As should be expected from the above, board supervision is mostly weak. There are a few dynamic and active chairpersons, who visit the bank a few times per week to listen to the report of the manager and provide assistance and guidance, without however meddling into the affairs of the managers. There are a few boards that establish committees for supervision, credit or other subjects that meet regularly and control the bank staff well. However, the predominant impression is that directors care little, if at all, for the fate of the bank, spend as little time on bank matters as possible, and try to extract as many benefits from the bank as possible. Where directors default on loans from their bank, they are usually not keen to push the management for active recovery. At the same time, there are boards with highly qualified personnel, who may be professional bankers, chartered accountants or businesspersons. It is, however, impossible to estimate the number of boards with qualified directors, but who are unwilling to contribute to effective and efficient supervision, as much as the number of boards where directors have good intentions but lack the skills for supervision and guidance.

3.75 **Audit** of community banks is compulsory, but the supervisory authorities in charge have been unable to enforce this regulation so far. Out of the banks visited in the field, 10 percent did not get their accounts audited in 2001, which increased to 16 percent in 2002 and further to 31 percent in 2003[94]. In addition, there are indicators that the statements of auditors are not always in

[91] A manager may have access to satellite TV in his office, which he would hardly notice, but would not go as far as installing a second TV set in the banking hall to make clients feel comfortable. In this regard, they could learn a lot from the orientation and practice of Rural Banks in the Philippines.

[92] In all banks except the two ones in Lagos.

[93] This has to do first with the sheer number of pages to be submitted to the CBN (27!), and also with the sequence of the data demanded. The entire reporting system requires substantial improvements.

[94] The banks were visited during the period of 8-24 June 2004. At that time, they are supposed to have submitted their accounts to the auditor. For the year 2003, the submission to the auditor was regarded as

total compliance with the ethics of the industry in the sense that some areas are not analysed with sufficient depth, or that auditors use considerable discretion in doubtful cases to comfort the client (see Box 5 below). Voices in the industry, the general public and within the supervisory authorities tend to cautiously confirm that sub-standard audit reports, which do not present the entire picture of the bank, cannot be excluded all the time, and suggest that the report of the auditors cannot be trusted in all cases.

Box 5: Collapse before the audit was finalised

One community bank had shown an impressive performance. The bank lent to farmers, used a decent building with a good banking hall given free of charge by the community, and paid dividends. With a change of the board, the new directors began to approve many loans to non-creditworthy clients without real collateral and to themselves as well. Excess liquidity was put into higher yielding term deposits, at the expense of liquid assets. Debt recovery was no longer pursued as before, despite the mounting arrears. Bad debt provisions were also not made. When clients started to make usual withdrawals around the end of the year, the bank faced liquidity shortages and could not immediately pay out deposits as demanded. The rumours that the bank had no more money spread like bushfire in January and led to a rush for withdrawals. The bank was illiquid and had to close in early February. Paradoxically, the auditor's financial report that came out a few months later portrayed the already collapsed bank as healthy and in good financial order.

3.76 In the past, several auditors often gave unqualified opinions about the soundness of the respective bank, despite a more than questionable quality of the loan portfolio, did not apply loan loss provisioning and did not comment on the falling value of equity.

K. PROFITABILITY

3.77 The overall statistics of the CBN show that about seven out of ten community banks recorded profits in 2002 and 2003[95]. Total profits before taxation for 564 banks amounted to NGN 1 150 million in 2003, which is about NGN 2 million per bank. On a longitudinal basis, average profits have increased over the period 2000 to 2003. As shown in the table below, profits before taxation increased by 60 percent over the two-year period according to the NBCB data, and by 36 percent according to the CBN data. However, all these data, in particular those from NBCB, may not include full bad debt provisions in accordance with the guidelines. This increase of profits should, however, be even more appreciated as the bad debt provisions increased by a factor of ten from 2002 to 2003.

compliance, while in the years 2002 and 2001, the actual auditor's report was regarded as compliance. The number of valid responses was 30 in 2001 and 32 in 2003.

95 72 percent in 2002 and 73 percent in 2003.

Table 13: Evolution of Profits Before Taxation (2000–2003)

Year	**2000**	**2001**		**2002**		**2003**	**2000-2**	**2001-3**
Indicator	Mean	Mean	Mean	Mean	Mean	Mean	% Change	% Change
Data source	NBCB	NBCB	CBN	NBCB	CBN	CBN	NBCB	CBN
Profit before taxation	1,061	2,158	1,425	2,518	2,861	2,039	60.0	36.0
Pre-tax profit/assets	4%	6%	4%	5%	6%	4%		
Pre-tax profit/paid-up capital	29%	42%	26%	41%	43%	29%		
N	654	579	128	590	316	564		

Note: Amounts in '000. Source: Annex 4, Table 3

3.78 **Returns**. The above table also shows that average returns on assets have been satisfactory, fluctuating around 4-6 percent over the three year period from 2000 to 2003 and between the different sub-sets, whereas pre-tax profits were substantial in terms of paid-up capital. Unfortunately, the data only provide information on profit before taxation, while the standard measurements use profits after taxation as numerator[96].

3.79 **Income and expenditure**. On the revenue side, the biggest income items were COT (usually 5 ‰) and interest received from placements and deposits. Depending on the importance of lending, interest received on loans may also be important, however with most of the loan interest income coming from overdrafts. On the expenditure side, interest expenses, general overheads, depreciation on fixed assets and loan loss provisions were the biggest items. Expenses for staff may be important, where the bank finances all wages, and may be a smaller portion only where the LGC deploys staff to the bank and pays most of their salaries[97]. The available data collected in the field and from NBCB indicate that overheads are substantial. Over the past years, total overheads fluctuated between 15 and 77 percent of loan amounts outstanding and between 5 and 23 percent of total assets, as shown in the table below. Unfortunately, the data quality in the field and of the NBCB and CBN do not permit a deeper analysis.

Table 14: Weight of overheads in loans and assets (2001-2004)

	Dec. 2001	**Dec. 2002**	**Dec. 2003**	**May 2004**	**Average**
Overheads/loans	35.2%	48.6%	77.3%	15.3%	41.9%
Overheads/assets	7.3%	8.7%	23.0%	5.2%	9.8%

Source: Field data

3.80 **Factors affecting profitability** from the point of view of managers[98] differ widely. Three factors were cited more frequently, i.e. the high rate of default leading to high bad debt provisions (58 percent), the high operational costs (42 percent), low levels of deposits (35 percent) and low patronage by government, in particular the LGC, to pay salaries through the community bank (29 percent). Other less frequently mentioned factors associated closely with the profitability

[96] Using a flat rate of taxation of 30 percent on profits before taxation, the returns on assets would fluctuate between 3-4 percent, and the returns on equity between 18-30 percent.

[97] In some banks, the LGC covered the salaries of one quarter to one third of the staff, which included especially the manager and accountant.

[98] The mission fully agrees with these priorities cited by the managers.

were liquidity problems (16 percent) and low levels of investments (13 percent). Surprisingly, only one manager mentioned the low levels of income gained from clearing cheques through the commercial banks, a feature that has for long dominated the debate over the most suitable future avenues of community banking in Nigeria. In single cases, other factors such as security, fraud, high rates of inflation, costs of training, inadequate banking hall, low levels of industrialisation, low public confidence in the bank, insufficient capital and poor pricing policies were also mentioned.

L. DEVELOPMENT STRATEGIES AND PLANS

3.81 None of the banks visited had any concrete and written corporate development plan. However, all managers had some ideas on how to solve the current problems their bank was facing and to make the bank more attractive and profitable. In most cases, these centred on loan recovery, savings mobilisation, especially including time deposits, training and motivation of staff, and computerisation of accounts. Other less frequently mentioned approaches included awareness campaigns to improve the corporate image of the bank, the employment of an internal auditor, improved supervision and control, and better lending approaches and policies. Managers were divided as regards the prime clientele the banks should target; there were two equally strong groups advocating for targeting either the richer or the poorer segments of the society, and a much smaller group favouring the middle-income groups. Very few were of the opinion that all groups should be included as a risk diversification strategy[99].

M. CONCLUSIONS

3.82 Community banks represent a very particular type of financial service provider close to the grass roots. Unlike their commercial bank competitors, they are familiar with the local cultures, values, attitudes and patterns of behaviour. However, this spatial and psychological proximity is not matched by products and services that are in line with the local cultures. Community banks have almost entirely abandoned the clients they are supposed to serve. Instead of using their comparative advantages and developing their originality, they copy the patterns and products of commercial banks and behave like mini-commercial banks without however any chance to achieve the depth and width of their larger competitors. On average, a CB served only 1430 depositors and 106 borrowers in December 2003. This is a rather disappointing result 10-13 years after their establishment. While their deposit services are a welcome service to the public in general, their savings products are not well developed. As community banks in rural areas do not lend much to local entrepreneurs, the amounts mobilised flow into the commercial banks, and from there to urban areas. Lending is poorly developed, and CBs have been ill prepared to lend to a clientele that is ready to default wherever there is an opportunity.

3.83 By virtue of these features, community banks have entirely lost their development mandate and do not serve the purpose for which their law has been enacted. They today serve a clientele that has lesser difficulties to access financial services than low-income people do. In fact, many community banks have difficulties to find enough suitable borrowers.

[99] 40 percent favoured low-income groups, 37 percent high-income groups and 17 percent average income groups. The balance opted for all groups at the same time.

3.84 Management is capable to run the day-to-day affairs, but not sufficiently prepared and trained to go beyond this. Directors have also not performed well, apart from a few outstanding examples, and have often abused their position by approving loans to themselves in an arbitrary manner. The absence of dynamism and innovations is evident, and can only be explained by the absence of a professional support system. The occasional training of community bank staff up to the year 2000 appears to have been carried out more by good intentions rather than being professional, and the huge knowledge and skills gap has never been filled systematically, neither by NBCB nor by the CBN[100].

3.85 These weaknesses imply that the entire set-up of the community banks was ill conceived right from the beginning. Community banks were designed as miniature and downgraded commercial banks. The emphasis was laid on a few formal banking criteria, the accounting system and the need to support local development, but lacked completely a business or banking spirit and an encouragement to search for the most suitable local solutions. Instead of guiding the newly established banks to become profitable and serve local communities, the NBCB guidelines imposed a minimum staff strength of 13 on them and preached community development. The NBCB reporting system did not envisage even standard banking parameters and ratios, nor were bad debt provisions or regular audits imposed and enforced. The manual accounting system is an inherent limitation to quality management and growth.

3.86 Community banks have never had the full attention of policy makers once they existed. Unlike in other countries with rural and community banks, such as Ghana, Indonesia, The Philippines or Sri Lanka, no development project has ever supported and strengthened them systematically and nation-wide. Operating under inadequate regulations and supported by a parastatal that did not have the experience and funding to carry out its functions, the community banks merely survived as a system, but without making an impact on clients, without penetrating their markets thoroughly, and without capturing a sizeable share of the financial markets in Nigeria.

3.87 The fact that there were once more than 1300 community banks, of which only about 750 may be able to survive, also means that more than 500 community banks collapsed and disappeared. And this in turn implies that many thousands of depositors lost their money, of which many must have belonged to the lower income groups. The beneficiaries were, as we have to assume, the better-off, who were able to escape from their repayment obligation.

3.88 At the same time, the community banks represent an enormous potential to reach clients with financial services. Given the various options to enhance access to financial services for the rural population, the community banks, together with the microfinance institutions, are likely to be the most promising options. The number of existing units – eventually around 750 – is very small compared with the population size of Nigeria and the potential of local entrepreneurs. Through the creation of branches and cash centres, as is done in Ghana, and eventually through the creation of new community banks, the density of bank services could be much enhanced. In addition, after years of negligence of the sector, there is an urgent need to realise that without substantial support to the system, the risks for the integrity of the financial system are enormous. Nigerians have had numerous cases of collapsing banks, and are very cautious as where to keep any excess liquidity. Some community banks became insolvent because rumours spread that the

[100] One should add here that the funds available by NBCB have never been sufficient to address this gap, and that the CBN is in charge of the community banks only since about 3 years.

bank was unable to refund deposits. Any repetition of such cases would be even more serious now that the CBN has taken over the supervision of the sector. The bank managers and directors have understood that without substantial external assistance, they would find it very difficult to improve their performance.

3.89 It is further evident that the costs of such a massive rehabilitation and capacity building programme cannot be financed from domestic resources alone.

3.90 Finally, it seems to be possible to assist the sector without too many difficulties. Positive signs in this regard are: (a) the keen expressed interest of the community banks met in the field; (b) the interest of the CBN in establishing an adequate rural finance framework and sound financial institutions; (c) the firm commitment of the FGN to strengthening of rural financial intermediaries; (d)the existence of a core group of dynamic rural banks with good results; (e) a relatively established concept and system of community banks, albeit with loopholes and weaknesses; (f) an oligopolistic position regarding deposits, and a near-monopolistic position regarding credit, once the banks start to lend; and (g) a huge unmet demand from customers and potential customers.

4. STRENGTHS, WEAKNESSES, OPPORTUNITIES AND THREATS

4.1 The strengths, weaknesses, threats and opportunities of the community banking sector are shown in the SWOT analysis below.

Table 15: SWOT Analysis of Rural Based Community Banks

Strengths	**Weaknesses**
• Originality of the concept in the financial sector landscape • Potential for providing relevant and meaningful financial services to rural areas • Lending monopoly in the formal sector, except where NACRDB intervenes • Often strong roots in the community • Good knowledge of rural areas and inhabitants • Part of the established Nigerian formal financial system since CBN take-over • Simple and rather secure banking services to salary earners • Concentration on savings deposits • Banking procedures simpler than in commercial banks • Lending not based on immovable property as main collateral • Existence of an umbrella organisation (NACOB) • Satisfactory capitalisation	• Poor management • Poor supervision through boards • Overstaffing • Low value of total assets • Insufficient savings mobilisation • Insignificant term deposits • Lack of penetration of rural areas, average to poor clients, farmers, craftsmen and the service sector • Insufficient financial analysis • Absence of any longitudinal data analysis • Poor public image due to poor past performance and bankruptcy of CBs • Poor product development and refinement • Poor market analysis and market potential analysis skills • Non-competitive interest rates • Lack of cheque clearing facilities • Insufficient loan policies and skills to appraise more complex loans • Poor debt recovery
Opportunities	**Threats**
• High demand for loans • No or insignificant lending activities by the formal banking sector to rural areas, with the exception of NACRDB in few areas • Higher loan volumes to poor and middle level clients, farmers, petty traders, artisans and other service providers • Deposit insurance through NDIC • Gain in public image along with better supervision and assistance • Reducing costs of operations and improved data analysis through computerisation in medium terms • Higher levels of deposits from non-conventional clients	• Declining patronage by LGCs • Lending activities by commercial banks • Declining income levels leading to lower deposits and shorter terms of deposits • High general wilful default propensity of the Nigerian public • Increasing costs of pursuing debtors, long duration of court cases • Increasing poverty levels in Nigeria

5. SUPPORTING COMMUNITY BANKS

5.1 Poverty is very widespread in Nigeria, and even deepening, bearing evidence that the oil revenues did not benefit many of the poorer segments of society. The percentage of persons living on less than US$1 per day increased from 27 percent in 1980, when poverty was measured for the first time in Nigeria, to 46 percent in 1985 and to 66 percent in 1996, and reached about 70 percent in 2000. With an estimated population of about 130 million, this percentage embraces 90 million people, roughly 30 percent of all poor in West Africa. Using a daily income of US$2 as a yardstick, 90 percent of Nigeria's population would be classified as poor. With rapidly increasing poverty rates in urban areas, the differences between rural and urban poverty levels have narrowed. Against this background, the development of the rural financial institutions that could provide relevant services to Nigerians becomes one of the important tools for poverty alleviation and economic growth. In this context, the strengthening of community banks would be one of the major options to consider.

5.2 The aim of this study is to lay the foundation for support programmes geared, among others, at the community banks. Some of the donors who are intending to fund projects supporting the micro and rural finance sector had at the time of the study already commenced with their project design, without however finalising them. This chapter therefore outlines some of the support requirements for community banks in Nigeria, as they emerged from the discussions with many institutions and individuals held so far, the field visits and the financial analysis.

5.3 **The community bank perspective**. The managers of community banks visited in the field were quite unanimous as regards external support: 90 percent of them[101] wanted capacity building and training in a wider sense, 83 percent refinance facilities and 76 percent assistance in the acquisition of equipment, in particular hardware and software to computerise the accounts. All requests can be closely associated with these three requirements. As regards capacity building, the bank managers want to see a wide range of training measures for directors, managers and staff of the banks on a more regular and continuous basis. As regards refinance facilities, they would want to see in place a mechanism at relatively low interest rates that could be tapped in case of need and without too many bureaucratic regulations. As regards the hardware, many banks indicated that they were already in the process of acquiring or installing hardware and software, or were planning to do this in the near future, and that they would be willing to participate in the costs of the exercise. This also applies to the costs of training, to which they must already contribute in line with the CBN requirements.

5.4 **The mission perspective**. The mission fully supports the requests for capacity building and the computerisation of accounts. It seems to be impossible to make substantial progress without a comprehensive training programme for the banks at all levels. In addition, improved levels of accounting, extended financial analysis and accelerated reporting to the boards and authorities can only be achieved if accounting is computerised. On the other hand, the mission has serious reservations as regards the proposal to refinance community banks for their lending in general, or to entrepreneurs and the poor in particular. Managers argue that their liquidity situation and the term structure of the deposits would not allow them to grant more loans to micro enterprises in their localities. Evidence from the field, however, reveals that the entire lending process of community banks is deficient and needs to be overhauled, and that community banks

[101] N = 29.

have difficulties identifying suitable borrowers. As a consequence, they mostly have excess liquidity, which they place in treasury bills or time deposits. In addition, their term structure allows them to grant short-term loans up to one year, which is what most clients want and what community banks should concentrate on, before moving to the more complicated levels of term lending. However, this view may have to be modified once community banks have engaged actively in savings mobilisation, have managed their loan processes, including the recovery side, are faced by a high demand for term loans and have acquired the competence to grant and recover these.

5.5 The analysis of the existing system has shown that there are many loopholes and deficiencies in concept and practice of community banking in Nigeria. This leads to the conclusion that patches of repair here and there are not sufficient to bring this system into full swing, but that it needs a complete overhaul and partial re-design.

5.6 **Other support.** Over and above these direct capacity-building measures, there is a need to undertake capacity-building measures in the CBN to strengthen its regulatory and supervisory functions, and to support the NACOB as the umbrella organisation of the community banks. Without an improved supervision by the CBN, it may not be easy to achieve higher levels of compliance of community banks with regulations. Without an improved data generation and data analysis system, which is coupled with an adequate flow of information back to the banks, it would not be possible to move the industry further and in turn improve on the regulatory side. As regards NACOB, its involvement is critical as it allows for an organised and participatory communication, planning and implementation of support measurements, without which support could hardly be effective and efficient.

5.7 Any support to NACOB should be seen under a long term perspective. In a financial system in a country as big as Nigeria, supervision must be first geared at the more important financial institutions, which are certainly the commercial banks. Under the current conditions, it would be difficult to imagine that the same depth and accuracy that needs to be applied in commercial bank supervision can be applied in the case of community banks. As a consequence, one may have to reflect on alternative measures of self-control of the system and of delegated control to a special body, such as NACOB. Any capacity building of NACOB should therefore be seen under the premise that in the medium to long run, this – or another similar body – takes care of some part of the supervisory activities.

5.8 A long term perspective may also be needed as regards a financial apex organisation of the community banks. The case of Ghana and other countries demonstrate that stand-alone banks have a certain growth limit, which they may not be able to surmount without a second-tier financial institution. The creation of an apex bank, as desired and proposed by many community banks, requires however that the primary institutions are strong enough to create, capitalise and control it. Without such ownership by the community banks themselves, it is hardly possible to create a viable institution. As a consequence, any planning for an apex bank should be postponed to a time when the existing units are strong enough to create it.

5.9 Projects planned to support the community banks in Nigeria may therefore comprise the following **components**:

- **Capacity building of community banks.** Activities may comprise: (i) computerisation of transactions, accounts and reporting; (ii) training of staff and directors; (iii) assistance in product development and refinement, organisational development, and development and refinement of procedures and manuals.

- **Public awareness on rights of shareholders and clients**. In view of the deficiencies observed regarding the holding of AGMs and publishing the annual reports, it may be useful to expand the capacity building at the level of the banks by directly addressing shareholders and clients through public awareness campaigns. While it is the role of the CBN to adequately supervise the banks, clients and shareholders are also instrumental to achieve transparency, accountability and profitability of operations and ensure that their deposits and share contributions are not mismanaged or misused.

- **Innovation funding**. Experience shows that innovations sometimes take a lot of time to materialise, as institutions are not always apt to assume the associated risks. As a consequence, there should be a fund that partly subsidises the testing of promising innovations. Successful models for this exist.

- **Capacity building of umbrella organisations**. Using the experience gained in other countries, umbrella organisations are more suitable to take over promotion, training and capacity building, concept development and lobbying than public institutions. Support to NACOB may therefore comprise some technical assistance for exchange of information, training of members, self-regulation, lobbying, etc. In a second phase, this may expand to the creation of an apex bank of the community banks.

- **Capacity building of the Central Bank of Nigeria**. Support to the CBN may comprise: (i) regulation and supervision of the rural and microfinance sector; (ii) development of operational manuals, prudential requirements and other regulation; (iii) hardware and software for the processing of returns from financial institutions; (iv) technical assistance for software handling, financial analysis and reporting; (v) staff training; (vi) vehicles and staff for supervision; and (vii) exposure to other countries with similar settings, problems and possible. It would be very useful if the CBN could produce a quarterly report on the returns submitted by community banks that compares the performance of the individual bank with other banks in the state, zone and nation-wide.

- **Facilitation of institutional linkages**. Once participating financial institutions show improved capacity and performance, projects may facilitate the establishment of linkages between community banks and MFIs on the one hand, and commercial banks on the other, in order to tap the optional refinance facilities under the SMIEIS[102]. For this purpose, a rating system of community banks and MFIs may need to be introduced. Participating financial institutions may also benefit from linkages with ongoing rural development projects, such as the CBARD funded by IFAD and AfDB in Northern Nigeria, CBARD funded by IFAD in the Delta region, the Nigerian Special Programme for Food Security, which is funded by the FGN and eventually other donors, and managed by FAO and FMARD, or the PROSAB in Borno State funded by CIDA. Moreover, linkages of financial intermediaries with farmer organisations, trade unions, craftsmen's guilds, cooperatives, savings and credit

[102] See Chapter 2, Section C.

groups, labour groups, women guilds and associations, which may be suitable borrowers, may also be facilitated. The aim here is to link ready-made borrowers with good savings and eventually credit track records and financial discipline on the one hand with financial institutions desirous to expand their lending activities on the other. Finally, it would be useful to establish ties with food processing and exporting industries and input suppliers that are desirous to increase their outreach and integrate financial schemes into producing-processing-marketing or commodity chains and outgrower schemes. In all these cases, it would be necessary to apply the "willing buyer – willing seller" principle and promote linkages between users and providers of financial services, without providing any guarantees or taking any risk.

5.10 **Other recommended support activities** include:

- **Independent comprehensive audit and assessment of all CBs**. Given that the examination of CBs undertaken by consultants and auditors has not led to satisfactory results in all cases, and further, that audit reports are not necessarily always reliable, there is a need to undertake a rigorous institutional, financial and risk audit of all CBs to be supported. This exercise will also allow for benchmarking and a longitudinal monitoring of the results achieved by a project. It seems to be more advantageous to undertake this exercise through a set of teams comprising CBN (OFID and the Development Finance Department [DFD]) staff and external auditors, backed up by international experts, than by commissioning this exercise entirely to the private sector.

- **Survey of (a) savings and loan products and (b) administrative, operational and other innovations**. These surveys permit to identify tried and tested product innovations and refinements of community bank operations, and serve as background for training and training material development. In the case of the Ghana Rural Financial Services Project, which is mainly supporting the rural banks of Ghana, the product surveys have been undertaken successfully and led to an improved knowledge by directors and managers regarding the different options for change. The same result could be expected from the survey of practical innovations.

- **Setting standards**. Over and above some manuals edited by CBN, there are no standards and guidelines for the community banks.

- **Research**. Over and above these activities directly targeting the institutions, there is a need to undertake more basic and applied research on a host of issues. Such issues may include, among others, past financial and outreach performance of banks, target groups and their specific requirements, public perceptions, acceptance and corporate image issues, different lending approaches to different target groups, the influence of cultural predispositions on performance and acceptance of community banks, especially regarding savings mobilisation, lending, community participation and governance, and the like. In a country as heterogeneous as Nigeria, the influence of local value systems and cultures on rural banking cannot be underestimated, and one may have to assume that recommended practices may have to be region specific in order to work. Such research, which may be undertaken by private sector consultants, universities and private and public research institutes in Nigeria, would help to analyse the environment in which the banks operate, analyse performance along specific indicators and on a more longitudinal basis, and help identify critical areas for improvement of the legal environment, operations and practices of community banks.

- **Documentation and publishing**. Nigeria has for quite a few years been barred from access to innovations in the rural and microfinance sector, and there is a general paucity of data available in the country on general information, practical innovations and 'best practices' in rural and microfinance. As a consequence, studies, manuals, guidelines and the like should be published and made available to the concerned financial institutions and the interested public. The most suitable form for this may be the internet, but in view of the limited number of rural people with access to the internet, other suitable forms should be identified. Other information to be made accessible or referred to may include credible statistics, financial sector development, legal development, etc.

5.11 It is obvious that not all community banks require the same type and depth of assistance, and that external assistance needs to be based on the actual demand for and interest in support. It may therefore be necessary to classify them in accordance with their size, location, clientele, performance and potential, and elaborate specific support mechanisms for them on this basis. The table below provides a range of support services by category of community bank.

Table 16: Support services to community banks

	Type 1	Type 2	Type 3	Type 4
Size	Mini and small	Medium	Large	Big
Location	Rural	Rural and peri-urban	Rural and urban	Urban
Assets in NGN	Below 30 million	Below 50 million	Below 100 million	Above 100 million
Lending	Marginal	Low	Moderate	Moderate
Computer Hardware	Laptops and printers	Laptops and printers	Laptops and printers	Desk tops and printers
Power supply	Solar	Solar	Solar/AC/stand-by generator	AC/stand-by generator
Software	Office packages, integrated accounting and banking transactions			Integrated accounting and banking transactions
Board training	Financial analysis, planning, supervision techniques			
Management training	Office management, planning, reporting, budgeting, staff supervision, rural market analysis		Planning, reporting, budgeting, staff supervision, urban market analysis	
Staff training	Computer software, accounting, customer care in rural areas		Computer software, accounting, customer care in urban areas	
Savings products	Market analysis for rural areas, product design, attracting savings, introduction of new products, linking savings and credit		Market analysis for urban areas, product design, attracting term deposits, introduction of new products, linking credit with insurance	
Credit and appraisal	Group and individual lending, integration of savings into lending, loan appraisal for agriculture, commerce and crafts, collateral substitutes, recovery techniques		Individual lending, integrated capital build-up, loan appraisal for commerce, service and crafts, consumer lending, standard banking collateral, recovery techniques, legal issues	
Investment	Asset-liability management, bank placements, direct investment in rural enterprises		Asset-liability management, placements	
Client orientation	Customer care and client orientation in rural areas		Customer care and client orientation in urban areas	

5.12 There are some changes in the regulatory and supervisory framework that the community bank managers[103] and the mission[104] recommend:

- Regarding reporting:
  - Abolition of the obligation to report to two different authorities, and submission of one data set per quarter to the CBN alone; where the NBCB wishes to obtain data, it should receive it from the CBN on the basis of inter-agency cooperation and agreement, not from the community banks directly.

[103] Bank managers are also demanding access to direct cheque clearing with the CBN, which is very unlikely to occur in the near future.

[104] Given that the NDIC is currently undertaking steps to assess the insurance of deposits in community banks, there is no need here to repeat this as a recommendation. The extension of the NDIC coverage is regarded as one essential tool to restore public confidence into the system.

- Simplification and streamlining of the reporting format to CBN, by concentrating on the most important issues; there is a wide discrepancy between data submitted by the banks and the data processed by CBN.
- Providing a more rational order to the report to be submitted.
- Extending the deadline for submission of data, as long as record keeping is manual.

- Regarding supervision:
  - More frequent on-site inspections.
  - Clearer guidelines for on-site inspections.
- Regarding data generation and data analysis:
  - Deeper analysis of financial data obtained from community banks.
  - Keeping of important data from the returns in a data base, as against the current practice to retain cumulative amounts only on some parameters, and allowing relevant institutions to further process these data to deepen the analysis and sharpen support activities.
  - Retaining the names and locations of community banks in the data base in order to allow for a deeper processing and analysis at later stages.
- Regarding regulation and enforcement:
  - Introducing a numbered accounting system, which is as close to the system applied by the commercial banks as possible, and making this compulsory for reporting purposes.
  - New sanctions for community banks that do not hold their AGM within a specified period.
  - New sanctions for directors with overdue loans for more than a specified period.
  - Sanctions against directors not participating in board meetings over a longer period of time.
  - Enforcement of the regulation that the composition of the board reflects the shareholding of the company.
  - Strict enforcement of the bad debt regulations.
  - Clear statement by CBN on which of the old NBCB regulations are still in force, such as the one on number of staff employed.
  - Clear guidelines on the opening of cash centres and branches, by keeping the requirements to the essential.
  - Review of the prudential guidelines.
  - Clearer guidelines for trading activities.

5.13 Finally, the study has shown that some community banks received a banking license, although they do not or no longer comply with the legal requirements. This refers to the insufficient bad debt provisioning, and to the insufficient equity requirements. In order to protect the depositors and re-establish confidence into the system, it would be necessary that the CBN demands full compliance with all regulations from all community banks, and demands shareholders to inject fresh capital up to the minimum required or otherwise face closure.

ANNEX 1: Distribution of licensed community banks by state

Sl. No.	State	NBCB license as at Sept.	CBN license as at May 2004
1	Abia	33	19
2	Adamawa	11	7
3	Akwa Ibom	15	7
4	Anambra	100	81
5	Bauchi	10	6
6	Bayelsa	1	1
7	Benue	21	7
8	Borno	5	2
9	Cross River	24	14
10	Delta	36	22
11	Ebonyi	7	6
12	Edo	43	20
13	Ekiti	27	18
14	Enugu	27	22
15	FCT	5	0
16	Gombe	4	7
17	Imo	63	37
18	Jigawa	4	1
19	Kaduna	20	6
20	Kano	10	5
21	Katsina	13	0
22	Kebbi	6	4
23	Kogi	33	23
24	Kwara	25	15
25	Lagos	67	39
26	Nasarawa	5	0
27	Niger	11	7
28	Ogun	58	43
29	Ondo	34	17
30	Osun	45	26
31	Oyo	59	42
32	Plateau	12	7
33	Rivers	27	10
34	Sokoto	6	4
35	Taraba	7	2
36	Yobe	1	2
37	Zamfara	6	3
	Total	**881**	**532**