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Minimum capital threshold and credit management strategies amongst microfinance banks in Nigeria

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Abstract

This study investigated the distribution of credit management strategies across the categories of MFBs in Nigeria. To achieve this objective, a survey was conducted on 115 credit managers randomly selected across the four categories of MFBs. Responses obtained were analyzed using statistical tools such as the bar chart and Kruskal Wallis rank test. The results showed that the distribution of loan collection policy is significant across the categories of MFBs. The post-hoc test further revealed that this credit strategy varies significantly between MFBs in the tier-1/tier-2 and state/national categories. The study concluded that the minimum capital threshold is a key determinant in the choice of credit strategies amongst MFBs in Nigeria. Therefore, it is recommended that the government should ensure funds availability to the microfinance banking sub-sector, to help the banks improve their capital base and adopt better credit management strategies.

Keywords: Capital threshold; Credit management strategies; microfinance banks.

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1. INTRODUCTION

Amongst several functions of financial institutions, one core duty is to ensure the safety of their customer's deposits while maximizing the revenues from them. It is therefore essential for them to have adequate techniques in place, which guarantee that this responsibility is achieved. Banks are usually the points of call for loans and credit facilities, either from individuals, corporations, or the government. They are the middlemen between those who have excess funds to spare (surplus) and those who need such (deficit), either for new businesses or expansion of existing ones. While regular commercial/merchant banks may carry out other businesses aside from this, Microfinance Banks (MFBs) are known to be primarily saddled with the business of giving loans or micro-credits to customers. Small to medium-scale enterprises can access credit facilities from MFBs, which are not readily available from regular banks, thus requiring the banks to maintain sound credit management policies (Peter et al., 2022; Aminkeng et al., 2024).

According to Sinkley (2002), and Rehman et al., (2019) effective management of credit is a critical component of a comprehensive approach to risk management and is essential to the long-term success of any financial organization. The risk-adjusted return of a financial institution is maximized through the maintenance of credit exposure within acceptable parameters. Studies have shown that poor credit management policies and strategies amongst financial institutions have resulted in financial downturns across the globe (Amarnadh & Moparthi 2024; Fraser & Simkins, 2010; Bezzina & Grima, 2012; Ugwoke et al., 2022). This makes it imperative for MFBs in Nigeria to maintain a robust credit management strategy, operate under a sound atmosphere, and achieve their corporate objectives.

Ringeera (2003) submits that one of the challenges hindering MFBs from functioning well is the poor credit policies, associated with their loan portfolios. Furthermore, Kalui and Kiawa (2015) opine that the successful integration of microfinance strategies into micro-policies makes banking in the micro-economy both viable and sustainable. Notable among the credit strategies among MFBs are the terms on the credit (Ringeera, 2003), appraisal of the loan applicants (Lebbe et al., 2016; Edwin & Omagwa, 2018), and the repayment policy (Ahmed & Malik 2015). While these strategies have been shown to influence the performance of MFBs in Nigeria (Sola, 2021), it is yet to be seen if they are the same or vary across the existing categories of MFBs in Nigeria.

Strategic policies in many organizations are usually known to be a function of corporate objectives which in turn are linked with capital base/structure (Madhavan, 2021). The Central Bank of Nigeria (CBN), to ensure sanity in the microfinance banking subsector, reviewed the minimum capital threshold for MFBs operating in the country (CBN, 2020). This action of the apex bank has resulted in four classifications of MFBs in Nigeria, namely national, state, tier-1, and tier-2. These classifications are tailored along the minimum capital requirement for the banks. The 'National MFBs' have a minimum operating capital base of N5 billion naira. This is followed by the 'State MFBs' with a minimum operating capital of N1 billion naira. The third and fourth categories are the 'Tier-1 MFBs' and 'Tier-2 MFBs' with operating capital of N200 million and N50 million naira respectively. While it is expected that these banks have strategies in place, with which they manage their credit risk, the concern for stakeholders and policymakers is if the capital base is a determinant.

1.1. Conceptual background

Credit management strategy is the combination of coordinated tasks and activities for controlling and mitigating risks confronted by an organization, through the use of key risk management tactics, procedures, and measures, in line with the objectives of the organization (Nikolaidou & Vogiazas, 2014;

Temba et al., 2024). Basle (2000) stated that effective credit management strategy requires establishing an appropriate credit environment where the board of directors approves credit policy and strategy and senior management implements these; operating under a sound credit granting process by establishing well-defined credit granting criteria; maintaining an appropriate credit administration of credit portfolio; measurement and monitoring process and ensuring adequate control over the risk.

When a bank offers credit to its customers, it incurs credit risk, which is the risk of non-repayment. Credit management thus forms an integral part of a bank's overall risk management strategy. The need for credit management in the microfinance banking sub-sector is inherent in the banking business. Microfinance institutions operate in an environment where customers are without credit histories or necessarily predictable borrowing behaviors making it more necessary to deal with credit risk management. The primary business of a microfinance bank, which is the provision of micro-credits, is thus hampered through a weak credit management policy.

Banks are usually required to operate within a capital base as a way of regulating their activities. The apex bank in Nigeria has provided four categories for Microfinance Banks (MFBs) in the country. These categories are based on a specified and approved minimum capital threshold (CBN, 2020). The categories are 'Tier-1', 'Tier-2' 'State', and 'National'. The 'Tier-1' consists of rural-based MFBs operating with a minimum capital threshold of ₦50 million naira. These banks are only allowed to have an office in the rural community where they operate, plus an additional cash center within the same locality. The 'Tier-2' MFBs are urban-based with a capital threshold of ₦200 million naira. They share the same restriction with the Tier-1, howbeit within an urban community. The 'State' MFBs have a license to operate in a specified state in the country with a minimum capital threshold of ₦1 billion naira. The 'National' MFBs can have a presence in more than one state in the federation and are required to maintain a minimum capital threshold of ₦5 billion naira (CBN, 2020).

The credit risk theory provides a theoretical background for this study. The theory holds that the risk in giving credit is primarily that of the lender. The theory states that to reduce credit risk, lenders must maintain a credit management framework for checking prospective borrowers, or require the borrower to take appropriate insurance or seek security/ guarantee from third parties. The framework is assumed to be developed along the lender's asset strength and core objectives. This theory supports the credit control strategies in literature, such as the client's/borrower's appraisal and credit terms and it's also a basis for the conceptual framework of this study.

1.2. Literature review

Nagarajan (2011), in a study on credit management practices among microfinance institutions in Mozambique, found that credit risk management is a dynamic process that could ideally be developed during normal times and tested in the wake of risk. The study concluded that financial institutions need to minimize risks related to losses through strategic management of portfolios and cash flow by building robust institutional infrastructure with skilled human resources and inculcating client discipline, through effective coordination of stakeholders. Gyamfi (2012) assessed the effectiveness of credit management techniques of microfinance firms in Ghana. The study, covering the periods 2003 to 2007 was conducted on twenty (20) microfinance firms in Accra. The result of the study ranked client character and management of the firm cash flows/savings as the dominant credit management techniques adopted by microfinance institutions in Ghana and further recommended client appraisal as a useful tool in credit risk management strategies.

Mwangi (2017) studied the factors affecting Microfinance Institutions' (MFIs) credit management practices in Kenya using three study variables, which were market concentration, portfolio quality, and market infrastructure. The study was conducted on forty-six (46) MFIs using descriptive statistics and correlation analysis and the results revealed that portfolio quality and market infrastructure have a positive and significant effect on credit management strategy, while market concentration has a negative but significant effect. Still in Kenya, Kisaka & Simiyu (2014) surveyed the credit management techniques used by MFIs. The study established that most MFIs in Kenya use 6C techniques of credit risk management. The results revealed that understanding the organization's exposure to credit is treated as being critical by the MFIs and to avoid loan losses, they used follow-ups. The study also established that the majority of the MFIs use a 'Credit Matrix' to measure credit migration and default risk while being faced with the challenges of strict operational regulations from the Central Bank of Kenya.

Liman et al., (2016) researched the types and nature of microfinance institutions in Nigeria. By collecting data from 121 microfinance institutions in Nigeria, they concluded that there are five categories of MFIs in Nigeria, which are MFBs, private institutions, government institutions, non-government institutions, and foreign-owned institutions. They also asserted that each category differs from others in terms of their ownership, organizational characteristics, and in particular, credit management strategies, which are measured in terms of loan duration, repayment structure, and loan policies. Musyoki & Kadubo (2012) had earlier justified this assertion in their research, where they established a significant difference in credit management strategies across banks, based on their assets.

1.3. Purpose of study

It is therefore necessary to examine the distribution of credit management strategies across microfinance banks in Nigeria. This study therefore seeks to determine the distribution of credit management strategies across the categories of MFBs in Nigeria. To achieve this, the following hypotheses were tested;

H_{01}: The distribution of credit terms is the same across categories of MFBs in Nigeria.

H_{02}: The distribution of client appraisal is the same across categories of MFBs in Nigeria.

H_{03}: The distribution of collection policy is the same across categories of MFBs in Nigeria.

2. METHODS AND MATERIALS

2.1. Data collection tool

A survey design was used in this study.

2.2. Participants

A total number of one hundred and eighteen (115) MFBs were purposively selected out of the existing seven hundred and nineteen (719) licensed MFBs (CBN, 2023). In the first instance, three MFBs (one state, one tier-1 & one tier-2) were randomly selected from each of the thirty-six states in Nigeria. Thereafter, seven national MFBs were included to make the desired sample size of 115. A credit manager/officer in each of the selected MFBs participated in the survey, involving a structured questionnaire adapted from previous studies (Gatimu & Frederick, 2014; Edwin & Omagwa, 2018, Sola, 2021).

2.3. Data analysis

Responses from the administered questionnaires were analyzed using SPSS (version 23) software. Descriptive statistical tools such as frequency distribution and bar charts were used for the demographic characteristics of the respondents, while Kruskal-Walli's rank test was used for the inferential analysis. The test is a non-parametric test that was chosen because of the ordinal nature of the data, representing the variables. It has a null hypothesis that the distribution of a variable is the same across sampled groups.

3. RESULTS

3.1. Demographic Characteristics

Figure 1

Gender Distribution

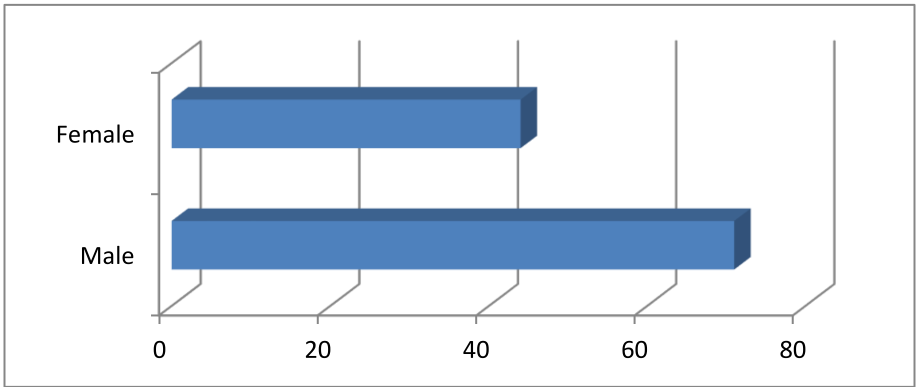


Figure 2

Years of Experience in MFBs

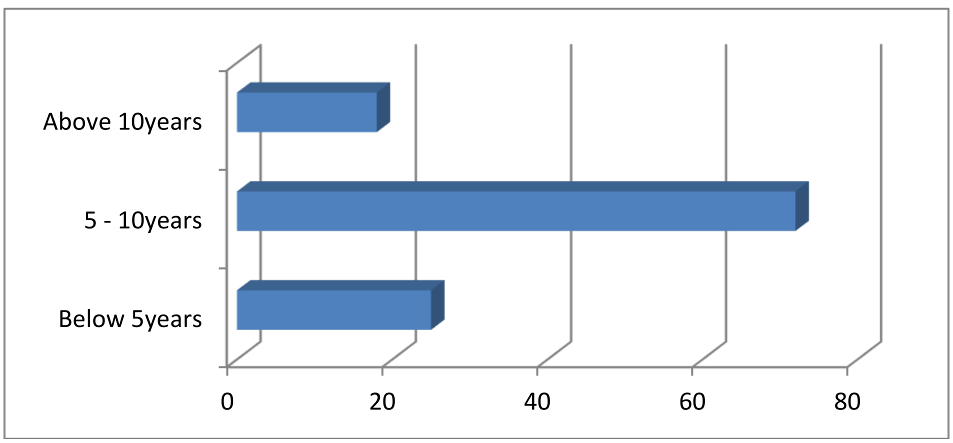
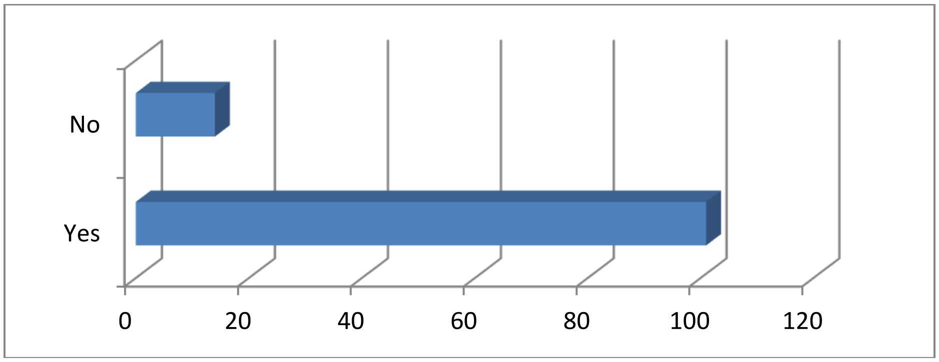


Figure 3

Certification in Microfinance Operations



The demographic characteristics of the credit managers/officers who participated in the survey are presented in Figures 1 – 3. The results indicate that more than half of them are male (62%) and have 5-10 years of working experience in the microfinance banking subsector (63%). In addition, almost all the respondents (88%) have certification in microfinance. The spread of these results suggests that the sampled credit managers/officers can provide necessary opinions on the subject under investigation.

3.2. Test of Hypotheses

Kruskal-Wallis rank test was used to analyze the distribution of the three credit management strategies (credit term, client appraisal, and collection policy) across the categories of microfinance banks in Nigeria. The summary of the test is presented in Tables 1 and 2.

Table 1

Distribution of Credit Management Strategies Across Categories of MFBs in Nigeria

Credit Strategies	MFBs	Mean Rank	Chi-Square	df	Sig.
Credit Term	National	99.01			
	State	101.04			
	Tier-1	88.23			
	Tier-2	78.02	2.77	3	0.250
Client's Appraisal	National	113.83			
	State	97.92			
	Tier-1	88.25			
	Tier-2	78.15	2.75	3	0.253
Collection Policy	National	88.17			
	State	118.14			
	Tier-1	85.76			
	Tier-2	66.35	10.3	3	0.006

Results from Table 1 show that the distribution of credit term as a credit management strategy across the categories of MFBs (National, state, tier-1 & tier-2) has a chi-square statistic of 2.77 with a degree of freedom of 3 and a p-value of 0.25, which is not statistically significant at the 5% level. Similarly, the distribution of client appraisal as a credit management strategy across the categories of MFBs has a chi-square statistic of 2.75 with a degree of freedom of 3 and a p-value of 0.253, which is also not significant at the 5% level. Furthermore, the distribution of collection policy, as a credit management strategy across the categories of MFBs has a chi-square statistic of 10.3 with a degree of freedom of 3 and a p-value of 0.006, which is statistically significant at the 5% level. The spread of the result here indicates that only the collection policy has a significant distribution across the categories of MFBs in Nigeria. H_{01}

Table 2

Hypotheses Test Summary

	Null Hypothesis	Test	Sig.	Decision
H_{01}	The distribution of Credit terms is the same across categories of MFBs	Independent-samples Kruskal-Wallis Test	0.250	Accept
H_{02}	The distribution of Client appraisal is the same across categories of MFBs	Independent-samples Kruskal-Wallis Test	0.253	Accept
H_{03}	The distribution of Collection policy is the same across categories of MFBs	Independent-samples Kruskal-Wallis Test	0.006	Reject

Table 2 shows the results of the hypotheses tested in this study. Hypotheses one and two have p-values above the 5% statistical level and are therefore accepted in their null form. This suggests that the distribution of credit terms and client appraisal are the same across categories of MFBs. However, hypothesis three has a p-value below the 5% level and it is therefore rejected in its null form, suggesting that the distribution of collection policy is not the same across categories of MFBs.

The outcome of Kruskal-Walli's test requires a post-hoc test to ascertain the pair-wise comparison of the distribution of collection policy across the categories of MFBs (tier-1, tier-2, state & national). This is presented in Table 3. The test has a null hypothesis that the pair-wise comparison of a distribution is the same.

Table 3

Post-Hoc Test for the Pair-wise Comparison of the Distribution of Collection Policy across Categories of MFBs

Pair-wise	Test Statistic	Std. Error	Std. Test Statistic	Sig.	Adj. Sig.
Tier 1 – National	5.40	18.96	0.28	0.01	0.02
Tier 2 – National	3.16	17.54	0.18	0.03	0.04
Tier 1 – State	32.24	10.05	3.21	0.00	0.00
Tier 2 – State	28.66	9.83	2.92	0.00	0.01
Tier 1 – Tier 2	8.45	11.06	0.76	0.26	0.38
State – National	-29.83	21.41	-1.39	0.16	0.49

The result from Table 3 indicates that the pair-wise distribution of collection policy between MFBs in the 'Tier-1' and 'National' categories is significantly different from each other (p = 0.02). A similar result holds for the pair-wise distribution of this credit strategy between MFBs in the 'Tier-2' and 'National' categories (p = 0.04). Furthermore, the pair-wise distribution of collection policy between MFBs in the 'Tier-1' and 'State' categories is significantly different (p = 0.0). The same result goes for MFBs in the 'Tier-2' and 'State' categories (p = 0.01). However, the pair-wise distribution of collection policy, as a credit management strategy between MFBs in 'Tier-1' and 'Tier-2' categories are not significantly different (p = 0.38). This also holds for the distribution of MFBs in the 'State' and 'National' categories (p = 0.49).

4. DISCUSSION

The empirical findings from the Kruskal-Walli's test have shown that there is a significant difference in the distribution of collection policy, as a credit management strategy, across the categories of MFBs in Nigeria. This suggests that the opinion of the credit managers/officers on this credit strategy is not the same when measured across these categories of the banks (national, state, tier-1 & tier-2). Furthermore, the result has shown that the pair-wise distribution of collection policy between MFBs in tier-1/tier-2 and national; tier-1/tier-2 and state categories are significantly different from each other. This indicates that MFBs in both tier-1 and tier-2 share different perceptions to their counterpart in the state and national categories, as it concerns the usage of collection policy for credit management.

These results imply that policies on loan collection strategy differ significantly between MFBs at the tier-1/tier-2 level and those at the state/national level. This suggests that the capital base of these MFBs, which is the basis for their categorization, is a determining factor in how loan collection strategy is practiced. This finding agrees with that of Liman et al. (2016), who opines that MFBs in Nigeria differ from each other in terms of their credit management strategies. The finding also corroborates that of Musyoki & Kadubo, (2012), who established that a bank capital base has a significant effect on its credit management strategy.

5. CONCLUSION

This study investigated the distribution of credit management strategies (credit term, client appraisal & collection policy) across the categories of microfinance banks in Nigeria (tier-1, tier-2, state & national). The result has shown that collection policy, as a credit management strategy differs significantly across banks in the tier-1 category (minimum capital of N200 million naira) and state category (minimum capital of N1 billion naira); tier-2 category (minimum capital of N50 million naira) and state category; tier-1 category and national (minimum capital of N5 billion naira); tier-2 category and national category. This establishes the minimum operating capital, as a major determinant of the choice of credit strategies amongst microfinance banks in Nigeria.

The study therefore recommends that the government should implement policies geared at enhancing funds availability to the microfinance banking sub-sector. This will help the banks to improve their capital base, which will in turn impact their credit management strategies. In addition, with more business capital for microfinance banks, there will be more loan disbursements to customers, which will improve their interest incomes and impact their profitability.

Conflict of Interest: The authors declare no conflict of interest.

Ethical Approval: This research did not harm any human participants. All participants remained anonymous. Informed consent was sought from all participants before they participated in the study.

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