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Undercapitalization and Loan Delinquency: Implications on Financial Inclusion in Nigeria

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Abstract

Financial Inclusion involves ensuring that the poor have access to financial services that are relevant to their needs especially in the rural communities. This study investigated the extent to which undercapitalization of rural banks and frequent loan delinquency influence the ability of deposit money banks to drive the inclusive growth agenda of the Central Bank of Nigeria. Out of the 250 questionnaires distributed, 179 were returned and analyzed. Being a categorical data, the study employed optimal scaling regression to measure the relationship between the dependent and independent variables. ANOVA and other statistical tests were also conducted. The study found that loan delinquency, undercapitalization and payment of utility bills were significant in measuring the inclusive growth initiative of the Central Bank of Nigeria. It therefore recommends among others that government should make policies that will increase the credit worthiness of the rural dwellers as well as encourage banks to support investment in the rural communities so as to equip the rural dwellers with the financial muscle to drive inclusive growth in Nigeria.

Key Words: Financial Inclusion, Undercapitalization, Loan Delinquency, Deposit Money Banks,

Introduction

Financial Inclusion involves ensuring that the poor have access to financial services that are relevant to their needs. It has the benefit of alleviating poverty, stimulating economic growth, and increasing the welfare of the poor. Financial inclusion aims at increasing the number of account holders in deposit money banks and other formal financial institutions. It also seeks to encourage the unbanked populace to make use of formal payment media, including cheques, credit cards, ATM cards, internet payments, mobile payments and so on. Martinez (2011) identified financial access as an important policy tool employed by government in fighting and stimulating growth given its ability to facilitate efficient allocation of productive resources, thus reducing the cost of capital. This process otherwise referred to as an inclusive financing system can significantly improve the day-to-day management of finances, as well as reduce the growth of informal sources of credit (such as money lenders), which are often found to be exploitative. An inclusive financial system is now widely recognized as a policy priority in many countries with initiatives coming from the financial regulators, the government and the banking industry. Financial inclusion complements economic growth as it contributes toward poverty alleviation. Ahmed (2006), noted that financial sector development is a driver of economic growth which indirectly reduces poverty and inequality while appropriate financial services for the poor can improve their welfare.

Such inclusive financial system is therefore a veritable avenue for economic development and growth given its capacity to ensure improvement in the delivery of efficient services, creation of saving opportunities and facilitation of capital formation among the poor Ahmed (2006). (Chakraborty, S. R and Rupayan P, 2013) defines financial inclusion as the process of ensuring access to appropriate financial product and services needed by vulnerable groups such as weaker societal sections and low income groups at an affordable cost in a fair and transparent manner by mainstream institutional players, thus making an inclusive financing arrangement critical aspects in the context of economic growth and development of any economy. Financial Inclusion is the perception which views inclusion as a progression inculcating some elements of hierarchy of needs with higher levels of financial inclusion achieved as more needs are fulfilled. This perception views Inclusive financing as an "hierarchy of financial needs" syndrome that starts by promoting non-cash methods of bill payment, advancing business through borrowing and fund investment (Amit Jain, 2012). The Financial Service providers have not been able to provide adequate financial service to the unbanked members of the society, this is partly due to frequent loan delinquency experienced in the hands of the active poor in an attempt to provide venture capital and other sources of funds to the rural dwellers. Another major constraint stems from the fact that most banks do not have the luxury of finance to service the active poor at the expense of corporate borrowers and high net worth individual customers that promises a better return to them. Inorder to mitigate the risk associated with lending to the active poor in the rural communities banks increase interest rates and demand valuable collaterals which the underserved could not afford. Where the banks decide to ;end money to the underserved, they prefer to give short term funds which can only serve as working capital for existing business but not as venture capital for start-ups that will engender sustainable economic growth. Even where they go ahead to borrow from these banks they often do not have the capacity to pay back because of cut throat interest rate and stringent conditions attached to loan. It is against this backdrop that this study attempt to investigate how undercapitalization of deposit money banks and inability of the rural communities to fulfil loan covenants weaken the inclusive growth agenda of the federal government. The major question this study will address is “to what extent do financial incapacitation of the rural communities hamper the inclusive growth agenda pursued by the Federal Government.

Research Objectives:

(i) To what level do the inability of the active poor to meet loan obligations affect government drive for inclusive growth;

(ii) To what extent do undercapitalization of deposit money banks in rural communities affect the level of financial inclusion of the underserved and underbanked in Nigeria;

(iii) To examine how inadequate delivery of tailor-made products and utility payment platforms affect inclusive growth.

Statement of Hypothesis

Hypothesis I.

H0: Loan delinquency by the active poor has no significant effect on their drive for financial inclusive growth.

H1: Loan delinquency by the active poor has significant effect on their drive for financial inclusive growth.

Hypothesis II

H0: Under capitalization of deposit money banks in rural communities has no significant relationship with financial inclusion in the remote localities in Nigeria.

H1: Under capitalization of deposit money banks in rural communities has a significant relationship with financial inclusion in remote localities in Nigeria.

Hypothesis III

H0: Inefficient service delivery and provision of tailor-made products by bank agents has no significant influence on customers' acceptance and usage of various bank products available in their locality.

H1: Inefficient service delivery and provision of tailor-made products by bank agents has significant influence on customers' acceptance and usage of various bank products available in their locality.

This paper is divided into five parts. Part one above is the introduction. Part two reviews the relevant literature, part three discusses the methodology employed in this study, and part four is data presentation and analysis while part five discusses the findings, conclusion and recommendations.

Review of related Literatures

As economic life becomes increasingly sophisticated and increasingly complex, those without access to the tools of modern economic life will become ever more marginalized and ever more mired in poverty. For a solution to be truly effective and deliver benefits to all involved parties, it must be based on consumer demand, not the desire of a stakeholder to promote a particular product or service. Governments, banks and businesses should be looking at bill payment solutions to help ensure that everyone will have the tools they need to build a safe and secure economic life. (Amit Jain , 2012). Inclusive finance that affords availability and usage of formal financial system for all members of an economy especially vulnerable and financially excluded group at an affordable cost will ultimately influence economic activities. In urban areas, low-salaried employees or self-employed in such positions as shopkeepers, street vendors, foreign exchange officers as well as small-scale farmers, small gold and diamond mine operators in rural areas and others who are engaged in subsistent income-generating activities such as food processing and petty trade, especially women and children of banking age will benefit from such financing activities. (Ogunleye, 2009) links financial inclusion to financial stability, stating that the former promotes the later by facilitating inclusive growth.

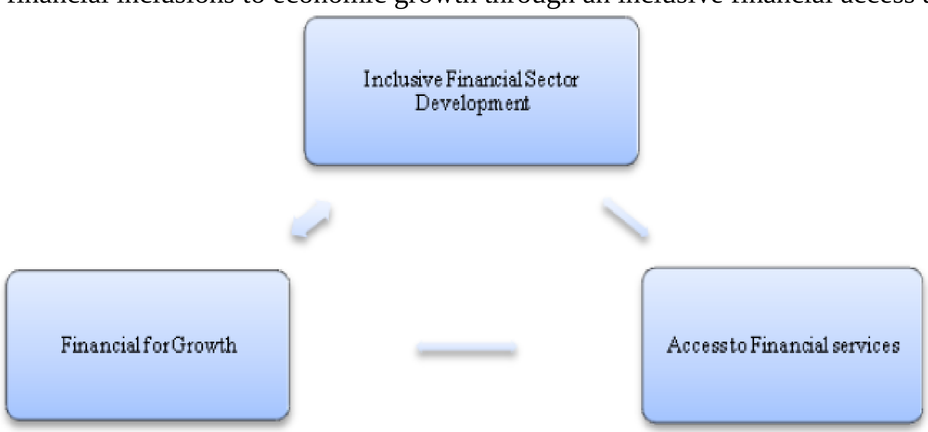
Financial inclusion is important for ensuring economic inclusion as financial sector development, drives economic growth by mobilizing savings and investment in the productive sector (Johnson and Nino-Lazarawa 2009). This is premised on institutional infrastructures that a financial system afford which contribute to a reduction in information and transaction cost as well as indirectly enables lowering of poverty, promote pro-poor growth and lessen income inequality; (Beck & Honohan, 2009).

Strategies and Models to Achieving Adequate Financial Inclusion

Innovative financial inclusion refers to the delivery of financial services outside conventional branches of financial institutions (banks and MFIs) by using information and communications technologies and non-bank retail agents (including post offices) as well as new institutional arrangements to reach those who are financially excluded. Besides traditional banking services, this concept includes alternatives to informal payment services, insurance products, savings schemes, etc (Kate Lauer and Timothy Lyman, 2015). Delivery mechanisms under such financing system include both mobile phone-based systems and systems where information and communications technologies, such as Point-Of-Sale (POS) device networks, are used to transmit transaction details between the financial service provider, the retail agent, and the customer in a branchless banking regime. Noticeable reforms adopted by many developing countries in the last decade to open up the financial sector to the hitherto financially excluded populace entails the use of interest rate liberalization, the switch from other direct monetary instruments, recapitalization, closure of some state-owned banks, and restructuring of commercial banks. The establishment in 1988 of the Agricultural Credit Support Scheme (ACSS) by the CBN was one of the early attempt for creating access to loans for practicing farmers and agro-allied entrepreneurs are encouraged to approach their banks for loan with large scale farmers allowed under the scheme to apply directly to the banks in accordance with the stipulated guidelines (CBN Special Report, 2013).

Literatures have further furnished us with numerous suggestions on how to bridge the gap between the rural poor and financial inclusion. Some of these suggestions presented in form of models attempted to identify clearly the problems of financial exclusion and strategies to be applied in order to elevate the poor and unbanked to full financial inclusion. One of such models is the Sustainable Financial Model by Chris Bold, David Porteous, Sarah Rotman, 2014), which identified three basic propositions for creating a sustainable long term inclusion within an economy; namely customers' needs proposition, business' case proposition and a compliant ecosystem. Another model tagged Social Development model represents the society as a three-inclusion representing the financially included, the base unbanked bankable, and the middle bankable.

Empirical evidences suggests that well developed financial system have strong positive impact on economic growth over a long period; (Demirgue-Kunt, A., & Levine R., 2008) evidence suggests that well developed financial system have strong positive impact on economic growth over a long period. Many academic literatures have also found a robust positive relationship at the country level between financial depth (deepening), cost, liquidity, income level and customer perception (Beck, Demirguc-Kunt and Levine 2007). The ineffectiveness of the two previously administered 'stylized financial sector policy reforms' in Nigeria in the nature of state led industrial and agricultural development (e.g. the Agricultural Credit Guaranty Scheme in Nigeria and the Market deregulation) made institutional building approach that focused on the performance of financial institutions in delivery services to the segment of the population with little or no access to finance. (Babajide A.A., Adegboye F.B. and Omankhanlen A.E, 2015) posit that there is need for adequate financial and political security measures to be put in place that will ensure a financially and politically secure system of governance, which would heighten public confidence in formal account creation and increase savings deposit mobilization within the financial system. Inclusive finance that affords availability and usage of formal financial system for all members of an economy especially vulnerable and financially excluded group at an affordable cost will ultimately influence economic activities. In urban areas, low-salaried employees or self-employed in such positions as shopkeepers, street vendors, foreign exchange officers as well as small-scale farmers, small gold and diamond mine operators in rural areas and others who are engaged in subsistent income-generating activities such as food processing and petty trade, especially women and children of banking age will benefit from such financing activities. Consequently, Ogunleye (2009) links financial inclusion to financial stability, stating that the former promotes the later by facilitating inclusive growth. Financial inclusion is important for ensuring economic inclusion as financial sector development drives economic growth by mobilizing savings and investment in the productive sector Johnson and Nino-Lazarawa (2009). This is premised on institutional infrastructures that a financial system afford which contribute to a reduction in information and transaction cost as well as indirectly enables lowering of poverty, promote pro-poor growth and lessen income inequality Honohan and Beck (2007). The AT&SG Report (2010) links financial inclusions to economic growth through an inclusive financial access as represented below:



Source: Innovative Financial Inclusion; Expert Group AT&SG Report

Mobilization of savings enhances financially excluded have access to financial savings Institution credit delivery and reduces poverty services of customers' perception through investment in productive sector and welfare improvement of the financial system contributes to reducing financial information irregularity, contraction in transaction costs, liquidity and customer's perception which in turn accelerates economic growth in Nigeria. Effective financial inclusive policies impact economies as it contributes to reduction in poverty, pro-poor growth and accelerated economic growth. In a study tracking the financial diaries of poor people in Bangladesh, India and South Africa, (Collins, D., Murdoch, J., Rutherford, S., & Ruthven, O, 2009) found causality between access to a range of appropriate and affordable financial services and improvement in poor people's welfare & income. As economic life becomes increasingly sophisticated and increasingly complex, those without access to the tools of modern economic life will become ever more marginalized and ever more mired in poverty. For a solution to be truly effective and deliver benefits to all involved parties, it must be based on consumer demand, not the desire of a stakeholder to promote a particular product or service. Governments, banks and businesses should be looking at bill payment solutions to help ensure that everyone will have the tools they need to build a safe and secure economic life. (Amit Jain 2012)

Methodology

The measuring instrument employed by this study is the survey technique. Out of the 250 questionnaires distributed, 179 were returned and analyzed. Being a categorical data, the study employed optimal scaling regression to measure the relationship between the dependent and independent variables. ANOVA and other statistical tests were also conducted. Only three out of the seven variables investigated were significant to the study hence the study restricted its objective and interpretation on Undercapitalization, Loan Delinquency and Payment of utility bills.

Model Specification

FI = f(Cost, LQ, UCP, PUTB, PRS, GEOSP)……………………………………1
FI = βo + β1Cost + β2LQ + β3LDQ β4UCP + β5PUTB + β6PRS + β7GEOSP + U…….2
FI = Financial Inclusion
Cost = Cost of financial inclusion
LQ = Liquidity Constraint
LDQ = Loan Delinquency
UCP = Undercapitalization
PUTB = Payment of Utility Bills
PRS = Products for Inclusive Growth
GEOSP = Geographical spread.
βo = Constant
$\beta_1 + \beta_2 + \beta_3 + \beta_4 + \beta_5 + \beta_6 + \beta_7$ = Coefficient of the Ind. variables
U = Error term

Estimation Technique

Being a categorical data, the study employed optimal scaling regression to measure the relationship between the dependent and independent variables. ANOVA and other statistical tests were also conducted to test the reliability and size of the data used.

Descriptive Analysis & Description

The demographic information of the respondents was analyzed with frequency distribution and percentages as shown in table 4.1. These factors considered were the respondents' age, educational qualification, gender distribution, marital status, staff position and length of service.

Demographic statistics

AGE	**Frequency**	**Percent**
18 to 28 years	39	21.8
28 to 38 years	77	43.0
38 to 48 years	44	24.6
above 48 years	19	10.6
Total	179	100.0
EDUCATIONAL QUALIFICATION	**Frequency**	**Percent**
FSL	2	1.1
WASC/GCE	11	6.1
OND/NCE	13	7.3
HND	31	17.3
BSC	65	36.3
MSC	52	29.1
PHD	2	1.1
OTHERS	3	1.7
Total	179	100.0
SEX	**Frequency**	**Percent**
FEMALE	67	37.4
MALE	112	62.6
Total	179	100.0
MARITAL STATUS	**Frequency**	**Percent**
MARRIED	96	53.6
SINGLE	71	39.7

DIVORCE	12	6.7
Total	179	100.0
STAFF POSITION	**Frequency**	**Percent**
Below 1 year	36	20.1
1 to 5 years	63	35.2
5 to 10 years	45	25.1
10 to 15 years	18	10.1
Above 15 years	17	9.5
Total	179	100.0
LENGTH OF SERVICE	**Frequency**	**Percent**
Below 1 year	36	20.1
1 to 5 years	63	35.2
5 to 10 years	45	25.1
10 to 15 years	18	10.1
Above 15 years	17	9.5
Total	179	100.0

The age distribution of the respondents in table 4.1 shows that majority of the participants 77(43%) were between the ages of 28 to 38 years, 18(21.8%) were within the age limit of 18 to 28 years, 44(24.6%) were between 38 to 48 years while 19(10.6%) were 48 years and above.The educational distribution of the participants by their qualification shows that most 65(36.3%) of them were B.Sc holders followed by M.Sc degree holder 52(29.1%), 31(17.3%) were HND holders, 13(7.3%) had OND/NCE, 11(6.1%) were WASC/GCE holders, 2(1.1%) had first school leaving certificate, another 2(1.1%) had PhD degree while those with other certificates were 3(1.7%). The analysis of the gender composition of the respondents indicates 112(62.6%) which constitutes the highest proportion of the respondents were the males while the females were 67(37.4%). In terms of marital status 96(53.6%) of the entire respondents were married, 71(39.7%) were still single and the remaining 12(6.7%) had divorced. In regard to the staff positions, it is observed that 11(6.1%) of the respondents occupy the position of senior managers and above, 25(14%) managers, 14(7.8%) principal officers, 32(17.9%) senior officers, 64(35.8%) officers and 33(18.4%) junior officers. Most 63(35.2%) of the respondents had 1to 5 years of service, 45(25.1%) had 5 to 10 years of service, 36(20.1%) had less than 1year of service, 18(10.1%) had 10 to 15 years of service while 17(9.5%) had served for a minimum of15 years.

Empirical Result and Discussion

Table 4.2 Reliability Statistics

Cronbach's Alpha	N of Items
.613	8

Source; Authors' survey, 2016

The internal consistence of the 8 item variables used in the study analysis was measured with Cronbach's Alpha statistic (table 4.2) with the Cronbach's Alpha co efficient of 0.613. This therefore indicates the instrument is reliable and statistically consistent across the entire participants covered in the survey.

Principal Component Analysis

Table 4.2 Component Matrix[a]

	Component		
	1	2	3
COST OF FIN INCLSN	.622	-.411	-.194
LIQDTY CONSTR	.592	-.508	-.057
GEOSPRDLIQCOST	.303	.668	-.462
PRDTS FOR INCLS GROWTH	.656	-.181	-.150
LOAN DELQNCY	.561	.470	-.222
PAYMT OF UTILITY BILLS	.410	.320	.499
UNDER CAPITAL	.457	.172	.684

Source; Authors' survey, 2016

The principal component analysis of the survey study (table 4.2) shows that the most variant perceptions among the respondents were prominently featured in respect to the various products of deposit money banks and other informal financial institutions in their drive for inclusive growth in Nigeria. Also notable is the significant variations in the participants perception on the banks geographical spread, liquidity and cost effect of financial inclusion in Nigeria. Evidence from the components analysis revealed significant variance in the respondents' perception on the effect of under capitalization of rural banks in meeting up with customers demand for loans.

Table 4.3 Model Summary

Multiple R	R Square	Adjusted R Square	Apparent Prediction Error
.725	.526	.476	.474

Source; Authors' survey, 2016

The result of the model summary in table 4.3 above shows a high level of relationship between financial inclusive growth perception and its determinant factors with the multiple correlation coefficient (R= 0.725) at 72.5 percent. The co efficient of determination (R-squared=0.526)

Indicates that the changes in the determinant factors considered in the study jointly and significantly explains 52.6 of the variations in the high acceptance and usage of rural banking products among local communities in Nigeria.

Table 4.4 ANOVA

	Sum of Squares	Df	Mean Square	F	Sig.
Regression	94.156	17	5.539	10.510	.000
Residual	84.844	161	.527		
Total	179.000	178			

Source; Authors' survey, 2016

The ANOVA result in table 4.4 measures the statistical significance of the model for the acceptance and use of rural banking products among local communities in Nigeria. The result of the F-statistics (10.510; P-value<0.01) shows the estimated data correctly fits the model at 1 percent significance level. This further indicates that the model is statistically different from zero and the estimated parameters valid for policy issues.

Table 4.5 Coefficients

	Standardized Coefficients		df	F	Sig.
	Beta	Bootstrap (1000) Estimate of Std. Error			
COST OF FIN INCLSN	.123	.134	2	.849	.430
LIQDTYCONSTR	.157	.185	3	.715	.545
LOAN DELQNCY	-.155	.094	3	2.704	.047
UNDER CAPITAL	.315	.186	3	2.873	.038
PAYMT OF UTILITY BILLS	.520	.277	2	3.534	.031
PRDTS FOR INCLS GROWTH	.124	.088	2	1.992	.140
GEOSPRDLIQCOST	.041	.119	2	.116	.891

Source; Authors' survey, 2016

Analysis of table 4.3 shows an insignificant direct relationship between the high cost perceptions of banking products and services and the high acceptance and usage of rural banking products among local communities in Nigeria. Detailed analysis of the results shows the extent of the relationship between high cost perception of financial inclusion through the use of banking products and services by bank customer and the level of acceptability and usage of rural banking products among local communities in Nigeria 0.123 percent though not significant. The result of the respondents' perception on liquidity constraint as a major hindrance to financial inclusion and the level of acceptability and usage of rural banking products among local communities indicate a direct but insignificant correlation at 5 percent significance level. The relationship between loan delinquency and acceptability and usage of banking products and services among the rural communities shows a significant inverse correlation at 5 percent level of significance. This implies that frequent loan delinquency experienced by deposit money banks appears to be a significant factor affecting the acceptance and usage of rural banking products among the rural communities in Nigeria. Further investigation on the result suggests that a percentage increase in the frequency of loan delinquency would significantly affect financial inclusion by 0.156 percent holding other factors at constant. Hence the frequency of loan delinquency featured here as significant determinant factor that could hinder the acceptability and usage of financial products and services especially in the rural communities.

The estimated coefficient for the effect under capitalization as a hindrance to acceptance and use of rural banking products among local communities in Nigeria shows a significant relationship at 5 percent level of significance. The correlation coefficient of the result indicates a percentage increase in undercapitalization of the rural banks would affect the acceptance and usage of rural banking products among the rural communities in Nigeria by 0.315 This suggests that increases in under capitalization of rural banks could be detrimental to the success of financial inclusion in the grass root areas in Nigeria. The result of the study thus provides evidence that under capitalization of the rural banks could significantly affect the level of financial inclusion in the country.

Evidently there is a significant and direct relationship between rural banking service provision and level of financial inclusion of the rural communities in Nigeria. Specifically the parameter estimate for the payment of utility bills shows a significant relationship with high acceptance and use of rural banking products among the local communities in Nigeria at 5 percent significance level. Furthermore a percentage increases in the rural banking service provision indicates significant direct influence on financial inclusion with an estimated coefficient of 0.52 percent. Thus the higher the effort by the deposit money banks in the provision of banking products and services in the remote areas the more the acceptability and usage of rural banking products among the local communities. Although there is an evidence of direct relationship between deposit money banks products to drive inclusive growth and high level of acceptance and use of the rural banking products it is however insignificant. This therefore suggests the insufficiency of these rural banking products and services to meet the need of the local communities. Hence more effort is required to effectively utilize the rural banking products in the drive for inclusive growth in Nigeria.

Findings

The study found that high cost of service delivery and liquidity positions of deposit money bank do not significantly affect financial inclusion. The result is however at variance with some literatures on financial inclusion which suggest high cost of service delivery by both providers and users of financial service products among the rural communities a major mitigating factor to inclusive growth. . Empirical analysis conducted discovered that frequent loan delinquency on the part of borrowers is a major constraint to driving the inclusive growth agenda of the Central Bank. Deposit Money banks are not disposed to lending to low income earners and rural communities dwellers because of their high risk profile nature and this hinder the acceptability and usage of financial products and services especially in the rural communities.

Under capitalization of the rural banks is a major hindrance to driving inclusive growth among the active poor in the rural communities. The acceptance of payment of utility bills through any of the mobile platforms is an indication of the acceptance of banking products and services by the rural communities.

Recommendations

Since liquidity and cost of service delivery by both providers and users of financial service products does not hinder inclusive growth, there is need for deposit money banks to make policies that will focus more on increasing the scale of its operations to capture more of the underserved and unbanked adult populace in rural communities. To minimize loan default rate, deposit money banks should put up a machinery to monitor the business of these category of customers who may not have the business acumen and financial expertise to embark on such projects for which the loan was obtained. Apart from making the loan available to them, they should offer some useful financial advise that will help them grow and nurture their business as most of them may be illiterates who cannot read and write. Also carrying out necessary checks via KYC (Know Your Customer) will be most appropriate too. When deposit money banks become part of their customer’s business, the customers will have confident in them and embrace any new product that the DMBS will introduce to them. Deposit money banks should fund their agents or branches in the rural communities so that they will have enough funds to design and provide tailor-made products which the rural communities will embrace. If they are under-funded they will not be able to provide products and services that will enable them to break even. Under funding is a major factor that contributed to the closure of most bank branches in the rural areas after the post consolidation period. There is need for deposit money banks to design more tailor made products that will meet the needs and yearnings of the underserved or unbanked adult population in the rural areas. By accepting to pay utility bills via any of the platforms offered by the deposit money banks is an indication that they are ready to embrace more products that will be designed to meet their specific needs and aspirations. The dearth of these customized products is an indication of financial exclusion in the rural communities.

Conclusion

From the foregoing, this study concludes that CBN should make and implement policies that will reduce incidence of loan delinquencies among deposit money bank. They should also encourage banks to diversify inorder to acquire the requisite finance that will deepen the economy and provide more investible funds for the active poor in the rural communities’. It should also increase funding of the different branches or sales outlet to enable them design and provide products and services that will be accepted by the rural communities. Increase in the number of adults using financial services will culminate directly or indirectly to growth in the gross domestic products as well as economic growth and development.

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