Critical Incidents in the Nigerian Microfinance Bank Industry: An Analysis of Research Findings

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Abstract

This study examines critical incidents affecting Nigerian Microfinance Banks (MFBs) by primarily using the findings of a mixed methods research conducted by Emokpae, (2020) on Nigerian Microfinance Bank industry to identify patterns, causes, and impacts on operational sustainability. The research explored how and why some Microfinance banks in Lagos, Nigeria survived over a period of 9 years (2010–18), whilst others did not. The analysis reveals four dominant critical incident categories: loan portfolio defaults triggered by lack of good corporate culture across all levels of the Nigerian Microfinance banks workforce, internal fraud and governance failures that accelerated mass cash withdrawal, core banking system failures that led to high incidence of unrecovered loans and CBN regulatory compliance breaches, particularly the unrecovered single obligor lending. These incidents were found to directly undermine customer trust, liquidity, and long-term sustainability of affected Microfinance Banks. Recurring causes include weak internal controls, inadequate staff training, and delayed adaptation to CBN recapitalization policies.

Keywords: Adaptation, Critical incidents, Fraud, Governance, Loan portfolio, Microfinance banks, Operational sustainability, Recapitalization, Regulatory, Recurring.

1. Introduction

Microfinance Banks (MFBs) play a pivotal role in advancing financial inclusion and poverty reduction in Nigeria by providing credit and savings services to low-income individuals and micro-enterprises excluded from conventional banking. As grassroots financial institutions, MFBs are expected to bridge the gap between formal financial systems and underserved communities, particularly in rural and semi-urban areas. However, the sector operates in a high-risk environment characterized by regulatory volatility, limited capital, and exposure to economic shocks.

Despite the policy frameworks established by the Central Bank of Nigeria (CBN) to strengthen the sector, including successive recapitalization directives, Nigerian MFBs continue to experience operational disruptions that threaten their sustainability. These disruptive, significant and often unexpected events are referred to as “critical incidents”. McAteer et al, 2010:107 in Emokpae, 2020, aptly describes critical incidents as the incidents that occur in organisations and in the lives of individuals that can alter the natural or intended course of the organisation and individual.

Understanding critical incidents is essential because a single event such as systemic fraud, mass loan default, or core banking failure can erode customer trust, trigger liquidity crises and lead to regulatory sanctions within a short period. The Critical Incident Technique offers a robust methodological approach for capturing such events directly from practitioners, yet its application in the Nigerian MFB context remains underexplored.

Literature on critical incidents in the lives of MFBs and their key promoters indicates that some of such incidents, how they were perceived and consequent reaction, contributed to the death of MFBs in Nigeria while some MFBs were strengthened by them (Emokpae, 2020). Against this background, this study analyzes research findings to identify, categorize, and interpret critical incidents reported

within the Nigerian microfinance banking industry. By moving beyond generalized challenges to event-level analysis, the study aims to provide evidence-based insights for MFB managers, regulators and policymakers seeking to strengthen operational resilience and safeguard financial inclusion objectives.

2. Literature Review

2.1 Concept of Critical Incidents in Organizations

The Critical Incident Technique (CIT) was developed by Flanagan (1954) to capture observable human activities that significantly contribute to success or failure in defined situations. A critical incident is defined as an event that is "critical" because it occurs in a situation where the purpose is clear and its consequences are sufficiently definite to leave little doubt about its effects (Flanagan, 1954). In management and organizational studies, critical incidents are used to identify non-routine events that disrupt operations and provide insights into risk, decision-making, and performance (Butterfield et al., 2005).

In financial institutions, critical incidents extend beyond daily operational errors to include events that threaten institutional stability, customer trust, and regulatory compliance (Adeyemi & Badmus, 2018). The relevance of CIT in banking research lies in its ability to move analysis from general challenges to specific, event-level data reported by practitioners (Gremler, 2004).

2.2 Risk and Operational Challenges in Nigerian Microfinance Banks

Nigerian MFBs operate within a fragile financial ecosystem. Prior studies identify recurring risks including high portfolio-at-risk ratios, weak corporate governance, and inadequate capital base (CBN, 2021; Nwanyanwu, 2011). The CBN's recapitalization policy of 2018 and 2021 increased minimum capital requirements, forcing many MFBs to merge, downgrade, or exit. Research shows this policy shift became a trigger for liquidity crises and mass loan defaults in several MFBs. 2020).

Governance failures have also been documented as critical threats. Adeyemi et al. (2017) found that internal fraud perpetrated by staff and management ranked among the top causes of MFB distress in Nigeria. Similarly, technological failures,

particularly core banking application downtime during peak transaction periods, have been reported to erode customer confidence and cause operational losses.

2.3 Critical Incidents and Sustainability of MFBs

The link between critical incidents and institutional sustainability is well established. A single incident such as regulatory sanction, system hack, or fraud can trigger a "bank run" and lead to license revocation by CBN (Sanusi, 2019). Studies on financial inclusion argue that the failure of MFBs due to unmanaged critical incidents reverses gains made in extending credit to micro-enterprises and rural populations (Enhancing Financial Innovation & Access, 2020).

Despite these insights, limited research in Nigeria has applied CIT to systematically map and categorize critical incidents in the MFB sector. Most studies adopt survey or correlation designs that report generalized challenges rather than specific disruptive events (Flanagan, 1954, 1954). This gap justifies the need for event-focused analysis to inform risk management and policy design.

While literature confirms risks in Nigerian MFBs, there is scarce empirical evidence using CIT to document specific critical incidents, their causes, and operational consequences from field research.

2.4 Theoretical Framework: Critical Incident Theory

This study is anchored on Critical Incident Theory (CIT), originally developed by John C. Flanagan (1954) through the Critical Incident Technique. CIT provides a systematic framework for identifying, classifying, and interpreting specific observable human activities that make a significant contribution to success or failure in defined situations (Flanagan, 1954). The theory assumes that organizational performance is not determined by routine operations alone, but by discrete, high-impact events that deviate from normal procedures and produce consequential outcomes (Butterfield et al., 2005).

The core propositions of CIT relevant to this study are as follows:

Proposition 1: Incident Specificity

Critical incidents must be clearly defined, observable events rather than generalized perceptions. In the context of Nigerian Microfinance Banks, this means isolating specific events such as a 72-hour system outage, a fraud case exceeding ₦10m, or a regulatory sanction, instead of broad statements like "poor management" (Gremler, 2004).

Proposition 2: Impact Threshold

An event becomes "critical" when its consequences exceed a threshold that affects organizational objectives. For MFBs, the threshold is crossed when an incident threatens liquidity, customer trust, regulatory compliance, or operational continuity (Adeyemi & Badmus, 2018). Minor service delays are routine; incidents that trigger depositor panic or CBN intervention are critical.

Proposition 3: Causal Attribution and Learning

CIT posits that analyzing critical incidents reveals underlying causal factors and provides lessons for future prevention (Bitner et al., 1990). By categorizing incidents and their antecedents, MFB managers can move from reactive crisis response to proactive risk management.

Application to Nigerian Microfinance Banking

In this study, CIT is adapted to examine how specific critical incidents within Nigerian MFBs influence sustainability and service delivery. The theory guides data collection by prompting respondents to recall actual events, and guides analysis by classifying incidents into categories such as operational, financial, governance, and regulatory failures. This event-level focus addresses the literature gap where MFB studies rely on survey-based generalizations rather than incident-specific evidence (Flanagan, 1954).

Thus, Critical Incident Theory provides both the methodological tool and conceptual lens for interpreting field data and deriving evidence-based recommendations for the Nigerian MFB sector.

3.0 Findings:

Microfinance banks in Nigeria operate with thin capital buffers and high depositor sensitivity. Using Critical Incident Technique, four incident types (**mass cash withdrawal, high unrecovered loans, weak corporate culture and CBN regulatory compliance breaches**) repeatedly emerged as drivers of MFB distress. Each of these incidents represents a specific, observable event that threatens sustainability when it occurs (Flanagan, 1954 and CBN, 2018).

3.1. Mass Cash Withdrawal

Mass withdrawal is a liquidity incident triggered by loss of confidence, rumor, or external shocks. Because MFBs convert most deposits into short-term loans, they hold minimal cash reserves. When many depositors withdraw simultaneously, the bank faces immediate cash shortage, forced asset sales, and borrowing at high cost [CBN].

According to Emokpae, 2020, "*when people heard that Integrated Microfinance bank (IMFB) has gone under, they believed all the microfinance banks have collapsed. Customers then rushed to their microfinance banks to withdraw their money. So there was a rush to withdraw money from other microfinance banks*"

The effect of that was threefold: 1) liquidity ratio falls below CBN regulatory minimum, 2) depositor confidence eroded, causing future withdrawals; 3) lending operations stalled as funds were diverted to meet cash demands.

3.2. High Incidence of Unrecovered Loans

High portfolio-at-risk is a credit incident where borrowers default and recovery fails. Each unrecovered loan reduces interest income and increases loan loss provisions (Nwanna & Daraojimba, 2020). Aggregated effects include: 1) declining profitability

and return on assets; 2) erosion of capital base, threatening CBN's minimum capital requirement; 3) diversion of staff time from new lending to recovery, reducing outreach to low-income clients. Emokpae, 2020 found that "…*some people viewed micro-finance banks primarily as their share of the national cake and therefore collected loans up to* ₦*50,000.00 and disappeared without coming back to repay it They just collected the money and disappeared. When the bank officers tried to locate them, they were nowhere to be found"*

3.3. Lack of Good Corporate Culture

Corporate culture is the set of values, ethics, and norms guiding staff behavior. A weak culture produces governance incidents such as insider loans, falsified records, collusion, and tolerance of fraud.

"Directors of Integrated Microfinance bank (IMFB) took some money as cost of living allowances and bought jeeps for themselves. The bank was the largest microfinance bank in Lagos as at 2010 and they were even competing with commercial banks. They are so many reasons for their death and some of them are what I have just said now – the directors used the bank's money to support their expensive lifestyles. This was in addition to collecting loans without paying back. And you know a microfinance bank behaving as if it is a world class commercial bank with gigantic edifices and buildings, buying big brand new cars that were worth several millions of naira, it was just a question of time for it to fail, such expenses were too much for a microfinance bank" (Emokpae, 2020).

The effects are both direct and indirect: 1) direct financial loss through fraud and unauthorized transactions; 2) indirect weakening of controls, making the bank vulnerable to mass withdrawals and loan defaults; 3) low staff morale and high turnover, reducing institutional memory. Gremler 2004 argued that organizations with poor culture cannot learn from incidents because failures are concealed.

3.4. CBN regulatory compliance breaches.

From the Emokpae, 2020's research findings, "when banks lend beyond the regulatory single obligor threshold of 5% , which was done, mostly through insider trading and often patronized by men, repayment defaults arises in many cases, so when deposit customers came for their money, the banks were unable to repay; leading to a run on

MfBs, ultimately leading to bank failures".

3.5. How did some Nigerian Microfinance Banks navigate through the turbulent banking period?

According to Emokpae, 2020's findings:

"People believed that if IMFB which every other microfinance banks looked up to could fail, that other microfinance banks would also fail. So there was mass panic withdrawal in the microfinance banking system and we at ... then were not excluded. The major thing that saved us was our liquidity position which my Managing Director always emphasized. He didn't joke with it and made sure that we always had good liquidity at any point in time. The CBN would give a benchmark of 20% but my MD would work with a minimum of 35%. Once our liquidity position reached 35%, we would stop lending money to customers. He ensured that we had a good liquidity at any point in time" (MFB MD).

"Although our liquidity went down drastically, my Chairman was able to meet all our financial obligations. When people saw that we were still functioning, they started bringing their deposits back and even brought more. In fact that is what we are still practicing here till date. So I give it to him. His experience worked" (MFB MD).

"We didn't have any other choice than to extend our marketing strength and marketing department to be able to bring in more deposits. We also slowed down our loan facilities to smaller amounts like twenty thousand, fifty thousand or hundred thousand naira. Before we gave out large amounts like five hundred thousand, we had to scrutinize it to ensure that we didn't give it out for a long period time. Six months was out of it; but if you are turning it around within a month or two, just to make sure that we stabilized. But we have gotten over it now. That is what keeps business going; meeting our financial obligations" (MFB MD).

"One of our striking bad experiences in the industry was on liquidity issue – cash in general. There was a time our liquidity fell drastically low because we lent too much to a particular sector – schools – when they were on two months long holidays because schools are one of our major customers. And because they can only pay

back when they are in session through students" school fees, it affected our operations within the holiday period. But we were able to cope until when school resumed and we started having free flow of cash again" (MFB MD).

"We were able to manage because we have a minimum liquidity benchmark of 20% as authorized by the CBN and at that point our liquidity had declined from 30% to 25%. CBN says 20% but we set ours at a minimum of 30%. But when we saw that our liquidity has reduced to 20%, one of the measures we took was to reduce the number and amount of loans we were giving and more importantly, we then went out for the recovery of all the other non-school loans. As for the school loans, we were stuck since they can only pay when they are in session. So we had to reduce the volume of our loan at that period and judiciously used our little cash for servicing customers" deposits. We actually postponed some of the loan requests by asking the customers to come back later at a certain period. That was how we were able to manage it" (MFB MD).

"In fact what I have heard from history is that there were about five or six microfinance banks in this Akute area about nine years ago and out of the number, only ours has survived. It was because we have able directors that have been able to manage the bank well. They were not coming to collect and collect money from the bank. The fact is that they were able to ensure that the books and progress of the bank were paramount to them; that is why the bank was able to survive while the others closed. In fact while all the other microfinance banks closed, this one survived because we had a very solid board of directors who were not bent on collecting their shares but made sure that things went well. All the microfinance banks in this area failed except us. It was only recently that one state microfinance bank was established down this road. But during that turbulent period, only this one survived because of our ***good corporate governance"*** *(MFB MD).*

"In fact that was one of the reasons why people were skeptical about banking with a microfinance bank. A situation where about six microfinance banks went under while only one of them in this area survived scared some people from patronizing us for they felt: "how are we sure that they are not the same thing" (MFB MD).

"I believe it is mainly because our directors are very educated and have a heart of doing clean business, that is interested in establishing and running a bank that will benefit people and they are of the same mind; they are also united and understand each other very well. This actually helped to keep the bank alive. If you have a board that is divided and every one of them has his personal interest, the moment every board member of a bank is unsettled, the bank must surely go under"(MFB MD).

"Another reason is the resolve of the management and staff of this bank to ensure that they do their jobs the way they are supposed to. When a bank has people with I don't care attitude, it is a major problem. So, the loyalty of the staff and their resolve to work with the management to make sure that the bank survived the period was also a contributing factor to our bank not failing when others did" (MFB MD).

"The issue of liquidity helped us too because it is like when somebody says you must count a hundred items and you counted a hundred and twenty of them instead. We did that so that it can guide us in knowing that while we cannot fall below the CBN"s 20%, the moment we are hitting below 30%, we should know that there is danger or red flag instead of falling to 20% before we realize the danger. So, that standard was set to enable us know that whenever it is below the level, we would know that there is a lot of unrecovered money outside. So, it has actually helped us because you always maintain whatever the regulatory authority put in place; and if you don't do that, before you know it, you would find yourself down"(MFB MD).

"The period we had the problem of liquidity, at the same period, our portfolio at risk was also affected because both of them are related. So, when it happens, you quickly tackle the problem from these two angles. While even though one set the 30% maximum for myself (which means you still have cash), but once the portfolio at risk tells me something else, I began to do something in order to reduce it. In fact apart from the regulatory authority's benchmark, we always ensured that we go below it. That is trying as much as possible to bring the portfolio at risk to as little as 1%, even when the regulation is 5%. This means that we have a zero tolerance for a default" (MFB MD).

4.0. Conclusion

The findings show that the identified four critical incidents were interdependent: Weak corporate culture gave way to poor credit appraisal which led to high unrecovered loans that stimulated low liquidity and increased vulnerability for mass cash withdrawal while CBN regulatory compliance breaches mainly led to the closure of the affected microfinance banks.

Consequently, licenses of 154 Nigerian Microfinance banks were revoked between 2010 and 2018, largely due to combinations of these incidents (CBN, 2018).

5.0. Recommendation

To mitigate these four critical incidents in the Nigerian Microfinance bank industry, I recommend:

i. Contingency liquidity plans for withdrawals,
ii. Strict credit risk policies for loan recovery, and
iii. Board-driven cultural reforms for governance.

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