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AN ENQUIRY INTO THE CONTRIBUTIONS OF MICROFINANCE INSTITUTIONS TOWARDS THE DEVELOPMENT OF SMALL SCALE BUSINESS IN NIGERIA

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ABSTRACT

This paper examined the impact of Microfinance Institutions' policies on the growth and development of Small Scale Business in Nigeria for the period 2005 to 2012. Nine (9) Microfinance Institutions and one hundred and fifty five (155) of their clients were interviewed. Records from the period shows that there is an increase in the numbers of savings and loans made by the Micro Finance Institutions, this signifies a rise in the need for Microfinance Institutions services in the economy. The study adopts the use of Multiple Regression Analysis to regress the relationship between the dependent variable and independent variables. We also employed the use of Analysis of Variance to determine the strength of the Regression Analysis. The OLS result suggests existence of positive relationship between both the dependent and independent relationship. Our findings suggested that macroeconomic policy should be designed in such a way that will encourage the survival of Microfinance Institutions and attracts low income – informal sector which in turn leads to increase in productivity and employment generation.

Keywords: Microfinance, Capital formation, SME, Economic growth and development, Profitability.

1. INTRODUCTION

The level of growth and development recorded in an economy cannot be separated from the level of growth and development recorded in its financial sector, as this sector helps in mobilization of funds from Surplus Spending Units (SSU) and channel same to Deficit Spending Units (DSU) based on sound pricing and efficient allocation principles. Besides this function, the financial sector also help in providing the mechanism for firms and other economic agents to appraise the value of firm's assets thereby allowing investors to make informed decision as to the allocation of their funds for lenders on the one hand, and the best alternatives form of liability for borrowers on the other hand Lawal (2014).

The financial system comprises of financial markets, financial institutions and financial instruments that interact with one another and the rest of the economy as well as the external sector so as to achieve macroeconomic goals and objectives in a given economy (Ojo, 2010), Enendu *et al.* (2010). Though financial institutions all play important roles in achieving economic growth and development, analysts tend to focus on the contributions of the well organized, big sized and well stimulated commercial and merchant banks as well as development financial institution to the economy, neglecting the role of the informal and small size microfinance institutions.

This paper used a set of Multiple Regression Analysis, ANOVA among other things to examine the impact of microfinance institutions facilities and policies on the growth and development of Small and Medium Scale Enterprises in Nigeria and provides meaningful recommendation for the practitioners, regulators as well as operators on how best to improve on and maximise the services offered by Microfinance Institutions.

This rest of this paper is structured as follows: Section 2 provides the literature review, section 3 deals with the use of methodological tools, section 4 presents the results of our finding, and section 5 provides the conclusion and recommendations.

2. LITERATURE REVIEW

Microfinance banks or institutions are one of the financial innovations introduced in Nigeria in the early 1990s as community banks mainly to provide financing to the economic activities of the economic active poor. It is characterised by Unit Banking system whose ownership and management evolved around community or a group of communities, and offers services ranging from deposits, credit to other financial services to its customers base on self-recognition and credit worthiness Mordi *et al.* (2010), Enendu *et al.* (2010)

Microfinance Institutions (MFIs) are financial institutions that offer micro or small scale financing to business operation of their clients. Microfinance on the other hand is the provision of a broad range of financial services which include deposits, loans, payment services, money transfers, and insurance to poor and low income households and the microenterprises. Founanou and Ratsimalahelo (2012), Cull *et al.* (2009), Legderwood (1999), Karlan and Goldberg (2007), Iganiga (2008) Oystein Strom *et al.* (2014), Charlotte and Adalbert (2013), Salim (2013), El-Komi and Rachel (2013), Marek and Anaïs (2013) , Philippe *et al.* (2013), Bert *et al.* (2013)). There activities and products are very crucial to the growth and development of Small and Medium scale Enterprises (SMEs) in an economy. Their clients are usually small scale operators and firms in the informal sector in the economy. MFIs focuses thei*r* attention on the economically active poor in an economy that are predominantly low income earners, civil servants, sole-proprietors, artisans, technicians etc that offers a variety of activities ranging from weaving, mental-working, furniture-making works, crafts, automobile mechanises, iron benders, petty, trading, food vendors, farmers, saloonists etc that adopts the use of simple technologies in production of goods and services María-Dolores *et al.* (2013), Odongo and Kendi (2013), Suman and Eric (2013), Cynthia (2013), Smets (2012), Dirk and Luciano (2013), Fausto *et al.* (2013), Serrano-Cinca and Gutiérrez-Nieto (2014).

Founanou and Ratsimalahelo (2012) observed that microfinance involves the provision of broad range of financial services such as deposits, loans, payment services, money transfers and insurance to poor and low income households and their micro-enterprises. Cull *et al.* (2009) classified MFIs into three groups viz: formal institutions i.e. (rural banks and cooperative societies); semi-formal institutions i.e. (non-governmental organisations); and informal models i.e. (money, lenders and shop keepers).

Mirero (2004) defined microfinance as deliberate finance products and services that are targeted towards the economically active poor Oji (2008), Mark (2001), Robinson (2001), Christen *et al.* (2003), Vogel *et al.* (2000), Berenbach and Churchill (1997) and Founanou and Ratsimalahelo (2012), CBN (2006), Otero and Rhyne (1994), Oluyombo (2010), Mawa (2008), Oke *et al.* (2007), Montgomery and Weiss (2005), Park and Ren (2001), Nathan *et al.* (2004).

Oluyombo (2011) studied the impact of microfinance banks credit on economic development of Nigeria and observed that about 70 percent of SMEs thrives on provisions of good credit schemes which are not readily available through the existing conventional banking system. He explained that MFIs offers a soft access to credit facilities for business owners to finance their business operation. In a related development, Arogundade (2010) studied the activities of MFIs in Ijebu Remo area of Ogun State, South-West Nigeria, to examined the possible changes in the financial operations of MFIs as a result of changes from community banking system to MFIs and observed that a number of variable such as information asymmetry, loan process, customers' request satisfaction have significant impacts on loan disbursement and provision by MFIs. He explained that in a situation where information asymmetry poses a negative effect, improved loan process and customers request were of added advantage.

Ojo (2009) investigated the effects of MFIs on entrepreneurial development of SMEs in achieving national growth and development, and found out that there is a significant difference in the number of entrepreneurs who used microfinance institutions to finance their business and those that would not, in terms of business outcome; in other words, business that uses MFIs performs better. However, he pointed out that though MFIs activities boast SMEs productivities through provision of credit facilities, their contributions to SMEs industry development in the economy as a whole is still insignificant. He concluded that MFIs all over the world and Nigeria in particular are one of the prime contributors in finance industry that have positively affected all the various economic agents through the services they render Ester (2014), Chiyah and Forchu (2010), Olaitan (2006), Rooyen *et al.* (2012), Derin and Dacin (2013).

In another development, Abdulmecit and Asli (2008) studied the microcredit strategies for SMEs in Turkey in the EU harmonization process and observed that though the knowledge of MFIs is still new to the Turkish financial system, it offers a vital means to alleviate poverty, thus supporting the supply of microloans is therefore not only an issue of entrepreneurship and economic growth, but also of social inclusion. They identified poor awareness, high level of risk and low return on investment, incessant failure and high handling cost for microloans, market gap as a result asymmetry information as the major challenges to the survival of microfinance in Turkey. They stressed that investment in R&D on microfinance related issues, the adoption of EU harmonization process and the establishment of regulatory framework for microfinance are crucial to enhance the contribution of MFIs to the economy. Mohamed and Rachel (2013) conducted an experimental test of Islamic compliant MFIs products in the context of Information asymmetry and costly state verification, and observed that their exist a significant higher compliance rates for Islamic compliant contracts than traditional contracts. They suggested that microfinance institutions should further develop products that tend to emphasis profit-sharing and joint venture so as to enhance economic growth and development in a nation Peter (2013), Linardi and Tanaka (2012), Valentina *et al.* (2013), Susanna *et al.* (2013), Dorfleitner and Priberny (2013), Robert and Frederick (2012).

Philippe *et al.* (2013) examined relationship between social efficiency and finance performance using a comprehensive data set that includes about 650 microfinance institutions. They used a self-organizing map approach to fully capture the existence of heterogeneity among the institutions; their findings suggest that a significant, positive relationship exist between social efficiency and financial performance. However, Rashid and Chowdhury (2001) are of the opinion that MFIs repayment rates are usually high (as high as 90 percent) with unacceptable limits.

3. RESEARCH METHODOLOGY

The study deals with a survey of views and experiences among the Small and Medium Scale Entreprenurers in Kwara South Senatorial District on the effects of credit facilities provisions by Microfinance Institutions as a source of capital formation. Five Local Government Area covered by the study are Offa, Irepodun, Oke Ero, Ekiti and Isin Local Government Areas in Kwara South Senatorial districts. Data for the study were generated mainly through the use of structured questionnaires, oral interviews and focus group discussion which were developed after the review of relevant literature. Fifty (50) trained research assistant were detailed to cover the LGAs, ten (10) per LGA. Data collection lasted between August and September 2012. A hundred and fifty five (155) respondents were eventually interviewed randomly from the business community in the LGAs. Capital formation was the dependent variable while patronage of MFIs, profitability level and size of employee base were the independent variable.

We used descriptive statistics, multiple regression analysis and Analysis of Variation (ANOVA) to examine the relationship between the dependent variable and the independent variables of the study, while correlation matrix was used to examine the direction of relationship among selected socio-economic features of the respondents and patronage of MFIs. The choice of these methodologies was based on the fact that they are most appropriate for the study for instance ANOVA is used in regression analysis for conducting various test of the overall significance of the regression; the test of the significance of the improvement in fit obtained by introduction of additional explanatory variables in the function; the test of the equality of the coefficients obtained from different samples; the test of extra sample performance of a regression; or stability of the regression coefficients; the test of restrictions imposed on coefficient of a function among other things Koutsoyiannis (2003), Gujarati and Porter (2009). It is also interesting to note that our data set comprises of both qualitative and quantitative data, thus, the use of both measure will provide avenue for creative approach in analysing the results. Specifically, we incorporate the Analysis of Variance technique into Regression analysis because this measure provides a good platform in testing the overall significance of a regression given that our test includes a number of explanatory variables. Our test aims at finding whether or not the explanatory variables do actually have any significant influence on the dependent variables. In other words, the test of the overall significance of the regression implies testing the null hypothesis:

Ho: $\beta_1 = \beta_2 = \beta_3 \ldots\ldots\ldots\ldots \beta_k = 0$

Against the alternative hypothesis:

H1: not all β_i's are zero.

We use ANOVA F* formula in calculating this such that

$$F^* = \frac{\sum \tilde{y}^2 / (K-1)}{\sum e^2 / (N-K)} \qquad (1)$$

The regression analysis is express as follows:

$$CAP_i = \beta_1 + \beta_2 MFI_{2i} + \beta_3 BIZ_{3i} + \beta_4 EMP_{4i}\ U_i \qquad (2)$$

Where

CAP_i = Capital formation / patronage of MFIs so as to access credit facilities

MFI_{2i} = numbers of MFIs clients that own a business

BIZ_{3i} = rate of increase in business profit (profitability level)

EMP_{4i} = size of employees engaged

U_i = random error term

4. RESULT AND DISCUSSION

4.1. Data Description

The table 1 shows the demographic character of the respondents, one can deduced that about sixty one percent (61.2%) of the respondents fall between the ages of 15-35, forty- seven respondents representing forty-nine percent of the respondents (49.47%) are male between the ages of 15-35. From the above one can see that those within the work active age (15-60) constitute a large member of respondents. This represents about ninety six percent (96.13%) of the respondents. This is in line with the findings of some authors like Deji (2005), Elumilade *et al.* (2008) and Ojo (2009).

From Table 2, it was found that 100 percent of the respondents owned their own business. About 1.29 percent started in year 2005, 14 percent in 2006, 5.7 percent in 2007, 13.6 percent in 2008, and 27.1 percent n 2009. The 2010 had the highest record of 43.2 percent of the population under the study. Table 3 shows the distributions of MFIs clients that own their business in the period under review, the profitability level in the year 2009 was about 60%, and the number of employees employed averaged about 15 employees. One can also see that as patronage of MFIs increases, the numbers of clients that open their own business began to increase. The same thing apply to the numbers of employees employed in the study area, it increases as more business are opened. The result shows that a very large percentage of the respondents owned their own business, an indication that they played vital role in wealth and job creation, hence reducing unemployment. Studies like European Commission (2007a), Maloney (2003), Sanfeliu *et al.* (2013), Mersland *et al.* (2013) have shown that sourcing fund through microfinance institutions to establish business is crucial to fighting unemployment.

4.2. Results of the Regression and Inter-Correlation Analysis between Variables.

Effect of Microfinance credit facilities on Capital Formation: Based on the R^2, F value, t-tests and 'a priori' expectation of the variables (Robert and Daniel, 1998), the linear function was chosen for the analysis. The result of the linear multiple regression analysis is presented below:

It could be deduced that the calculated t is greater than tabulated t such that, 3.394 >1.96, thus, we reject the H_0 (for H_0: $\beta_2 =0$); the data support the conjecture that MFIs have contributed greatly to capital formation in business financing. The same test outcome can be obtained using the *p*-value. In this case we reject the H0 because 0.000<0.05.Also, since 0.520<1.96 we reject the H_0:β_3=0 and conclude that there is evidence from the data to suggest that there is a functional relationship between capital formation and profitability level. Using the *p*-value to perform the test, we reject the H0 because 0.000<0.05.The interpretation of R^2 is that 97.9% of the variation in the level of capital formation is explained by the variation in the patronage of MFIs and by the variation in the level of profitability. It means that only 2.77% of the variation in the capital formation of the respondents is left unexplained and is due to variation in the error term or to variation in other variables that implicitly form part of the error term.

4.3. Result of Analysis of Variance

The rules say if F* > F we should reject the null hypothesis, that is, we accept that the regression is significant, in other word, not all β_i's are zero. Similarly, if F* < F, we reject the null hypothesis, that is we accept that the overall regression is not significant. From our result, the value of F* at 47.455 is greater than F at 0.005. We conclude that the regression analysis is significant.

4.4. Implication of the Result

The result of this paper shows that Microfinance Institutions could be one of the strategies to improve capital formation needed to finance a business, thus adequate provision of loan able funds to the business owners/ clients will enhance their investments, and this will invariably increase their income and ability to generate employment, as corroborated by Budavari (2006), Burritt (2003), Nowak (2007), European Commission (2007) On this note, this paper submits that regular enlightenment campaign and education should be organized by the government and other Non-Governmental Organisations (NGOs) for business owners especially the small scale business, on the advantages of partnering with MFIs . This could have a multiplier effect on business expansion which will in turn reduce aggregate unemployment and increase aggregate output in the economy. Similarly, enabling environment should be created for MFIs to thrive in the economy as this will afford them the opportunity to advance more credit facilities to the would-be borrowers.

5. CONCLUSION AND RECOMMENDATION

The study observed a positive relationship between capital formation through the use of microfinance institutions facilities and increase in the numbers of small and medium scale businesses. This shows that there is an increase in the demand for microfinance facilities especially among the economically active poor, an indication that microfinance facilities could serve as veritable tool for development as it offers the poor opportunity to move out of poverty line through the use of cycles of loans and repayments system. We therefore suggest that microfinance institutions should tailored their lending policies towards growing entrepreneur skills of their clients by channelling credit facilities primarily toward small and medium scale businesses. They should also help in increasing the duration of clients' loans by spreading the pay-back period over a longer time, create more windows to access soft loan, aid credit sales financing, introduce a good monitoring scheme for loan execution as this will not only aid loans repayment but as well enhance proper utilisation of credit facilities for the purpose for which it was borrowed for. We also recommend that microfinance should help small scale entrepreneurs to developed workable business plan that can grow their business from small size capacity to a higher size capacity.

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APPENDIX

Table-1. Demographic character of the respondents

Age		**Sex**	
	Frequency	**Male**	**Female**
15 – 35	95	47	48
36 – 45	30	10	20
46 – 60	25	5	20
61 – 75	5	2	3
75 – above	-	-	-
Total	155	64	71

Source: Field survey

Table-2. Distribution of respondents by ownership of business and patronage of MFIs

Year	Numbers of respondent that start business (X)	% of the respondents
2008	2	1.2
2009	14	9.03
2010	9	5.7
2011	21	13.6
2012	42	27.1
2013	67	43.2
Total	155	100

Source: Field survey

Table-3. Distribution of respondents by patronage of MFIs, ownership of business, profitability level and average numbers of employees.

Year	No of clients that access credit facilities	No of clients that owns a bus.	Profitability level*	Average number of employees
2008	2	1	5	2
2009	14	7	7	5
2010	9	6	9	10
2011	21	13	4	10
2012	42	25	6	15
2013	67	32	8	20
Total	155	84	39	62

* The level of profitability was deflated by 10% to make the data easier for computation.

Source: Authors Field Survey

Table-4. Results of the Regression and Inter-Correlation analysis between variables.

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.990[a]	.979	.959	4.937

a. Predictors: (Constant), numbers of employees, profit level, numbers of clients that owns a business

ANOVA[b]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	3469.741	3	1156.580	47.455	.005[a]
	Residual	73.116	3	24.372		
	Total	3542.857	6			

a. Predictors: (Constant), numbers of employees, profit level, numbers of clients that owns a business

b. Dependent Variable: dependent

Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients		
		B	Std. Error	Beta	t	Sig.
1	(Constant)	-2.152	4.224		-.509	.646
	numbers of clients that owns a business	2.336	.688	1.175	3.394	.043
	profit level	.567	1.089	.070	.520	.639
	numbers of employees	-.779	1.348	-.228	-.578	.604

a. Dependent Variable: dependent

Source: Authors Computation through the use of SPSS.