

# Impact of Microfinance Banks on Micro and Small Enterprises in Ogun State, Nigeria

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**Received:** 21<sup>st</sup> December 2017/ **Revised:** 25<sup>th</sup> April 2018/ **Accepted:** 4<sup>th</sup> June 2018

**How to Cite:** Akingunola, R. O., Olowofela, E. O., & Yunusa, L. (2018). Impact of Microfinance Banks on Micro and Small Enterprises in Ogun State, Nigeria. *Binus Business Review*, 9(2), 163-169. <https://doi.org/10.21512/bbr.v9i2.4253>

## ABSTRACT

This research investigated the impact of microfinance on Micro and Small Enterprise (MSE) in Ogun State, Nigeria. There were two research problems. First, it was whether microfinance bank (financial intermediation services) assists MSEs in Ogun State, Nigeria. Second, it was whether microfinance banks assist MSEs in improving the volume of trade they engaged in Ogun State, Nigeria. The purposive and stratified sampling method was used. The survey obtained 408 respondents in MSEs in Ogun State. The research problems were tested with simple regression analysis. Findings from the first problem show that there is a negative relationship between intermediary financial services (credit disbursement) and MSEs. The second finding also shows there is a positive relationship between microcredit and business expansion. The research concludes that businesses that access microcredit have grown averagely regarding business expansion. Therefore, it is recommended that microfinance banks should increase the size of loan and interest charged to MSEs, so they have enough funds to finance their operations. The researchers further recommend that government should review the activities of microfinance institutions.

**Keywords:** microfinance bank, micro and small enterprise, simple regression analysis

## INTRODUCTION

Ogun State is one of the states of Nigeria. It is in southwestern of the country covering land areas of approximately 16,406.226 km<sup>2</sup>. It is bounded in the west by the Republic of Benin, on the south by Lagos State and the Atlantic Ocean, on the east by Ondo State and the north by Oyo State, this turns the state to gateway state. The geographical location and business friendly economy policy of the state make it a new jersey of Nigeria, where micro entrepreneurs even from neighboring states and countries established in the three senatorial districts of the state. This makes micro enterprises been the source of employment and income generation to many individuals. All this has the tendency of making the state one of the biggest financial and commercial center in West Africa.

However, it is a challenge for entrepreneurs to finance new businesses or expand the activities of existing businesses. It is very critical in the promotion of entrepreneurship development (Bharti & Shylendra, 2007). Moreover, Simtowe and Phiri (2007) and Muktar (2009) asserted that credit was a precondition to the growth of enterprises even though the state was hosting 42 licensed microfinance banks and access to credit at the lower part of the pyramid.

Despite the promising potentials, the state has not achieved its full potential regarding economic growth and development. This can be seen from the level of human and material endowments in the state. Moreover, the micro enterprises operate below the satisfactory level in the effectiveness and efficiency on the lives and living conditions of the people.

Hitherto, the Nigerian government accepts

the role of driving force in the economy with the enactment of commercialization and denationalization law. Hence, the emphasis is moved from large-scale industries to Micro, Small, and Medium Enterprises (MSMEs) due to their capacities in developing domestic linkages. It is for rapid and sustainable industrial development through extensive coverage of a mixed group of businesses ranging from retailer outlets to refined manufacturing firms (Wignaraja, 2003). The development of Micro and Small Enterprises (MSEs) is seen as the main means towards refining standard of living of the population. Although having this major advantage, MSEs have limited access to the financial support services by formal financial institutions such as credit. This happens because MSEs are not able to prepare the necessary collateral securities demanded by the formal institutions. Moreover, it is difficult for the banks to restore the high cost in facing MSEs. Moreover, MSEs have many associated risks in borrowing the credit, so it is uninviting by the banks to agree with them (World Bank, 2001).

The incapacity of MSEs to fulfil the requirement of the formal financial institutions for loan creates an idea for informal institutions. It attempts to fill the gap based on informal social networks. This idea gives birth to microfinance. In 2005, according to CBN (2011), the federal government of Nigeria adopted microfinance as the main financing for MSEs in Nigeria. Therefore, the government mandated the Central Bank of Nigeria (CBN) to develop appropriate guidelines and policy framework for effective microfinance operation in Nigeria. It covered the majorities of the poor especially those who were economically active to create millions of jobs and reducing poverty. This increased the percentage of microcredit in the economy from 0,9% in 2005 to 20% in 2020. Moreover, it was expected to increase GDP from 0,2% in 2005 to 5% in 2020 (CBN 2012). To increase the participation of the state and local governments in microfinance in 2015, the government did several things. It eliminated gender disparity and improved women's access to financial services about 5% annually. It also increases the linkages among specialized financial institutions, money deposit banks, development banks, and microfinance banks about 10% annually (CBN, 2011).

Despite the efforts made by CBN (Ojo, 2007; Van Rooyen, Stewart, & De Wet, 2012; Agbaeze & Onwuka, 2014; Suberu, Aremu, & Popoola, 2011), it indicates that access to essential financial services, especially access to funding, is still elusive for this poor and active people in the economy. Although after the introduction of microfinance banks, the licensed have been increasing. The problem is why the access to funding is difficult. Moreover, Oluseye (2014), kolawole (2013), and Lloyd and Robbins (2014) suggested that most of the MSMEs did not experience desirable growth due to the lack of basic financial services such as access to credit, insurance services, and financial advice.

This research is related to financial intermediation which is interconnected to McKinnon (1973), Shaw

(1973), and Schumpeter (1934). They emphasized the crucial role of finance in augmenting economic growth through the financial intermediation process. Their argument focused on the role of banks in facilitating technological innovation through its intermediary role. Therefore, Schumpeter (1934) proposed that strong potentials of financial institutions provided unlimited funding for innovative entrepreneurship for impulsive economic growth. The research largely contended to where entrepreneurship led, finance followed thereby. It substantiated the demand following the role of finance.

Similarly, Shaw (1973) and McKinnon (1973) described the supply-leading roles of financial institutions. It included microfinance institutions in the provision of credit facilities that would advance the growth of output. Thus, it could reduce poverty by engaging the poor in trying small businesses. Several researchers have examined partly or separately on the relationship between microfinance bank and MSEs. However, there are dilutions in their findings.

Moreover, Ojo (2009) considered the impact of microfinance on the entrepreneurial development of small-scale enterprises in Lagos State, Nigeria. The research used simple random sampling technique to select 60 respondents. It revealed that there was no significant effect of microfinance institutions in predicting entrepreneurial development. Joseph and Imhanlahimi (2011) examined the impact of microfinance banks on the entrepreneurial and economically active but poor people in the rural area in Nigeria. The objective was to determine whether they were included in the category of people targeted by microfinance banks. It also saw whether they could get access to credits and whether the credits or other service had an effect to their livelihoods, homes, and standard of living. The results indicated a small effect of microfinance banks on their living.

Jegede, Kehinde, and Akinlabi (2011) analyzed the poverty alleviation and microfinance loan disbursement using t-test, chi-square test, and f-test. Their findings indicated that microfinance institutions had big role in easing poverty by changing economic status and increasing income. Moreover, it was also different for people using microfinance institutions and those who did not use it. They concluded that microfinance institution was a great strategy for reducing poverty and preparing the credit to the poor people.

Then, Akande (2012) evaluated the impact of microcredit on the performance of women who had small-scale enterprises in Oyo state. They used the structured questionnaires and chi-square to test the hypothesis. The result revealed that the performance of those who patronized microfinance bank did not improve significantly due to short repayment periods and high-interest rates charged. Moreover, Gumel (2012) examined the availability of credit facilities by microfinance institutions in Northern Nigeria. The research used survey method and collected data through the self-developed Likert scale questionnaire.

The findings showed there was no significant difference in microfinance institutions affiliation and geographical location among genders regarding the available credit by microfinance institutions.

Yaqub (2012) considered the impact of microcredit on the welfare of small-scale enterprises in Alimosho local government of Lagos State. The researcher used the chi-square test with 95 microentrepreneurs. Microcredit affected the welfare of the small scale entrepreneurs significantly. Thus, it was recommended the reasonable interest rate charged by microfinance banks. The microfinance banks could give some period before repaying the loan started. Thus, the the beneficiaries could invest the loan for a longer period.

Babajide (2012) investigated the effects of microfinance on the growth of MSEs in Nigeria. The research used panel data and multiple regression analysis. It measured the 502 randomly selected financial enterprises by microfinance banks. It revealed that the access to microfinance did not enhance the growth of MSEs in Nigeria. Furthermore, it was recommended that the recapitalization of the microfinance banks should enhance their capacity to support growth and expansion of MSEs.

Osoimehin, Jegede, Akinlabi, and Olajide (2012) analyzed the challenges and prospects of development in MSEs in Nigeria using Z-test statistical technique. It analyzed 100 questionnaires in 10 local government of Lagos State. The result revealed that the phenomenal growth of MSEs in Nigeria was mainly due to the people's quest to be self-employed. It was not because it was easy to establish or manage. They explained that the financial constraints and lack of management skill hampered the efficient performance of MSEs in Nigeria.

Franca (2013) evaluated the impact of micro credit institutions on the development of SMEs in Anambra State. About 450 respondents with chi-square test were used. The research found out the significant relationship between microcredit institutions and SMEs development. The existed small degree of association suggested that capital (microcredit) was not the only factor that affected SMEs in the research. The research further concluded that it was necessary for microcredit institutions, SMEs, and government to work together for the best interest of development of SMEs and Nigerian economy in general.

Ashamu (2014) analyzed the performance of microfinance institutions in Lagos State. It was based on the development of SMEs with 110 questionnaires using descriptive statistics. The research revealed that the operations of microfinance institutions had grown phenomenally in the last three years. It was primarily encouraged by expanding informal sector activities. Moreover, the reluctance of banks to give the fund the emerging micro enterprises and the conversion of the community banks to microfinance banks drove the operations of microfinance. The researcher further suggested the urgent need to approve and implement a policy framework that would regulate and standardize

the microfinance institutions' operations. It should also access the medium to long-term sources of funds, such as Small and Medium Industries Equity Investments Schemes (SMIEIES), Bank of Industry (BOI), and others.

Moreover, Olusanya, Sufian, and Temi (2014) examined the impact of microfinance bank on SMEs in Nigeria and the impact of microfinance policy on employment opportunities in Nigeria. They used 100 structured questionnaires with Spearman correlation. They agreed that microfinance bank had a significant effect on the growth of SMEs in Nigeria and microfinance policy affected employment opportunities significantly in Nigeria.

Abdussalam and Tukur (2014) investigated the effect of microfinance on the growth of small enterprises in Sokoto State, Nigeria. They used multiple regression for the selected sample of 120 firms. The results showed that access to microcredit had a positive relationship with value of physical assets of the firms. Moreover, they also found access to microcredit affected employment generation positively. Therefore, they recommended that microfinance banks should increase the size of loan offered to MSEs. Thus, they had enough funds to run their operations.

Okibo and Makanga (2014) studied the effects of microfinance institutions on poverty reduction in Kenya. It was analyzed using descriptive survey design with stratified sampling technique. Microfinance institution provided microfinance services to different groups of women. Moreover, the institution used various strategies to deliver its services such as granting small loans to women to help them to start and grow their businesses and educating their children. They recommended that microfinance institutions like PAWDEP could arrange mechanisms to increase technical and business skills through training and loan utilization for the poorest. They also suggested that microfinance institutions should put micro insurance schemes. It could help clients to pool risk or share losses.

Ahmed (2015) examined the challenges in facing microfinance institutions in poverty eradication in Mogadishu (Somalia). The research utilized survey research with SPSS. The results showed there was a positive impact of microfinance institutions on the alleviation of poverty. There was a misconception about microfinance institutions. It was because of less mentionable support from government, newly inception, donor funding, and inadequate loans. Those hindered the microfinance institutions.

Taiwo, Yewande, Edwin, and Benson (2016) analyzed the role of microfinance institutions in financing small businesses. They used primary data obtained via interviews in 15 small businesses across Lagos State. Their finding revealed that micro-financing significantly promoted businesses by reducing the resource gap for small businesses. They further recommended the recapitalization of microfinance banks to enhance their capacity and to support small business growth and expansion. The previous researches on the topic with

similar findings and conclusion have been asserted by Abdussalam and Tukur (2014), Olusanya, Sufian, and Temi (2014), and Yaqub (2012).

Although Babajide (2012), Idowu (2010), and Olowe, Moradeyo, and Babalola (2013) have examined the issue of accessibility of fund by MSEs in Nigeria, not many of researchers have assessed the impact of microfinance bank on MSEs in Ogun State, Nigeria. Therefore, this research intends to examine the impact of microfinance on microenterprises in Ogun State, Nigeria. The researchers want to answer the two main problems. First, it is whether microfinance bank (financial intermediation services) assists MSEs in Ogun State, Nigeria. Second, it is whether microfinance banks assist MSEs in improving the volume of trade they engage in Ogun State, Nigeria.

## METHODS

The research is conducted in the three senatorial districts of Ogun State, Nigeria. The reason for selecting Ogun State is because of the paucity of research on this phenomenon in Ogun State. It is also because of the proximity of the researchers to reduce the cost of research and accessibility to information.

Due to the nature of the research intended by the researcher, the population comprises the entire population of micro-enterprises in the three senatorial districts in Ogun State. It consists of Ogun Central, Ogun East, and Ogun West. The state has 20 governments structured into three senatorial districts and forming the geographical area of coverage in this research. Nigerian Population Census (NPC) (2006) affirmed that the total population of this area was 3.751.140. The number represents the entire residents of the state among the three senatorial districts and 20 local governments in the state. To get the sample size, the researchers use the equation by Cochran (1977). It is as follows.

$$n1 = \frac{n0}{1+n0/population} \quad (1)$$

Where:

Population size = 3.751.140

$n_0$  = the return sample size which is required based on Cochran's equation (383).

$n_1$  = the return sample size which is required since the sample is <5% of the population.

The procedure results in the minimum returned sample size. However, many of the education, social, and management researchers often use methods of data collection such as survey and other voluntary participation methods. Barlett, Kotrlik, and Higgins (2001) stated that the response rates were typically below 100%. Moreover, Fink (1995) added that oversampling could add costs to the survey. However, it was often needed. Meanwhile, Cochran (1977)

suggested that the variances of estimates could increase. It was because the target sample was bigger than the sample obtained. This factor can happen in selecting the size of the sample.

Therefore, to anticipate it, the response rate of 75% is achieved based on prior research experience. The following equation is used to determine the drawn sample size required to produce the minimum sample size.

$$n2 = \frac{383}{0,75} = 510 \quad (2)$$

Where:

$n_2$  = adjusted sample size to response rate.

The return rate that is anticipated= 75%.

Minimum sample size (new) = 383.

Hence, the sample size used is 510 questionnaires. It is distributed equally among three senatorial districts in Ogun State. However, 408 are returned. Thus, it represents 78,9%.

The researchers use open-ended questions in the questionnaires for microenterprises owners. The change in dependent variable after getting the credit is measured. The components of the dependent variable with the independent variable are indicated by inferential statistics (simple regression). It also establishes the relationship between the variables and calculates whether the changes which are observed in the components are significant or not. Therefore, microfinance bank is the independent variable while the dependent variable is micro enterprises.

## RESULTS AND DISCUSSIONS

To examine the first objective regarding the financial intermediation role of microfinance banks in servicing MSEs in Ogun State, Nigeria, this equation is used.

$$\begin{aligned} CD &= F(MFO) \\ CD &= a + bMFO + Ut \end{aligned} \quad (3)$$

Moreover, the equation (4) examines the second objective. It determines the impact of loan disbursement on the volume of MSEs in Ogun State, Nigeria

$$\begin{aligned} MEV &= f(MFO) \\ MEV &= a + bMFO + Ut \end{aligned} \quad (4)$$

Where:

MEV = Micro Enterprises Volume of trade

CD = Credit Disbursement to retail Business

MFO = Microfinance bank Operations

a = Intercept of the dependent variable.

b = Independent variable coefficient

$U_t$  = Error term.

The reliability is achieved through a split halve method. Cronbach Alpha is used to ascertain the questionnaire reliability. The test result reveals a coefficient alpha of 0,763. It suggests that the research uses a strong reliable instrument. The result is in Table 1.

Table 1 Reliability Test

Cronbach's Alpha	Item numbers
0,763	14

Table 2 The Financial Intermediation Role (Credit Mobilization) of Microfinance Banks in MSEs

Dependent Variable: PA				
Method: Least Squares				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	2,017470	0,133480	15,11436	0,0000*
MF	0,214762	0,101813	2,109388	0,0355**
R-squared	0,750814			
Adjusted R-squared	0,738384			
S.E. of regression	0,907600			
Durbin-Watson stat	1,637304			
F-statistic	4,449519			
Prob (F-statistic)	0,035521			

\*Significant at 1%, \*\*Significant at 5% and S (Source: Researchers, 2017)

The analysis in Table 2 is conducted to examine financial intermediation (credit mobilization) role of microfinance banks in servicing micro businesses in Ogun State, Nigeria. The model constant gives positive value of 2,58 as the value for the intercept of the model is significant at 1%. Furthermore, the coefficient of microfinance banks (MB) is -0,269. This implies that a negative relationship exists between microfinance bank operations and dispersion of credit among the MSEs in Nigeria. It means that the activities of microfinance banks do not favorably dispense credit to the micro businesses in Nigeria. This finding is inconsistent with Imoisi (2014), and Boateng, Boateng, and Bampoe (2015). They found that microfinance institutions had assisted to relax the constraints of the poor people to the access to productive capital and consequently broken the vicious circle of poverty caused by low income and low investments. However, the coefficient is statistically significant by seeing the prob. value (0,0105).

The R-Squared of the model is 0,65. It shows that the explanatory variables explain about 65% of changes in the dependent variable. This means the chosen variables are potent in explaining the level of

credit disbursed to micro businesses. However, other variables are not captured in this research that accounts for credit mobilization to the micro businesses.

Then, the next analysis is regarding whether microfinance banks assist MSEs in improving the volume of trade they engage in Ogun State, Nigeria. Table 3 shows impact of loan disbursement on the volume of MSEs in Ogun State.

Table 3 The Impact of Loan Disbursement on the Volume of MSEs

Dependent Variable: PA				
Method: Least Squares				
Variable	Coefficient	Std. Error	T-Statistic	Prob.
C	2,017470	0,133480	15,11436	0,0000*
MF	0,214762	0,101813	2,109388	0,0355**
R-squared	0,750814			
Adjusted R-squared	0,738384			
S.E. of regression	0,907600			
Durbin-Watson stat	1,637304			
F-statistic	4,449519			
Prob (F-statistic)	0,035521			

\*Significant at 1%, \*\*Significant at 5%, and \*\*\*Significant at 10%

(Source: Researchers, 2017)

The analysis in Table 3 is conducted to evaluate impact of loan disbursement on the volume of MSEs in Ogun State using ordinary least square. It evaluates the impact of loan disbursement on the volume of MSEs in Ogun State. In Table 3, the model constant is 2.08, this is positive value as for the intercept of the model, the value should be significant at 1%. Furthermore, the coefficient of microfinance banks is 0,2147. It can mean that a positive relationship exists between microfinance bank operations and volume of trade engaged by MSEs. Moreover, microfinance banks have helped to improve the volume of MSEs in Ogun State over the years. This finding is inconsistent with Van Rooyen, Stewart, and De Wet (2012), Abraham and Balogun (2012), Kasali, Ahmad, and Ean (2015). They indicated that microfinance increased the levels of indebtedness among already impoverished enterprises and exacerbated economic, social, and environmental vulnerabilities due to stringent conditions. It included active guarantors and inability to make pre-loan and weekly repayment. Similarly, it was found that majority of respondents agreed that credits did not make MSEs successful in their undertakings rather it made them more dependent on credit from microfinance banks. It is also discovered that the coefficient is statistically significant as evidenced by an examination of the prob. value (0,0355).

The R-Squared (0,75) of the model is high. It shows that the explanatory variables explain about 75% of changes in the standard of living of business owners. Impliedly, the research indicates that the chosen variables are strong in explaining the improvement in the volume of trade of the MSEs studied. However, there may be other variables that are not used in this research that accounts for the improvement in the volume of trade of the retailers sampled.

## CONCLUSIONS

Micro enterprises development is a multidimensional process with a tremendous capacity to accelerate economic growth and development. This can happen if the access to credit and other resources that will enhance the business expansion and growth is available. Microfinance bank in Nigeria has not been performed commendably well. It also has not played the expected financial intermediary role regarding the provision of loan for MSEs that will enhance the business. Moreover, it has not influenced the operating mechanisms of MSEs to accelerate business growth, create employment, and alleviate poverty. This situation has been a great concern to the government, citizen, operators, practitioners, and organized private sectors.

This research observes that micro businesses can expand and maintain the business because of the activities of the informal financial services provider. The provider such as Gbomulelanta, Gbomulekanta, Baba Ijebu, and Sharp Sharp can prepare a relief loan package for the micro businesses in group lending activities using social collateral.

The study recommends that federal government should review the activities of microfinance institutions because most microfinance banks have derailed from the core mandate. Moreover, there is a need for sensitization of MSEs to keep the adherence to good management that will enhance the access to credit. Likewise, governments at different levels in Nigeria should widen the support programs for micro enterprises in improving the financial assistance, technicality, marketing, and managerial support to promote and sustain the development.

The research limitation is that the data used for this study are from microfinance banks and micro enterprises. Thus, through structured questionnaires to microfinance banks customers, it makes data retrieval for the research hard. The future researcher should evaluate comparative analysis of microfinance activities in Nigeria with other Less Developed Countries (LCD), especially in Sub Saharan Africa nations. It can enhance microfinance operation in Nigeria.

## ACKNOWLEDGEMENT

We would like to thank our department's research seminar platform for contributions from the members during its presentation at that forum. Thanks to our erudite professors and seasoned scholars.

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