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Microfinance Credits and Growth of Business Firms in Nigeria

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***Abstract* – The paper investigates the relationship between microfinance credit and small and medium business growth in Nigeria, for the period 2006-2014. The results from panel data analysis show that bank credit has negative and statistically insignificant relationship with business growth in Nigeria. The result suggests that credit provision from banks have no apparent effect on growth of businesses. In addition, sales of the firms and the loans obtained by the firms are statistically significant suggesting that assets of businesses would grow with increase in sales over time. Also, loan, a source of business finance, if assessed on regular basis, subject to the need of the business, would lead to increase in asset drive of businesses.**

***Keywords* – Credit, Microfinance, Small and Medium Business, Growth, Nigeria.**

I. INTRODUCTION

Most of the successful economies of the world have as their backbone, Small and Medium Enterprises (SMEs). The growth of SMEs in a country is expected to result in generation of employment and facilitation of equitable distribution of income among the citizens of the country. Aremu and Laraba (2011) indicated that about 75 percent of employment generation could be attributed to growth in SMEs. SMEs have the potential to engineer industrial growth, social and economic development, poverty reduction, in both developed and developing nations like Nigeria. For example, countries like European Union (EU), United State of America (USA) and China have over 43 million SMEs employing between 60 and 70% of their overall labour force thereby generating contributing more to their Gross Domestic Products (GDP) relative to large companies (SBA, 2016).

In Nigeria, which is a developing nation, SMEs is continuously being relied upon to facilitate a pathway to poverty reduction through creation of wealth and job among the citizens. Following Nigeria independence and the slow growth recorded in several sectors of Nigerian economy, SMEs have been given attention to gain advantage in the aspect of employment, revenue generation and economic stability. A number of actors in the private sectors were given opportunities to make inroad into several sectors that were hitherto controlled by government. In addition, relevant agencies were set up to monitor and support growth and development of small businesses in the country. This is premised on the success recorded by the hitherto developing nations of the world, through SMEs. As at 2013 which was the last time a survey was carried out on SMEs in Nigeria, the available record provided by the Small and Medium Enterprises Development Agency of Nigeria (SMEDAN) showed that the small enterprises in Nigeria are up to 68,000 while the medium enterprises are 4,670 (SMEDAN, 2013). Out of these numbers, SMEDAN indicated that about 14,000 Micro Small and Medium Enterprises (MSMEs) operators in Nigeria have been provided with microfinance credit to formalize their businesses. But the actual growth rate of the SMEs in relation to this credit facility was not provided.

Ogujiuba, Fadila and Stiegler (2013) argued that the promising potential of SMEs as a viable option to drive improved livelihoods among Nigerians cannot be unlocked without adequate financing and access to credit by small and medium business entrepreneurs. The expected contribution of SMEs to national development have

however been hampered by poor financing leading to increased search light on alternative ways of financing the small business sector aside limited government interventions. Considering the relevance of SMEs to national development, microfinance is institutionalized by the Nigerian government to help small businesses and poor entrepreneurs overcome challenges associated with poor standard of living (Irobi, 2008). Thus, microfinance is regarded as a financial service designed to offer credits or loans, micro-leasing and micro-insurance among others to small business entrepreneurs and economically disadvantaged households. It is expected that provision of microfinance support to these categories of people will stimulate growth of their businesses thereby helping them to raise their income and livelihood.

Inadequate and lack of timely credit provision is considered a major obstacle to sustainable growth of small businesses in developing countries (Owualah, 2007). Both theoretical and empirical studies have not only shown a direct and positive link between credit provision and business growth, they also suggest that both long and short-term business survival depends on credit availability. But, there is a growing inability of Nigerian small business firms to access credit from formal institutions, largely due to strict requirements and availability of collateral which are beyond the capacity of small entrepreneurs. As a result, microfinance credit provisions came on board with regulatory backing from the financial regulatory body in Nigeria.

This study examines the relationship between microfinance credit and growth of SMEs in Nigeria. It provides answers to the question of whether microcredit provision has significant influence on growth of SMEs in Nigeria. The paper is presented in sections. Section II provides insight into theoretical frame of the study while section III is literature review. Subsequently, methodology of the study is presented in section IV while section V presents the results. The last section is conclusion of the study.

II. THEORETICAL FRAMEWORK

The concept of credit has been viewed in several ways. But, the common description of the term credit considers it to be a borrowed capital. American Bankers' Association described credit to include loans-both personal and home, bank overdrafts as well as credit cards. It has also been referred to as repayment of debt in line with agreement reached with the creditor, the duration of which could vary. In the case of SMEs, the main source of external source of credit as indicated by OECD (2006) is micro finance institutions. The Financial services provided for small scale business owners are known as micro finance. It covers both credits provision and deposits. The scope of small business with designated access to micro finance covers small scale producers, repairer, traders, recyclers and small scale service providers. A number of programmes which primarily include skilled based training are within the scope of microfinance (Rai, 2004). Conceptually, microcredit could be considered to be small loans. Meanwhile, microfinance is institutional and is more applicable in situation where financial institutions and agencies that are non-governmental offer supplementary loans to SMEs in additional to other financial services such as savings and insurance. Consequently, microcredit could be viewed as a part of microfinance in the aspect of provision of credit to the needy. Additionally, microfinance comprises delivery of supplementary credit related services like savings, insurance as well as pensions and payment.

Microfinance being a credit product entails a number of features. The main feature of microfinance involves provision of small loans to individuals or groups with a view to helping them kick start income generating activities. Capital savings over a period of time is a key aspect of microfinance activities because it plays the role of financial security for the poor in addition to helping them to accumulate sizable capital to manage financial

constraints. Usually, short term loans are given out to the needy for up to a year period. The repayment schedules are flexible and could be acceptable if it is scheduled on weekly basis. The payment installments usually comprise of the principal and interest, that may amortized over a period of time (Ledgerwood, 1999, Mohammed and Mohammed, 2007).

Globally, efforts have been made by governments to provide adequate financing of the underprivileged via formation of agricultural based development banks and lending schemes through the support of establishments of co-operatives and self-help groups. Adeyemi (2008) noted that provision of credit to the poor is an important instrument for poverty reduction in the world. An example of benefit of the scheme is provided by Ehigiamusoe (2008) who noted condition of living in Bangladesh is a good indication of method of development through small loans. Small loans are effective weapons for addressing mass poverty since most poor cannot afford any amount to expand or even initiate a small scale business". In spite of years of provision of micro credit facilities coupled with policy orientation as well as entrance of new players, the story is different in Nigeria as supply of micro finance remains inadequate relative to demand. This puts question of inefficiency on the microfinance operations in Nigerian operational system. This could be attributed to institutional inadequacies which includes poor capitalization, wasteful managerial and regulatory loopholes (Adeyemi, 2008).

The relevance of finance especially its access cannot be over emphasized. The role is more recognized as a key factor to SMEs growth, the world over. Hence, financial inclusion is known to be an essential instrument for SMEs growth. Lack of access to finance impedes the ability and capacity of entrepreneurs to participate in new business enterprise and also inhibits growth. Diagne and Zeller (2001) noted that inadequate access to financial credit by the needy do have negative values for SMEs and general welfare. "Access to credit further increases SMEs risk bearing abilities; and improves risk-copying strategies and enables consumption smoothing overtime. The idea of creating Micro Finance Institutions (MFIs) is to provide an easy accessibility of SMEs to fund businesses that cannot access formal bank loans (Diagne and Zeller, 2001).

Microfinance banks help to empower the underprivileged and offer valued tool to help the process of economic development. In the opinion of Kolawole (2013) the development of micro enterprises in developing nations is necessary due to their abilities to promote business development. One of the main objectives of micro credit is to address the welfare of the vulnerable due to improved access to loans that may not be available through formal financial establishment. Existing literature indicate that most small enterprises are not growth oriented while for some, it is a voluntary (Masurel and Montfort, 2006). Considering the research conducted by Kolvereid and Bullvag (1996) on SMEs growth pattern and the findings that growth desire are more likely to be relevant to forecast "actual growth". In the view of Arbaurgh and Sexton (1996) some enterprises do not become larger while relationship could not be found between size and age of business firm.

There are no known strategies to raise growth of firms. Consequently, the possibility of attaining desired level of growth could be increased if firms avoid over emphasis on a particular strategy of business transformation. Also, given different competencies appropriate importance depends on the level or stage of development (Chaston and Mangles, 2001). Three different factors which may hinder the growth of SMEs are considered to include opportunity, need and ability.

The Theories of Firm Growth

Existing bodies of literature with focus on growth of small businesses are largely viewed from two schools of

thought. These schools consider growth in relation to small businesses to be of diverse perspective. The first takes its argument from the perspective of organizational life cycle while the second school analyzed growth from the perspective of strategic choice of the firm. Under the first school, firm growth and its evolution is considered to be a natural phenomenon. This implies a normal growth curve of small businesses under natural business condition. The idea propagated by the two schools of thought could be summed to mean that small businesses will experience growth under certain conditions. However, these conditions are hinged upon the characteristics of the business owners, the level of organization of firm resources, and available environmental opportunity.

Although, the theory is rooted in economic literature, its relevance to business activities is based on a number of factors highlights its importance. Some of these include its relation to the survival of business firms. Trade of and pecking order theory is important theories which are investigated in the literature on SMEs (Jindrichovska, Ugurlu and Kubickova, 2013) According to Geroski, (1995), growth of a firm is positively related to high likelihood of business survival in a competitive market. Secondly, the growth of firm has been directly linked to employment. Unequivocally, one of the expectations from business growth is contribution to an economy through generation of jobs or generally, employment opportunities. This brings about the third benefit and relevance of the theory; positive effect on economic growth. Penrose (1959) argued that one of the net outcomes of growth of firms is contribution to economic growth. He contended that both forward and backward linkages are expected to lower or higher depending on the evolution of firms. Also, growth of firm is linked to evolution and increased innovation in technological changes. According to Pagano and Schivardi (2003), business firms that desire growth and survival in a competitive industry needs incorporation of new technologies in order to be more efficient. The determinants of firm growth have been highlighted by a number of theories. Some of these factors in line with the explanatory theories are presented in this section. Very early studies on the growth of firm largely focused on the influence of age and size on growth of firms. But the factors influencing firm behaviour are many. Also IFRS has effect on SMEs in the Europe (Ugurlu and Jindrichovska 2019). Storey (1994) identified three categories of factors influencing growth. These are entrepreneurial factors, firm specific factors and strategy based factors. According to Storey (1994) entrepreneurial factors are considered to include motivation, experience and age which are viewed to be the inherited and learnt abilities of the entrepreneurs. On the firm specific factors, variables such as market experience reflected in the number of business years, sector of business and size are included. The third factor is associated with technology. However, these factors are interrelated. SMEs which develop a clear strategy for engaging market competition may not have high results if the business manager lacks basic skills to handle emerging market situation or even the skill or capability to drive motivation of the employees.

SMEs are widely reported to face numerous challenges especially credit constraints, lack of entrepreneurial and business management skills among others. Consequently, the reason for entrepreneurial business is growth. The overview of growth in Nigeria shows that the rate stood at an average of 3.1% between 2011 and 2019. Although, the growth rate reach 6.9% growth rate in 2011-an all time high, the rate has been fluctuating. Hence, the increasing effort to boost SMEs for improved national growth (CEIC, 2019).

III. Literature Review

The impact of financial factors on growth was tested by Becchetti and Trovato (2002) found that rejection of loan application by firms' constraints business growth. Analysing the impact of microfinance, Chemin (2008) found a positive effect on expenditure per capita. Aguilar (2006) in Malawi found no significant difference

between borrowers and no borrowers with respect to growth of businesses. Based on panel data techniques, Amin et al. (2003) reported that although microcredit is found to be useful for the poor, its usefulness to the most vulnerable, destitute is limited. Mosley (2001) analyzed the effect of micro finance on poverty. The study showed that relative to other poverty reduction measures, micro finance seems to be more successful and reduces poverty. Earlier,

Kuzilwa and Mushi (1997) investigated the contribution of credit to entrepreneurial undertakings. Their results showed that enterprises output increases after being able to gain access to the credit. Furthermore, the enterprises in question who have known entrepreneurs benefit from business training and guidelines and were observed to perform better than the rest. The performance and sustainability of MFIs was investigated by Chijoriga (2000) in Tanzania but the findings showed that performance of financial institutions operating at micro level in the study area is poor. The findings of Chijoriga (2000) showed that MFIs in Tanzania lack participatory ownership and many is donor driven. The findings of Rweyemanu et al. (2003) indicated that interest rates are part of the significant hurdle to achieving decision to borrow. Meanwhile, Niskanen and Niskanen (2007) found that the premises for growth analysis were laid on lending characteristics of firms. The findings suggest that increase in the number of lending financial institutions reduces the growth rates in the bigger firms. In the findings of Brown et al. (2004) based on panel data econometrics, access to external credit was found to be more related to the development and growth of sales.

The empirical evidence provided by Quaye (2011) shows that MFIs has positive effect on the growth of SMEs. Also, the study done by Madole (2013) indicates that credit obtained from Bank improve businesses in terms of increase in firms' profit, sales turnover and increase in business diversification and capital. The study concluded most of the small businesses depend on bank loan for business capital growth Koech (2011). Waithanji (2011) reported linear and direct effect of credit access on financial performance of the sampled firms. Furthermore, the findings indicate that small enterprises gain from provisions of loans obtained from micro finance establishments. In the study conducted by Carpenter (2001), and Owualah (2007), poor financial access was implicated as a possible roadblock to the potentials of SMEs in Nigeria. The existing notion is that, the potentials inherent in SMEs to contribute to national economy could only be tapped if there is adequate financing to support entrepreneurs and their businesses. However, due to the limited size of the small business sector, opportunity to gain access to funds in the national commercial banks becomes practically impossible. Some of the possible reasons for this difficulty include the notion that small businesses are risky business that is full of uncertainties. Additionally, high rate of transaction costs to process loan could be very discouraging.

IV. RESEARCH METHODOLOGY

Data for the study are mainly from secondary sources. Data are sourced from annual reports and accounts of business firms in Nigeria while data on credit provision for SMEs are sourced from Central Bank of Nigeria (CBN). A total of 17 business firms were sampled over the period of nine (9) years between 2006 and 2014. The sampling was based on availability of data and access to loan and credit from regulatory agencies in Nigeria. Data collected were analysed using panel data technique. Panel data presents a number of advantages more especially because of the possibility of joining both time variant and cross-sectional factors together as single analytical data. Also, high heterogeneous variables could also be analysed across countries and firms over time. In addition, panel data reduces the problem of associated with multicollinearity of variables. Unlike individual time and cross-

section data, panel data permits econometric analysis over a short period of time and insufficient cross-section data (Ugurlu, 2010).

Baltagi (2005) highlights the benefits of panel study to include ability to account for individual heterogeneity. It could control state and time-invariant factors which are not possible through individual time series analysis or cross-section study. Furthermore, in the aggregate production function, the country-specific factor is usually ignored in cross-section regression. But, this is often found to correlate with the explanatory variables included in the model which usually leads to variable bias. The framework of panel data provides opportunity for correction of this type of bias. Panel data is also associated with provision of data that is more informative, varied with better degree of freedom and efficiency.

With panel data, models are usually estimated through fixed or random effect estimation techniques. If there is similarity among individuals, use of OLS may be better, but if there is no independency of individual-specific component with respect to the independent variables, or there is assumption of differences among the countries, fixed effects estimator is considered appropriate. In other words, if the focus is on a specific set of firms or countries and there us willingness to restrict the inference to the behaviour of those firms or countries, fixed effect model is usually suggested. But, if there is random assumption with respect to the exogenous variables, random-effect estimator is presumed to be better (Ugurlu, 2010). In order to test for discrimination between the estimators of both the random and fixed effects specification, Hausman test is usually conducted. Hausman (1978) offers an approach for such test. In the Hausman approach, estimators of vectors of coefficients of both models are put on a comparison level. Based on the Hausman result, random effect was found appropriate for the study (Chi2 (4) = -3.71)). The empirical model is implicitly specified as: $y = f$ (Equity, Sales, Loan, Bank Credit).

$$y_{it} = a_0 = \beta_1\, equity_{it} + \beta_2 sales_{it} + \beta_3 loan_{it} + \beta_4 bankcredit_{it} + \in_t \quad (1)$$

The dependent variable is the asset of the firms over the period of time and the explanatory variables include equity, sales, and microfinance credit to businesses. The parameters of the model (βs) are all expected to be positive.

V. Results and Discussion

Descriptive Statistics of the Study Variables

Table 1 shows descriptive statistics of the variables. Over the period under study (2006-2014), the mean of equity of the sampled firms is lowest at the value of ₦15, 200, 000 (Nigerian currency where 1$ = ₦360). The total asset value of the firms presents a mean value of ₦30, 200, 000. Meanwhile, the mean sales value of the firms is ₦24, 300, 000. The average value of loans obtained by the firms from all sources is ₦16, 600,000. Assessment of these values show that equity of the firms is lowest, followed by loans obtained by the firms, sales and size (assets) of the firms. The standard deviation of the values which is an indication of the stability of the variables over the study variables is also presented in the Table. The result suggests that the sales of the firms represent the least stable among the variables (₦, 98,100,000) an indication of high level of sales variability in the business firms over the period under study. This is followed by loans obtained by the firms (₦71, 700,000) and firms equity (₦67, 800,000). The least volatile or the most stable of the study variables is the asset of the firms which represent the size. It implies that over time, business firms in Nigeria have been able to maintain their assets in the midst of uncertainty over access to loans. Results further show that the minimum value of equity of the

firms over the period is ₦8, 106 while the maximum value from any of the firms is ₦ 393,000,000. There are firms with minimum record of asset at zero level while firms with the highest asset or size have maximum value of ₦ 657,000,000. The minimum value of sales of the firms over the period is ₦10, 433.00 while the maximum sales value recorded by any of the firms is ₦539, 000,000.00. There are records of firms with zero (0) access to loans while the maximum value of loans of loan obtained by the firms is 567,000,000.00 over the sample period. The mean value of the variables is pictorially illustrated in Fig. 1. The pictorial representation clearly depicts total assets of the firms as the highest, followed respectively by sales, loans and equity of the firms.

Table 1. Descriptive statistics of the variables.

Variable	Obs	Mean	Std. Dev.	Min	Max
Equity	143	1.52E + 08	6.78E + 08	8106	3.93E + 09
Tasset	149	3.02E + 08	1.24E + 09	0	6.57E + 09
Sales	145	2.43E + 08	9.81E + 08	10433	5.39E + 09
Loans	146	1.66E + 08	7.17E + 08	0	5.67E + 09

Source: Data Analysis, 2019.

Correlation of the Study Variables

Results in Table 2 show the correlation of the study variables. The coefficient of correlation between size (Asset) of the business firms and equity of the firms is strong and positive (r = 0.887). This is an indication that increase in equity of the firms could also raise the asset of the firms. The coefficient of correlation between sales and equity is positive (r = 0.843) suggesting a direct association between the two variables. An increase in sales results in higher equity of the firms. Positive coefficient was also observed between the loans obtained by the firms and equity of the firms (r = 0.761). The direction of association suggests the value of total loans obtained by the firms could lead to increase in equity of the firms. Data from the central banks of Nigeria on credit financing of businesses suggest there is weak association between credit provision by banks to business firms and equity (r = 0.198).

The coefficient of correlation between sales of the firms and asset (size) is high and positive (r = 0.848). The result suggests that both sales of firms and size and complementary. An increase in the value of the sales could lead to higher value of size or assets of the firms. Higher value of assets also suggests ability of the firms for sustainable growth in the long term. Total loans obtained by the firms show higher and positive correlation coefficient with asset of firms (r = 0.918). The result indicates that loans could contribute to increased asset value of business firms. Similarly, credit financing from banks to business firms also show positive correlation with asset. The values corroborate the expected direct relationship between financing provision and growth of businesses over a period of time.

Table 2. Correlation of the study variables.

	Equity	Asset	Sales	Loan	Credit
Equity	1				
Asset	0.887	1			
Sales	0.843	0.848	1		

	Equity	Asset	Sales	Loan	Credit
Loan	0.761	0.918	0.789	1	
Credit	0.198	0.242	0.202	0.212	1

Source: Data Analysis, 2019.

Random Effect Estimates of the Model

The results in Table 3 show the estimated regression of business growth in Nigeria. The Hausman test was considered to choose between fixed effect and random effect model. However, the test fails to reject the null hypothesis of non-significance of random effect (chi2 (4) = -3.71)) (see Appendix). Hence, random effect is considered appropriate for the model. Growth is captured using the asset of the firms following Alemu (2015). The overall R-square, a measure of contribution of independent variables to the dependent variation, is 0.759, indicating that about 76% of the included variables account for the variation in the growth of the firms. Other diagnostics such as Wald chi2 (4) was significant (5%).

The independent assessment of the variables show that only sales of the firms over the period under study (β = 0.396, t = 5.23) and the loans obtained by the firms are the only significant variables. Both variables are positive and significant at 5% indicating that assets of businesses would grow with increase in sales over time. Also, loan, a source of business finance, if assessed on regular basis, subject to the need of the business, would lead to increase in asset drive of businesses.

Table 3. Results of Random effect model of business growth.

	Coeff	Std. Err.	z	p>|z|
Equity	.009	.006	1.48	0.140
Sales	.396	.076	5.23	0.000
Loans	.749	.111	6.73	0.000
Bank credit to business	-1.189	1.596	-0.74	0.456
Constant	1207695	665411.9	1.81	0.070
sigma_u	1283477.1			
sigma_e	2303252.8			
Rho	.23694554			
Wald chi2(4) = 172.89				
Prob > chi2 = 0.0000				

Source: Data Analysis, 2019.

VI. CONCLUSION

The study showed the relationship between microfinance credit and growth of SMEs and analyse the influence of credit to SMEs on growth of businesses in Nigeria. Primarily, microfinance scheme was established to provide financial support to fledging businesses and thereby secure jobs, income and growth of business climate in Nigeria. The findings show that only sales of the firms over the period under study (β = 0.396, t = 5.23) and the

loans obtained by the firms are the significant variables. Both variables are positive and significant at 5% indicating that assets of businesses would grow with increase in sales over time. Also, loan, a source of business finance, if assessed on regular basis, subject to the need of the business, would lead to increase in asset drive of businesses.

Following the findings of this research, the study concluded that microcredit provision to firms, by formal credit institutions in Nigeria has no effect on growth of businesses. Firms were only able to benefit from sales which could be as a result of large population and consumption nature of the populace. Meanwhile, the totality of loans gathered by the firms from several sources including friends, relations and associates significantly impact business growth. Based on these, further clearer conclusions are that micro-financing scheme in Nigeria has no empirical linkage to business growth in the country. Hence, capacity of small business to benefit from expansion that is expected to be occasioned by government and institutional financial support is weak. In order to enhance growth of SMEs, an increase in provision of microfinance credit to businesses is suggested. This is to ensure even growth of SMEs businesses and achieve consequential benefit expected from them.

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