

## **Microfinance Banks' Loans and Small and Medium Enterprises Performance in South-West Nigeria**

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### **Abstract**

*The study assessed the effect of microfinance banks' loans on Small and Medium Enterprises (SMEs) performance in south-west Nigeria. As a survey research, questionnaire method was employed to obtain the required data from 160 purposively selected respondents from 80 SMEs that employ more than 3 employees across Ogun State as respondents for the study with only 135 questionnaire returned in useable form. Hypothesis of "no effect" was tested using multiple linear regression test. The results of the test revealed- that microfinance banks' loans to SMEs have effect on SMEs performance in south-west Nigeria.*

**Keyword: Microfinance Banks, Loans, Small and Medium Enterprises, Performance, South-West Nigeria**

### **Introduction**

Small and Medium Scale Enterprises (SMEs) are the engines for growth and development of any society or nation, specifically, developing nations. This is because of the facts that they have become major sources of employment for the teaming unemployed youths, wealth creation, provision of varieties of goods and services and improvement of Gross Domestic Product (GDP) and Gross National Product (GNP) for developing economies of the world. It is also becoming an instrument for ensuring peaceful coexistence among societies.

The international year for microcredit in 2005, stressed on the relevance of microfinance as integral part of collective efforts at achieving the Millennium Development Goals (MDG). On this note, Smeck and Havrland (2006) stated that sustainable access to microfinance funds help to alleviate poverty through income generation. The Central Bank of Nigeria (CBN) introduced microfinance bank policy option having used a number of failed fiscal and physical credit options in the past in attempt to empowered the vulnerable and poor group of people to have access to credit facilities to start up new or expand existing businesses. This led to the approval

of licenses to two categories of microfinance banks in Nigeria- those licensed to operate within a local government and those to operate within a state or federal capital territory, with a minimum capital requirement of N20 million and N1 billion respectively.

Microfinance banks' loans to SMEs option by the Nigerian government is one of the numerous strategies that have been adopted to alleviate poverty and empower the poor to establish new ventures or expand existing business through the provision of micro credits which cannot be accessed through the formal or conventional banking system. The major challenge of government in developing nations has not been on how to identify the poor in the society, but on how to equip institutions that can reach the poor at minimum costs. That is, on how to empower the poor and vulnerable people financially, so that they could engage themselves in profitable economic activities.

SMEs represent the sub-sector of special focus in any meaningful economic restructuring programme that targets employment generation, poverty alleviation, food security, rapid industrialization and reversing rural-urban migration (Olowe, Moradeyo & Babalola, 2013). The strategic option of using microfinance banks by the Nigerian government is because access to business funds is a major problem of the Nigerian SMEs. This is because a lot of them do not have the connections and collateral required to access funds from the formal banks. This has led to poor performance of existing SMEs and dead ideas of would be entrepreneurs. In this direction, Olowe et al. (2013) noted that Microfinance Banks (MFBs) emerged as a substitute to the formal banks, as they are effective and powerful instruments for poverty reduction among people who are economically active, but financially constrained.

MFBs services in Nigeria include loans to customers, acceptance of deposits, payment services, and insurance services. Olowe et al. (2013) opined that microfinance institutions have contributed significantly towards the poor in rural, semi-urban and urban dwellers by empowering them through micro credits which have improved their ability and living standard in a number of countries across the globe.

Like other developing countries, the Nigerian microfinance banks have become institutions for employment generation, resettlement of people who are internally displaced by conflicts/wars, and for providing for those who are disadvantaged/isolated economically and socio-culturally. This is because most communities in Nigeria who would not have been able to access credits for businesses have been able to do so through microfinance banks' credits scheme with or without collateral. This study is to undertake an assessment of the effect of microfinance banks' loans on SMEs performance in south-west Nigeria.

## **Literature Review**

### **Microfinance Loans and SMEs performance**

A number of studies have been conducted in this area with varied findings and conclusions across developing countries. For example, Duru and Ogbe (2013), on the relationship between microfinance banks and financing of SMEs in Kogi state of Nigeria, found that beneficiaries of

microfinance banks' loans improved in their income generating abilities, equipment acquisition, employment generation and improved standard of living, but with a high default rate in loan repayment.

Oni and Daniya (2012), on the role of government and financial institutions in the development of SMEs in Nigeria, found that financial institutions provide the necessary financial lubricant that facilitates the development of SMEs, but that government needs to step up its policy implementation to complement their efforts. In the same vein, Idowu, Ambali and Otunaiya (2008) on the effect of microfinance banks on Piggery business in Osun state of Nigeria, found among others that level of education, years of experience in piggery farming and the number of pigs had significant positive effects on funds sourced from financial institutions

Furthermore, Suberu, Aremu and Popoola (2011), on the impact of microfinance institutions on SMEs in Nigeria revealed that a number of SMEs had benefited from microfinance loans with or without collateral, and that such loans improved their performance, through competitive advantage. On Microfinance credit and sustainability of SMEs growth in Nigeria, Oni, Paiko and Omin (2012), affirmed that the credits contribute to sustainable growth of SMEs in Nigeria. However, they found that their service outreach were poor.

Edafiaje (2011), on the role of microfinance bank on SMEs in Ozoro and Warri in Delta state of Nigeria, found that microfinance, specifically, those sponsored by government had increased the level of credit disbursement, agricultural production and other economic activities.

Akande(2012), on the impact of micro credit on the performance of women owned SMEs in Oyo state, Nigeria, found that their credit facilities enhance SMEs' performance, but not sufficient for the required growth.

Also, on a study of the effectiveness of microfinance banks on poverty alleviation in Kwara state of Nigeria, Yahaya, Osemene and Abdulraheem (2011) found that their loans to SMEs reduced poverty, improved employment opportunities and performance of SMEs in the state. Moreover, Olowe e tal. (2013) on a study of the impact of microfinance banks on SMEs growth in Nigeria, found that financial services from microfinance banks have positive impact on SMEs' growth in Nigeria. Specifically, findings of the study showed that duration of loan repayment had positive impact on SMEs growth, but that high interest rate, collateral and loan repayment frequency have constrained SMEs' growth ability. In addition, it shows that there was a high default rate in loan repayment which has constrained the lending abilities of microfinance banks in Nigeria.

On the other hand, Ilegbinosa and Opara (2014) on microfinance banks impact on poverty alleviation in Edo state of Nigeria, observed that SMEs services have the potential of alleviating poverty by ensuring wealth creation and self sufficiency.

In other developing countries, Ayuun (2013), on the impact of microfinance on poverty alleviation in Bahawalpur of Pakistan, observed the following in the operations of MFBs- an

increase in income to the poor and customer satisfaction, inadequate markets coverage and high interest rate. He also noted that they focused more on the agricultural sector. He concluded that a positive relationship exists between microfinance banks' credit and poverty alleviation through improved standard of living and financial opportunities to start up new and expand existing businesses for improve performance.

From Ghana, Owusu-Dankwa and Adole (2014), on the impact of money lending institutions on SMEs in Ghana, found that SMEs benefit from loans, though, only a few of the SMEs were capable to secure the fund; the study also revealed positive contributions towards improve profit, stock and sales which place them on competitive advantage over rivals. The research findings' differences of the above reviewed studies left gap such as what is the effect of MFBs loans on SMEs performance? This gap is the major objective of this study.

### **Government Policies and Development of SMEs in Nigeria**

Recognising the indispensability of the small-scale private sector enterprises as the dynamic impetus for general economic growth and development, many countries have instituted enterprise support networks and structures to fuel the development of these enterprises. Nigeria is not an exception in this regard. At various times since the 1970s, successive Nigerian government has designed and introduced a variety of measures to promote small and medium enterprise development. These measures included fiscal, monetary and export incentives. Fiscal incentives introduced include tax holidays and tariff concessions. For example, small enterprises were given tax holidays for the first six years of their operations in the past. In terms of monetary authority support, the Central Bank of Nigeria (CBN) introduced credit guidelines requiring commercial, merchant and microfinance banks to allocate a substantial portion of their loan-able funds to small and medium enterprises. A number of other developmental financial institutions and schemes were also established by the past and present governments at all levels to aid the development of the small and medium enterprises in Nigeria. Prominent among the institutions are: National Bank of Commerce and Industries (NBCI), National Industrial Development Bank (NIDB) now Bank of Industry (BOI), Peoples' Bank, and recently the Microfinance Bank (MBF), to facilitate loans to SMEs with the aim to stimulating production for local consumption and for export.

Other incentives were provision of manpower training, machinery acquisition, installation and maintenance supports, coupled with extension services. These services were provided by a number of industrial centres or institutions like the Federal Institute of Industrial Research Oshodi (FIIRO), Industrial Development Centre (IDC), Centre for Industrial Research and Development (GIRD), Centre for Management Development (CMD), and Project Development Agent (PRODA) among others.

The above support programmes have had varied levels of success in Nigeria. While the initiatives are beautiful in theory, there is the need to improve on the implementation strategies, if the set objectives must be realised.

## **Methodology**

### **Population, Sampling Technique and Sample Size**

The actual population of study was not known to the researchers. That is, there was no definition as to what constitute the population of SMEs in the Nigerian south-west. Therefore, the researchers used purposive sampling technique to select 80 SMEs that employed more than three employees, coupled with stratified method to select one hundred and sixty (160) respondents, making it two respondents each from each of the selected SMEs to form the sample size. However, of the 160 administered with questionnaire, only one hundred and thirty-five (135) were retrieved in a useable form. It was hoped that whatever information and findings from the sample will be adequate for making a general statement about the population under study.

### **Research Instrument**

A structured questionnaire was employed for data collection. The questionnaire contains questions based on a 6-points rating scale (6 point likert scale) from strongly disagree, disagree, slightly disagree, slightly agree, agree to strongly disagree. The scale was used to solicit respondents' level of agreement or disagreement to the positive statement of discuss. It contained the following sections:

Section A: This section contains questions about the socio-demographic features or characteristics of respondents such as sex, qualifications, and business type of respondents. On the other hand, section B dealt with major questions on the subject using 6 point likert scale.

For effectiveness in the process of questionnaire administration, two research assistants were employed, trained and used to support the researchers in the course of data collection. They were used because of the enormous task of administering questionnaire in Nigeria.

### **Validation of Research Instrument**

As a survey instrument, questionnaire has been used to capture behavioural and perception measures. The quality was judged according to Eisenhardt (1989) and Yin (1994), on four criteria- constructs validity, internal validity, objectivity and reliability.

Construct validity aimed at ensuring that the questions in the questionnaire measured correctly or effectively the concepts under study. To achieve this, experts in microfinance and SMEs' sectors were presented with initial draft of the questionnaire for scrutiny as to the correctness and ability to measure the concepts in relations to the stated objectives of the study. Their observation, corrections and opinion led to modification of the initial draft of the questionnaire.

Internal validity measured the extent to which the independent and not other variables correctly measured the dependent variables. To achieve this, variables that have been used by a number of previous studies were modified to suit this research purpose. Variables in this category were used by Olowe et al (2013, Ayuun (2013), and Owusu-Dankwa et al.(2014).

Objectivity of a research instrument has to do with research questions that are fair, free from biases but balanced in nature. To achieve this, experts' opinion was incorporated into the final draft of the questionnaire. Reliability has to do with consistency of instrument to generate same results when used by different sets of people under similar circumstances. To measure this, a pilot study was conducted before the final study. There was no significant difference in the findings.

### **Hypothesis of the Study**

*Ho: There is no significant effect of microfinance banks' loans on SMEs performance.*

### **Data Analysis Techniques**

The focus of the study is to make inference about the studied population through statistical hypothesis testing at 5% significant level. The study used the Statistical Package for Social Science version 21 (SPSS V.21) for both descriptive and inferential statistical data testing. In specific terms, frequency table and percentage score were used to describe the population studied, while multiple regression and correlation techniques were used to test and achieve the objective of the study.

### **Model Specification**

The study used multiple regression test in order to undertake an assessment of the effect of microfinance banks' loans on SMEs performance in the Nigerian south-west region. Microfinance Banks' Loan is captured in this paper using loans disbursement rate, re-payment frequency, interest rate, loan duration, and collateral, while profitability is used as proxy for SMEs' performance.

The functional relationships of variables and the regression equation of the dependent and independent variables are stated below;

$$i) \text{ SMEsPerf} = f(\text{LDB}, \text{LDU}, \text{LIR}, \text{LRP}, \text{LCL})$$

$$ii) \text{ SMEsPerf} = \beta_0 + \beta_1 \text{LDR} + \beta_2 \text{LDU} + \beta_3 \text{LIR} + \beta_4 \text{LRF} + \beta_5 \text{LCR} + \varepsilon$$

Where;

SMEsPerf = SMEs Performance

LDR = Loan Disbursement Rate

LDU = Loan Duration

LIR = Loan Interest Rate

LRF = Loan Repayment frequency

LCR = Loan Collateral Requirement

$\beta_0$  = Constant

$\beta$  = Beta Coefficient of the equation

$\varepsilon$  = Error term

### **Findings and Discussion**

#### **Demographic Characteristics of Respondents**

Table 1 shows that of 160 copies of the questionnaire administered on 160 respondents, only 135 copies were retrieved and used for analysis, while 25(15.6%) were not returned. It shows that male respondents were in majority 96(71%), while female were in minority with 39(29%). Table 2 shows that 112(83%) respondents were from the non-manufacturing SMEs while 23

(17%) were from the manufacturing. This shows that SMEs in south-west Nigeria are dominated by non-manufacturing.

Table 3 shows that 28(21%) respondents were OND/NCE holders, 69(51%) were First School Leaving Certificate (FSLC) holders, 36(27%) were secondary school certificates holders, while the remaining 2(2%) were BSc and its equivalence holders. This shows that SMEs are dominated by FSLC holders.

Table 4 shows that non-manufacturing male respondents were 74(66.07%), while female were 38(33.93%). On the other hand, the manufacturing SMEs were 22(95.65%), while female was 1(4.35%). It shows that the manufacturing SMEs are dominated by the male.

Table 5 shows that the model is statistically significant at 1%. It also shows that **R**, **R<sup>2</sup>** and **adjusted R<sup>2</sup>** are respectively **0.603**, **0.364** and **0.339**. The implication of this is that a change in microfinance banks' loans to SMEs will account for **36.4%** of the change in the performance of SMEs in South-west Nigeria. This leads to the rejection of the hypothesis, and the conclusion that microfinance banks' loans to SMEs have positive significant effect on performance. This finding agrees with the findings of Duru, et al., (2013), Olowe, et al., (2013) and Owusu-Dankwa et al., (2014).

To support the above finding, the **R= 0.603** in Table 5 is an indication of a positive relationship between MFBs loans and SMEs performance. Also, a further test in Table 8 shows that increase in loan disbursement, duration, and reduction in loan interest rate, repayment and collateral have positive effect on SMEs performance in south-west Nigeria. Though all the loan factors have positive effect on the performance of SMEs, reduction in collateral has the highest ( $R = 0.505$ ); followed by reduction in loan repayment ( $R= 0.451$ ); increase in loan disbursement rate ( $R = 0.405$ ); reduction in interest rate ( $R = 0.268$ ); increase in loan duration with weak contribution ( $R = 0.152$ ). This finding agrees with the findings of (Ayuuum et al., (2013 and Duru et al., (2013).

### **Conclusion and Recommendations**

The study concludes that microfinance banks' loans have positive effect on SMEs performance in south-west Nigeria. The study recommends that the Nigerian government should engage in effective monitoring and control of microfinance banks to ensure that loans appropriated for the SMEs sector are not diverted to other sectors anymore. In addition, there should be effective control of interest rate; reduction in collateral requirements; adequate loans and loans' repayment period, so as to achieve the objective of employment for all in 2020.

### **Limitations of the Study**

The inability to ascertain the actual population of study makes it difficult to determine the sample size objectively. The sample size of 160 is quite small considering the number of SMEs in south-west Nigeria. This makes it important for subsequent studies in this area to increase the sample size. Subsequent researches should be done in other regions in Nigeria for comparison of results.

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## Appendix

**Table 1**

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	MALE	96	71.1	71.1	71.1
	FEMALE	39	28.9	28.9	100.0
	Total	135	100.0	100.0	

**Table 2**

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	NON-manufacturing	112	83.0	83.0	83.0
	manufacturing	23	17.0	17.0	100.0
	Total	135	100.0	100.0	

**Table 3**

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	OND/NCE	28	20.7	20.7	20.7
	FSLC	69	51.1	51.1	71.9
	SEC CERT	36	26.7	26.7	98.5
	BSC EQUIV	2	1.5	1.5	100.0
	Total	135	100.0	100.0	

**Table 4 QA \* QB Crosstabulation**

Count		QB		
		NON-manufacturing	manufacturing	Total
QA	MALE	74	22	96
	FEMALE	38	1	39
	Total	112	23	135

**Table 5 Model Summary<sup>b</sup>**

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics					
					R Square Change	F Change	df1	df2	Sig. F Change	Durbin Watson
1	.603 <sup>a</sup>	.364	.339	1.05652	.364	14.765	5	129	0.000	1.838

- a. Predictors: (Constant), LDR, LDU, LIR, LRF, LCR  
 b. Dependent Variable: SMEs PERF.

**Table 6 ANOVA<sup>b</sup>**

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	82.407	5	16.481	14.765	.000 <sup>a</sup>
	Residual	143.993	129	1.116		
	Total	226.400	134			

- a. Predictors: (Constant), LDR, LDU, LIR, LRF, LCR  
 b. Dependent Variable: SMEs PERF.

**Table 7 Coefficients<sup>a</sup>**

Model	Unstandardized Coefficients		Sig.
	B	Std. Error	
1 (Constant)	.611	.561	.279
LDR	.215	.072	.003
LDU	.012	.062	.845
LIR	.141	.067	.037
LRF	.225	.110	.042
LCR	.303	.092	.001

**Table 8 Correlations**

VARIABLES	SMEs PERF	LDR	LDU	LIR	LRF	LCR
SMEs PERF	1.000					
LDR	.405**	1.000				
LDU	.152	.240**	1.000			
LIR	.268**	.061	.175	1.000		
LRF	.451**	.359**	.143	.156	1.000	
LCR	.505**	.332**	.102	.238**	.564**	1.000

\*\* . Correlation is significant at the 0.01 level (2-tailed).

\* . Correlation is significant at the 0.05 level (2-tailed).