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Effect of Microfinance Banks Loans on Performance of Small and Medium Scale Enterprises in Nigeria

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ABSTRACT: This study examined the effect of microfinance bank loans on the performance of small and medium scale enterprises in Nigeria. These businesses are essential to the country's economic growth, job creation, and poverty alleviation, but many of them struggle to obtain financing from traditional banks because of barriers like a lack of collateral. Microfinance banks are meant to bridge this gap by offering financial services tailored to these businesses' needs. The main goal of this study is to evaluate the effect of microfinance bank loans on the performance of small and medium scale enterprises controlled by lending rate. The study used a quantitative research design and secondary data from the Central Bank of Nigeria (CBN), National Bureau of Statistics (NBS), and Small and Medium Enterprises Development Agency of Nigeria (SMEDAN) to gather information. The information spans ten years, from 2013 to 2023. The effect of microfinance bank loans on the performance of small and medium-sized businesses was investigated using multiple regression analysis. The outcome demonstrated that loans from larger microfinance banks considerably improve the performance of small and medium scale enterprises. According to the study, small businesses should receive better financial support and favourable lending terms. To sum up, this study emphasizes how crucial microfinance is to helping small and medium-sized businesses close the financial gap so they can prosper and support the national economy.

Keywords: Microfinance banks loans; small and medium scale enterprises, Nigeria.

1. INTRODUCTION

Small and medium scale enterprises are crucial to any country's economic growth. They are essential in predicting a country's future economic expansion. In the sense that they are essential to the creation of new jobs, innovative ideas, or improved renovations of existing ones. They also aid in reducing poverty. Small and medium-sized businesses, or SMEs, are widely acknowledged as important forces behind innovation, economic expansion, and job creation. About 84% of Nigeria's workforce is employed by small and medium-sized businesses, which account for a significant portion of the country's economy and contribute roughly 48% of its GDP (SMEDAN, 2021). Compared to larger businesses that have established stability over time, Small and medium scale enterprises are more flexible and can respond swiftly to changes in the market. They are therefore extremely important for stability and economic growth. Social development also depends on them. For a portion of the population, including low-income and marginalized groups, they generate income and offer employment opportunities (Ekwunife, Nduka, & Ogini, 2022). Although they play a crucial role in society, they frequently struggle to develop in certain nations, such as Nigeria, because of financial constraints and other issues that prevent them from thriving (Nduka, Atueyi, Osakwe, & Mbanefo, 2021). Limited financial access, poor infrastructure, poor business support services, trade restrictions, weak supply chains, unstable economies, security issues, etc. are a few of these challenges (Obidike, Onyeka, & Nduka, 2022).

One of their main problems, which led to the establishment of microfinance banks in Nigeria, is their restricted access to financing. However, by offering financial services to people and businesses that traditional banks underserve, microfinance banks (MFBs) were created to close this financing gap (Logan, Okanya, Nduka, Manasseh, Ede, Onoh, Omeje, Ozioko, & Agu, 2021). Since the Central Bank of Nigeria (CBN) introduced the Microfinance Policy, Regulatory and Supervisory Framework in 2005, the country's microfinance industry has experienced significant growth. With an emphasis on SMEs, this framework was created to address the need for the economically engaged poor to have greater access to financial services (Central Bank of Nigeria, 2019). MFBs' primary responsibility is to support these businesses with small, low-interest loans, savings accounts, and financial advising

services. These services are anticipated to promote economic stability, drive growth, and lessen poverty (Nwankwo, Ewuim, & Asoya, 2019).

Giving small loans (microcredit), savings accounts, insurance, money transfers, and other financial services to people, small businesses, or entrepreneurs who do not have access to traditional banking services because of their low income or financial situation is known as microfinance (Karlan & Valdivia, 2018). Bangladeshi economist Muhammad Yunus invented the idea of microcredit in the 1970s, which is when microfinance first emerged (Duflo, Banerjee, Glennerster, & Kinnan, 2018). The Central Bank of Nigeria (CBN) introduced the Microfinance Policy framework in 2005, marking the beginning of microfinance in Nigeria in the 1990s (Central Bank of Nigeria, 2022). The rise of unofficial microfinance organisations in the 1990s supports the claim that microfinance in Nigeria began in that decade. People who were mostly shut out of the conventional banking system started receiving small loans and savings services from a number of community-based organisations, cooperatives, and non-governmental organisations (NGOs) in the 1990s (Monogbe, Akinpelumi, Achugbu, & Nduka, 2016). The foundation for a microfinance movement that supports low-income households and small business owners was created by these grassroots initiatives. The Microfinance Policy framework was introduced by the Central Bank of Nigeria (CBN) in 2005. Using the framework set up in the 1990s, this policy was implemented to formalise, regulate, and grow the microfinance industry.

According to Nduka, Ananwude, and Osakwe (2019), the 2005 framework gave microfinance an organised approach that improved its capacity to reach a larger population and support national economic development. With its origins in the microfinance activities that began in the 1990s, the CBN's effort was a direct response to the growing demand for an inclusive financial system. Nonetheless, the Community Bank Program (CBP), Nigeria's first microfinance bank, was founded in 1991 (Ihugba & Njoku, 2017). With the founding of the first MFB, the Fortis Microfinance Bank, in 2005, the CBP was eventually superseded by Microfinance Banks (MFBs) (Ihugba & Njoku, 2017). To sum up, microfinance banks were created to close the gap between small and medium-sized businesses, whose main growth obstacle has been their restricted access to financing.

Therefore, the purpose of this study is to determine how microfinance banks affect the growth and viability of small and medium-sized businesses.

Small and medium scale enterprises have been acknowledged for playing a critical role in the nation's economic development, job creation, and poverty alleviation. According to Beck, Demirguc-Kunt, and Soledad (2018), they are therefore continuously confronted with major constraints that hinder their growth and sustainability, with limited access to financing being one of the most important ones. However, because they lack collateral, have a short credit history, and are seen as unstable, traditional banks frequently view small and medium scale enterprises as high-risk borrowers. As a result, they have strict lending requirements that many SMEs are unable to achieve (Beck, Demirguc-Kunt, & Soledad, 2018). The purpose of this study is to assess how microfinance banks affect small and medium scale enterprises and to describe how these banks have been able to handle the difficulties these companies have experienced. There is still a substantial gap in the literature about the true impact of microfinance banks on the expansion and sustainability of SMEs, despite the fact that numerous writers have studied relevant subjects. Duflo, Banerjee, Glennerster, and Kinnan (2018) and Karlan and Valdivia (2018) were among the authors who concentrated on the theoretical accessibility of microfinance services to SMEs. They talked about how far microfinance institutions could reach. Factual information regarding the accessibility and use of microfinance banks' services by small and medium-sized enterprises is, nevertheless, lacking. According to research by Beck, Demirguc-Kunt, and Soledad (2018), SMEs still encounter significant obstacles when trying to enter microfinance institutions; this is why this study was conducted.

2. LITERATURE REVIEW

Microfinance is the provision of financial services to low-income individuals, small enterprises, and entrepreneurs, including savings, insurance, loans, and money transfers (Karlan & Valdivia, 2018). However, microfinance banks are specialized financial organization that operate as licensed businesses under the supervision of national banking authorities and offer these services in accordance with conventional banking rules (Cull, Demirgüç-Kunt, & Morduch, 2021). This sets microfinance banks apart from other kinds of microfinance organisations, which might not necessarily have bank licenses and

might provide a smaller selection of services. According to Cull, Demirgüç-Kunt, and Morduch (2021), microfinance banks generally have a larger branch network and a broader geographic reach than non-bank microfinance organizations. Their ability to serve the poorest clients may be limited, though, as this wider reach frequently entails greater operational costs and more stringent regulatory restrictions. Although all microfinance banks offer microfinance services, Helms and Reille (2017) contend that the size and scope of their operations differ greatly from those of other MFIs, underscoring the particular opportunities and difficulties that these organisations face. Businesses classified as small and medium-sized are those whose workforces or revenue turnover are below specific thresholds established by local or federal laws. The European Commission defines small and medium-sized businesses as those that employ less than 250 people and generate less than 50 million Euros in revenue annually. The Small and Medium firms Development Agency of Nigeria (SMEDAN) defines small and medium-sized firms in Nigeria as companies with fewer than 200 workers and assets under 500 million naira (excluding land and buildings) (SMEDAN, 2021). Due to their contributions to innovation, job creation, and economic diversification, small and medium-sized businesses are essential to economic growth (Beck, Dermirguc-Kunt & Levine, 2005). Their expansion and sustainability are hampered by issues like poor managerial abilities, insufficient infrastructure, and restricted access to financing (Etim, 2020).

The Financial Intermediation Theory, which was applied in this study, is extremely pertinent since it offers a framework for comprehending how financial institutions, like microfinance banks, help close the gap between savers and borrowers, especially in the context of small and medium-sized businesses. According to financial intermediation theory, banks and other financial institutions play a crucial role in enabling the transfer of cash from savers to borrowers (Ogunewe, Ananwude, & Nduka, 2020). This theory states that financial intermediaries are necessary to mitigate knowledge asymmetries and transaction costs between lenders and borrowers. As financial intermediaries, microfinance institutions are essential in helping SMEs who are frequently neglected by traditional banks raise savings and obtain credit. According to the theory of financial intermediation, financial intermediaries are there because they carry out important tasks that improve economic

efficiency. These include lowering transaction costs, supplying liquidity, and lowering lending and borrowing-related risks. Financial intermediaries lower the expenses involved in connecting borrowers and savers. Banks can provide cheaper transaction costs than direct financial markets by combining resources and taking use of economies of scale. But in order to offer liquidity, banks convert illiquid assets like loans into liquid liabilities like deposits. This procedure allows borrowers to secure long-term loans while guaranteeing savers have access to their money when needed. Financial intermediaries use their knowledge of credit evaluation and diversification to reduce risk. By combining the money of many savers and lending to a range of borrowers, they spread risk and lessen the impact of any one borrower's default.

The function of microfinance banks (MFBs) in assisting small and medium-sized businesses (SMEs) and their influence on economic growth, particularly in developing nations like Nigeria, have been extensively studied throughout the years (Aniefor, Nduka, Ananwude, & Ezeaku, 2021). However, there are conflicting results from the empirical research on the connection between microfinance, SME performance, and economic development (Anusi & Nduka, 2022; Nduka, Achugbu, & Ucheahara, 2016). Numerous studies have examined how microloan amounts affect the performance of SMEs, highlighting how crucial easily accessible funding is for company expansion. For example, Afolabi (2017) looked at how microloans affected the profitability of SMEs and discovered that having access to greater loan amounts greatly improved SMEs' capacity to expand, boost income, and boost profitability. Similar findings were made by Ayadi and Adegbite (2019), who found that SMEs who had access to larger microloans had better business outcomes, such as improved cash flow, product diversity, and market share. These studies did point out, though, that many SMEs are still limited by tiny loan amounts, which prevents them from growing and expanding significantly. On the other hand, some studies, including Adelakun and Alabi (2021), contended that although MFB loan amounts are advantageous, other elements, like efficient money management, entrepreneurial abilities, and market circumstances, are also very important in predicting SME performance. They noted that insufficient business models or market strategies could cause problems for SMEs even with loans that are comparatively greater. This point of view emphasizes the significance of a wider range of conditions for

guaranteeing business growth and implies that loan size alone may not be the most important factor determining SME success.

The literature generally agrees that interest rates have a major impact on the performance of SMEs when it comes to the impact of microfinance bank lending rates. One of the main obstacles to SME growth is frequently mentioned as high financing rates. High interest rates frequently result in loan defaults, decreased profitability, and, in certain situations, firm closure, according to Olalekan and Clement's (2021) analysis of the impact of microfinance interest rates on the sustainability of SMEs. Their research found that although MFBs give SMEs the necessary funding, borrowing costs are still too high, offsetting some of the benefits of having access to capital. Additionally, SMEs that operate in more unpredictable markets are especially susceptible to high interest rates, which reduce profit margins and deter investing in the company, according to Nwankwo, Ewuim, and Asoya (2019). High lending rates provide difficulties, but SMEs can still prosper in these environments if they have good financial planning and run their businesses effectively, according to studies like that of Ihugba and Njoku (2017). They underlined that microfinance assistance combined with good financial management techniques might lessen the adverse effects of high interest rates, and they proposed that enhancing business capabilities could help to some extent to lessen the burden of high rates.

Attention has also been paid to the role that SMEs play in the expansion of the national economy, specifically the connection between GDP and SME performance. Financial institutions and the Nigerian government have repeatedly underlined the importance of SME development as a catalyst for economic expansion. Empirical research, like that of Etim (2020), showed that SMEs boost exports, foster innovation, and create jobs, all of which have a major impact on Nigeria's GDP. According to their research, which demonstrated a positive relationship between GDP growth and SME expansion, SMEs are the foundation of the Nigerian economy because they provide a vibrant entrepreneurial ecosystem. Nevertheless, despite the recognised significance of SMEs, some research suggests that systemic issues have prevented the sector from reaching its full potential. Oladejo and Yusuf (2020) said that poor infrastructure, a lack of funding, and a lacklustre application of policies have all contributed to Nigeria's SMEs' slow growth. They maintained that while SMEs do

contribute to GDP, their influence could be much greater if these issues were properly resolved, for example, by providing more helpful microfinance services. Regarding the direct causal relationship between MFB lending conditions and SME contributions to national economic performance, there are still gaps in the literature. Although research like that of Ayadi and Adegbite (2019) has emphasised the significance of microfinance in supporting the growth of SMEs and entrepreneurship, it frequently ignores the precise processes by which microfinance interventions result in more general economic outcomes like GDP growth. Furthermore, there is a dearth of empirical research on the long-term viability of SMEs supported by MFB, with the majority of studies focussing on immediate financial results.

The calibre of microfinance services offered to SMEs is the subject of another noteworthy discovery. The effectiveness of microfinance interventions is hampered by inefficient loan processing, poor customer service, and a lack of technology infrastructure, according to Afolabi (2017) analysis of the administrative capabilities of MFBs in Nigeria. According to the report, SMEs' ability to effectively employ loans for risk management or business expansion depends in large part on the calibre of financial intermediation services, even though access to financing is crucial. In order to enhance service delivery to SMEs, the report suggested that MFBs increase their investments in capacity-building and digital platform use. Another crucial area of attention is loan repayment performance. Many SMEs have trouble repaying their loans, especially when interest rates are high or repayment terms are too short to fit the business cycle, according to research by Cull, Demirgüç-Kunt, and Morduch (2018). According to the survey, loan defaults account for a sizable amount of SME failures in Nigeria. In order to improve loan payback performance and, in turn, SME sustainability, the study recommended that MFBs implement more flexible loan options, such as longer repayment periods and reduced interest rates. Additionally, some empirical research have emphasised the role of non-financial services offered by MFBs. Ogundele, Adewumi, and Balogun (2019) discovered that MFBs that provide training, capacity-building initiatives, and business advising services in addition to credit provision typically have a more favourable effect on SME performance. According to their findings, SMEs who had business development assistance and financial literacy training from MFBs outperformed those that solely obtained loans in terms of growth and

profitability. This research highlights how crucial it is to provide SMEs with comprehensive support that goes beyond financial products in order to secure their long-term survival and growth.

Additionally, some research has looked at how microfinance affects SMEs in different regions of Nigeria. According to research by Duflo, Banerjee, Glennerster, and Kinnan (2018), SMEs in urban areas gain more from microfinance services than those in rural areas, indicating that the efficacy of MFBs differs by region. The predominance of MFBs in cities, where infrastructure is more advanced and economic activity is more thriving, is mostly to blame for this urban-rural divide. Additional obstacles that SMEs in rural locations must overcome include limited access to MFBs, smaller loan amounts, and higher borrowing costs, all of which hinder the expansion of their businesses in these areas. The paper suggested that in order to guarantee more inclusive SME growth across the country, authorities should concentrate on extending MFB services to rural areas. Eze and Ibe (2018) investigated the connection between economic instability and MFB performance. They discovered that MFBs experienced liquidity issues during times of economic volatility, such the COVID-19 pandemic and the 2016 recession, which therefore decreased their ability to lend to SMEs. According to their research, SMEs were especially susceptible to financial difficulties throughout these periods, and many of them had to rely on micro lending to get by. Building resilience in SMEs and MFBs is crucial, as the researchers also found that MFBs with robust capitalization and varied portfolios were better equipped to continue lending to SMEs during economic shocks.

3. METHODOLOGY

Through the use of secondary data collected over a ten-year period (2013–2023) from the Central Bank of Nigeria (CBN), National Bureau of Statistics (NBS), and Small and Medium Enterprises Development Agency of Nigeria (SMEDAN), this study employed a quantitative research design. Small and Medium Scale Enterprises (SMEs) in Nigeria is the dependent variable, whilst microfinance bank loans (MFBL) and lending rates (LR) are the independent variables. The Ordinary Least Square (OLS) technique was the main instrument used to analyze the data. Loan amounts from microfinance banks are anticipated to improve the performance of

small and medium-sized businesses. The study's model is expressed as follows:

$$SMEP = f(MFBL + LR) \quad 3.1$$

In Econometric form, equation 3.1 becomes:

$$LogSMEP_t = a_0 + a_1 LogMFBL_t + a_2 LogLR_t + e_t \quad 3.2$$

Where:

$SMEP$ = Small and medium scale enterprises performance

$MFBL$ = Microfinance banks loans

LR = Lending rate

4. RESULTS AND FINDINGS

The Jarque-Bera normality test, which is displayed in Table 4.1 descriptive statistics, requires that a series' histogram be bell-shaped in order for the Jarque-Bera statistics to be considered significant. All of the variables have Jarque-Bera probabilities that are significant at a 5% significance level, indicating that they are regularly distributed.However, the kurtosis values, which indicate how close the data is to a normal distribution, can also support this. All variables have values that are close to three and not greater than three, according to the kurtosis values. The series' level of asymmetry is gauged by its skewness. It demonstrates that every variable is positively skewed to the right. Stated otherwise, the distribution is symmetric around each individual mean.

Table 4.1: Descriptive Statistics

	SMEP	MFBL	LR
Mean	20511.55	47.43186	15.55432
Median	21340.05	30.44605	16.63561
Maximum	26607.54	123.9321	19.32667
Minimum	13702.84	10.74789	11.48313
Std. Dev.	3771.013	41.38603	2.610621
Skewness	-0.397351	0.649035	-0.432704
Kurtosis	2.553639	2.00248	1.907547
Jarque-Bera	6.346162	7.11668	9.809327
Probability	0.000069	0.002158	0.007201
Sum	205115.5	474.3186	155.5432
Sum Sq. Dev.	1.28E+08	15415.23	61.33806
Observations	10	10	10

Source: E-views 12.0 Output Data

The findings of a regression analysis are shown in Table 4.2, where the independent variables are microfinance bank loans and lending rates, while the dependent variable is

the performance of small and medium scale enterprises. With a strong p-value of 0.117 and a coefficient of 56.87 for the amount of loans and advances given by microfinance banks, it appears that the performance of small and medium scale enterprises is not statistically impacted by the size of loans and advances given by microfinance banks. The loan rate's coefficient is 122.9, but its high p-value of 0.8146 indicates that it has no statistically significant effect on the performance of small and medium scale enterprises. With an R-squared value of 0.46, the model explains 46% of the variation in the performance of small and medium-sized businesses. This suggests that the model and the data fit each other well. Despite being somewhat lower at 0.31, the corrected R-squared still demonstrates how well the model explains the relationship between the variables. With a p-value of 0.115 and an F-statistic of 2.997, the model is not statistically significant overall. The residuals appear to be free of significant autocorrelation, as indicated by the Durbin Watson statistic of 0.75. According to the data, the performance of SMEs was positively and marginally impacted by the size of the loans and advances made by microfinance banks. The findings that microfinance bank loans can improve the performance of small and medium scale enterprises are supported by Eze and Ibe (2018) and Ayadi and Adegbite (2019). The performance of small and medium-sized businesses was negatively and negligibly impacted by lending rates. The findings of Ogundele, Adewumi, and Balogun (2019) and Olalekan and Clement (2021) supports the assertion that small and medium scale enterprises with access to larger microfinance bank loans experienced better business outcomes, including increased market share, product diversification, and improved cash flow. However, these studies also noted that many small and medium scale enterprises are still constrained by small loan amounts, which limit their capacity for substantial growth and expansion.

Table 4.2: OLS Regression

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	19725.30	8903.172	2.215536	0.0623
MFBL	56.86780	31.83366	1.786405	0.1172
LR	-122.9159	504.7747	-0.243507	0.8146
R-squared	0.461302	Mean dependent var		20511.55
Adjusted R-squared	0.307389	S.D. dependent var		3771.013
S.E. of regression	3138.360	Akaike info criterion		19.18411
Sum squared resid	68945139	Schwarz criterion		19.27489
Log likelihood	-92.92057	Hannan-Quinn criter.		19.08453

F-statistic	2.997152	Durbin-Watson stat	0.751157
Prob (F-statistic)	0.114738		

Source: E-views 12.0 Output Data

5. CONCLUSION AND RECOMMENDATIONS

Through the provision of banking services and the satisfaction of beneficiaries' financial requirements in rural areas, microfinance banks favourably impact the expansion of small businesses. This study examined the impact of microfinance bank loans on small and medium scale enterprises in Nigeria between 2013 and 2023 and came to the conclusion that lending rate-controlled microfinance bank loans had no bearing on the output level of small and medium scale enterprises. It is advised that microfinance institutions provide adaptable loan products to meet the various demands of small and medium-sized businesses. These products should allow for adjustable payback terms and interest rate adjustments based on loan sizes and risk profiles. Small and medium-sized businesses should prioritize effective cash-flow management, create realistic business plans that match loan amounts to growth stages, and make sure they have enough collateral to obtain loans. Therefore, it is recommended that small and medium scale enterprises implement strategies to effectively and methodically utilize microfinance banking chances to enhance aspects such as employee motivation, work rate, advertising, and others in order to help raise their level of performance in their businesses. In order to lessen their reliance on microfinance banks for basic financial needs, they should also try to attract investors to invest in their companies

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