MICROFINANCE AND ENTREPRENEURIAL DEVELOPMENT IN NIGERIA

Carl Osunde

Department of Business Administration, Novena University, Ogume, Nigeria

and

Agboola G. Mayowa

Covenant University, Ota

Abstract

This research study investigates the impact of microfinance on entrepreneurial development of small scale enterprises in Nigeria and its global significance. Microfinance institutions world over and especially in Nigeria are identified to be one of the key players in the financial industry that have positively affected individuals, business organizations, other financial institutions, the government and the economy at large through the services they offer and the functions they perform in the economy.

Keywords: Microfinance, entrepreneurial development, entrepreneurship, small and medium-scale enterprises

Introduction

Small scale enterprise is very crucial to the development of a country's economy, especially countries like Nigeria. Entrepreneurship is sine qua non to national development, poverty eradication and employment generation. It is the bedrock of any nation's industrialization. A number of studies have been carried out on the impact of microfinance on entrepreneurial development. In fact, academic interest that shows the impact of microfinance on entrepreneurial development is evidenced by the fact that some academic journals have devoted special issues to research establishing this linkage.

Some scholars focused on the mechanism by which poverty is reduced. Amin, Rai, and Topa (2003) focus their article on the ability of microfinance to reach the poor and vulnerable. They focus their article in such a manner because of concerns that microfinance is only serving people slightly below or above the line of poverty, however the really poor and destitute are being systematically excluded. By contrast, Copestake, Halotra and Johnson (2001) analyze the impact of microfinance on firms and individual well being. Copestake et all focus on business performance and household income to establish a link between the availability of microfinance and overall wellbeing of the poor. Evans and Adams (1999) approach the microfinance question at a slightly different angle.

Research shows most of the studies on impact of microfinance on entrepreneurial development that have been reported were carried out on industrialized countries. This means that there is a major gap in the relevant literature on developing countries including Nigeria, which has to be covered by research. This research attempts to fill this gap by studying the situation in Nigerian and providing more empirical evidence on the effects of microfinance on global entrepreneurial development.

The importance of microfinance to entrepreneurial development made the Central Bank of Nigeria adopt it as the main source of financing entrepreneurship in Nigeria. Despite this, however, finance is still considered as one of the major hindrances to entrepreneurial development in Nigeria (Ubom, 2003). While government and Non Government Organisations (NGOs) have been engaging a number of programmes and policies to encourage entrepreneurship in the country, Nigeria is still on the list of the poorest countries in the world with unemployment level rising alarmingly. It is therefore necessary to undertake an assessment of the extent to which microfinance can impact entrepreneurial development in Nigeria.

Microfinance history in Nigeria

The Nigerian business environment offers many entrepreneurial opportunities. Various programs and policies were being put in place by both the Federal and State governments to encourage entrepreneurial activities. The Nigerian Enterprises Promotion Decree (NEPD) of 1972 which was revised in 1977, the Small and Medium Enterprises Development Agency of Nigeria (SMEDAN), and National Directorate for Employment (NDE) are some of the means through which Nigerian government aims at encouraging entrepreneurial spirits in the country (Ubom, 2003). The extent to which the Nigerian populace has taken advantage of the numerous business opportunities in the country however remains a perturbed issue. This is especially so if one considers the rate of unemployment that keeps increasing over the years in the country. Despite the numerous advantages of being an entrepreneur, an average Nigerian citizen seems to prefer salaried job which has led to high unemployment rate in the country. The bedrock of any nation's industrial development is entrepreneurial activities. Unfortunately, there is uneasy access to the conventional loan from the commercial banks to start up a small or medium scale enterprise. The resultant effect is that the underdevelopment situation of the country is getting worse while government seems incapable of taming the ugly incidence. The symptom of this situation is high poverty rate, high unemployment rate, and economic dependence on foreign countries.

Commercial banks usually demand for collateral security before giving out loans for business purposes. This is a necessary factor in obtaining loan as collateral security serves as guarantee for recovering of loans given out by commercial banks in case of repayment default. An average citizen in Nigeria cannot provide such collateral security. This results to inability of an average Nigerian to access loans from commercial banks. Thus the difficulty of access to loan from financial institutions such as commercial banks constitutes a great setback to entrepreneurial development in Nigeria (Parker, 2006). The evolution of microfinance in the 1970s is to break the barricade to access capitals by low income individuals for developmental purposes. Microfinance is the provision of financial services to low-income, poor and very poor self-employed people (Otero, 2000). To say that microfinance empowers the entrepreneurial spirits that exist among small-scale entrepreneurs worldwide is not an exaggeration. Microfinance has the ability to strengthen micro enterprises and encourage best practices among operators of small and medium scale enterprise. Over two and half decades, governments of developing countries have formulated great programs for economic development. One possible explanation for the relative absence of SMEs in the poor economies is the difficulty of obtaining access to finance. Large firms in these countries can secure financial assistance because they have assets that can serve as collaterals for loans. It could be recalled that the Central Bank of Nigeria (CBN) in its monetary policy circular No. 35 for the year 2001, stated the new initiative that evolve under the aegis of the bankers committee to give impetus to current efforts aimed at ensuring adequate resource allocation to SMEs. This initiative requires banks to set aside 10% of their profit before tax for the financing and promotion of SMEs in Nigeria. A recent survey of funding sources for businesses in 40 developing nations conducted by the World Bank (USAID, 1995) confirms this general picture very well. Large firms generally have more access to bank credit both local and foreign than small firms, whereas the latter rely heavily on internal funds and retained earnings. Nonetheless, the survey suggested that there is considerable heterogeneity across countries in sources of finance for SMEs. Microfinance has evolved as an economic development approach intended to benefit low income men and women. The term refers to the provision of financial services to low income clients, including the self employed. Financial services generally include savings and credit; however, some microfinance institutions also provide insurance and payment services. In addition to financial intermediation, many microfinance institutions provide social intermediation services such as group formation, development of self confidence, and training in financial literacy and management capabilities among members of a group. Thus, the definition of microfinance also includes both financial intermediations and social intermediations. Microfinance clients are typically self-employed, low income entrepreneurs in both urban and rural areas. Clients are often traders, street vendors, small farmers, service providers and artisans and small producers such as blacksmiths and seamstresses. Usually, their activities provide a stable source of income (often from more than one activity). Although they are poor, they are generally not considered to be the poorest of the poor (Ledgerwood, 1997).

The practice of microfinance in Nigeria is rooted in its culture and dates back several centuries. While the microfinance institution has not been structured in the past, the *informal* sector of the microfinance institution was always present. The family unit, a component of the informal sector in Nigeria, is strong and people frequently rely on their family's support when other avenues fail. Other informal microfinance institutions provide savings and credit loans to its members; structured like solidarity loans. In recent years, the microfinance institution has developed to more than just the informal sector. The *formal* microfinance institutions provide savings, credit and insurance facilities to the public. Similar to other countries, the goal of the microfinance institutions is to provide access to credit for the rural and urban, low-income earners, however its impact has been limited due primarily to inadequate funds. In order to enhance the flow of financial services to Nigerian rural areas, the Nigerian government initiated a series of publicly-financed micro credit programs and policies targeted at the poor, for example, the Agricultural Credit Guarantee Scheme. This credit encouraged lending institutions to lend to the poor because the Nigerian government bore the risk of loan default. Microfinance services in Nigeria have adopted both the supply led and demand driven strategy of microfinance, as a result, the number of NGOs involved in microfinance activities has increased dramatically to 900. The inefficiencies of the formal sector in providing funds for the poor have also led to this increase in microfinance institutions.

As the microfinance institutions in Nigeria continued to grow, there were no established governmental policies for regulating and supervising activities in the industry. In 2000, the World Bank, in a meeting with the Nigeria government regarding microfinance, recommended the Central Bank of Nigeria take up the responsibility of developing an appropriate policy, as well as regulatory and supervisory framework for the operation of MFIs. In responding to this recommendation, the Central Bank of Nigeria conducted a baseline study of MFIs in 2001. The survey identified constraints on the operations of MFIs, specifically the lack of performance standards and the absence of a regulatory framework.

Why then is there a need to study microfinance in Nigeria, one might ask? There remain inefficiencies in the current state of microfinance in Nigeria and future roadblocks can be avoided by studying what others have done. Furthermore, there is a need for more capital in the microfinance sector of the economy to increase its impact in the lives of people. There is also a need for the government to review its policies and renew its resolve on its proposed legislation.

The Nigerian experience of micro finance institutions can be a valuable road map to enable policy makers in other countries develop vibrant MFIs that will impact positively on the development of small businesses in their respective countries.

Objectives of micro finance institutions

Selecting a target market depend on the micro service provider and the perceived demand for financial services. In any country, there are underserved enterprises and households, ranging from the ultra poor who may not be economically active, to small growing enterprises that provide employment in their communities. This range or continuum constitutes the demand size for micro finance services. Often, the supply side does not offer a corresponding continuum services. Microfinance institutions need to supply services that fill the gaps and integrate the underserved group into the market. The goal of microfinance institutions as development organization is to service the financial needs have served and underserved market as a means of meeting development objectives. These development objectives generally include one or more of the following; to reduce poverty, to empower women or other disadvantaged population groups, to create employment, to help existing business grow or diversify their activities and to encourage the development of a new business. In World Bank study of lending for SMEs projects, three objectives were most frequently cited, these include; to create employment and income opportunities through the creation and expansion of micro enterprises, to increase the productivity and income of vulnerable groups, especially women and the poor, to reduce rural families dependence on drought prone crops through diversification of their income generating active ((Yaron, Benjamin and Piperk, 1997).

Impact of microfinance on entrepreneurial development

Microfinance is vital to the development of entrepreneurship activities in Nigeria. People have access to capital for entrepreneurship development in Nigeria through microfinance. Microfinance has affected entrepreneurship in the country positively.

The major contribution of microfinance institutions to the developing economy like that of Nigeria is its role in promoting entrepreneurship development in the nation. One of the goals of entrepreneurship routed by successful Nigerian government has been the reduction of unemployment and poverty alleviation. A cordial thrust in public policy for the achievement of indigenous entrepreneurship through the provision of long term loans and equity capital by banks for enterprise. Given the gap between savings and invertible funds, the short fall is provided by credit delivery. Many newly developed and developing countries have therefore made credit delivery an endurable strategy in the development of entrepreneurship in both industry and agriculture.

Impact evaluation of microfinance and its global significance

1 *Small Loans:* Certainly microfinance is not microfinance unless loans remain under a certain manageable size, but how small is best for serving the dual needs of the client and the institution? What number of different loan products maximizes impact before becoming unmanageable for the institution and confusing for the client? What other products, such as savings and insurance can be effective complements or substitutes for loans?

2. *Collateral-free Loans:* To what extent do collateral requirements or collateral substitutes discourage the poor from participating in MFIs, and to what extent do they raise repayment rates? How effective are collateral substitutes compared to traditional collateral?

3. *Loans for Entrepreneurial Activity:* Is this essential for maintaining repayment and ensuring impact on the household? The poor face a variety of credit needs and allowing them to use credit for any type of expenditure could serve them best. Or, loosening the requirement could encourage further indebtedness without a means of escape. To what extent do business skills training help clients manage their enterprises and bolster repayment rates? Why do so many micro-entrepreneurs seem to stagnate at a certain business size, and what can be done to help them expand, employ others, and open additional locations?

4. *Group Lending:* Recent evidence from Nigeria and other countries has raised questions about the extent to which high repayments rest on group liability. Can individual liability work as well, or nearly as well?

5. *Market-level Interest Rates:* To what extent do high interest rates drive out the poor? Do high rates attract riskier clients? Does subsidized credit "crowd out" market-priced services from competing MFIs?

6. *Focus on Poor Clients:* What is the impact of microfinance on the poor? Does microfinance work for the very poor? What specialized services, if any, serve the "poorest of the poor?" Does one need to provide financial literacy along with the loan in order to be effective?

7. *Simple Application Processes:* Most MFIs have simple applications, or else they would have few clients. A useful extension is to determine what types of marketing are most effective at increasing take-up of services among the poor.

8. *Provision of Services in Underserved Communities:* To what extent does offering credit and savings in poor communities deepen access and increase welfare? Do programs that conduct meetings in the field but require clients to make repayments at the bank branch have lower client retention? Can provision of services in remote areas be profitable?

9. *Focus on Female Clients:* Anecdotally, many studies report that women have higher repayment rates than men. Is this true, and if so, what program designs can work best to encourage men to repay their loans? What products and policies can generate

the greatest increase in empowerment of female clients?

Impact evaluation of microfinance need not be focused strictly on the impact of credit versus no credit. Instead, prospective evaluation can help MFIs, policymakers and researchers around the globe to design better institutions. Good evaluation not only can deliver to donors an assessment of the benefits that accrued from their investment but also can provide financial institutions with prescriptions for how best to run their businesses and how best to maximize their social impacts.

Conclusion

This article shows that the microfinance institutions are evident tools for entrepreneurship development due to the various services they offer and the role they performs towards the development of the economy. Microfinance institutions world over and especially in Nigeria are identified to be one of the key players in the financial industry that have positively affected individuals, business organizations, other financial institutions, the government and the economy at large through the services they offer and the functions they perform in the economy. It is expected that with the current reforms put in place by the Federal Government through its regulatory authorities, microfinance institutions in Nigeria will be able to compete favorably in the global market and gainfully increase entrepreneurship development in Nigeria. Microfinance institutions have positive relationship with the Nigerian economy represented by expanded GDP. Although, interest rate is not significantly influential, the results of findings of this study can still be summarized that the microfinance institutions and their activities go a long way in the determination of the pattern and level of economic activities and development in the Nigerian economy.

Recommendations

The financial institution need to put more effort in financing SMEs, their role need to be felt by the SMEs in terms of growth and development.

The financial institution whose role needs to be visible in promoting SMEs growth and development is microfinance. SMEs themselves should be more receptive to new ideas and prepared to make financial commitments to ensure growth.

This study recommends that guidelines by microfinance institutions to finance SMEs need to be flexible to accommodate the SMEs only when financial institutions appreciates and give technical assistant to the SME would be contributing to the SMEEIS to ensure success in the SME sector. It is the researcher hope that microfinance institutions in Nigeria will develop more interest in supporting the growth of SMEs.

References

Amin, S., Rai, A. S., Topa, G. (2003) “Does Microcredit Reach the Poor and Vulnerable? Evidence from Northern Bangladesh”, *Journal of Development Economics*, 70(1), 59-82

Copestake, J. B., Halotra, S., Johnson, S. (2001) “Assessing the Impact of Microcredit: A Zambia Case Study”, *Journal of Development Studies*, 37(4), 81-100

Evans, T. G., Adams, A. M. (1999) “Demystifying Non Participation in Microcredit: A Population-Base Analysis”, *World Development*, 27(2), 419- 430

Fasua, K. O. (2006) *Entrepreneurship Theory, Strategy and Practice*. Abuja, Bee Printing & Publishing CO.

Ledgerwood, J. (1997) *Sustainable Banking for the Poor Project*. (World Bank) South Asia,

Morduch, J. (1999) “The Microfinance Promise”, *Journal of Economic Literature*, Vol. 37, No.4, p 319

Ojo, O. (2003) *Fundamentals of Research Methods*. Ibadan, Nelson Clemmy Press

Otero, M. (2000) Bringing Development Back into Microfinance, *ACCION International*

Park, A. (2001) “Microfinance with Chinese Characteristics”, *World Development*, 29, (1), 39-62

Parker, S. C., (2006). *The Economics of Entrepreneurship*, London, Edward Edgar Publishing Ltd.

Ryne, E., Holt, S. (1994) Women in Financial and Entrepreneurial Development, Education & Social Policy. Washington, D. C., *Discussion Paper* 40, World Bank