Impact of Micro Finance Lending On Small Scale Entrepreneurial Business in Ogbomoso Area of Oyo State

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Abstract: *This work examined the impact of microfinance institutions lending on small scale enterprises performance within Ogbomoso area of Oyo State of Nigeria. A total of 360 registered small scale enterprises in the five local government area of Ogbomoso, Oyo State constituted the population. Stratified sampling technique was employed to capture the small scale enterprises into homogeneous categories as wholesalers, retailers, restaurants and service delivery. A sample of 270 Small Scale Enterprises was drawn proportionately and randomly from the strata. Questionnaire was administered on respondents and they were analyzed using descriptive statistics such as frequency tables, pie charts and figures. Inferential statistics was employed using Chi square and correlation tests at 95% significance level. The result shows that there was an association between microfinance lending and Small Scale Enterprises performance. The amount of loans is significantly and positively related with performance of Small Scale Enterprises in Ogbomoso area of Oyo State*

Keywords*: Microfinance institutions, Microfinance lending, Small Scale Enterprises.*

I. Introduction

Nations in the world has recognized their determination towards economic growth and development by employing the use of small scale enterprises as key drivers. This significant role is in no small measure recognized by financial institutions in the world such as World Bank, European Union and African Development Bank. USAID (2010) submitted that Small Scale Enterprises contribution to countries GDP was 14% with about 2 million people gainfully employed. This has no small measure combat poverty level as well as reduction on unemployment rate. The success story of Small Scale Enterprises (SSEs) was linked to Yunus in 1976 who experimented this in the rural area of Bangladesh which was operationalized by Grameen Bank. Positive outcome of the exercise metamorphosis into approved registered groups having access into the establishment of Small Scale Enterprises (SSEs) approved registered groups collectively granted access to financing of their business that individually practically becomes impossible. This practice had become a process upon which third world countries engage its developmental agenda of economic growth, development, poverty reduction and unemployment. This microfinance model eventually spread around the world, especially in third world countries (Roy, 2009). Such lending will increase the income of Small Scale Enterprises (SSEs) operators and poor people respectively. This role performed resulted in increased sales, acquisition of asset and technology. Thus increased income from firms as profit or wages and salaries establish a link between the availability of microfinance lending and overall well-being of the poor. Thus, both research and practice have seen an increasing concern about the microfinance Institutions' lending and Small Scale Enterprises (SSEs) performance. No nation in its entirety can have vibrant economic development without the provision of financial services which is germane to her growth. This is crucial at bringing her into a global view of positive economic direction among the forces to be reckoned with all over the world. Small scale enterprises (SSEs) have become center of attraction for economic development, economic growth and job creation in the world.

Poor people in developing countries usually do not qualify for any type of services from the formal and commercial banking sector. The term, "unbanked" is used to describe the world's working poor who are excluded from the formal banking sectors. Lack of credit histories and documented records on small entrepreneurs or farmers make it difficult for a commercial bank to assess the creditworthiness of the borrower. Furthermore, they are excluded from the formal banking system since they are most of the time unable to provide collateral (MIX 2011). Yet, people living in poverty, like everyone else, need access to a diverse range of financial services to help run a small business, manage risks, and plan for a more stable future. Small-scale enterprises, which employ fewer than five people, are often the first step. Small Scale Enterprises is often the sole source of family income but can also act as a supplement to other forms of income. Among such were small retail kiosks, sewing workshops, carpentry shops and market stalls. Microfinance institutions exploit new contractual structures and organizational forms that reduce the riskiness and costs of making these small and uncollateralized loans are needed for either micro entrepreneur, building a house for a family and in that way they serve the people living in poverty.

Much of the interest rests on an attractive "win-win" argument: microfinance institutions that follow the principles of good banking will also be those that alleviate the most poverty. By eventually eschewing subsidies and achieving financial sustainability, microfinance institutions will be able to grow without the constraints imposed by donor budgets. In the process, according to the argument, these institutions will be able to serve more poor people than can be served by institutions fuelled by subsidies. A key principle of this argument is that poor households demand access to credit, not "cheap" credit, meaning that institutions can charge high interest rates without compromising outreach. If the argument is right, much poverty alleviation can be achieved at no cost to governments and donors – or perhaps even at a small profit. The conflicting argument against the "win-win" argument is that the high interest rates conflict with the original social economic development goals of the Micro Finance Institutions. Another point of this conflicting argument is that there has never been evidence that the most affective poverty alleviation programs can be – or should be – self-financing through Micro Finance Institutions. There is, likewise, no evidence showing whether a customer is better off after being served by an Micro Finance Institutions than before (Morduch, Jonathan 2000). No matter what argument turns out to be right, there is a number of Micro Finance Institutions in the world reaching out to poor people, and by new methods trying to overcome the increasing risk of providing financial services to the poor. In spite of this emphasis previous studies did not provide sufficient justification for the link between microfinance institutions' lending and Small Scale Enterprises (SSEs) performance in Ogbomoso area of Oyo State. Therefore the question of whether microfinance institutions lending improves or worsens Small Scale Enterprises (SSEs) performance is stills worthy of further research such as the one being undertaken in this study. In addition, the effects of microfinance institutions lending on the Small Scale Enterprises (SSEs) have not received adequate attention in Local Government Area of Ogbomoso of Oyo State.

In many societies, small scale enterprises are the engine of growth. Specifically, in countries such as Malaysia, Thailand, China, and India, small scale enterprises have been responsible for more than 70 percent of exports and this is why these countries, according to Duro (2013) have been growing in leaps and bounds. In Nigeria, small scale enterprises are beset with a myriad of challenges which are in no small measure affecting their growth. The most pronounced, however, is access to funds and effective infrastructure to operate, especially electricity. As observed by Sacerdoti (2005), even banks with retained liquidity levels in excess of what is required by law have shown reluctance in extending loans to small scale enterprises. Despite the efforts of microfinance institutions taken the lead in meeting the need of Small Scale Enterprises by providing loans other find this situation outside the reach of poor people and small scale enterprises,that had not benefited from the conventional formal financial. It was in this context that the study investigated the effects of microfinance institutions lending in enhancing the performance of Small Scale Enterprises. The situation is even more difficult where Small Scale Enterprises were left un-attended to due to the limited finances availability.

II. REVIEW OF RELEVANT LITERATURE

Small Scale Enterprises (SSEs) were bewildered by low level of access to technology, stiff competitions from bigger firms, limited financial resources, poor planning and control of debtors and unfavorable government policies among others. According to Yaron (1997) the study found that poor access to loans and limited finance as the main causes limiting the growth of micro and small enterprises. A study by Grameen Bank (1983) found that many Small Scale Enterprises had limited capital, lacked relevant skills and a host of others that constrained their growth. However, there are a number of factors that influence the decisions of Small Scale Enterprises' operators and mangers before deciding the source and amount of finance to finance business investments to invest in business activities. Prasad, Green and Murinde (2005) found that financing policy, capital structure and firm ownership are all strongly linked. Their argument was that financing policy by firms requires managers to identify ways of funding new investment. Carpenter and Petersen (2002) expressed that firms whose financial needs exceed their internal resources may be constrained to pursue potential opportunities for growth. Internal financing had handicapped Small Scale Enterprises based on its structure driving it unto an unsuccessful outfit in developing economies. Therefore micro credits are seen as a way out of this predicament that had bedevilled it over years. Access to credit enables the Small Scale Enterprises owner to cover some or all of the cost of capital equipment, expansion, or renovation of buildings. Appropriate loan sizes for clients matching their needs, realistic interest rates, savings as a prerequisite, regular, short and immediate repayment periods and achieving scale can contribute to the sustainability of Small Scale Enterprises. The review of literature shows mixed results. Some studies argue that loan size borrowed significantly and positively do contribute to the development and growth of businesses especially Micro and small Enterprises, while other studies indicated that Microfinance institutions that accessed Microfinance finance institutions loans did not show any sign of growth. Due to mixed results it was worthy to investigate the relationship between loan sizes and performance. The need to promote the industrial sector has continued to be a major concern of most governments worldwide, especially developing countries like Nigeria. With the growth of

Small Scale Enterprises, Olorunshore (2002) and Egban (2004) believed that the Nigerian economy will have the potential of being competitive in the global market.

Theoretical Model

The theoretical model to this work centred on the joint liability model also known as group lending, economies of scale and agency costs. Conventional banks comprise of commercial banks and microfinance banks had for the most part denied the poor access to credit, because they are believed to be un-creditworthy. In the face of this predicament was Grameen Bank, as the pioneer in the industry succeeded where others have failed. The solution to this lies in its unique group lending contracts. There are many variations of the group lending contract, but the first one, was the one designed by Grameen Bank where the borrowers organize themselves into a group of five and present themselves to the bank. After agreeing to the bank rules, the first two members of the group receive a loan. If the first two successfully repay their loans, then four to six weeks later, the next two are offered loans, and after another four to six weeks, the last person is finally offered a loan. As long as all the members in the group repay their loans, the promise of future credit is extended. If a member of the group defaults on a loan, then all the members are denied access to future credit if they do not pay for the defaulting member (Sengupta, Rajdeep, Aubuchon and Craig 2008).

The Grameen model configured into a highly standardized loan product, or model, that allowed serving cost-efficient poor people with small loan needs. The customers are often entrepreneurial poor who invest ever growing loans into their small-scale businesses such as petty trade, poultry, milking cows and so on (Barman, Deepak 2009). Group lending, or the joint liability contract, is the most celebrated lending innovation in the industry. The group pools funds to use for business loans, savings, and mutual support, and members cross-guarantee individual loans. This methodology is simply an extended version of the joint liability model.

The first motivation of the different group lending contracts were economies of scale, but other benefits showed quickly: the members within the group can help mitigate the problems that an outside lender would face – agency costs. But the most difficult agency problem faced by lenders is that of adverse selection – ascertaining the possible credit risk of borrowers. Economic theory helps show how joint liability contracts mitigate adverse selection. The lender can mitigate the adverse selection problem when customers, who do not directly inform the bank of the reliability of other customers, form themselves into a group (peer selection). That is, giving a joint liability contract; safe customers will more likely group together with other safe customers, leaving the risky types to form groups by themselves. This “assorting matching” mitigates the adverse selection problem because now the risky borrowers are the ones who must bail out on other risky borrowers, while the safe borrowers form a safe group together. As a result, all borrowers can be charged a lower rate (Sengupta, Rajdeep, Aubuchon, and Craig 2008).

Joint liability contacts were seen as the breakthrough to the poor market. And since then, other innovative methods, such as dynamic and progressive loans (a type of dynamic incentive in which access to larger amount of credit becomes available after each successfully repaid loan), frequent repayment schedules, and non-traditional collateral has also been used. In many cases, they operate alongside group contracts.

Not all Microfinance institutions' apply the group lending principle; instead, some Microfinance institutions prefer to lend to individuals without any shared liability aspect. This reflects that group lending also has some shortcomings, e.g. that it only fully works in rural settings where social control is higher (Dieckmann, Raimar). The sequential loan is an innovative method used by some Microfinance institutions that offer individual lending. Small Scale Enterprises do not generally supply material guarantees or reliable financial and accounting information when they seek microcredit. Thus, discriminating between Small Scale entrepreneurs without resorting to adverse selection and group lending is a crucial problem that Microfinance institutions must face. To identify micro entrepreneurs with higher potential, Microfinance institutions can apply these sequential loans. In practice, this means that the Microfinance institutions start off by giving one loan to the borrower, and if this is repaid, they will provide another, and so on. Stepped lending is another term for the same process in which the borrowers who repay loans on time are eligible for increasingly larger loans. This innovation keeps initial risk low, allowing small scale entrepreneurs to grow their businesses and increase their incomes and improving the quality of the portfolio at risk (Ayayi, Ayi Gavriel 2010).

III. Methodology

This study employed descriptive survey research design. The population were established Small Scale Enterprises in Ogbomoso Area of Oyo State of Nigeria. The managers of Small Scale Enterprises were targeted because they were involved in decision making with regards to financing and management of the businesses. Three Hundred and Sixty (360) registered Small Scale Enterprises were considered in the study. However, Small Scale Enterprises in active operation in the last five years were considered for the study because it was assumed that this length of time will provide meaningful measures of performance. Following the data screening and evaluation, a sample of two hundred and seventy (270) Small Scale Enterprises (SSEs) were finally drawn proportionately from the strata.

S/N	Type of Business	Population	Sample	Sample %
1	Wholesalers	80	60	22.22
2	Retailers	100	75	27.78
3	Restaurants	60	45	16.67
4	Service Delivery	120	90	33.33
Total		**360**	**270**	**100**

Table 1 Population and Sample Size
Source: Field survey 2015

Questionnaires administered were analyzed using descriptive statistics and summarized in frequency tables, pie charts. Inferential statistics was employed using Chi square and correlation.

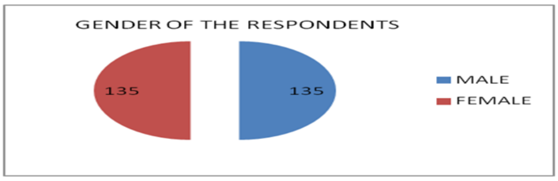
IV. RESULTS AND DISCUSSIONS

Demographics Variables

Table 2 **Gender equity observed among the SSE operators in the study area.**

Gender	Number	Perentages %
Male	**135**	**50**
Female	**135**	**50**
Total	**270**	**100**

Source: Field survey 2015



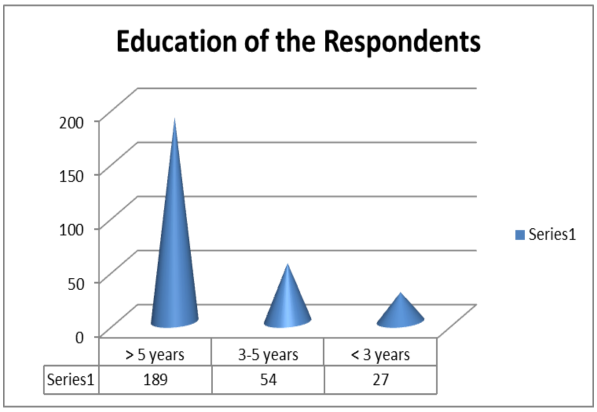
Source: Field survey 2015

Gender equity was observed among the Small Scale Enterprises operators in the study area. Fifty percent (50%) of the respondents were male while the other fifty percent (50%) were female.

Table 3: **Education attainments of the respondents**

S/N	Academic certificate	Total number	percentage
1	Primary	25	9.2
2	Secondary	110	40.74
3	Tertiary	135	50
Total		**270**	**100**

Source: Field survey 2015



Source: Field survey 2015

From the above chart it was shown that 50% (135) of the respondents attained post-secondary education certificate while 40.74% (110) of the respondents has Secondary school certificate. The remaining respondents 9.26% (25) had primary school certificate. Majority of the respondents did not acquired additional training except for the one they had before commencing the business. 87.78% (237) of the respondents admitted that they did not possess additional training after they had started the business while 12.22% (33) had additional training on the business they are doing. They admitted that in-service training/ seminars/workshops are crucial to their continuous growth. They are venerable tools to their survival and expansion.

CHARACTERISTICS OF SMALL SCALE ENTERPRISES

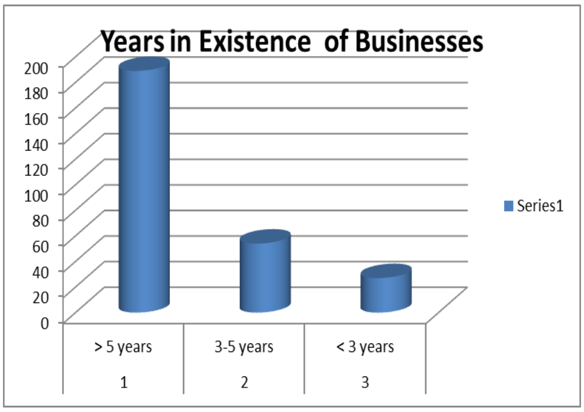
Composition

Out of 270 respondents, 90 (33.33%) were in the service delivery while 75 (27.78%) accounted for retailers businesses. Wholesale businesses accounted for 60 (22.22%) while restaurant businesses accounted for 45 (16.67%).

Table4: **Years of existence of Small Scale Enterprises**

S/N	Years of existence	Total number	percentage
1	>5years	189	70
2	3-5 years	54	20
3	<3 years	27	10
Total		**270**	**100**

Source: Field survey 2015



Source: Field survey 2015

70% (189) of the Small Scale Enterprises had been in existence for more than five years. (20 %) (54), of the Small Scale Enterprises had been in operation for a period between 3-5 years with a small proportion of 27 (10%) having operated for less than three years.

Micro Finance Institutions loan accessibility and effect on Small Scale Enterprises performance.

From the entire respondents, 94% prefer obtaining Micro Finance Institution loans because of low interest rate meaning that the financial costs associated to the loan is bearable. It also shows that no hidden cost associated with the loan obtained. The respondent frown at the hidden cost associated to conventional loans from financial institutions because it is very high and complex to understand. The preference to go for the loan is lack of collateral facilities that constraint accessibility as was the case with conventional loans.
71.4% of the respondents established that they had enjoyed taken Micro Finance Institutions loans in the past. 92% of the respondents preferred assessing Micro Finance Institutions loans. The reason attributed to this is accessibility to loans without stringent procedures. Others with different opinion noted that the amount accessible is meager so it limits access to opportunities of getting bigger and better. However 8% of respondents disagree with the process and procedure of obtaining and accessing the Micro Finance Institution loans because the structural approach is weak and the framework is rather flexible. Requirement for accessing loan is the group savings (85%) and guarantor (15%). 183 (67.78%) of the respondents established that there was an increase in income and sales volume from Micro Finance Institutions loan accessed and used for the progress and expansion of the business while 192 (71.11%) of those who accessed microfinance loans reported that they could repay loan plus interest from their business activities. This finding is consistent with that of Hussein (1995); Makokha (2006) that larger loans translates to advancement and expansion of business in term of capital, sales and profit. The study findings revealed that there was a significant positive relationship between amount of loan taken and increase in income.

Relationship between Loan and Income

Characteristics:	> N 40,000
Increase in Income:	
Agree	183 (67.78%)
Disagree	87 (32.22%)
X^2- Value	7.927
P-value	0.005

CONCLUSION

Findings of the study revealed that 71.4% of the respondents established that they had enjoyed taken Micro Finance Institutions loans in the past. 92% of the respondents preferred taken Micro Finance Institutions loans. The reason attributed to this is accessibility without stringent procedures. Greater percentage of the respondents established that there was an increase in income and sales volume from Micro Finance Institutions loan accessed and used for the progress and expansion of the business while respondents who accessed microfinance loans reported that they could repay loan plus interest from their business activities. Significant positive relationship exists between amount of loan taken and increase in income.

VI. RECOMMENDATIONS

Based on the finding and conclusion, the study recommends that the grace period for the repayment of the loans be extended to avoid default of repaying loans. The longer grace period will enable borrowers to pay interest and principal using income generated from the borrowed money.

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