

The Impact of Microfinance Banks on Economic Growth in Nigeria

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Abstract

This paper investigates the impact of microfinance banks on economic growth in Nigeria over the period of 1992-2013. This study made use of quantitative secondary data from the Central Bank of Nigeria (CBN) statistical bulletin (2013) to carry out this study. The empirical perspective of this study employed the Augmented Dickey-Fuller Unit Root Test, cointegration test, error correction model (ECM) and the parsimonious test. Empirical evidence from the study has shown that the activities of microfinance bank has the capacity to influence the entire economy if it is well coordinated. The results of the study indicate that microfinance bank loans and domestic investment significantly and positively affect the growth of Nigeria's economy based on the magnitude and the level of significance of the coefficient and p-value and, there is a long-run relationship between microfinance bank loans, investment and economic growth in Nigeria. The implication of this finding is that if loans extended by the microfinance banks to the business sector do not increase it will not generate a corresponding increase in the growth of Nigerian economy. This study therefore recommends that Microfinance banks (MFBs) should be front-liners of ethical and professional conduct by ensuring that soft loans are given to credible and promising entrepreneurs.

Keywords: Microfinance Banks, Investment, Economic Growth, Inflation

Introduction

The operation of microfinance institutions date back to the pre-independence period in Nigeria when traditional thrift saving system and activities of the traditional group networks served as proprietors of financial exchange led by traditional money lenders could not handle the growing expansion and needs of people in rural communities.

The failure of conventional banking in Nigeria to meet the socio-economic complexities (needs) of the rural communities that consequently experience rapid growth and changes as well as government desire to reach rural areas with development gave rise to the emergence of community banks (now microfinance banks) as a way of providing financial answers to the low income earners or people so as to finance and improve their income generating activities, i.e. productive activities. Microfinance banks can be seen as an economic growth method intended to advantage the low income class of a given country like Nigeria, both rural and urban poor.

Microfinance according to the Central Bank of Nigeria (2005) is about providing financial services to the poor who largely constitute the 65% excluded from access to financial services of conventional banks. More so, lack of access to credit has been identified as the reason behind the growing level of poverty in many developing countries. This further emphasizes the crucial role microfinance institutions play in economic growth especially in their service for unserved and underserved markets (economically active person in rural and urban areas) to help meet economic and development objectives which include to reduce poverty (considered as the most important). Create employment, help existing businesses to grow or diversify their activities, empower women and other disadvantaged groups and even encourage the growth of new businesses (Khander, 2003). In 2005, the Central Bank of Nigeria (CBN) formulated a new policy framework to enhance the access of financial services to micro-entrepreneurs and low income households who require such facilities (soft loans and investable funds) to expand and modernize their operations and their contribution to economic growth and development in Nigeria. The objective is in line with the institution's policy in ensuring financial inclusion for all, such that financial services reach the poor whether in rural or urban communities as this would help improve their productivity level and also help contribute to the nation's gross domestic product (GDP). In 2004, the Central Bank of Nigeria asserts that the emergence of microfinance institution has been largely due to the inability of the formal financial institutions to provide financial services to both the rural and urban poor. In view of the need for financial inclusion, both the government and non-governmental agencies have, over the years, implemented series of microfinance programmes and institutions as well as governmental agencies providing policy strategies needed to improve the productivity of micro, small and medium scale enterprises.

Community banks which have been transformed into microfinance banks were developed as self-sustaining financial institution owned and managed by local communities such as community development associations, town unions, cooperative societies, farmer's group, social club whose sole aim or objective is to promote rural development and enhance economic growth as well economic development at the grassroots level by improving the saving habits of the people. Microfinance banks serves as part of the veritable vehicles for channeling funds for rural development. The total assets of microfinance banks grew from ₦981.0 million to ₦15,463.5 million in the year 2002. The number of microfinance banks, which was 66 in 1991, peaked at 1355 in 1995 but fell drastically to 769 in the year 2002, and in 2006 it further fell to 750. The number however, increased to 801 as at the end of 2010 (CBN Statistical Bulletin 2010). Microfinance banks in promoting and enhancing economic growth in Nigeria economy is faced with stiff difficulties like repayment problems, inadequate finance (poor financing). In a bid or in an attempt to resolving the above identified problems salvaging microfinance banks in Nigeria, this research work is intended to provide answers to the following questions: how have credit institutions, especially microfinance banks, been able to impact positively on the level of economic growth in Nigeria in the midst of the aforementioned problems; do the rural and urban poor really use the loans and advances from microfinance banks for productive activities that will promote and enhance economic growth or do they use it for their personal needs i.e. getting married, build houses; how has financial inadequacy or insufficiency in microfinance banks affected or limited the availability and affordability of soft loans to aspiring entrepreneurs in Nigeria. It is therefore imperative to investigate the role of microfinance banks in promoting economic growth in Nigeria.

Literature Review

Microenterprises in Nigeria have not made the desired impact on the economy (Nwachukwu, 2012). This may not be unconnected to the numerous challenges facing the enterprises, among which is finance. Olorunshola (2001) rightly observed that the major gap in Nigeria's industrial development process is lack of long and in some cases short term finance for Microenterprises.

Microenterprises usually raise their finance through informal sources. The sources comprise owners' savings/retained earnings, contributions/borrowing from friends, relations etc (Ango, 2011). In most cases finance generated from informal sources fall short of the required capital for Microenterprises (Okungwu and Saleh, 2004). To raise the balance of the required finance, entrepreneurs look up to the formal sources, which comprise banks, other financial institutions, cooperative societies and government loans agencies (Ango, 2011). There are a lot of challenges for Microenterprises in raising finance through the formal sources, especially as it affects banks and other financial institutions (Lawal, 2010).

Dauda (2007) evaluates the performance of Nigeria's community banking scheme and observes that deposits generated significantly grew over the period of evaluation (1992 – 2004). The study attributes the deposit growth to improved grass root banking habit. Although their aggregate loan portfolio to agriculture and rural based real sector activities increased nominally over the period, the credit exposures are relatively much lower than their exposure to general commerce, (19.2% against 47.6%). The study remarks that this trend is counter-productive to policy efforts at boosting real sector growth and sustainable economic development in Nigeria.

Olujobo (2011) attempt to investigate the contributions of microfinance banks to Nigeria's economic growth and employs credits disbursed by the microfinance institutions as a proxy for their operational activities. The study employs the Ordinary Least Squares (OLS) regression technique and finds a weak, though positive relationship between Nigeria's microfinance banking operations and the nation's economic growth. Consequently, it recommends that microfinance institutions should channel very high proportion of their credits to the productive and real sectors of the economy for valuable impact of their operations on Nigeria's economic growth.

Babajide (2012) studied the effects of micro financing on micro and small enterprises (SMEs) in South West Nigeria using Diagnostic Test Kaplan-Meier Estimate, Hazard Model and Multiple Regression Analysis. The study indicates that microfinance enhances survival of small business in South West Nigeria; that microfinance does not enhance growth and expansion capacity of MSEs in Nigeria; that microfinance impacts significantly on the level of productivity of MSEs operators in South West Nigeria and that the provision of non-financial service by microfinance institutions enhances the performance of micro and small enterprises (MSEs) in South West Nigeria.

Okpara (2010) examines the critical factors that induce poverty among the enterprising poor in Nigeria and the extent to which micro credits have assisted in alleviating poverty. The study's selected causative factors for poverty include low profit, high cost of start-up or expansion funds for business and low rate of business growth. Employing two-stage regression technique within a quadratic equation framework, the study finds that in the first or take-off stage of microfinance banking, poverty was observed to have increased, though at a declining rate with increase in micro credits. In the second stage of the study which started from the year 2001, persistent increases in disbursed micro credit facilities are

observed to have significantly lowered the poverty index in Nigeria. Consequently, the study calls for policy measures to establish microfinance institutions in every community in Nigeria.

Methodology and Data

Data and Sources

This study employed time series secondary data spanning from 1992 to 2014. This period is chosen due to the availability of data and it marks the commencement of the activities of microfinance banks in Nigeria specifically in 1992. The relevant data were collected from the Central Bank of Nigeria Statistical Bulletin, 2014 edition. Data collected include gross domestic product (GDP), Microfinance Bank Loans (MFBL), Domestic Investment (INV) and Inflation (INFL).

Model Specification

This study specifically employ multiple regression analysis with OLS econometric technique for data analysis to empirically verify whether a significant positive relationship exists between the dependent variable (gross domestic product) and the independent variables (microfinance bank loans, domestic investment and inflation) in the Nigerian economy. Model which specifies that economic growth (RGDP) is significantly influenced by Microfinance banks loan, domestic investment and inflation are formulated as follows;

$$GDP = f(MFBL, INV, INFL)$$

$$RGDP = \beta_0 + \beta_1 MFBL + \beta_2 INV + \beta_3 INFL$$

RGDP = Real Gross Domestic Product

MFBL= Micro-Finance Bank Loan

INV= Investment

INFL = Inflation

β_0 = intercept

$\beta_1 - \beta_3$ = Coefficient of the independent variables.

Result and Discussion

Considering table 1 all the variable used in this analysis are stationary at first difference while table ,reveals that there is a long run relationship between dependent variable (RGDP) and the independent variables (MFBL, INV and INFL) within the period under review 1992-2013. Table 3 and 4 displays a regression result of impact of Microfinance banks on the economic growth of Nigeria. As specified above, the results were obtained using the ECM and the Ordinary Least Square (OLS) method of estimation. From the empirical evidence the error correction estimates for the short-run dynamics is rightly signed with negative coefficient value of -0.000786 and absolute 2.790210 T-statistics value coupled with 0.0131 probability values. These estimates confirmed the long-run equilibrium condition evidenced among the variables included in the model and it further suggests that 0 .78 percent of disequilibrium within a year is corrected for while the remaining 99.2 percent are corrected for in the following year.

The productive capacity of microfinance bank loans which is indicated as (MFBL) is positive and insignificant both for the short-run and long-run situations with 0.069 and 4.214 coefficients coupled with 2.973 and 6.842 absolute T-statistics value and probability values of 0.009 and 0.000. This implies that if MFBL increase by 1 unit RGDP will increase by the magnitude of the coefficient both in the short and long run. The immediate effect of domestic investment (INV) is significantly positively related to economic growth both in the short-run

and long-run situations. This implies that a unit increase in INV will cause RGDP to increase by the magnitude of the coefficient both in the short and long run

The long-run inflation (INFL) values is -0.967 coefficient, 4.337 absolute T-statistics value and 0.0004 probability value; however, in the short run INFL is positive but does not significantly impact on real gross domestic product in Nigeria with 0.0007 coefficient, 1.701 absolute T-statistics value and 0.108 probability values in the long-run and 46.675 coefficient, 4.3 T-statistics and 0.002 probability values in the short-run situation. The implication is that INFL positively and negatively affects national outcome significantly.

The long-run adjusted R² obtained is 0.965. This shows that the independent variables included in our model accounts for 96.5 percents variations in economic growth in Nigeria (proxy as RGDP) while the remaining 3.5 percent unexplained variations is due to other extraneous factors that also necessarily accounts for the movement in economic growth in Nigeria and there are captured by the error term. The implication is that the models do not suffer from any misspecification error. Complementing this is the F-ratio statistics with 165.6 with probability values of 0.000. This is highly significant at the 5 percent levels; thus, lending credence to the conclusion that the model has goodness of fit. More so, the Durbin Watson (DW) statistics of 2.22 imply that the model is free from autocorrelation or serial correlation problem.

The short-run adjusted R² obtained is 0.984. This shows that the explanatory variables included in our model accounts for 98.4 percents movement in gross domestic product in Nigeria while the remaining 1.6 percent unexplained variations is due to other extraneous factors that also necessarily accounts for the movement in economic growth in Nigeria which is explained by the stochastic term. The implication is that the models do not suffer from any misspecification error. Complementing this is the F-ratio statistics with 326.95 with probability values of 0.000. This is highly significant at the 5 percent levels; thus, lending credence to the conclusion that the entire model has goodness of fit. More so, the Durbin Watson (DW) statistics of 1.768 imply that the model is free from autocorrelation or serial correlation problem. From empirical standpoints, the findings in this study support the results obtained in the studies of Oluyombo (2011).

Conclusion and Recommendations

Based on the empirical findings, the following conclusion can be established: (i) Microfinance bank loans have a stimulating or expansionary effect on real gross domestic product in Nigeria over the years. The possibility of this; is traceable to the fact that microfinance bank gives soft loans to productive and promising micro, small and medium scale enterprises (MSMEs) that are key players in the drive for economic growth. More so, microfinance bank loans have played a vital role in the economic growth in Nigeria because it serves as a catalyst for economic growth in Nigerian economy. (ii) Generally it is believed that inflation has more of a negative impact on gross domestic product than of a positive impact. It is therefore recommended that more attention be given to the issue of inflation and its dampening effect on the economy. Microfinance institutions should channel very high proportion of their credits to the productive and real sectors of the economy for valuable impact of their operations on Nigeria's economic growth. Microfinance banks (MFBs) should be front-liners of ethical and professional conduct by ensuring that soft loans are given to credible and promising entrepreneurs.

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Tables

Table 1

Augmented Dickey-Fuller Unit Root Test

Variable	Level	First difference	Lag(s)	Model	Order of integration
RGDP	-1.160675	-3.779183**	1	Trend & Intercept	I(1)
MFBL	-0.624516	-6.198514***	1	Trend & Intercept	I(1)
INV	-3.021082	-4.976680***	1	Trend & Intercept	I(1)
INFL	-1.510591	-4.795772***	1	Trend and Intercept	I(1)
ECM(-1)	-5.018111***		0	None	I(0)

Source: Author's computation

Table 2

Unrestricted Cointegration Rank Test (Trace)

Hypothesized No. of CE(s)	Eigenvalue	Trace Statistic	0.05 Critical Value	Prob.**
None *	0.985322	140.4174	63.87610	0.0000
At most 1 *	0.812737	55.98922	42.91525	0.0015
At most 2	0.493374	22.48439	25.87211	0.1248
At most 3	0.358686	8.884733	12.51798	0.1876

Trace test indicates 2 cointegrating eqn(s) at the 0.05 level

* denotes rejection of the hypothesis at the 0.05 level

**MacKinnon-Haug-Michelis (1999) p-values

Unrestricted Cointegration Rank Test (Maximum Eigenvalue)

Hypothesized No. of CE(s)	Eigenvalue	Max-Eigen Statistic	0.05 Critical Value	Prob.**
None *	0.985322	84.42813	32.11832	0.0000
At most 1 *	0.812737	33.50483	25.82321	0.0040
At most 2	0.493374	13.59966	19.38704	0.2821
At most 3	0.358686	8.884733	12.51798	0.1876

Max-eigenvalue test indicates 2 cointegrating eqn(s) at the 0.05 level

* denotes rejection of the hypothesis at the 0.05 level

**MacKinnon-Haug-Michelis (1999) p-values

Source: Author's computation

Table 3

Long-Run Estimation Result

RGDP	Coefficient	Std. Error	t-Statistic	Prob.
C	328.9407	18.69188	17.59805	0.0000
MFBL	4.213927	0.615903	6.841870	0.0000
INV	2.87E-06	9.57E-07	2.999942	0.0077
INFL	-0.967169	0.222982	-4.337433	0.0004
R-squared	0.965039	Mean dependent var		538.8727
Adjusted R-squared	0.959213	S.D. dependent var		193.4640
S.E. of regression	39.07177	Akaike info criterion		10.33164
Sum squared resid	27478.85	Schwarz criterion		10.53001
Log likelihood	-109.6481	Hannan-Quinn criter.		10.37837
F-statistic	165.6218	Durbin-Watson stat		2.228034
Prob(F-statistic)	0.000000			

Source: Author's computation

Table 4

Short-Run Estimates Error Correction Model

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	4.529274	0.177778	25.47714	0.0000
LOG(MFBL)	0.069436	0.023354	2.973128	0.0090
LOG(INV)	0.108825	0.014278	7.621646	0.0000
INFL	0.000703	0.000413	1.701025	0.1083
ECM(-1)	-0.000786	0.000282	-2.790210	0.0131
R-squared	0.987890	Mean dependent var		6.251795
Adjusted R-squared	0.984862	S.D. dependent var		0.336127
S.E. of regression	0.041355	Akaike info criterion		-3.328969
Sum squared resid	0.027364	Schwarz criterion		-3.080273
Log likelihood	39.95417	Hannan-Quinn criter.		-3.274995
F-statistic	326.3026	Durbin-Watson stat		1.768668
Prob(F-statistic)	0.000000			

Source: Author's computation