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Research Article

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Empirical Analysis of Challenges of Microfinance Banks in Financing Small Scale Enterprises in Nigeria

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ABSTRACT

The introduction of microfinance banking in most developing economies like Nigeria was borne out of the need to bring financial services nearer to the people, particularly the low income earners given the inaccessibility of such services from conventional banks. This study assessed the problems encountered by the Microfinance Banks (MFBs) in financing Small Scale Enterprises (SSEs) in Osun State, Nigeria. Descriptive survey research design was adopted for this study. The population for the study comprised all microfinance banks and small scale enterprises in Osun State. Ninety (90) management staff members of thirty (30) MFBs were purposively sampled and four hundred and fifty (450) SSEs were randomly sampled. One set of questionnaire designed to collect data was tested for reliability using *Cronbach's* alpha: QMFB (r = 0.793). Data was analysed using descriptive statistics such as tables, percentages and pie charts. Findings revealed delay in payment of loans(21.1%). deviation from the loan agreement (18.9%), diversion of the loan granted (23.4%), non compliance with advice (14.4%) and non repayment of loans granted (22.2%) as challenges facing microfinance bank in financing small scale enterprises in Osun State, Nigeria. In conclusion, activities of MFBs on the SSEs in the study area were mostly hindered by diversion of the loan granted to non SSEs business activities, therefore MFBs were advised to organize training for the SSEs

Introduction

Microfinance can be defined as lending small amount of money for enterprise development and attainment of income above poverty line (Lashley, 2004). It is the provision of small units of financial services to low income client which are usually excluded from mainstream financial system (Ehigiamusoe, 2008). Lashley (2004) opined that microfinance is to provide meager amount of capital in order to allow poor micro entrepreneurs to reap the benefits of their labour.

Microfinance Institutions (MFIs) are one of the specialized financial institutions established by private individuals, government, donor agencies or non-governmental organisations with sole aim of ensuring financial inclusion. The essence of MFIs are to provide microfinance services such as provision of micro loan, micro saving, micro

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insurance, transfer services and other financial products targeted at poor or low income individuals (Kurfi, 2008) Microfinance banks transact all banking business except that they are not allowed to do foreign exchange business. They serve their forex customers by making use of their correspondents' banks. Because a microfinance bank is not allowed to access the clearing house operations, its cheque books bear the names of their correspondence banks. Microfinance bank used basic instruments like savings accounts, current accounts, fixed deposits, investment accounts, credit or lending products such as over drafts, leases, term loans of various terms but mainly starts tenured trading loans, salary advance, LPO financing etc. they also ender support services such as financial advisory services, feasibility reporting particularly for startup small medium enterprises SMEs, financial training, micro insurance services, and money transfers both locally and internationally in conjunction with their correspondence banks, micro pensions, capacity building etc.

Microfinance bank as a unit bank shall be allowed to open new branches in the same state, subject to meeting the prescribed prudential requirements and availability of minimum free funds of ₦20.0 million for each branch. Microfinance bank can also attain the states of a state MFB by spreading organically from one location to another unit it covers at least two-thirds of the local government areas of that state subject to meeting the prescribed the prudential requirements and availability of minimum free funds of ₦2.0 million for each branch to be opened in the new state.

According to Alegiuwo (2008), an microfinance bank licensed to operate in state shall be allowed to open a branch in another state, subject to opening branches at least two-thirds of the local governments of the state at is currently licensed to operate, in subject to the provision of ₦20 million free funds and if in the view of the regulatory authorities it has satisfied all the requirements stipulated in the microfinance regulatory policy and guidelines of 2005.

Microfinance banks can be established by individuals, group of individuals, community development associations, private corporate entities or foreign investors, universal banks that intend to set up any of the two categories of microfinance bank as subsidiaries shall be required to deposit the appropriate minimum paid up capital and meet the prescribed prudential requirements.

In Nigeria, microfinance banking is being guided by the microfinance regulatory policy and guideline of 2005 issued by central bank of Nigeria. Microfinance banks render services to the poor and small and medium scale enterprises while the poor is defined as a person living with less than 2 dollars (about ₦290) a day. However, those living with less than a dollar a day are said to be living below the poverty line. The small and medium enterprises are defined as persons doing business with less than ₦1.5 billion.

Microfinance bank is not allowed to lend more than ₦500, 000 (five hundred thousand naira) to single individual or business. Microfinance banks credit classification is more stringent than the mega banks, for example while a mega bank may only classify an account as loss if it stays unpaid for interest and capital for up to 3650 days, microfinance banks must classify such loans as loss if they remain unpaid for 90 days, microfinance bank operators opt for very short term liquid.

The diversity in concept of small scale enterprise or industry is exemplified by a study carried out on Small Scale Industries in seventy-five countries by the Georgia Institute of Technology in which over five different definitions were compiled. Thus, there is no universally accepted definition of small scale industries. The problem with most of the single variable definition is that these are inflexible and arbitrary. If project cost, or capital or turnover is used, the definition may

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become irrelevant in later years due to global inflation (Aderemi, 2002).

Some definitions appear acceptable for some countries. For Egypt, Israel and Italy, the United Nations report on the development of producing industries as organisations employing ten or more persons as small scale enterprises. In Great Britain, small scale industries include those with an annual turnover of two million pounds or less and with less than 200 paid employees. This definition makes no reference to capital investment. In Indonesia, those industries employing less than 10 full time workers are termed as small scale industries while to Japanese and Americans, small scale industries are those employing between 300 and 500 workers. For countries like Japan, India, Philippines, North Koreaand South Korea, there are really no distinctions between small and medium-sized industries.

Nigerian Institute of Social and Economic Research (NISER) (1987) defined small scale industries as those establishments engaged in production (manufacturing) or semi-production or repair type activities employing a maximum of 50 persons or with a maximum capital of ₦150,000. Federal Ministry of Industry (FMI), (1972) said that a small scale enterprise is an enterprise having investment capital in land, building, machinery and equipment and working capital up to ₦60,000 and employing not more than 50 persons. Between 1972 and 1981, the Ministry reviewed the investment capital three times. For example, it was reviewed to ₦60, 000 in 1972, to ₦150,000 in 1973, ₦250,000 in 1979, and ₦500,000 in 1981 but excluding cost of land apparently to reflect the economic trends and national economic policies of the time.
However, the definitions of small scale enterprises by Federal Ministry of Industries (1989) and NISER (1987) were employed for this study. Small scale enterprises would then include those enterprises with initial fixed capital of not more than ₦500, 000 and engaged in production (manufacturing) or semi-production or repair type activities, trading and occupations, and employing a maximum of 50 people.

Statement of Problem

There are lots of studies that examined: the impact of microfinance banks (MFBs) on economic growth and social development; the positive effect of MFIs and MFBs on women empowerment as well as rural development (Cheston and khun, 2002; Kabeer, 2005; Littlefield, 2003, Sayial, 2009). Despite the fact there are many researches regarding the impact of microfinance on economic and social development, one of the major area that still attract attention in microfinance banks are the challenges bedeviling them. In view of this, the paper is targeted at empirically pinpoint some of the pressing challenges of MFBs in financing small scale enterprises and proposed solutions to address them.

Research Questions

Based on the problem statement highlighted above, the main research question of this study was what are the problems encountered by MFBs in financing Small Scale Enterprises in Osun State?

Objective of the Study

The overall objective of this study was to assess the problems encountered by microfinance bank operators in financing SSEs in Osun State.

Review of Empirical Studies

Das; Srinivasan and Kodamarty (2010) examined strategies to address the challenges of microfinance. They found that challenges encountered by microfinance institutions (MFIs) include the accessibility of microfinance services to the poor, the capital inadequacy of MFIs, demand and supply gap in provision of micro credit micro saving, high transaction cost,non-availability of documentary evidence and problem of re-payment tracking.

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Nwanyanwu (2011) examined problems and prospect of microfinance in Nigeria. Secondary source was employed for data collected while descriptive statistics were employed for data analysis. The study found that microfinance holds a lot of prospects for the Nigerian economy as it is expected to empower low income earners, reduce poverty, generate employment. The study also observed that among the problems faced in the microfinance industry are inadequate finance, high risk, heavy transaction cost, mounting loan losses, low capacity and low technical skills on micro financing.

MabhunGu; Masamba;Mhazo; Jaravazaand Chiriseri (2011) study showed that the major challenge of MFIs is the criteria used in granting micro credits which result to low out reach.

Noruwa (2012) examined the role and sustainability of Microfinance banks in reducing poverty and development of Entrepreneurship in Urban and Rural areas in Nigeria. Data are collected through structured questionnaire. The study identified high rate of loan default among the small and medium scale enterprises which poses serious consequences for microfinance banks. It was found that the challenges facing microfinance banks include, among others, the documentation of credit process, wrong information, identity of the loan applicant and unstable economic situation in the country. Ikechukwu (2012) investigated the prospects and problems of microfinance banks (MFBs) in Nigeria and identified the problem of MFBs to include lack of infrastructures such as electricity, lack of banking culture among their clients, detestation of interest rate in some part of the country, lack of confidence on the part of prospective clients, limited support for human and institution capacity.

Kanayo and Jumare (2013) examined the challenges of microfinance access in Nigeria: Implications for entrepreneurship development. Content analysis of available literature approach was used for the study. The paper argued that microenterprises finance cannot be financially viable because small loans are too costly to administer and the profits from such lending too meager to permit profitability. The study found that microfinance institutions have collapsed in Nigeria due to poor loan quality, default in loan payment, high transaction costs, wide spread delinquency, and management deficiencies.

Nasir (2013) found lack of product diversification, low outreach, high interest rate, late payment or delay in payment of microfinance clients, inadequate funding, and neglecting urban poor and high cost of transaction as the challenges of MFIs. Nawas and Shariff (2013) study found that one of the major obstacles of MFIs is loan repayment problem.

Ogujiuba and Fadila (2013) conducted a research titled "Challenges of microfinance access in Nigeria: Implications for Entrepreneurship Development". The paper argued that microenterprises finance cannot be financially viable because small loans are too costly to administer and profits from such lending too meager to permit profitability. Based on the content analysis of available literature in the study, the researchers found that microfinance institutions have collapsed in Nigeria due to poor loan quality, default in loan repayment, high transaction costs, with spread delinquency and management deficiencies.

Anderibom (2015) carried out a study titled an assessment of the roles, challenges and prospects of microfinance banks in Nigeria: Evidence from Yola. The study revealed the challenges face by microfinance banks as difficulty in recovery of loan (78%), lack of adequate ICT and related banking technology (67%), limited outreach/ awareness (61%) and poor funding inadequate capital (54%) Lawan; Falchrul and Mohammed (2015) examined the lingering challenges of microfinance institutions (MFIs) and proposed way forward to address them. They reviewed some literature by way of methodology and found the following challenges that bedeviling MFIs:

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low out reach, criteria used in granting micro credits, regulatory problems, inappropriate human resources, delay in loan repayment, high transaction cost and infrastructure.

Methodology

Descriptive survey research design was employed to investigate the main challenges facing microfinance banks in financing small scale enterprises in Osun State, Nigeria. This study was carried out in Osun State of Nigeria. The study area was chosen based on geographical proximity and preparedness of the respondents. The State is bounded in the North by Kwara State, in the West by Oyo State, in the East by Ondo State and in the South by Ogun State. The main ethnic group in these states is Yoruba. Agriculture is the predominant occupation of the people in the study area.The small scale entrepreneurs in the state are farmers, artisans, traders and others who engaged inweaving and dying. These people need micro credit assistance to boost their businesses. Population of the study was ninety (90) management staff of the thirty MFBs in the study area comprising the microfinance bank managing directors, heads of operations and heads of credit for thirty microfinance banks. The whole population was sampled. One instrument, titled on "Challenges of Microfinance banks in financing small scale enterprises in Osun State, Nigeria (CMBFSSEs)" was designed for data collection. The instrument has a section for problems encountered by microfinance operators in financing small scale enterprises. *Cronbach* method was used to measure the consistency of the instruments. The instrument obtained a *Cronbach* co-efficient of r = 0.793. The estimated correlation coefficient was positive and very close to one. These revealed that the instrument was reliable.

Descriptive statistics like tables, frequencies, bar and pie charts were employed to analyse the data collected.

Problems Encountered by MFB in Financing SSEs in Osun State

Responses of the participants (MFB officials) on problems of MFB in financing SSEs were analysed and presented in Table 1 and Figure 1

Table 1: Problems encountered by MFB in Financing SSEs in Osun State, Nigeria

	Frequency	Percent	Cumulative Percent
Delay In Repayment Of Loans	19	21.1	21.1
Deviation From The Loan Agreement	17	18.9	40.0
Diversion Of The Loan Granted	21	23.4	63.4
Non Compliance With Advice	13	14.4	77.8
Non-Repayment Of Loans Granted	20	22.2	100.0
Total	90	100.0	

Source: Field survey

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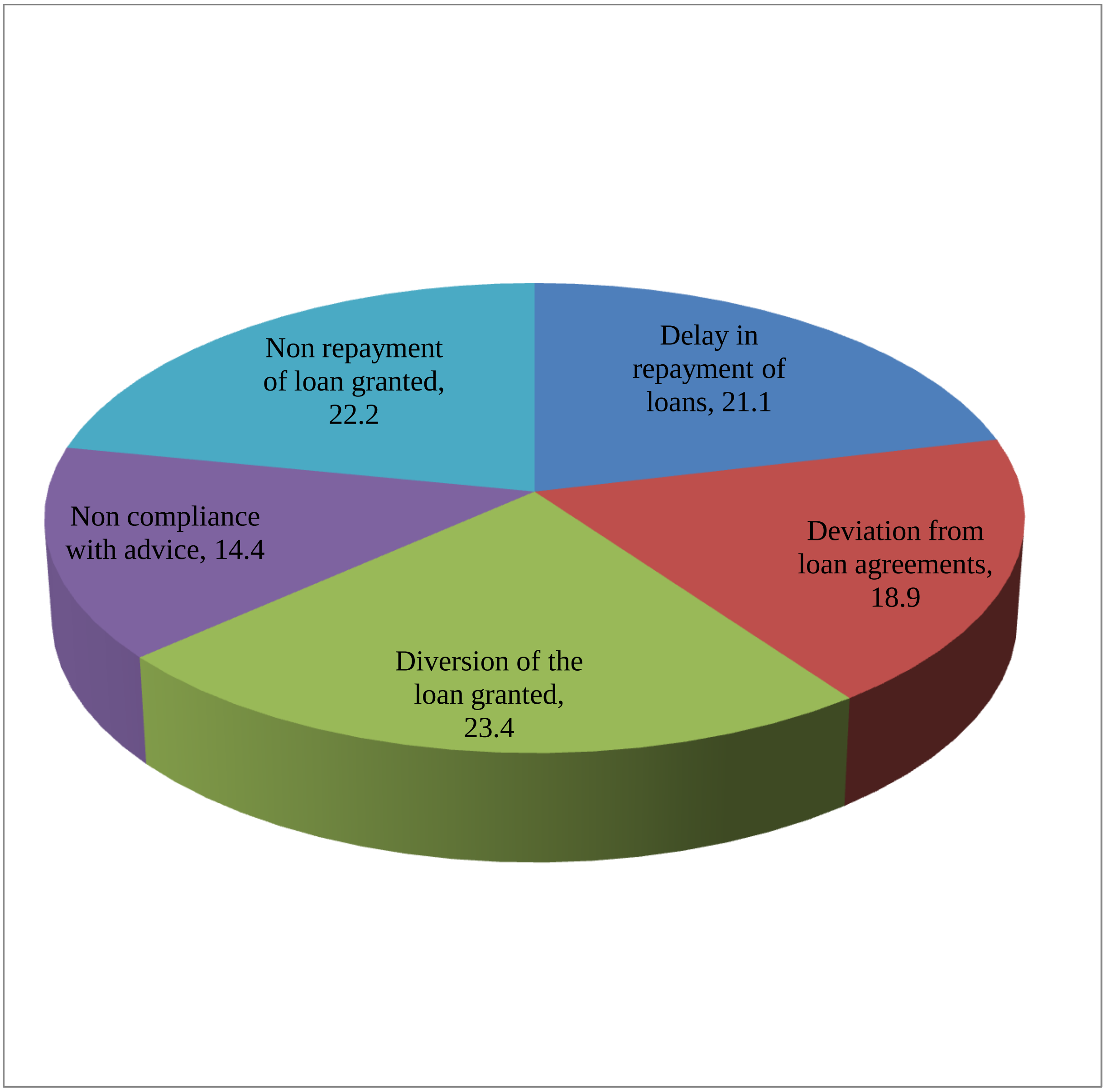

Figure 1: Perceived Problems encountered by MFB in Financing SSEs in Osun State, Nigeria
Source: Field survey

Table 1 and Figure 1 revealed the following as the problems encountered by MFBs in financing SSEs: diversion of the loans granted, non-repayment of loans granted, delay in repayment of loans, deviation from the loans agreement and non-compliance with advice given by MFB operators. The findings of this study revealed diversion of the loan granted to SSEs as the most critical problem faced by MFBs. This finding tallies with the result of Nwanyanwu (2011) who identified diversion of funds, inadequate finance, and frequent changes in government policy, heavy transaction costs, huge loan losses, low capacity and low technical skill in the industry as impediments to the growth of microfinance sector.

Conclusion

This study examined the problems encountered by microfinance bank in financing have enhanced the small scale enterprises in Osun State, Nigeria. The study found diversion of the loans granted, non-repayment of loans granted, and delay in repayment of loans, deviation from the loans agreement and non-compliance with advice given

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by MFB operators as factors affecting MFBs in financing SSEs in Osun State, Nigeria.

Recommendations

Based on the findings of this study, there is the need for a complete overhauling of the policy thrust of the sector through a comprehensive reform agenda to enable the microfinance banks improve on their service delivery and curtail the excesses of the SSEs operators which include delay in repayment of loans, diversion of microfinance loans, and non-compliance with the microfinance guidelines for loan utilisation. MFBs should provide training on management of funds for SSEs customers.

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