THE IMPACT OF MICROFINANCE BANK CREDIT ON ECONOMIC DEVELOPMENT OF NIGERIA (1992 – 2006)

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Abstract

This paper x-rays the contribution of microfinance bank to the economic development of Nigeria for fifteen years by using secondary data collected from the Central Bank of Nigeria records, annual reports and statistical bulletin. The ordinary least square estimation technique was adopted using linear regression model. The study found a weak positive relationship between microfinance banksô finance and long run economic growth in Nigeria, and between microfinance banksô finance and capital formation. There was large positive correlation between microfinance banksô finance and penetration ratio. The results suggest a net outflow of finance from the microfinance banks that may jeopardize the economic development of the nation. There should be a policy framework that constrains the microfinance banks to channel a minimum percentage of their deposit to productive sector of the economy in form of credit and the productive sector must be properly defined and classified for easy compliance by the microfinance banks and monitored by a regulatory authority.

Key words: Microfinance bank, Economic development, Deposit mobilisation, Loan penetration, Capital formation.

Introduction

Microfinance institutions are fast becoming a household name globally due to their acceptance as a means of reaching those that were not served by the conventional big banks to the extent that local and international organizations are exploring the modalities of deriving the best in the application of microfinance concept to almost every area of economic needs of individuals and organizations over the years (Oluyombo, 2007). The numbers of microfinance bank in Nigeria grew from 401 in 1992 to 757 in 2010 while their fixed assets moved from N967.2 million to N55.05 billion. The non oil gross domestic period also was on the increase. During the same period, 42.84 percent of Nigerians lived below the poverty level in 1992 and it increased to 65.59 in 1996 and 70.2 percent in 2002. However, the Millennium Development Goals (MDGs) 2005 report that 54.4 percent of Nigeriaôs estimated 120 million people live on less than $1.00 per day despite the existence of 757 microfinance banks in the country. The growth opportunity inherent in microfinance services and likewise the challenges for full development of microfinance institutions with the increasing rate of poverty in the nation has raised some essential questions as to the economic importance of

this type of financial service providers since they are meant to be catalyst for economic development. Thus, this study aims (i) to determine if microfinance banks have contributed to the long run growth of the economy; (ii) to identify the relationship that exists between deposit mobilized and credit disbursed by microfinance banks as a source for capital formation and (iii) to ascertain if microfinance banks loans and advances penetrate to the economy.

Hypothesis of the Study

For the purpose of this study, the following hypothesis are formulated and tested:

Hypothesis 1. Microfinance banks have not contributed significantly to long run economic growth.

Hypothesis 2. There is no significant relationship between microfinance banksô finances and capital formation.

Hypothesis 3. There is no positive relationship between microfinance banks and loan penetration to the economy.

Microfinance Banks and Economic Development

The Central Bank of Nigeria - CBN (2005b) stated that microfinance is about providing financial services to the poor who are traditionally not served by the conventional financial institutions. Three features distinguish microfinance from other formal financial products. These are (i) the smallness of loans advanced and or savings collected (ii) the absence of asset-based collateral, and (iii) simplicity of operations.

Microfinance is the provision of a broad range of financial services such as deposits, loans, payment services, money transfers, and insurance to poor and low-income households and, their micro enterprises. Microfinance services are provided from three types of sources: formal institutions, such as rural banks and cooperatives; semiformal institutions, such as nongovernmental organizations; and informal sources such as money lenders and shopkeepers. Institutional microfinance is defined to include microfinance services provided by both formal and semi-formal institutions. Microfinance institutions are defined as institutions whose major business is the provision of microfinance services. (Asian Development Bank ï ADB, 2000).

Otero and Rhyne (1994) describe microfinance as a revolution that involves the large scale provision of small loans and deposit services to low-income people by secure, conveniently located and competing commercial financial institutions thereby generating the process needed to democratize capital. This definition means that the numbers of microfinance institutions should be large enough to meet the needs of low income earners in the nation through the provision of deposit and loan facilities and to give room for healthy competition among them. However, Ledgerwood (2000) define microfinance as an economic development approach intended to benefit low-income women and men. It means that the purpose of microfinance is to reach the low income earners either in the urban or rural areas with financial services that will enable them create wealth without any discrepancy as to the sex of such person.

Microfinance is an economic approach to the delivery of financial services to those that are hitherto unreachable at a fee that is affordable and economic to the users of such

services, and also, using funds from the providers of financial services to generate adequate returns for the users, thereby building up their enterprises and creating employment opportunities which will reduce the poverty level in the economy (Oluyombo, 2010). Microfinance is a holistic approach designed to improve the lot of micro, small and medium scale entrepreneurs both in the rural and urban areas in accessing fund as at when needed from the conventional banks.

The operation of microfinance worldwide is unique; Even though microfinance organizations work like banks; their financing methods are deeply rooted in the philosophy of alleviating the plight of the poor and others that are deprived from accessing banking services as a result of their economic power, education, financial status and lack of adequate collateral for conventional bank loan.

A study of the impact of local banks on regional economic development was undertaken in Philippines by Crouzille et al (2009). They used the Central Bank of the Philippines data of rural banks from 1993 to 2005 to assess the specific influence of rural banks on economic development for the period. Griffith et al (2009) research was conducted to find out the contribution of microfinance institution on the national development of Barbados from 1970 to 2004 using data from annual reports of eight credit unions.

Crouzille et al (2009) asserted that a crucial mechanism for economic development through banks is the reduction of financial constraints for firms that rely heavily on external finance. This implies that the inability of business organization to access credit from the banks will hamper economic development of the nation and the extent to which the microfinance banks in Nigeria could influence access to loans and advance by their customers is a key issue in meeting their objectives.

FitzGerald (2006) found a robust relationship between bank credits to gross domestic product ratio in developing countries, even though in many cases, the researcher observed that their financial systems are far from efficient. Griffith et al (2009) result shows that there is positive impact on the accumulation of assets over a period of time and credit unions have a significantly positive long-run effect on national development.

Crouzille et al (2009) found a negative and significant correlation between rural banks and economic development. For intermediation ratio, they found a positive and significant correlation for two regions of Philippines. The long run relationship between rural banks and economic development was traced to the development of the banking sector in the country.

Research Methodology

The scope of this work is limited to only microfinance banks approved by the Central Bank of Nigeria (CBN). The choice of microfinance banks is based on the fact that they are widely located and situated in several communities in the rural and urban centre across different geographical locations in Nigeria. Moreover, they are owned by individuals in conjunction with the community in which they are located, mobilizing significant volume of deposit and also providing loans and advances. In addition, it is mandatory for them to submit their financial reports at regular interval and render their annual reports to the CBN. Their reports are found in government publications like the Central Bank of Nigeria annual report, statistical bulletins and the banking supervision report. It is from these authentic sources that the scope of this research work as it relates to the period of coverage of fifteen years (i.e. 1992 to 2006) was determined. The Ordinary Least Square (OLS) estimation technique was adopted using Linear Regression Model (LRM) with SPSS statistical software to evaluate the

stated objectives by conducting Pearson correlation, co-efficient of determination (R^2), adjusted R^2 and F-statistics (ANOVA). These statistics were also used to test the relationship that exists between the dependent and independent variables. Ratio values of Microfinance Banks Finances (MBF) were used as the independent variable while Intermediation Ratio (IR), Loan Penetration Ratio (LPR) and Economic Growth (EG) as dependent variables. This process aligns with previous work of Anyanwu (2004) in Nigeria, Griffith *et al* (2009) in Barbados and Mpako (2007) in South Africa. The linear regression model is stated thus: Yi = (bo + bi Xi) + (µi). Where: Yi = dependent variable, bo = the constant term, bi = coefficient of variation, Xi = independent variable and µi = stochastic term (also referred to as error term). The model uses some alphabet to denote different variables as follows: EG = Economic Growth, IR = Intermediation Ratio, LPR = Loan Penetration Ratio and MFBF = Microfinance Banks Finance. Hence, EG = bo + bi MFBF + µi, IR = bo + bi MFBF + µi, and LPR = bo + bi MFBF + µi

Data Presentation and Analysis

Data for loan and advances granted by microfinance banks in Nigeria from 1992 to 2006 to all sectors of the economy are given in table 1. The non-oil gross domestic product (GDP) per capita serves as proxy for economic growth since microfinance banks are classified under non-oil GDP. The economic growth measures the non-oil GDP at a constant basic price divided by the total population of the country. The population figure was derived from the official census figures for year 2001 and 2006. The population figures for other years were based on the 2.8 percent annual growth rate used by the Central Bank of Nigeria (CBN, 2004) using 1991 figure as base year. The use of population and the non-oil GDP has been used in a similar study undertaken by Mpako (2007) and Griffith (2009). Bank credit to the private sector ratio is a better measure of the level of financial intermediation (FitzGerald, 2006 and Crouzille, 2009). The intermediation ratio was arrived at by dividing the total deposits on yearly basis by the yearly total loans and advances. The loan penetration ratio of the microfinance banks is determined by growth in total deposit divided by total loans and advances. The key macro-economic performance of microfinance banks based on the ratios and other calculations above are shown in table 2 below to give the general economic indicators of microfinance bank from 1992 to 2006.

TABLE 1. MICROFINANCE BANK LOANS AND ADVANCES STRUCTURE IN NIGERIA (1992 – 2006)

Year	Agriculture & Forestry (N'm)	% of Total	Minning & Quarrying (N'm)	% of Total	Manufacturing & Food Processing (N'm)	% of Total	Manufacturing & Others (N'm)	% of Total	Real Estate & Construction (N'm)	% of Total	Transport & Commerce (N'm)	% of Total	Others (N'm)	% of Total	Total (N'm)
1992	29.50	21.72	3.70	2.72	7.70	5.67	12.20	8.98	14.60	10.75	45.60	33.58	22.50	16.57	135.80
1993	123.20	18.82	5.70	0.87	69.60	10.63	60.00	9.17	47.50	7.26	280.00	42.78	68.50	10.47	654.50
1994	155.40	12.73	32.20	2.64	98.30	8.05	102.70	8.41	34.90	2.86	513.80	42.09	283.30	23.21	1,220.60
1995	98.60	8.73	17.90	1.58	68.90	6.10	55.90	4.95	102.60	9.08	575.70	50.96	210.20	18.61	1,129.80
1996	229.40	16.38	17.60	1.26	81.60	5.83	73.80	5.27	92.70	6.62	695.00	49.64	210.10	15.00	1,400.20
1997	367.40	22.70	28.50	1.76	125.00	7.72	75.00	4.63	105.20	6.50	729.90	45.09	187.80	11.60	1,618.80
1998	962.70	38.10	31.00	1.23	172.90	6.84	126.50	5.01	67.10	2.66	1,042.70	41.27	123.90	4.90	2,526.80
1999	1,007.20	34.05	27.00	0.91	200.80	6.79	92.70	3.13	71.90	2.43	1,447.80	48.94	110.90	3.75	2,958.30
2000	656.63	35.91	19.33	1.06	124.57	6.81	73.07	4.00	46.33	2.53	830.17	45.40	78.27	4.28	1,828.37
2001	77.60	5.91	4.80	0.37	110.80	8.43	261.80	19.92	40.70	3.10	484.50	36.87	333.80	25.40	1,314.00
2002	390.50	9.06	58.80	1.36	549.60	12.75	425.40	9.87	450.80	10.46	1,385.40	32.14	1,050.40	24.37	4,310.90
2003	625.00	6.28	59.50	0.60	809.20	8.13	1,727.90	17.36	574.10	5.77	2,733.10	27.46	3,425.80	34.41	9,954.60
2004	483.10	4.26	510.60	4.50	331.80	2.92	1,088.10	9.58	279.20	2.46	2,875.30	25.32	5,785.60	50.96	11,353.70
2005	69.90	0.48	14.70	0.10	64.90	0.45	2,795.10	19.21	214.80	1.48	1,591.90	10.94	9,796.10	67.34	14,547.40
2006	965.10	5.85	405.00	2.45	1,088.70	6.60	2,087.40	12.65	839.80	5.09	4,504.00	27.30	6,608.50	40.06	16,498.50
Total	6,241.23	8.73	1,236.33	1.73	3,904.37	5.46	9,057.57	12.68	2,982.23	4.17	19,734.87	27.62	28,295.67	39.60	71,452.27

Source: Computed from CBN annual report, CBN banking supervision annual report and CBN statistical bulleting ï various issues

Table 2. Key Macro-Economic Indicators of Microfinance Bank (1992 – 2006)

YEAR	INTERMEDIATION RATIO	GDP PER CAPITA	LOAN PENETRATION RATIO	MFB FINANCE RATIO
1992	4.71	3.1239	-	0.003384304
1993	3.34	4.6973	2.36608	0.007240581
1994	2.64	7.0414	0.84262	0.00689412
1995	2.51	11.7391	-0.33820	0.003519776
1996	2.05	15.1202	0.02978	0.002869289
1997	1.97	16.5001	0.18878	0.002715762
1998	1.76	18.2610	0.50352	0.003285191
1999	1.40	19.5468	-0.10611	0.004103875
2000	1.57	20.6042	-0.69760	0.002180784
2001	2.51	25.7206	0.32661	0.001619007
2002	2.25	29.8904	1.48582	0.004290431
2003	1.82	33.9335	0.84138	0.006820586
2004	1.89	56.2153	0.29355	0.004769039
2005	1.97	68.2927	0.50288	0.005148973
2006	2.06	82.4722	0.32035	0.004753733

Test of Hypothesis

Hypothesis 1: This hypothesis was used to test the impact of microfinance banks on the economic growth of the nation on a long run basis of fifteen years. The Pearson correlation coefficient (r) result of .121 shows a positive correlation while the strength of the relationship between microfinance banks and long run economic growth following Cohen (1988) suggestion cited in Pallant (2007) of small correlation where r = .10 to .29, medium correlation if r = .30 to .49 and large correlation when r = .50 to 1.0 means that there is small correlation between GDP per capita and microfinance banks finance. The result can be interpreted as weak positive (Saunders et al, 2009). This means that there is a weak positive relationship between microfinance banks and long run economic growth in Nigeria. The coefficient of determination (r^2) which is also the measure of the goodness-of-fit is 1.5 percent. This shows that only 1.5 percent of the variance of long run economic growth in relation to microfinance banks finance can be explained by a linear line as contained in the model. The result implies that we reject the alternate hypothesis that Microfinance banks have contributed significantly to long run economic growth.

Model Summary(b)

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics					Durbin-Watson
					R Square Change	F Change	df1	df2	Sig. F Change	
1	.121(a)	.015	-.061	24.332724311	.015	.195	1	13	.666	.160

a Predictors: (Constant), MFB finance
b Dependent Variable: GDP per capital

ANOVA(b)

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	115.277	1	115.277	.195	.666(a)
	Residual	7697.059	13	592.081		
	Total	7812.336	14			

a Predictors: (Constant), Microfinance Banks Finances
b Dependent Variable: GDP Per Capita

Hypothesis 2: The deposit divided by loans and advances was used as proxy for intermediation ratio which represent the capital formation in the economy. The Pearson correlation coefficient (r) result of .119 shows a positive correlation. However, the strength of the relationship between microfinance banks and capital formation as depicted by intermediation ratio following Cohen (1988) suggestion as stated above means that there is small correlation between capital formation and microfinance banks finance. The result can be interpreted as weak positive (Saunders et al, 2009). This means that there is a weak positive relationship between microfinance banks finance and capital formation. The measure of the goodness-of-fit as revealed in the coefficient of determination (r^2) is 1.4 percent. This shows that only 1.4 percent of the variance in intermediation ratio which represents capital formation in the economy in relation to microfinance banks finance can be explained by a linear line as contained in the model. The result implies that microfinance banks contribute only 1.4 percent of the capital formation in the economy between 1992 and 2006. We therefore reject the alternate hypothesis that there is a positive relationship between microfinance banks finances and capital formation.

Model Summary(b)

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics					Durbin-Watson
					R Square Change	F Change	df1	df2	Sig. F Change	
1	.119(a)	.014	-.062	.847268086	.014	.187	1	13	.672	.533

a Predictors: (Constant), MFB finance
b Dependent Variable: Intermediation

ANOVA(b)

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	.135	1	.135	.187	.672(a)
	Residual	9.332	13	.718		
	Total	9.467	14			

a Predictors: (Constant), MFB finance
b Dependent Variable: Intermediation

Hypothesis 3: The hypothesis was used to test the relationship between microfinance banks finance and loan penetration. The Pearson correlation coefficient (r) result of .681 shows a positive correlation which means that increases in one variable causes increase in the second variable. There is large positive correlation between penetration ratio and microfinance banks finance. The result can be interpreted as strong positive (Saunders et al, 2009). Therefore, there is a strong positive relationship between microfinance banks finance and loan penetration to the economy. The coefficient of determination (r^2) is 46.4 percent. This shows that 46.4 percent of the variance in penetration ratio in the economy in relation to microfinance banks finance can be explained by a linear line as contained in the model. The result implies that microfinance banks contributed 46.4 percent of the loan penetration to the economy between 1992 and 2006. We therefore fail to reject the alternate hypothesis that there is a positive relationship between microfinance banks and loan penetration to the economy.

Model Summary(b)

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics					Durbin-Watson
					R Square Change	F Change	df1	df2	Sig. F Change	
1	.681(a)	.464	.419	.582887114	.464	10.373	1	12	.007	1.632

a Predictors: (Constant), MFB finance
b Dependent Variable: Penetration

ANOVA(b)

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	3.524	1	3.524	10.373	.007(a)
	Residual	4.077	12	.340		
	Total	7.601	13			

a Predictors: (Constant), MFB finance
b Dependent Variable: Penetration

The summary of the test of hypothesis which shows the hypotheses that were rejected and those that could not be rejected are itemized in table 3 below.

Table 3. List of Null Hypotheses Rejected and Fail to Reject

No	Alternate hypothesis	Rejected	Fail to Reject
H1	Microfinance banks have not contributed significantly to long run economic growth.		X
H2	There is no positive relationship between microfinance banks finances and capital formation.		X
H3	There is no positive relationship between microfinance banks and loan penetration to the economy.	X	

Out of the three null hypotheses tested, the result revealed that one hypothesis that there is no positive relationship between microfinance banks and loan penetration to the economy was rejected which means that the null hypothesis cannot be proved statistically. The other two hypotheses were not rejected; it means that the hypotheses can be substantiated statistically based on the data used.

Discussion of Result

There was a weak positive correlation between microfinance banks associated with long run economic growth (r = .121) with Sig value of .666 from the ANOVA result. It means that microfinance banks are not making significant unique contribution to the prediction of long run economic growth. This implies that microfinance banks may be a catalyst for economic growth if their potentials are properly harnessed. However they have not made any significant contribution to the long run economic growth of Nigeria and their impact is yet to be felt in the economy. Moreover, only 1.5 percent of the long run economic growth of Nigeria is traceable to microfinance banks between 1992 and 2006 covered by this study. This percentage is too small to cause a meaningful positive change in the growth of the economy. This shows that microfinance banks have not really improved nor developed the economy of the nation because 39.6 percent of loans given by the microfinance banks went for other areas that do not directly contribute to economic development of the people. Hence it appears that there is a net outflow of finance from the microfinance banks that may jeopardize the economic development of the nation. This finding has therefore supported Buckley (1997) that in Kenya, Malawi and Ghana, formal microfinance institutions are averse to extending credit to entrepreneurs but they do not appear to have difficulties in extending deposit facilities. Griffith et al (2009) result shows that credit unions have a significantly positive

long-run effect on national development. These results have shown that positive or negative impact on microfinance institutions on economic development has to do with the development of the financial system in such country.

The relationship between microfinance banks and capital formation was weak but positively correlated (r = .119). The ANOVA result of .672 implies that microfinance banks are not making significant unique contributions to capital formation in the economy. Microfinance banks contribute only 1.4 percent of the capital formation in Nigeria for fifteen years. The intermediation ratio shows how desperate the microfinance banks are to collect deposit from the rural people more than to disburse credit. The permissible ratio should not be more than 1.5, but the researcher observed that it is only in one year (1999) that the ratio was below 1.5 meaning that loan disbursement correlates with the deposit mobilized. Finance affects economic development through capital accumulation (Crouzille et al, 2009). The intermediation ratio went as high as 4.71 in 1992 which means that the microfinance banks mobilize deposit without returning the fund in form of credit for capital formation in the economy. This supported the United Nations Report (2005) which places Nigeria on 80th position among the 108 developing countries in Human Poverty Index.

There was a strong positive correlation between microfinance banks and loan penetration (r = .681). Since the Sig value of .007 from the ANOVA suggests that microfinance banks are making a significant unique contribution to the prediction of loan penetration in the economy. Moreover, 46.4 percent of loan penetration in the economy is traceable to the operation of microfinance banks between 1992 and 2006 covered by this study.

Conclusion

Although, loans and advances could be assumed to have recorded some constant increase especially for the period between 1992 and 1996, and between 2002 and 2006.The relative increase is not commensurate to the total deposit and could hamper sustainable economic development. Therefore, it is expedient for microfinance banks to improve on their loans and advances portfolio. The researcher noticed that from year 2001 the deposit mobilization rate went so high and in some years like 2003 to 2006, it was more than double that of loans and advances for the same period. The implication of this scenario is that cheap funds are sourced from the people without an equivalent disbursement in forms of loans and advances to the same community where the deposits were mobilized. The loan and advances ratio to total deposit shows that MFBs were able to disburse credit more than 50% of their deposit only in 1997, 1998, 1999, 2000, 2003, 2004 and 2005. The result is not encouraging because the minimum acceptable ration of between 50% and 60% (Griffith et al, 2009 and Mpako, 2007) only occurs in 7 years out of the 15 years considered. It is evident therefore, that the loan and advances given by Microfinance Banks to their various communities for the years 1992 ï 2006 were not a reasonable proportion of the funds mobilized from them. This is a lopsided arrangement that does not justify the basic reasons for the establishment of microfinance banks in Nigeria. The move away by banks from the financing of productive investment and small scale enterprises has been encouraged by regulatory authorities concerned for bank liquidity (FitzGerald, 2006).

Recommendation

In view of the findings from this study as discussed above, the researcher is of the opinion that there is need for the Central Bank of Nigeria to consider the implementation of educational programme that will systematically expose microfinance banks owners, directors, management and staff to the skill necessary for the performance of their respective duties for proper delivery of microfinance products and services in the nation. The government through the Central Bank of Nigeria should stipulate a minimum percentage of the microfinance banks deposit that should be extended as loans and advances. There should be a policy framework that constrains the microfinance banks to channeling a minimum percentage of her deposit to productive sector of the economy in form of credit and the productive sector must be properly defined and classified for easy compliance by the microfinance banks and monitoring by the regulatory authorities.

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