Academic Journal of Economic Studies
Vol. 5, No. 2, June 2019, pp. 114–119
ISSN 2393-4913, ISSN On-line 2457-5836

Analysis of the Effect of Microfinance Institutions on Poverty Reduction in Nigeria

Ehiabhi Andrew Tafamel

Department of Business Administration, Faculty of Management Sciences, University of Benin, Benin City, Nigeria, E-mail: tafandrew@yahoo.com

Abstract

Credit inaccessibility constitutes a major hindrance to business growth in Nigeria, where a large majority of micro and small business owners do not have adequate collateral to secure a loan. This study examined the effect of microfinance institutions on reduction of poverty as well as entrepreneurial activities in Nigeria. The study employed a survey research instrument through the administration of questionnaires to two hundred (200) micro and small-scale business enterprises in Ikpoba Okha Local Government Area of Edo State, Nigeria. The study adopted Pearson correlation, multivariate regression techniques, Heteroskedasticity diagnostic test and Ramsey RESET test for data analyses. The results showed that microfinance institution and poverty alleviation were positively and significantly related while entrepreneurial activity and poverty reduction were positively and insignificantly related. The study recommended that microfinance institutions should be given a conductive environment to operate in order to assist in developing micro and small business enterprises, thereby help mitigate the effect of poverty ravaging the Nigerian society.

Key words

Poverty Reduction, Microfinance Institutions, Entrepreneurial Activity and Small Scale Business

JEL Codes: G21

Received: 05 March 2018 **Revised: 20 April 2019** **Accepted: 08 May 2019**

1. Introduction

The activities of microfinance business covers the provision of financial services such as credit and savings to the low-income groups, new venture owners and impoverished households in order to engage in as well as expand existing economic activities or small-scale businesses and improve their standard of living. Interestingly, microfinance has work towards alleviating poverty by way of improved labour productivity, high employment rate, and improved real wages (Awojobi and Bein, 2010). Microfinance has gained momentum in the provision of financial services to venture owner and economically advantaged people in the society at large (Okpara, 2010). Making finance available to individuals according to Vohra and Sehgal (2012) is a basic function of financial institutions, since they are saddled with the social obligation of fulfilling the credit needs of users of credit. Micro finance bank grants soft loan and advances to individuals and business organizations to encourage engagement in developmental investments which will ultimately contribute to growth in the economy (Chirwa and Mlachilla, 2004).

The need for microfinance cannot be overemphasized since the level of poverty in Nigeria is quite alarming. The depth and incidence of poverty in Nigeria have been explained through quantitative and qualitative measurements in detail (Okunmadewa *et al.*, 2005). For instance, Omotola (2008) alleged that about 70 percent of Nigeria population in wallow in penury. Soludo (2006) adds that in a robust economy, nothing works well without focusing on programmes or activities which are targeted at poverty reduction via empowerment of individuals through increased accessibility soft micro-credit. Institutional systems of the financial sectors have to be improved upon with good motivation scheme created for microfinance institutions and employees in meeting the new trend in the corporate business world. The tendency of microfinance carrying out their function of financial lending effective in alleviating poverty in Nigeria has encountered constraints which border on adequate quality and quantity of manpower availability (Akanji, 2001). The study of Agbaeze and Onwuka (2014) on the effect of micro-credit on poverty reduction in Enugu East Local Government Area of Nigeria revealed that microcredit has positively impacted on poverty reduction among the rural dwellers. It implies that the rate of poverty is on the high side despite the access to credit from different microfinance institution.

This study thus seeks to assess the effects of microfinance institutions on poverty reduction in Nigeria. The study would be of a reference point for academia and regulatory agency in Nigeria on the poverty reduction through the presence of micro-credit.

2. Literature review

2.1. Poverty reduction

Poverty is dynamic factor in the global world. People experience poverty due to lack of basic services (health care, education and clean water) natural disaster, lack of assets, health problems, lack of income, lack of access to credit, or the lack of natural resources that generate income for the government in order to cater for the need of the increasing population. Ajufo (2013) added that youth unemployment, especially among graduates have resulted in youth restiveness and other social vices such as arm robbery, prostitution, political thuggery and destitution which lead to increase poverty rate in the country. This corroborates the opinion of Safiriyu and Njogo (2012). The presence of full employment and economic development is a panacea for poverty reduction in any emerging economy. According to Al-Mubaraki and Busler (2013:366), "economic development is the method of creating wealth by the gathering of human, financial, capital, physical and natural resources to produce marketable goods and services".

2.2. Microfinance institution

The activity of micro credit improves the goals for entrepreneurship and results in a smooth functioning of organizations and economies (Keister, 2005). Adamu (2007) cited on Ogujiuba *et al*. (2013) are of the view that microfinance institutions have gain popularity through an expansion of the informal sector of the economy as well as hesitation on the part of financial institution especially commercial banks to finance government-sponsored cooperatives and non-governmental programmes without requiring collaterals and fixing and bottlenecks that stifle the registration processes that hindered the micro credit user to access the loan facility. The high growth rate of the Nigerian population creates a high demand on microfinance institutions for entrepreneurs and other business organizations for credit and savings access (Awojobi and Bein, 2010). Given the last census count, the market for microfinance institutions in Nigeria is quite enormous because the country has over 150 million populations. Moreover, microcredit institution has the holding capacity to raise revenue to meet operating costs (mobilization and training, loan administration, bad debts) (Ogujiuba *et al.*, 2013). Microfinance institutions have made some successful contribution to the creation and lending of credit which are easily assessable and closely supervised (Bahar, 2001).

2.3. Entrepreneurial activity

Entrepreneurs are expected to create a platform that will result in positive externality through the production of new goods and services as well as develop new technology for more expansion (Hausmann and Rodrik, 2003). According to Ihugba *et al*., (2014), "the Nigerian government is not doing enough to encourage entrepreneurs through sound policies in order to create enabling environment for entrepreneurship activities to greatly influence the development of the economy. In other words, the governments have to make available the enabling environment for private sector led investment through the delivery of suitable infrastructural amenities". Entrepreneurial activities potentially create wealth, generate employment, develop entrepreneurial skills development and result in sustainable economic development. Gries and Naudé (2011) thus defines entrepreneurship as "resource, process and state of being through and in which individuals utilize positive opportunities in the market by creating and growing new business ventures for the gradual development of the economy". Meanwhile, entrepreneurial activity is not meant for solving unemployment problem, poverty and under-development in the developing nations but for strategic and rapid economic development in both developed and developing nations (Praag and Versloot, 2007).

2.4. Empirical reviews

Okpara (2010) studied the effect of microfinance bank on Nigerian poverty reduction. The multiple regressions revealed that microfinance institution and poverty trend is based on hard economic times, low profit, inflation, inadequate finance to operate businesses as well as expand existing ones. The study also showed that poverty is increasing at a slower rate due to increased microfinance credit. It concluded that microfinance credit has drastically reduced the Nigerian poverty index. Similarly, Rajendran and Raya (2010) examined on the influence of microfinance institution on rate of poverty reduction in India. The empirical result that microfinance activities have significantly reduced poverty. This therefore means that the presences of microfinance institution significantly lead to poverty reduction and enhances women empowerment for positive economic development.

Ogujiuba *et al.* (2013) investigated the problems facing microfinance in Nigeria. It was revealed from the content analysis that default in loan repayment, widespread delinquency, management deficiencies, high transaction costs and poor loan quality are responsible for the epileptic activities of microfinance institutions in Nigeria. In same vein, Okonkwo *et al*. (2015) studied the effect of the activities of microfinance institutions on the rate of poverty in Nigeria focusing on households in rural communities that are engaged in farming. They stated that Nigeria poverty index which is relatively high is highly embarrassing to the economy with increasing rate of unemployment. They also found out that financial services provided for poor by microfinance institutions have greatly alleviate poverty level.

2.5. RELATED THEORIES

The study was anchored on hold-up and soft-budget-constraint theories because when there is lending constraint experience by the microfinance institution would greatly hinder the growth of entrepreneurial activity and widen the poverty gap.

2.5.1. The Vicious Cycle of Poverty

The vicious cycle of poverty theory shows that there exist circular movements and relationships between poverty and growth/development in less developed countries (LDCs) like Nigeria. Jhingan (2003) added that poverty vicious cycle start productivity level which is extremely on the low side due to deficiency of capital, low level of savings, market perfections, low rate of investment, low level of income, economic backwardness and underdevelopment.

2.5.2. Hold-Up and Soft-Budget-Constraint Theories

Financial institutions preference of lending had created inefficiencies that exclusively affect the relationship between the firm and the bank. It creates two forms of constraints: hold-up and soft-budget constraints. On the view of the hold-up lending constraint, improvement in firms' investment decisions among existing choices due to potential incentives increases banks' profitability (Von Thadden, 2004). In the case of soft-budget lending constraint, multiple bank lending enables financial institutions reduces inefficient credits. This will reduce strategic default of the firms. In essence, the multiple bank lending creates a platform for banks to adequately finance entrepreneurs as well as improve their incentives.

3. Methodology of research

3.1. Research design

Yin (2003) defines research design "as a logical sequence that connects the empirical data to a study's initial research questions and ultimately to its conclusions". This study adopted a survey research design for the collection of primary data. Zikmund (2003) states that "surveys provide a quick and accurate means of accessing information on a population at a single point in time" The population of this study consisted of small scale business and households carrying out entrepreneurial activities in Ikpoba Okha Local Government Area of Edo State. The simple random and judgmental sampling techniques were used to select the respondents for the study.

3.2. Model specification and measurement of variables

The model specification of this study is based on multivariate regression econometric models. Multivariate regressions econometric explain the variation between the activities microfinance institutions and poverty reduction in Nigeria. The multivariate regressions with an error term (e_t) is expressed in the equation below:

$$Y = B_0 + BX_1 + BX_2 + e_{t.} \quad (1)$$

The mode was re-written as:

$$PORDN = B_0 + B_1MFIN + B_2ENPA + e_t \quad (2)$$

Where:

PORDN = Poverty Reduction; MFIN = Microfinance Institution; ENPA = Entrepreneurial Activity; B_0 = Constant; e_t = error term.

The variables measured accordingly with the use of Likert-type 5-point scale and measurement instruments were evaluated for their reliability and validity. Chaka (2006) states that, the acceptable limit for the Cronbach's Alpha coefficient is 0.70. Therefore, a coefficient of at less 0.80 is regarded as reliable and viable (Sekaran, 1992). The measures are in the survey are expected to exceed this minimum threshold (Scheepers *et al.*, 2008).

In this study, the reliability for the internal consistency of the variables ranges between 0.718 and 0.756. The highest reliability internal consistency result was poverty reduction (0.756) followed by microfinance institution and entrepreneurial activity with a Cronbach's Alpha value of 0.724 each. The Cronbach's Alpha value of all variables is more than 0.70. This means scales in this reliability analysis were well-established and the result was acceptable for further empirical analyses.

Vol. 5 (2), pp. 114–119, © 2019 AJES

4. Data Analysis

This study used multivariate regression techniques in examining the significant impact of the variables. Pearson correlation matrix was adopted to investigate the relationship between the variables, White Heterosedasticity regression test was conducted to investigate the significant relationship between the variables, Ramsey Reset test was used to test for the misspecification of the model and a diagnostic test was also carried out using Breusch-Pagan-Godfrey Heteroskedasticity to test for heteroskedasticity in the regression results. The analyses were conducted using Eviews 8.0 econometric software and Statistical Packages for Social Sciences (SPSS 21) econometric software.

4.1. Data presentation, analyses and discussion of results

Table 1 shows the correlation matrix result which measures the degree of linear relationship among the given variables for the study. The result of the correlation coefficient revealed that a highly positive correlation relationship exists between microfinance institution (MFIN) and poverty reduction (PORDN=0.9261). This means the presence of sound microfinance institution might help to reduction the rate of poverty through micro-credit offering. A weak positive correlation relationship exists between entrepreneurial activity (ENPA) and poverty reduction (PORDN=0.0102). This means the presence of sound microfinance institution might help to span up the growth of entrepreneurial activity. From the table, no two variables were perfectly correlated which implies that the problem of multicollinearity is absent from our model. This is laudable since the presence of multicollinearity among explanatory variables could result in coefficients possessing implausible magnitudes and wrong signs as well as the existence of bias in the standard errors.

Table 1. Correlations Result

Variable	PORDN	MFIN	ENPA
PORDN	1		
MFIN	0.9261	1	
ENPA	0.0102	-0.0178	1

Source: Author's Computation (2018)

In order to test the individual significance of the variables, multivariate regression techniques were adopted and the result is presented in table 2 below:

Table 2: White Heterosedasticity Regression Results

Variable	**Coefficient**	**t-test**	**Prob-Value**
C	0.5843	2.6381	0.0111
MFIN	0.8193	17.2440	0.0000
ENPA	0.0261	0.4965	0.6218
R-Square = 0.858542			
Adjusted R-Square = 0.852768			
F-Statistic = 148.69			
Prob(F-Statistic) = 0.000000			
Durbin Watson Statistic = 1.870503			

Source: Author's Computation (2018)

It would be observed from table 2 that the value of coefficient of determination (adj. R^2) is 0.852768. This implies that about 85% systematic variations in poverty reduction were jointly explained by microfinance institution and entrepreneurial activity while the remaining 15% was captured by error term. This means that the model overall is good for statistical prediction. The F-statistic value of 148.69 denotes a significant linear relationship between microfinance institution and poverty reduction in Nigeria. Following the results in the table above, it would be revealed that microfinance institution. (MFIN) had a significant positive impact poverty reduction (PORDN= 17.2440) at 1% significance level. By implication, we were 99% confidence level that the contribution of microfinance institution to the economy would significantly reduce the rate of poverty. The significant impact of microfinance institution was because the variable passed the individual test of significance at 1% level of significance. The findings of Okonkwo, Ezike and Igboji (2015) and Rajendran and Raya (2010) supported the finding that financial services provided by microfinance institutions have greatly reduce the poverty rate. The study therefore suggested that we should reject the hypothesis that microfinance institution has no significant impact of poverty reduction in Nigeria. On the contrary, entrepreneurial activity (ENPA) ad an insignificant positive impact poverty reduction (PORDN= 0.4965) even at 5% level of significance. The insignificant impact of entrepreneurial activity was because the variable failed the individual test of significance even at 5% level of significance. The finding was contrary to the opinion of Gries and Naudé (2011). The study therefore suggested that we should accept the hypothesis that entrepreneurial activity has no significant impact of poverty reduction in Nigeria. The Durbin Watson (DW) statistics of 1.870503 implied that auto-correlation is absent in the regression results but was not relevant in this study because of the nature of data employed. The Breusch-Pagan Godfrey White heteroskedasticity test conducted as shown in Table 3, indicates that the high probability value of F-statistic (0.5570) and observed R-squared (0.5414) showed that there is absence of heteroskedasticity in the regression results.

Table 3. Breusch-Pagan Godfrey White heteroskedasticity Result

F-Statistics	0.59	prob. F (2, 49)	0.5570
Obs*R-Square	1.22	prob. Chi-Square (2)	0.5414
Scaled explained SS	2.06	prob. Chi-Square (2)	0.3564

Source: Author's Computation (2018)

To test for the misspecification of model adopted in this study, a Ramsey RESET test was conducted as seen in Table 4. Our results indicated that the insignificant value of t-statistic, F-statistic and likelihood ratio (0.3248. 0.3248 and 0.3029) revealed that model for the study was well specified.

Table 4. Ramsey RESET Test

	Value	df	Probability
t-statistic	0.99	498	0.3248
F-statistic	0.98	(1, 49)	0.3248
Likelihood Ratio	1.06	1	0.3029

Source: Author's Computation (2018)

5. Conclusions and recommendations

Poverty sometimes arises due to natural disaster, is lack of assets, lack of income, lack of basic services (health care, education and clean water), health problems, lack of access to credit, or the lack of natural resources that generate income for the government in order to cater for the need of the increasing population. The activity of micro credit improves the goals for entrepreneurial activity which include job creation, income generation for individuals and government, poverty reduction and wealth creation. The study recommended that microfinance institution should be given a conductive environment to operate in order to reduce the effect of poverty. The study therefore suggested that further studies be carried out in this area by extending the scope to other sector of the Nigerian economy.

References

Adewale, A. (2007). Promoting medium and small scale industries in Nigeria. *The Nigerian Banker,* 6-11.

Agbaeze E. K & Onwuka, I. O. (2014). Impact of micro-credit on poverty alleviation in Nigeria: A Case of Enugu East Local Council. *International Journal of Business and Management Review, 2* (1), 27-51.

Al-Mubaraki, H.M & Busler, M (2013). Business incubation as an economic development strategy: *A Literature Review. International Journal of Management, 30* (1): 362-372.

Awojobi, O & Bein, M. A (2010). Microfinancing for poverty reduction and economic development: A case for Nigeria. *Munich Personal RePEc Archive (MPRA).*

Akanji, O.A (2001). Microfinance as a strategy for poverty reduction. *CBN Economic and Financial Review*, 4.

Asemelash, B (2002). The impact of microfinance in Ethiopia: The case of DCSI in Ganta Afeshum Woreda of Eastern Tigray.M.A.Thesis, Department of RLDS, AAU.

Chaka, T. C. (2006). Factors that promote corporate entrepreneurship within the first Rand Bank : A research report submitted to the Gordon Institute of Business Science. University of Pretoria.

Chirwa E & Mlachilla M (2004). Financial reforms and interest rate spreads in the commercial banking system in Malawi. *IMF Staff Papers, 57* (1), 96-122.

Coyne, C.J & Leeson, D.T. (2004). The plight of underdeveloped countries, *Cato Journal, 24* (3): 235-49.

Englama, A. & Bamidele, A. (1997). Measurement issues in poverty. In poverty alleviation in Nigeria, selected papers for the 1997 Annual Conference of the Nigerian Economics Society, 141-156).

Elumilade, O. O.; Asaolu, T. O & Oladele, P. O. (2010). The evaluation of financing of micro-enterprises in Osun state of Nigeria.

Felicia, O.O (2011). Determinants of commercial banks' lending behaviour in Nigerian. *International Journal of Financial Research*, 2 (2).

Gries, T & Naudé, W.A. (2011). Entrepreneurship and human development: A capability approach, *Journal of Public Economics, 3* (1): 216-224
Hausmann, R & Rodrik, D. (2003). Economic Development as Self-discovery, *Journal of Development Economics, 72* (2): 603-33.
Ihugba, O.A., Odii, A & Njoku, A (2014). Theoretical analysis of entrepreneurship challenges and prospects in Nigeria. *International Letters of Social and Humanistic Sciences, 5*: 21-34.
Mejeha, R.O & Nwachukwu, I (2008). Microfinance institutions in Nigeria, MPRA Paper, No. 13711.
Ogujiuba, K, Fadila, J & Stiegler, N (2013). Challenges of microfinance access in Nigeria: implications for entrepreneurship development. *Mediterranean Journal of Social Sciences, 4* (6), 611-617
Okonkwo, T. O, Ezike, K.N.N & Igboji, C (2015). Poverty in Nigeria and effects of microfinance on poverty alleviation among rural farming households. *Journal of Agriculture and Veterinary Science, 8* (7), 56-62
Okunmadewa, F.Y, Yusuf, S.A & Omonona, B.T. (2005). Social capital and poverty reduction in Nigeria, Revised report submitted to *Africa Economic Research Consortium (AERC),* Nairobi, Kenya.
Okpara, G. C (2010). Microfinance banks and poverty alleviation In Nigeria. *Journal of Sustainable Development in Africa, 12* (6), 117-190.
Omotola, J.S. (2008). Combating poverty for sustainable human development in Nigeria: The continuing struggle. *Journal of Poverty*, 12 (4), 496-517.
Rajendran, K & Raya, R. P. (2010). Impact of microfinance: An empirical study on the attitude of SHG leaders in Vellore district (Tamil Nadu, India). *Global Journal of Finance and Management*, *2* (1), 59-68.
Scheepers, M.J., Hough, J. & Bloom, J.Z. (2008). Nurturing the corporate entrepreneurship capability. *Southern African Business Review*, *12* (3).
Schmiemann, M (2008). Enterprises by sizes and classes: Overview of SMEs in the EU, statistics in focus, 31, Luxembourg: Eurostat.
Shane, S & Venkataraman, S. (2000). The promise of entrepreneurship as a field of research, *Academy of Management Review, 25* (1): 217-26.
Soludo, C. (2006). Understanding micro-finance policy in the Guardian newspaper Tuesday, May 1, 25 – 27.
Stiglitz, J.E. and A. Weiss, (1981). Credit rationing in markets with imperfect information. *America Economic Review, 71,* 393-419.
Tavakol, M., & Dennick, R. (2011). Making sense of Cronbach's alpha. *International Journal of Medical Education 2,* 53-55.
Van Praag, M & Versloot, P.H. (2007). What is the value of entrepreneurship? A Review of Recent Research, Small Business Economics, 29, 351-382.
Vohra, P. S. and Sehgal, p. (2012) a case of comparative study of loan performance in selected indian private banks: An important tool of profitability. *Indian Journal of Finance*, 6, (1).
Von Thadden, E.L. (2004). Asymmetric information, bank lending and implicit contracts: The Winner's Course, *Finance Research Letters,* 1, 11-23.
Zikmund, W.G. (2003). Exploring marketing research (7th edition). USA: Thomson, South Western.