An Assessment of the Factors Influencing Small and Medium Enterprises Performances and Access to Credit from Deposit Money Banks in Akure, Nigeria

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Abstract

Lending among other services is being rendered by deposit money banks, this is done to enable their customers have access to financial support towards the development of their business activities as well as economic development. Data for the study was collected from the 96 registered small scale business enterprises in Akure, Ondo State, that were randomly selected. Descriptive statistics were used to analyse the socio economic characteristics of the respondents, while the Ordinary Least Squares (OLS) regression technique was used to analyse profit function of the respondents. The factors influencing the output of small scale business and its profitability model was developed and estimated profit function obtained in the study revealed that all the independent variables have positive coefficients while number of the family members have negative effect on independent variables. Findings revealed that financing of small scale enterprise is an issue of interest in the effort to raise production and productivity. This is as a result of the implementation of bank policies affecting the small scale enterprise. The study recommends that there is need to re-engineer the finance system to accommodate the small scale enterprise and investments.

Keywords: Small scale enterprises, entrepreneurship, deposit money banks, lending policies

Introduction

Lending is one of the financial services render by the deposit money banks to their customers. Deposit money banks grant loans and advances to individuals, business organizations as well as government in order to support their business as a mean of aiding their growth in particular or contributing toward the economic development of a country in general (Olokoyo, 2011). Deposit money banks also perform functions such as received deposit (savings), mobilization and financial resource to their customers. These roles make deposit money banks an important phenomenon in economic growth and development. Deposit money banks decisions to lend out loans are influenced by a lot of factors such as the prevailing interest rate, the volume of deposits, the level of their domestic and foreign investment, banks liquidity ratio, prestige and public recognition to mention a few (Olokoyo, 2011).

In Nigeria, low level of income and saving among small scale enterprises impose considerable limitations on the availability of adequate equity capital for financing small business enterprises. Capital inflow from other formal credit sources is also restricted on several grounds the available loanable found from credit institutions established be the government have been grossly inadequate to meet the requirement of the millions of needy entrepreneurs the remoteness of such institution from those in critical need of credit and the cumbersome lending procedures further limit their accessibility to formal credit. The study was aimed at analysing the lending policies in the commercial institution markets with the view of establishing their role in determining the access of small-scale enterprises to financial services from formal sources.

Literature review

Lending which involves the creation of risk and management of same, effective management of risk inherent in the lending requires an articulated and well-conceived lending policy and practices. In other to minimise default in lending, appropriate methods of risk measurement should be adopted by lender (Adewusi, 2011). Two aspects of risk assessment were identified in the literature which includes the qualitative and qualitative, which must be assessed for the purpose of the credit transaction. Somoye (2005) affirmed that to evaluate the qualitative risk, loan officers have to gather and appraise information on the borrower record of financial responsibility determine his true or current need for borrowing, identify the risk facing the borrowers' business under current and political situations. Lender need to estimate the degree of the borrower commitment regarding the repayment of loans. Caprio and Klingebiel (1999) argued that in order to properly estimate the financial capability of a portfolio, bank should not only limit their analysis to project evaluation techniques alone but by evaluating every conceivable risk that could become threat in the overall performance of such loan.

Lending practices in Nigeria could be traced to four different phases:

(i) **The period before the emergence of banks in Nigeria:** During this period 'Esusu' are the most widespread indigenous saving and credit association in Nigeria. This involves voluntarily mutual aid association in which the members pool their individual savings and have access to credit on favourable term.

(ii) **The period of industrial revolution:** This increase the pace of commercial and production activities thereby bringing about the need for large capital outlays for projects. Many investor at this period were unable to meet up with the sudden upturn in the financial requirements and therefore turn to the banks for assistance. However, the emergence of banks in Nigeria in 1872 with the establishment of the African Banks Corporation (ABC) and later appearance of other banks in the scene during the colonial era witnessed the beginning of banks' lending practice in Nigeria (Olokoyo, 2011). Though, the lending practices of the then colonial banks were biased and discriminatory and could not be said to be a good lending practice as only the expatriates were given loans and advances. This among other reasons led to the establishment of indigenous banks in Nigeria.

(iii) **The period of the advent of Structural Adjustment Programme (SAP) in the country in 1986:** The lending practices of banks were strictly regulated under the close surveillance of the bank's supervisory bodies before this period. The SAP period brought about some relaxation of the stringent rules guiding banking practices. The Bank and Other Financial Act Amendment (BOFIA) 1998, requires banks to report large borrowing to the Central Bank of Nigeria (CBN). The CBN also require that their total value of a loan credit facility or any other liability in respect of a borrower, at any time, should not exceed 20% of the shareholders' funds unimpaired by losses in the case of deposit money banks and

(iv) **The 2004 bank recapitalization revolution:** This brings about unprecedented competition among many financial institutions. This increase competition has result in number of unforeseen difficulties. Many banks find it difficult to lend money to their customers while many were closed done or merged together because they find it difficult to meet the twenty-five-billion-naira target of the CBN

Institution's credit lending is one of the most important financial sources for any credit intensive business both in developing and developed country. In developing countries like Nigeria, bank loan account for the larger percentage of the total loan term. The inability of Deposit money banks and other formal institutions to cater for the credit needs of small scale enterprises was as a result of many factors; the conditions stipulated by most of thefinancial institutions such as copy of the title documents of the landed properties, processing fee of 0.25% per annum and management fees of 0.5% per quarter including perfection charges, certificate of incoporation, detailed profile of the organisation, photocopy of registered title document on of a land among others have pronounced effect on small scale enterprises (Olowofeso and Oyetunji, 2013). Thesehas obstructed the affordability of loan by small scale enterprises

Uduechi (1985) opine that most financial institutions were unable to provide long term funds to small scale enterprises, such institutions prefer to give out short time loan and recover their profit without delay. However, some of the small scale enterprises are unable to meet the conditions stipulated by most of the financial institution for which therefore discourage investment (Adera, 1995). Despite the efforts to overcome the widespread lack of financial services, especially among small scale enterprises in Nigeria, and the expansion of credit to small scale enterprises in the county, majority of the small scale enterprises still have only limited access to bank services to support their private initiatives.

Determinant of deposit money bank lending policies in Nigeria

Lack of access to finance is one of the critical problems facing small scale entrepreneurs in Nigeria for generating persistent income inequality, as well as slower growth of their business. Without inclusion of financial systems, individuals and small enterprises need to rely on their own limited savings and earnings to become entrepreneurs, or take advantage of promising growth opportunities (Olowofeso and Oyetunji, 2013). Financial sector policies that encourage competition, provide the right incentives to individuals, and help overcome access barriers are thus central not only to stability but also to growth, poverty reduction, and more equitable distribution of resources and capacities. A well-functioning financial system has long been recognized as essential for economic development. The work of its financial sector has, over the years, emphasized the importance of financial stability and efficiency. Promoting broader access to financial services, however, has received much less attention despite the emphasis it has received in theory. The access dimension of financial development has often been overlooked, mostly because of serious data gaps in this area. The empirical evidence that links access to financial services to development outcomes has been quite limited, providing at best tentative guidance for public policy initiatives. The increasing emphasis by policy circles in recent years on building more inclusive financial systems thus highlights the need for better data and analysis

The inability of the credit market to provide adequate loan to their creditors have mainly been characterized by the inability to satisfy the existing demand for credit by the creditors. This was as a result of difficulties in loan administration like screening and monitoring, high transaction costs, and the risk of default. Credit markets are characterised by information asymmetry, agency problems and poor contract enforcement mechanisms (Nissanke and Aryeetey, 1995). They are mainly fragmented because different segments serve clients with distinct characteristics. Because of this, lending units are unable to meet the needs of borrowers interested in certain types of credit. This was as a result of credit gap that captures those borrowers who cannot get what they want from the informal market, yet they cannot gain access to the formal sources. Enterprises that want to expand beyond the limits of self-finance but lack access to bank credit demand external finance, which the informal sector is unable to satisfy.

According to Aryeetey et al., (1997) two main theoretical paradigms have been advanced to explain the existence of this fragmentation: the policy-based explanation and the structural-institutional explanations. The policy-based explanation, fragmented credit markets (in which favoured borrowers obtain funds at subsidized interest rates, while others seek funds from expensive informal markets) develop due to repressive policies that raise the demand for funds. Unsatisfied demand for investible funds forces credit rationing using non interest rate criteria, while an informal market develops at uncontrolled interest rates. Removing these restrictive policies should therefore enable the formal sector to expand and thereby eliminate the need for informal finance. The structural-institutional explanations, imperfect information on creditworthiness, as well as cost of screening, monitoring and contract enforcement among lenders, results in market failure due to adverse selection and moral hazard, which undermines the operation of financial markets. As a result, lenders may resort to credit rationing in the face of excess demand, thus establishing equilibrium even in the absence of interest rate ceilings and direct allocations

Aryeetey and Gockel (1991) examine some of the factors that influence demand for formal savings and lending facilities in Ghana and observe that incomes, bank formalities and banks' preference for large transactions were the major ones. Travel costs and time are among other factors that determine transaction costs to the entrepreneurs. Besley (1994) has classified major features of rural credit markets that can be used to explain the existence of formal and informal credit markets in Africa. Among these are the existence of collateral security and covariant risk. Collateral security is often beyond the reach of many borrowers in rural areas. But even where this is not the case, the ability of the lender to foreclose is often limited, making enforcement of loan repayment difficult. Such difficulties help to explain the use of informal financial markets, which use social sanctions to ensure enforcement. In rural areas, shocks in incomes that create borrowers' potential to default will affect the operation of credit markets. In most rural economies, borrowers are faced with risks arising from uncertainties about their incomes. By diversifying their loan portfolios, lenders can avert such risks. However, credit markets in rural areas are segmented, with lenders' loan portfolios being concentrated on borrowers facing common shocks to their incomes. An important cost of segmentation is that funds fail to flow across groups of individuals despite the benefits of doing so. According to Besley (1994), this kind of segmentation may also be reinforced by government regulations. In incomplete markets, rural households could use partially functioning credit markets to provide insurance against income shocks mainly by trading insurance. However, due to incomplete information about the nature of the risk faced by each individual, and possible changes in the private behaviour of other individuals, insurance arrangements are only partial or totally absent ((Aryeetey, 1996, Aryeetey and Udry, 1997). Another important factor of the formal markets relates to penalties is that in the absence of formal contract enforcement mechanisms, the formal institutions rely on lending practices that emphasize loan screening rather than monitoring, which appears to suggest more concern with adverse selection than moral hazard.

Methodology

Akure is a traditional city like other Yoruba towns in the south western part of Nigeria. It lies approximately on latitude 70 171 North of the equator and longitude 50 141 East of the Greenwich Meridan. Akure is the capital of Ondo State, which was created in 1976 out of formal Western State. Been the state capital the town is characterized by many commercial activities. Many inhabitants of the town are involved in small scale enterprises and they need loan to expand their business thereby increase their profit margin.

Questionnaires were administered to the small scale entrepreneurs to collect information on the social economics characteristics of the respondents and other economic variables. According to the Micro Small and Medium Scale Enterprises report (MSMES, 2012) there are 596 registered small scale enterprises in Ondo State, out of which 160 are in Akure - the study area. Simple random sampling was used to choose 96 SME's representing 64% of the entire study population.

Model specification

The profit model formulated for the small scale beneficiary in Ondo State were specified as follows;

Profit = f(Location of the business, Age of the respondents, Educational qualification, Revenue level/ income, Number of family members, number of the staff/ Labour). That is,

PROFIT = β0 + β1LOCAT + β2AGE + β3EDUCAT + β4INCOME + β5NUMBER + β6LABOUR + l i ……………………..(1)

Where PROFIT = Profit, LOCAT= Location of the business, AGE= Age of the respondents, EDUCAT= Educational qualification, INCOME= Revenue level/ income, NUMBER= Number of family members, LABOUR= number of the staff/ Labour

Where β0, β1, β2, β3,,,,,,,,,β6 are parameters to be estimated and l i = Error term

Data Analysis and Discussion

Descriptive statistics were used to analyse and discuss the socio-economic characteristics of the respondents while the Ordinary Least Squares (OLS) regression technique was employed for analysing the profit function.

Table 1: **Socio-economics characteristics of the respondents**

Characteristics	Frequency	Percent
Gender		
Male	55	
Female	41	42.7
Total	96	100
Qualification		
Non formal education	7	7.3
Primary school	21	21.9
Secondary school	32	
Post-Secondary school	36	37.5
Total96	100	
Interest rate charge		
Low	15	15.6
Normal	3	3.1
High	78	
Total	96	100
Collateral security		
Landed property	63	
Farm crops	11	11.5
Personal guarantee	1	1.0
Share certificate	6	6.3
Deposit account	1	1.0
Guarantee by recognize person in the community	14	
Total	96	100

Source: Data Analysis, 2015

The social economic characteristics of the respondents were shows in table 1, in which 55 (57.3%) of the respondents were male and 41 (42.7%) were female. This implied that majority of the respondents were male. The table also shows that majority of the respondents have formal education 21(21.9%), 32 (33.3%) and 36 (37.5%) for primary, secondary and post-secondary education respectively. 7 (7.3%) of the respondent were without formal education. The level of interest rate charge from the respondents were also considered, 15 (15.6%) of the respondents agree that the interest rate charged was low, 3 (3.1%) for normal while 78 (81.3%) was with the opinion that the rate was high. The implication of this is that, higher interest rate will discourage the small scale owner in borrow money from the deposit money banks. The finding of this study agree with the study of Olowofeso and Oyetunji (2013), who noted that the higher level of interest rates charge by the financial institutions have negative effect on the price of the product. It was also discovered that the collateral security such as landed property, guarantee by recognise person in the community, farm crops and other were very difficult for small scale business owner to avoid and lead to reduction in the number of people apply for the loan a number of loan granted by the institutions. The findings also concur with that of Chodechai (2004) who noted that charging too high loan rates and collateral may also create an adverse selection situation and moral hazard problems for the borrowers.

Table 2:The OLS result for the profit model

Model	Coefficients	Std. Error	T-value	Sig
(Constant)	.075	.191	.392	.696
Location of the business	.172	.080	2.147	.034
Age of respondents	.168	.120	1.405	.163
Educational qualification	.014	.079	.182	.856
Revenue level/ income	.280	.072	3.883	.000
Number of the family members	-.064	.121	-.530	.598
Number of staff/ Labour	.022	.069	.322	.748

Source**:** Data Analysis, 2015

The model can be re- written as:

PROFIT = 0.075 + 0.172LOCAT + 0.168AGE + 0.014EDUCAT + 280INCOME – 0.064NUMBER + 0.022LABOUR +1I …………………… (2)

The independent variables are empirically examined to show which of the variables significant influence on profitability model. The profit model produce R2 = 0.779, indicate that 78% of the variation in the profit of the small scale entrepreneurs is explained by the fitted model. The estimated profit function shows that all the independent variables have positive coefficients except the number of the family member which have negative signs. The variables with positive coefficients implies that an increase in the number of such variable would lead to an increase in the profit model of small scale while an increase in the number of family member would lead to decrease in profit model. Findings of this study agree with the study of Aryeetey and Gockel (1991) whom observe that incomes, bank formalities and banks' preference for large transactions were the major factors that influence demand for formal savings and lending facilities. The findings also concur with those in Mugerwa (2000) who noted that deposit money bank fail to grant loan to some customers because of their low level of income. He also noted that some small scale business owners usually consist of members of the same family with inevitable resources at their disposal. The owners have extended families that eat into the finances of the businesses because of the culture/traditional responsibilities. The monies are pulled out from the business cash sales this automatically reduces on their working capital, business profits and subsequent business growth. The small scale business owners start the businesses as a way of raising income as well as maintaining their families. Given the importance of the small scale business to their owners, they continuously seek for credit especially from the deposit money banks to boost their businesses. However, some of the loan goes to the family problem while some of it goes to the business. The business has to support the family, which may constrain the business performance and the subsequent effectiveness of the loan. The effects of family size on loan repayment may be due to pressure on income generated from the business which can then reduce loan repayment capacity.

Conclusion and recommendations

Financing small scale enterprises is an issue of interest in the effort to raise production and productivity as the implementation of bank lending policies will continue to affect the small scale enterprises. Limited access to credit is seen as a result of supply constraints, and not the demand side because the high interest rate charge on loan and other policies stipulated by the bank make it difficult for small scale entrepreneurs to access loan for Small-Scale Enterprises. Finding from the study identify some variables (Location of the business, Age of the respondents, Educational qualification, Revenue level/ income) as positive contributors that lead to an increase in the profit model of small scale. The higher the level of education of investor, the more the investment opportunities that open to such investor, this will give him an idea of investment portfolio diversification which therefore leads to an increase in income generation. Also for an investor to continue to be in business, while maximising profit, there is need to differentiate between the business and the family. The study therefore recommended that there is a need to re-engineer the finance system to suit the small-scale enterprises. There is a need for financial institutions to make long-term loan accessible to small-scale entrepreneurs and with a reduced interest rate. Also, a viable investment requires certain degree of education (formal or informal). Therefore, investors are encouraged to process the quality and finally family member must be made to pay for whatever services they enjoy in the business. This will prolong the lifespan of the business

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