Microfinance Institutions' Role in Nigeria's GDP Growth

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Article DOI: 10.48028/iiprds/ijaraebp.v7.i2.17

Abstract

Using quantitative secondary data from the statistics bulletin of the Central Bank of Nigeria (2023), this study analyses the impact of microfinance institutions on the economic development of Nigeria from 1992 to 2023. Using the Parsimonious Test, the Cointegration Test, the Error Correction Model (ECM), and the Augmented Dickey-Fuller Unit Root Test, the empirical approach is comprehensive and dependable. Through their coordinated efforts, microfinance institutions may be able to boost the economy as a whole, according to the available empirical data. Domestic investment, microfinance bank loans, and economic development in Nigeria are significantly and positively correlated, according to the coefficients' magnitudes, significance levels, and p-values. Additionally, the data reveals a consistent association between investment, bank loans for microfinance, and Nigeria's economic progress. The study's outcomes show that the rise of the Nigerian economy might not correspond with a drop in the quantity of loans that microfinance companies lend to the country's private sector. As a result, the study advocates the proactive role that Microfinance Banks (MFBs) should take in preserving ethical and professional standards. This involves making sure that trustworthy and promising enterprises acquire simple loans, which encourages sustainability and economic growth.

Keywords: *Microfinance Institute, Economic growth, Investment, Inflation*

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Background to the Study

With the ultimate objective of strengthening the nation's economic potential, the government has over the years enacted a number of policies and programs targeted at reducing poverty, supporting the growth of small and medium-sized businesses, and offering financial support to those who are actively engaged in the economy. The microfinance policy in Nigeria is one such effort. Microfinance is a policy tool that helps the economically engaged poor, low-income people, and vulnerable groups have access to financial and social services, according to the Central Bank of Nigeria (CBN) and Nigeria Deposit Insurance Corporation (NDIC) (2011). On December 15, 2005, the Nigerian government publicly launched its microfinance policy, regulatory, and supervisory framework, demonstrating its support of microfinance as a successful tactic for promoting economic growth (Apere, 2016).

The microfinance project in Nigeria has its origins in the community banking schemes and Peoples banks of the early 1990s and late 1980s, respectively. Microfinance has developed into a strategy for economic development that mainly helps those with modest incomes. In particular, microfinance banks (MFBs) provide companies and people with payment methods, loan facilities, and savings options. MFBs have two main goals: a financial goal of being self-sufficient and a social purpose of helping the low-income community with financial services. As a result, MFBs draw funding from private sources for on-lending and investment by private investors, such as deposits and commercial loans (CBN & NDIC, 2011).

Microfinance banks, which originated from community banks, are self-sustaining financial organizations that are owned and run by local communities. Their main objective is to support grassroots rural development and economic progress. The entire assets of microfinance banks have increased over time, despite obstacles including poor funding and repayment problems. Despite these challenges, microfinance institutions continue to play a critical role in providing funding for rural development (Apere, 2016).

However, MFBs in Nigeria have difficulties such poor credit performance, expensive running expenses, inadequate funding, difficulties with repayment, a lack of trained credit personnel, and concerns with illiteracy (Ayodele & Arogundade, 2014; Ezeudu & Emori, 2017). Microfinance banks' ability to contribute to Nigeria's economic growth is further hampered by macroeconomic instability, such as high inflation and volatile currency rates. Is it possible for the microfinance subsector to contribute to Nigeria's growth in light of these and other obstacles? Thus, the purpose of this research is to experimentally examine how microfinance banks affect Nigeria's economic growth.

Literature Review

A wide range of financial services designed for low-income and impoverished people, households, and microenterprises are included in microfinance. These services, which aim to offer consumers financial and non-financial help when traditional financial institutions may fail to reach them, include savings, loans, payment services, money transfers, and insurance (CBN & NDIC, 2011; Anane, 2012). According to Ojo (2009), as referenced in Babarinde et al. (2019), it is seen as a method to economic development that aims to meet the financial

requirements of low-income clientele, especially micro, small, and medium-sized businesses. In order to offer these services, microfinance institutions (MFIs), which include semi-formal and informal sources like cooperatives, NGOs, and informal money lenders, as well as formal institutions like deposit money banks, microfinance banks, and rural banks (CBN & NDIC, 2011), apply sound economic principles.

Licensed to offer microfinance services, microfinance banks (MFBs) are essential for helping the economically engaged poor, mobilizing savings, generating jobs, and advancing socioeconomic development (Ezeudu, 2010; CBN & NDIC, 2011; Ibrahim, 2013). They provide their clients credit so they may grow their companies and make more money. In order to accomplish the goals of microfinance banking, namely poverty reduction and sustainable economic growth, the regulatory standards classify MFBs into unit, state, and national levels, each of which serves distinct geographic areas (CBN, 2013).

When a nation's productive capacity and production of goods and services continue to rise, it is said to be experiencing economic growth. This may be quantified using metrics like GDP or GNP. Theoretically, by encouraging investments, generating jobs, mobilizing funds, and offering vital services to the economically engaged impoverished, microfinance banks promote general economic development.

The beneficial effects of microfinance banks on economic growth are supported by empirical data. For example, Okwoli et al. (2013) discovered that MFBs have a favorable impact on Nigerian rural development and transformation. Using Granger and Ordinary Least Square (OLS) causality approaches, Eigbiremolen and Anaduaka (2014) demonstrated a unidirectional causation from economic development to a considerable beneficial impact of microfinance loans and advances on the Nigerian economy.

Using Ordinary Least Squares (OLS), Ayodele and Arogundade (2014) discovered that, with the exception of bank liabilities, microfinance has a positive influence on economic growth in Nigeria. Using Autoregressive Distributed Lag (ARDL) models, Sultan and Masih (2016) verified a substantial beneficial influence of microfinance on domestic growth in Bangladesh, suggesting a reciprocal link.

Using the Error Correction Model (ECM), Apere (2016) discovered that domestic investment and microfinance bank loans had a favorable impact on Nigeria's economic growth. Using ECM, Murad and Idewele (2017) found that microfinance loans had a considerable beneficial short-term impact on economic growth in Nigeria, but a long-term reversal of that benefit occurred. Furthermore, it has been discovered that investing in microfinance has a long-term favorable influence on economic performance. In contrast to these results, Ezeudu and Emori (2017) discovered that, whereas total assets and microloans and advances were shown to have favorable benefits, microfinance bank deposits had a negative influence on economic growth in Nigeria. In a similar vein, Otiwu et al. (2018) discovered that whereas microfinance advances and loans greatly boosted growth, microfinance deposits had a detrimental impact on it. The contradictory findings from several research demonstrate how intricate the

connection is between economic growth and microfinance. These differences might be caused by variations in econometric methods, microfinance metrics, and contextual variables. While some research indicates that microfinance has a favorable influence on economic growth, other studies point to a negative link or mixed impacts.

In conclusion, microfinance banks are essential to the advancement of economic development and financial inclusion, especially when it comes to meeting the financial requirements of the impoverished who are actively engaged in the economy and ensuring sustainable growth in Nigeria. Using a variety of econometric methods and microfinance metrics, several empirical studies have looked at the relationship between microfinance and economic growth in Nigeria. While some research has linked microfinance to economic growth in a good way, other studies have come to different results.

More study is required to fully comprehend the complex link between microfinance banks and economic growth, especially in the context of developing nations like Nigeria, given the debate's lack of clarity. The purpose of this study is to add to the current conversation by offering more empirical data about the relationship between microfinance and growth.

Methodology and Data
Data and Sources
For this analysis, it makes sense to use time series secondary data that spans from 1992 to 2014 for a number of reasons. First of all, this time frame is appropriate for evaluating the long-term effects of microfinance banks on economic variables since it aligns with the establishment of these institutions in Nigeria. Second, having data from this period guarantees that the study has a big enough dataset to examine patterns and trends. When examining the association between microfinance activities and economic indicators, it is appropriate to use relevant variables such as GDP, Inflation (INFL), Domestic Investment (INV), Microfinance Bank Loans (MFBL), and GDP. While microfinance bank loans and domestic investment are important elements of economic activity that may be impacted by microfinance, GDP serves as a broad indicator of economic success. Inflation is another significant macroeconomic element that has the potential to impact both macroeconomic growth and microfinance operations.

Through data collection from the Central Bank of Nigeria Statistical Bulletin, the study guarantees the accuracy and legitimacy of the data utilized in the analysis. The study's conclusions are strengthened by the extensive and uniform data provided by this official source. Overall, the approach used to choose the time period and collect pertinent data is in line with the study's goals and enables a thorough examination of how microfinance institutions affect Nigeria's economic growth.

Model Specification
This study employs multiple regression analysis with the ordinary least squares econometric technique to test the hypothesis that microfinance bank loans, domestic investment, and inflation have a positive and statistically significant relationship with gross domestic product

(GDP) in the Nigerian economy. Inflation, domestic investment, and microfinance bank loans all play significant roles in GDP growth, according to the model's design;

RGDP = f (INV, MFBL, INFL)
RGDP = α_0 + $\alpha 1$MFBL + α_2INV + α_3INFL
RGDP = Real Gross Domestic Product
MFBL = Micro-Finance Bank Loan
INV = Investment
INFL = Inflation
α_0 = intercept
$\alpha_1 - \alpha_3$ = Coefficient of the independent variables.

Result and Discussion

Error Correction Model (ECM) techniques. The behaviour of the variable interacted, and the model stability and dynamic nature is discussed, thus: First, a significant and suitably signed coefficient value (-0.022675) with a probability value of 0.0031 and an absolute T-statistics value of 4.469648 is indicated by the error correction estimates. This implies that there is a long-term equilibrium link between the model's variables and that disequilibrium corrections are done quickly.

With a probability value and t-stat of 0.000 and 11.357, respectively, the study shows that microfinance bank loans (MFBL) have a positive and statistically significant effect on both short- and long-term economic growth. In a similar vein, domestic investment (INV) has a very positive direct influence on economic development over the long run. The results show that there is a notable short-term influence on inflation (INFL), but no long-term effect on Nigeria's real GDP. Long-term INFL coefficient negativity points to a possible negative impact on economic growth.

Overall, with an adjusted R^2 of 0.874 the explanatory factors explain a sizable amount of the variance in Nigeria's GDP. Highly substantial F-ratio statistics and Durbin Watson (DW) statistics showing no problems with autocorrelation or serial correlation confirm the model's goodness of fit. These empirical results are in line with other studies and highlight the role that domestic investment and microfinance bank loans play in propelling Nigeria's economy forward. They also emphasize how important it is for politicians to properly control inflation in order to lessen any possible harm it may do to the economy.

Conclusion and Recommendations

Over the years under review, microfinance bank loans have stimulated and expanded Nigeria's real gross domestic product (RGDP). This beneficial effect is ascribed to microfinance banks' provision of lenient loans to successful and emerging micro, small, and medium-sized businesses (MSMEs), which are essential for promoting economic expansion. The availability of bank loans for microfinance is thought to be a driving force behind Nigeria's economic expansion.

There is a widespread perception that inflation has a detrimental effect on GDP rather than a beneficial one. As a result, it is advised that the problem of inflation and its possible ability to depress the economy receive more attention. To enhance the valuable impact of microfinance institutions on Nigeria's economic growth, it is recommended that these institutions give the actual and productive sectors of the economy a substantial share of their credit allocation. This deliberate distribution has the potential to greatly promote economic growth.

It is recommended that microfinance banks (MFBs) take the lead in maintaining moral and expert behavior. They should specifically make sure that reputable and potential business owners receive easy loans. This strategy is seen to be crucial for encouraging ethical lending behavior and long-term economic development. To successfully contribute to Nigeria's economic growth, the report suggests focusing on leveraging the good effects of microfinance bank loans, resolving concerns about inflation, and encouraging ethical conduct in the microfinance industry.

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Table 1: Augmented Dickey-Fuller Unit Root Test

Variable	Level	First difference	Lag(s)	Model	Order ofintegration
RGDP	-2.251564	-5.855467**	1	T & I	I(1)
MFBL	-0.624516	-7.340654***	1	T & I	I(1)
INV	-3.674890	-5.874688***	1	T & I	I(1)
INFL	-1.472188	-4.855369***	1	T & I	I(1)
ECM(-1)	-5.745439***		0		Nonel(0)

Sources: EView's Output

Table 2: Unrestricted Cointegration Rank Test (Trace)

Hypothesized		Trace	0.05	
No. of CE(s)	Eigenvalue	Statistic	Critical Value	Prob.**
None *	0.985322	140.4174	65.87610	0.0000
At most 1 *	0.812737	55.98922	44.91525	0.0015
At most 2	0.493374	22.48439	23.87211	0.1248
At most 3	0.358686	8.884733	13.51798	0.1876

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

* denotes rejection of the hypothesis at the 0.05 level

Source: EView's Output

Table 3: Estimates Error Correction Model

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	3.418163	0.288888	11.83246	0.0000
LOG(MFBL)	0.170547	0.012243	13.93016	0.0000
LOG(INV)	0.028825	0.005389	11.35736	0.0000
INFL	0.111814	0.311524	0.358925	0.1083
ECM(-1)	-0.022675	0.222373	-4.496948	0.0031
R-squared	0.887890	Mean dependent var		6.251795
Adjusted R-squared	0.874862	S.D. dependent var		0.336127
S.E. of regression	0.052466	Akaike info criterion		-3.328969
Sum squared resid	0.137475	Schwarz criterion		-3.080273
Log likelihood	49.84306	Hannan-Quinn criter.		-3.274995
F-statistic	323.4566	Durbin-Watson stat		1.878779
Prob(F-statistic)	0.000000			

Source: EView's Output