

Significance of Microfinance Banks in Financing Small Scale Enterprises in Selected Local Government Areas of Osun State Nigeria

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Abstract

This study examined the significance of Microfinance Banks (MFBs) in financing Small Scale Enterprises (SSEs) in selected local government areas (LGAs) of Osun State Nigeria. Descriptive survey research design was adopted for this study. The population for the study comprised all microfinance banks and small scale enterprises in selected local government areas of Osun State. Multi-stage sampling technique was used to select Seventeen (17) LGAs where MFBs are located in the study area and Four hundred and Fifty (450) SSEs were randomly sampled. A set of questionnaire designed to collect data was tested for reliability using Cronbach's alpha: QMFBFSSE ($r = 0.88$). Data were analysed using descriptive statistics such as tables, bar charts, frequencies as well as simple percentages while Analyses of Variance (ANOVA) and multiple regressions were used to test hypotheses one to four at 0.05 level of significance.

The significance of MFB finance on SSEs capital indicated start-up capital (11.94%), working capital funding (12.4%) and capital support for expansion (14.39%). Mean scores of MFB finances among different categories of customers revealed 25.9 ± 16.8 , 16.5 ± 8.3 and 23.6 ± 14.5 in small scale, medium scale and large scale enterprises respectively. A regression analysis designed to examine the influence of sources of finance on SSEs' performance revealed that sources of finance had significant impacts on SSEs' total capital: $F_{(4,103)} = 32.842$; sales $F_{(4,103)} = 31.288$; number of employees $F_{(4,103)} = 5.838$; and profit $F_{(4,103)} = 19.313$; all values being significant at 0.05 level. In conclusion, MFB significantly finance the SSEs in the study area.

Key words: *Microfinance banks, Small scale enterprises and Financing.*

INTRODUCTION

Micro-credit, as a strategy, is usually associated with the work of Muhammad Yunus' Grameen Bank. The bank was founded more than twenty-five years ago in Bangladesh. Today, micro-credit can be found practically in all countries of the world. Support for the programme has been on the increase in recent times and there is a lot of optimism about the capacity of micro-credit to reduce poverty. According to Jolis (1996), Muhammad Yunus believes that he can eradicate world poverty by empowering the poor by the use of micro-credit programmes.

Micro-credit is the name given to extremely small loans made available to poor borrowers. Alternatively, it can be conceptualized as small loans made available to the low or extremely low-income groups in the society without any collateral to secure such loans. Khander (2005) wrote that "micro-credit is an extension of an unsecured, commercial-type loan at an interest to a poverty-stricken borrower who owns less than 0.5 acre of land and relies heavily on wage income." Micro-credit programmes are set up in the following ways; space loans are disbursed in a group setting to the poor borrower, with some amount of non-credit assistance made available. The non-credit assistance ranges from skills training, marketing assistance to lessons in social empowerment. Credit facilities are targeted at landless or assetless or non collateralised borrowers by the financial institutions or donor agencies for the success of the programmes.

Micro-credit can be aimed at poverty reduction among desiring women borrowers. This is due to the policy of social empowerment and women's ability to increase their repayment rate than men, more so that the loans are collateral-free and borrowers have the full freedom to choose the activities to be

financed. Also, micro-enterprise cluster claims to enhance these effects by improving on the strategies of micro-credit. According to Zamman (2000), Micro-enterprises clusters can solve many of the problems associated with microcredit-financed enterprises such as distance from markets and inefficiency. Also, it helps beneficiaries to insure themselves against crises by building up household assets and community efforts.

However, despite the spread and number of micro-credit programmes among policy makers, adequate data are somehow lacking. According to Ostrom (1993), there is little standardization across studies as to how to define or conceptualize critical processes and measures of more traditional lending agencies. This could have helped in the reduction of total loss in case a borrower fails. Other aspects of micro-credit programmes such as skill training and female empowerment also contribute to an entrepreneur's ability to cope with crises by increasing the variety of responses that can be made to challenging situations. These reductions in vulnerability are important because they allow poor people to begin to hold their own in the society. Gains made in prosperous times are partially protected during bad times, which make the cycle of poverty to be arrested. This is really a vital benefit for a large proportion of the poor who live in rural areas.

Research Question

What is the significance of microfinance banks on the SSEs performance in the study area?

Research Objective

Objective of the study was to determine the impacts of microfinance banks on small scale enterprises' financing.

Hypotheses of the Study: The following hypotheses were formulated to guide the study:

H₀₁:- Microfinance banks do not significantly finance small scale entrepreneurs in Osun State.

H₀₂:- Sources of finance have no significant impacts on small scale enterprises' performance in the study area.

Literature Review:

Sources of Finance to Small-Scale Enterprises

Two main sources of finance to small-scale enterprises are the informal (non-institutional) and formal (institutional) sources.

Informal (Non- Institutional) Sources of Finance

Apart from personal savings, the most important non-institutional sources of fund in Nigeria to small scale entrepreneurs have been identified to be relatives, friends, merchant and private money lenders (Ihimodu, 1991). The non-institutional sources of finance account for over 35 percent of the value of the loan in many rural communities in Nigeria (Okorie, 1986) and the relative ease of obtaining the loans is devoid of administrative delays, non-insistence by the lender on collateral security from the borrower and the flexibility built into repayment programmes have made the non-institutional sources relatively easier to access. However, some of these sources (especially merchant money lenders) are known not only to charge exorbitant interests on loans, but often advance such loans to borrowers on restrictive terms, (Msheliza, 1986). In addition, Obeta (1990) opined that interest rates by informal sources range between 20 and 200 percent. In spite of its popularity, informal sources have not supplied the amount of finance that entrepreneurs need (Miller, 1977).

The relative ease of obtaining loans and flexibility built into repayment has made non-institutional sources extremely popular among small scale enterprises. However, many problems are associated with non-institutional sources of credit. These include

- (i) They tend to be small and proprietary in size, confine activities to small neighborhoods. Thus, non-institutional sources of credit can only cater for a limited number of trusted clients.
- (ii) Volume of lending is very small and may not meet the needs of the borrower.
- (iii) Many of the loans from non-institutional credit system are at outrageously high rates of interest, as well as purchasing of borrower output at unreasonably low prices. It is not

uncommon for borrowers to pledge their entire properties as collateral for money borrowed from money lenders.

- (iv) Adoption of third party guarantees as a technique of overcoming the problem of collateral is defective in that enforceability is difficult and ineffective (Balogun and Oni,1999).

Formal (Institutional) Sources of Finance

These sources are said to be formal because their operational procedures and terms tend to be standardized and subject to Central Bank of Nigeria control (Oyeyinka, 2002). These institutional credit sources (Commercial banks, Nigeria Agricultural and Cooperative bank, Peoples Bank, Community Bank or Microfinance Bank) are characterised by low cost of credit as a result of heavy subsidies financed out of general resources provided by other sectors of the economy.

Political considerations are sometimes compelling in making policy decisions but are hardly brought to public knowledge. Ogunfowora *et al* (1972) attributed most of the shortcomings in institutional credit in Nigeria to factors such as interference, cumbersome and time consuming loan processing.

Miller and Osuntogun (1975) were of the opinion that cumbersome and time consuming bureaucratic procedures in processing of loans by institutional credit sources often create time lag between application and disbursement of loans. By the time the loans are finally disbursed to small scale entrepreneurs, it may not be useful for the on- going operations.

In the same vein, Akande and Oni (1999) identify the following main problems associated with institutional sources of credit:

- (i) Scarce collateral.
- (ii) Underdeveloped complementary institution.
- (iii) Covariant risk.
- (iv) Enforcement problem.
- (v) Imperfect information.
- (vi) Bureaucratization of lending which slows down loan processing and exposes credit to political or religious pressures and impedes proper working of finance institutions.
- (vii) Lack of suitably trained personnel with background to supervise small scale projects.
- (viii) Management problems leading to inefficient application of funds and diversification of funds to non-business ventures and sometimes non- productive uses.
- (ix) Counterproductive government monetary and fiscal policies.
- (x) Misconception about loans.

Several inadequacies have been noticed on the part of state credit institutions. These include faulty initial concept, lack of initial groundwork, wrong training and experience, lack of continuity, shortage of technical staff and over-compliance (Balogun and Oni, 1999). Policy makers in Nigeria, as in most other countries have identified lack of access to credit as an impediment to the growth of small scale entrepreneurs in developing countries (Kolajo, 1993). Various policies concerning credit have been aimed at improving access and availability of credit to small scale enterprises in Nigeria. This has been done for two main reasons. First, small scale enterprises (SSEs) provide employment for most of the citizens and secondly, credit policies, as development instruments are politically attractive. Unfortunately, wrongly perceived credit policies have hampered rather than enhanced the rate of technological and small scale enterprises growth in Nigeria and other developing countries as evident from some analyses of operational performances of some of the policies.

Methodology

Descriptive survey design was adopted for this study. This study was carried out in selected LGAs in Osun State of Nigeria. Population for the study consisted of all the microfinance banks and small scale enterprises in the LGAs as at 31st December, 2014. Multi stage sampling technique was employed. Seventeen (17) LGAs where MFBs are located in Osun State was chosen for the study. Ninety (90) management staff of the microfinance banks in the LGAs and four hundred and fifty (450) small scale enterprises was sampled using purposive and simple random sampling techniques respectively.

Model Specification

The empirical analysis in this sub-section of the study was based on the theoretical relationship between entrepreneurial performance and the microfinance bank activities in terms of financing with a view to

examining the significance of microfinance banks in financing the small scale enterprises in Osun State. The empirical model was developed from the works of Asaolu (2004). Asaolu (2004) examined performance evaluation of cooperative investment and credit society in financing small scale enterprises. The model specification is specified as:

$$PF = f(SF) \dots\dots\dots(1)$$

Where, 'PF' represents performance of the SSEs

'SF' represents sources of finance to the SSEs

Equation (1) presents the functional relationship between SSEs' performance and sources of finance for SSEs. From the equation, performance consists of four measures (sales, total assets, number of employees and profits) and sources of finance to SSEs consist of four components as well (personal savings, loans from commercial banks, loans from microfinance banks and loans from cooperative societies).

The above equation can be re-specified in an explicit form as shown below;

$$sales_i = \beta_0 + \sum_{k=1}^n \beta_i sf_k + \varepsilon_{1i} \dots\dots\dots(2)$$

Where,

Sales = is average monthly sales.

SF = is a vector of sources of finance variables which include personal savings, loans from commercial banks, loans from microfinance banks and loans from cooperative societies.

$$total\ asset_i = \gamma_0 + \sum_{k=1}^n \gamma_i sf_k + \varepsilon_{1i} \dots\dots\dots(3)$$

Where,

Total Asset = represents present total capital

SF = is a vector of sources of finance variables which include personal savings, loans from commercial banks, loans from microfinance banks and loans from cooperative societies.

$$Emp_i = \theta_0 + \sum_{k=1}^n \theta_i sf_k + \varepsilon_{1i} \dots\dots\dots(4)$$

Where,

Emp = number of employees

SF = is a vector of sources of finance variables which include personal savings, loans from commercial banks, loans from microfinance banks and loans from cooperative societies.

$$profit_i = \pi_0 + \sum_{k=1}^n \pi_i sf_k + \varepsilon_{1i} \dots\dots\dots(5)$$

Where,

Profit = average monthly profit

SF = is a vector of sources of finance variables which include personal savings, loans from commercial banks, loans from microfinance banks and loans from cooperative societies.

Results and Discussion

Table 1: Significance of MFB on SSEs Performance

Serial Number	SSEs Performance	Increased (%)	No Change(%)	Decreased(%)	Total (%)
i	Total capital	265(71)	108(29)	-	373(100)
ii	Number of employees	168(45)	200(53.7)	5(1.3)	373(100)
iii	Sales	236(63.3)	137(36.7)	-	373(100)
Iv	Profit	266(71.3)	106(28.4)	1(0.3)	373(100)

Source: Field survey, 2015

Table 1 revealed the significance of microfinance banks on small scale enterprises. It showed that 71% of the SSEs agreed that there was an increase in the total capital while the remaining 29% agreed that there were no changes. Also, 45% of the SSEs agreed that there was an increase in the number of employees of SSEs with the intervention of MFBs' financial products while 53.7% agreed that there was no change and 1.3% agreed that there was a decrease in the number of employees. 63.3% of the SSEs agreed that there was an increase in their sales with the intervention of MFBs while the remaining 36.7% agreed that there were no changes. 71.3% of the respondents agreed that there was an increase in the profit while 28.4% agreed that there was no change in the profit and the remaining 0.3% agreed that there was a decrease in the profit. Summarily, the study found an increase in SSEs total capital, sales, and profit as impact of MFB on SSEs' performance. The study found no change in SSEs' employees as an impact of MFBs on SSEs' performance.

Table 2 Forms of Small Scale Enterprises' Financing in Osun State

Sources of capital	Start-up capital	Working capital	Expansion
Personal savings	27.18	25.68	25.81
Borrowed from friends	8.00	6.76	7.43
Loans from commercial banks	7.39	7.81	8.46
Loans from microfinance banks	11.94	12.45	14.39
Gifts & grants	8.43	7.43	8.29
Cooperative Societies	8.35	10.39	10.65
Others	28.71	29.48	24.97

Source: Field survey, 2015

Table 2 presented the sources of small scale finances. From the table, 11.94% of SSEs' start-up capital, 12.45% of SSEs' working capital and 14.39% of SSEs' expansion capital was from microfinance banks in Osun State. In total, 38.78% of SSEs' capitals came from MFBs while the major part of SSEs' capital came from personal savings. The findings of this study revealed that the size of the loan from microfinance banks is small and this result tallies with Coleman (2006)'s argument that the size of loans given to low income earners and micro-clients by microfinance institutions were too small to make any significant difference in their welfare. The result of this study agreed with Nkamnebe (2005) and Gulani and Usman (2014) who reported that SSEs look for credit from other sources than MFIs and concluded that personal savings is the most accessible source of finance to SSEs.

Testing of Hypotheses

H0₁: MFBs do not significantly finance SSEs

To test Hypothesis One, analysis of variance was employed to determine whether there were significant differences among the mean rankings of large scale enterprises, medium scale enterprises, small scale enterprises and individual customers. Tables 3, 4, 5 and 6 presented the summary.

Table 3: Financing-Start-up capital of MFB Customers

Parameters	Mean ± standard deviation
Large scale enterprises	20.2±12.1 ^{bc}
Medium scale enterprises	17.0±8.9 ^c
Small scale enterprises	25.9±16.0 ^{abc}
Individual consumers	32.8±20.2 ^a

Mean \pm standard deviations down the column with different superscript were significantly different at 5% level. Mean separation done by Schaffe
Source: Field survey, 2015

Table 3 revealed that the mean rankings of large scale enterprises, medium scale enterprises, small scale enterprises and individual consumers were statistically different from one another. Individual consumers had the highest mean value of 32.8 followed by small scale enterprises with mean value of 24.4, implying that MFBs finance individual consumers with the highest start – up capital. The result also showed that MFBs finance small scale enterprises with more start-up capital than large and medium scale enterprises. This finding corroborates the CBN 2005 guideline which states that microfinance institutions are to provide financial services such as credit to help low income earners who engage in income-generating activities.

Table 4: Financing Working capital of MFB Customers

Parameters	Mean \pm standard deviation
Large scale enterprises	19.6 \pm 11.0 ^c
Medium scale enterprises	15.1 \pm 7.5 ^{bc}
Small scale enterprises	26.0 \pm 18.0 ^{ab}
Individual consumers	30.7 \pm 3.73 ^a

Mean \pm standard deviation down the column with different superscript is significantly different at 5% level. Mean separation done by Schaffe
Source: Field survey, 2015

Table 4 revealed that the mean rankings of large scale enterprises, medium scale enterprises, small scale enterprises and individual consumers were statistically different from one another. Individual consumers had the highest mean value of 30 followed by small scale enterprises with mean value of 26, implying that MFBs finance individual consumers with the highest working capital. The result also showed that MFBs finance small scale enterprises with more working capital than large and medium scale enterprises. The findings of this study corroborates the CBN (2005) guidelines which state that microfinance institutions are to provide financial services such as credit to help low income earners engage in income-generating activities to expand or grow their small businesses. The result of this study also supports the view of Yahaya, Osemene and Abdulraheem (2011) that financial services needed by the poor (small scale entrepreneurs inclusive) include working capital loans.

Table 5: Financing- Expansion capital of MFB Customers

Parameters	Mean \pm standard deviation
Large scale enterprises	30.9 \pm 17.0 ^b
Medium scale enterprises	17.5 \pm 8.5 ^a
Small scale enterprises	25.6 \pm 16.3 ^a
Individual consumers	27.4 \pm 17.3 ^a

Mean \pm standard deviations down the column with different superscript were significantly different at 5% level. Mean separation done by Schaffe
Source: Field survey, 2015

Table 5 indicated that the mean rankings of large scale enterprises, medium scale enterprises, small scale enterprises and individual consumers were statistically different from one another. Large scale enterprises have the highest mean value of 30.9 followed by individual consumers and small scale enterprises with mean values of 27.4 and 25.6 respectively, implying that MFBs finance large scale enterprises with the highest expansion capital. The result also showed that MFBs finance small scale

enterprises with more expansion capital than medium scale enterprises. The result of this study conforms to Yahaya *et al* (2011)'s view that Nigeria must pursue a progressive microfinance programme that can influence the expansion of commercially viable or successful businesses in order that the operators will not sink back into poverty.

Table 6: Financing-Aggregate Total Capital of MFB Customers

Parameters	Mean \pm standard deviation
Large scale enterprises	23.6 \pm 14.5 ^b
Medium scale enterprises	16.5 \pm 8.3 ^c
Small scale enterprises	25.9 \pm 16.8 ^{ab}
Individual consumers	30.3 \pm 18.5 ^a

Source: Field survey, 2015

Table 6 indicated that the mean rankings of large scale enterprises, medium scale enterprises, small scale enterprises and individual consumers were statistically different from one another. Individual consumers had the highest mean value of 30.3 followed by small scale enterprises with mean values of 25.9. However, large scale enterprises and medium scale enterprises had mean values of 23.6 and 16.5 respectively. This revealed that SSEs among business enterprises received the highest finance from MFBs. This implies that MFBs significantly finance SSEs. Therefore, Hypothesis One was not accepted.

H0₂: Sources of finances do not significantly affect the SSEs performance

To test Hypothesis Two, regression analysis was employed to examine the relationship between the independent variable (finances) and dependent variables (SSEs performance indicators of total capital, number of employees, sales, and profit and aggregate performance). Table 7 presented the summary of the results.

Table 7: Influence of Sources of Finance on SSEs Performance Indicators

Variables	Total capital			Number of Employees			Sales			Profit			Aggregate performance		
	β	T	p-v	B	t	p-v	β	T	p-v	β	T	p-v	B	t	p-v
Personal Savings	-8.06	-.13	0.89	.000	-.11	.91	.000	-.42	.66	.000	.07	.48	2.46	.012	.99
Loan from commercial banks	-.001	-.656	.513	-.002	-.88	.37	-.000	-.47	.06	.000	-.15	.87	-.001	-.310	.75
Loan from MFBs	.002	3.07	.003	.002	1.5	.11	.002	2.2	.02	.001	1.5	.12	.008	2.65	.10
Cooperative	-.006	-8.21	.000	-.004	-3.3	.00	-.006	-8.4	.00	-.005	-5.9	.00	-.009	-1.97	.05
R ²	0.558			0.185			0.549			0.429					
Adj. R ²	0.541			0.153			0.531			0.406					
F-Statistics	32.482			5.838			31.288			19.313					
p- Value	p<.01			p<.01			p<.01			p<.01					

Source: Field survey, 2015

Table 7 showed that personal savings, loans from commercial banks, loans from microfinance banks and cooperative societies were joint predictors of SSEs total capital ($F_{(4, 103)} = 32.482$; $p < .05$). The predictor variables jointly explained 54.1% of the variance of total capital (Adjusted $R^2 = 0.541$). The result showed that only the loan from MFBs ($\beta = 0.002$, $t = 3.073$, $p < .05$) was an independent predictor

of total capital. This implies that total capital employed by SSEs operators were sourced from MFBs. The result agreed with Ojo (2009) who affirmed that credit from MFBs has significantly improved SSEs capital base.

Table 7 also revealed that personal savings, loans from commercial banks, loans from microfinance banks and cooperative societies jointly predicted the number of employees engaged by SSEs with ($F_{(4, 103)} = 5.838$; $p < .05$). The predictor variables jointly explained 15.3% of variance of number of employees (Adjusted $R^2 = 0.153$). The result also revealed that none of the predictor variables positively and independently predicted SSEs number of employees.

Table 7 also indicated that sales were jointly predicted by personal savings, loans from commercial banks, loans from microfinance banks and cooperative societies ($F_{(4, 103)} = 31.288$; $p < .01$). This means that predictor variables jointly explained 53.1% of variance of sales (Adjusted $R^2 = 0.531$). Furthermore, loan from MFBs ($\beta = 0.002$, $t = 2.285$, $p < .05$) was the only one that has a positive significant impact on sales. This implies that the level of sales turnover of SSEs was determined by the amount sourced from MFBs.

Table 7 also revealed that profit level of SSEs were jointly predicted by personal savings, loans from commercial banks, loans from microfinance banks and cooperative societies ($F_{(4, 103)} = 19.313$; $p < .01$). This means that predictor variables jointly explained 40.6% of variance of profit (Adjusted $R^2 = 0.406$). The finding of this study is consistent with Mbat0 (1991) who stated that MFBs finances are pertinent to increase efficiency required by the SSEs. Furthermore, personal savings ($\beta = 0.000$, $t = 0.702$, $p > 0.05$), loans from commercial banks ($\beta = 0.000$, $t = -0.158$, $p > 0.05$), and loans from microfinance banks ($\beta = 0.001$, $t = 1.555$, $p > 0.05$) were not significantly independent predictors of profit. Loans from MFBs had positive impact on profit but not significant. This might be as a result of high lending rate.

Table 7 also revealed that personal savings ($\beta = 2.46$, $t = 0.012$, $p > 0.05$) had a positive impact on aggregate performance of SSEs but not significant, while loans from MFBs ($\beta = 0.008$, $t = 2.65$, $p > 0.05$) had positive significant impact on aggregate performance at 10% level. This implies that the impact of MFBs in Nigeria has been felt by SSEs due to recapitalization policy. This result is in line with Peter (2001), Gatewood *et al* (2004), Kuzilwa (2005), Lakwo (2007) and Ojo (2009) who affirmed that MFBs finances had positive impacts on business performance.

Recommendations: This study seeks to determine the challenges of microfinance banks in financing SSEs in Osun State of Nigeria. Based on the research findings and conclusion, the following policies are recommended for proper development of MFBs in the state. These include;

- There should be innovating new products in the microfinance industry in the state different from the conventional products to guide against non-repayment of loans. There could be new ideas. For instance, if the initial loan sizes are small, the loans should be increased step by step upon successful repayment of each subsequent loan. A customer can start with relatively short loan terms, ranging from 12 weeks to 4 months and subsequent loans amounts could be linked to the amount of mandatory savings in the clients' bank after repayment of the previous loan. This will help to guide against the incidence of non-repayment of loans when the loan and the chargeable interest are not allowed to build up before payment. In addition, this could also help clients to get over the challenge of looking for a viable guarantor before securing a loan.
- Microfinance banks should introduce loan products and strategies targeted at financing technology acquisition by SSEs so that all loans will not be directed at trading of goods and services alone. There is the need to widen the technological base of small scale enterprises to foster the development of the real sector of the state economy. In order to encourage technology acquisition, microfinance banks can categorise their loans into low and high interest loans. The conventional loans to clients can be maintained as high interest loans, while loans for capital assets or technology acquisition should be low interest loans, which can be secured by a mortgage over a fixed asset.
- Related institutions should be strengthened through reformed policy and legal framework to reduce constraints to SSEs financing. Rules and regulations guiding the microfinance activities should also be enforced. This will undoubtedly reduce the occurrence of loan diversion and non-repayment of loans that threaten the progress of microfinance activities in the state. There should also be geographic expansion of microfinance operations in the state. The microfinance institutions should move to rural areas while simultaneously expanding clients' bases in urban areas.

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