Original Research Article

The Influence of Bank Credit Financing on the Growth of SME's in Nigeria

Abstract

This study examines the impact of bank credit financing on the growth of Small and Medium Scale Enterprises (SMEs) in Nigeria. It assesses the relationship between bank credit variables such as bank loan, savings and lending rates on SME growth. The study population was the SMEs in Nigeria, and employed secondary data obtained from the Central Bank of Nigeria's statistical Bulletins over a 27-year period (1992 – 2022). An ex-post facto research design was employed to analyze the data. Findings reveal that the specified variable such as loans have positive influence but insignificant on the growth of SMEs at 5% significance level (0.002344), while savings has positive and significant impact on the growth of SMEs at 5% significance level (0.088330) and lending rate has negative influence on the growth of SMEs in Nigeria. Therefore, the bank should encourage savings and loans to provide adequate financing for SMEs expansion, which will thus have a significant effect on their growth.

Keywords: Bank credit, Commercial bank loan, Savings, SMEs Growth

Comment [NN1]: Please remove numbers and discuss only the key findings

Comment [NN2]: Please revisit your topic. Best to focus on credit financing

Comment [NN3]: Is there something interesting beyond this?

1.1 Introduction

Small and Medium Enterprises (SMEs) are recognized all over the world as backbone of modern economies because they make major contributions to global economic growth and sustainable development through employment generation, poverty alleviation, wealth creation and food security. It is the recognition of the important roles played by SMEs that has resulted in increased attention and education on the approach to develop and sustain a viable SMEs sector (Fred, Omatayo, Maxwell, Adeshola, Augusta, Stephen 2018).It is a known fact that bank credit plays a major role in the development of the economy. Small and Medium Scale Enterprises (SMEs), being an engine growth of the economy, need this credit for capital accumulation which in turn promotes performance and economic growth (Ubesie, Onuaguluchi& Mbah, 2017).

Comment [NN4]: Need citations

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In the view of Ofoegbu, Akanbi and Joseph (2013), SMEs are the panacea for the economic growth and development of many developing countries including Nigeria. They believe that interest on SMEs would contribute to the creation of jobs, as well as providing fertile ground for skill development and acquisition, which serve as a mechanism for backward integration and vehicle for technological innovation and development. SMEs generate employment, bring industrialization and development to the rural areas, utilize indigenous material resources and redistribute income among the poor. Gbandi and Amissah (2014) asserted that SMEs have gained recognition and labeled as the backbone of the private sector development and partnership.

Comment [NN6]: Overly depending on old literature and most of the ideas are unnecessarily repeating

However, SMEs in Nigeria still encounter challenges such as stringent conditions on bank credit, maturity mismatched, inadequate collateral securities, faulty implementation and monitoring of fund disbursed by the government among others and hence handicapping the aim of the policies (Ubesie*et al.*, 2017; Nwosa&Oseni , 2013).

The interest rate charged on the borrowed funds reflects the level of the risk that the lender undertakes when securing the loan. Kakuru (2000) argues that Bank credit financing includes both secured and unsecured loans. He further says that security for the loans involves a form of collateral as an assurance for the loan. Therefore if the debtor defaults on the loan, that collateral is forfeited to satisfy payment of the debt.Growth of small and medium enterprises SMEs involves increased level of output, increased number of employee performance, increased level of creativity and innovation, industrial restructuring and wealth generation in both developing and developed economies Nigeria Investment Report (NIA, 2008).

In Nigeria, The SME sector is the backbone of major developed economies, as well as important contributors to employment, economic and export growth. In South Africa, SMEs account for 91% of businesses, 60% of employment and contribute 52% of total GDP. In Nigeria, SMEs contribute 48% of national GDP, account for 96% of businesses and 84% of employment. According to the Nigeria Bureau of Statistics, small and medium scale enterprises (SMEs) in Nigeria have contributed about 48% of the national GDP in the last five years. With a total number of about 17.4 million, they account for about 50% of industrial jobs and nearly 90% of the manufacturing sector, in terms of number of enterprises.Small and medium enterprises are businesses which are independently owned and operated by a few individuals. They can be defined in terms of sales volume and number of employees in the business indicated by structural development, profitability and employment levels. They mainly engage in buying produce, market vending, catering and confectionery, shop keeping, second hand clothing, health/herbal services, secretarial services, telephone services, handicraft, transport and many others Nigeria Bureau of Statistics report (NBOS, 2004).

An obstacle limiting the development of SMEs in Nigeria is the death of infrastructural facilities and financial sources for the sub sector. In most cases, the operators often find financing options particularly banks inaccessible. This phenomenon has pushed many operators to explore other alternative funding sources with high interest rate and other implications. In response to that, government came with various financial windows for the SMEs through the Central Bank of Nigeria. These include Micro, Small and Medium Scale Development Fund (MSMSDF), microfinance banks, direct loans from state governments among many other financial windows. Over a short period, it has yielded significant improvement in their activities (Jibir, 2015).

Proper management of debts lead to growth and smooth operation of businesses and poor management of debts will not only cripple the ability of commercial banks and other lending institutions to offer credit facilities to small and medium enterprises but threatens their profitability and survival (UIA Report, 2008). Onwuka (2015) saw the problem facing SMEs as inadequate funding on the part of the commercial banks and other financial institutions and poor management on the part of small business owners.

Despite the fact that the Nigerian government implemented different policies, starting from the adoption of the Structural Adjustment Programme (SAP) in 1986, establishment of Bank of Industry (BOI), Small Scale Industries Credit Scheme (SSICS), World Bank Small and Medium Enterprises Loan, Refinancing and Rediscounting Facility (RRF) of the Central Bank of Nigeria, Small and Medium Enterprises Equity Investment Scheme (SMEEIS), Small and Medium Enterprises Development Agency of Nigeria (SMEDAN) - (Ubesie, Onuaguluchi& Mbah, 2017). Furthermore, the N200 billion Small and Medium Scale Enterprises Guarantee Scheme (SMECGS) was instituted by the CBN in 2010 and, in 2013, the MSME improvement fund with share capital of N220 billion. Subsequent interventions were industry specific such as N50 million textile intervention fund, agricultural and manufacturing sectors' support facility (RSSF), etc. (Nwosu &Ochu, 2017).

The Small and Medium Industries Equity Investment Scheme (SMIEIS) which is one of the policy implemented by Nigerian government, is a voluntary initiative of bankers" committee which requires all licensed banks to set aside 10 percent of their profit before tax (PBT) for equity investment in, and promotion of SMEs. Despite the existence of programmes and policies on financial support for SMEs in Nigeria, very few small and medium scale businesses receive financial assistance (credit) when they need it. This has constrained the development of their businesses and hence their performance. Mambula (2002) found that 75 percent of small firms he studied in Nigeria considered lack of financial support as a major constraint militating against the growth of small business. It was found that small business owners consider procedures for securing credit from banks unwieldy and the acceptable collateral for such loans are imprudent.

On the other hand, banks claim that most small business owners that apply for loans do not present acceptable investment or business plan and viable feasibility study. With regard to the un-credit worthiness of most SMEs as viewed by the banking system, this study has become necessary to ascertain how banking credit financing to the small and medium scale enterprises has imparted on SMEs growth in Nigeria.

2.1 Literature Review

Information Asymmetry is a theory that identifies the relationship between variables and SMEs in the application of bank loans. Thus, this study adopts the information asymmetry theory to understand how firms apply for bank loan. The main formal financing source for SMEs is the bank. According to the European Central Bank (2011), 40% of respondent firms use their overdraft facilities or credit lines, and more than one-third of firms have used bank loans. Longenecker (2012) mentioned that commercial banks are the primary providers of debt capital to firms. Commercial banks prefer firms with proven track records and sufficient collateral in the form of hard assets. Proven track records and collaterals are difficult to obtain for small businesses.

The lack of access to bank loans of SMEs is attributed to information asymmetry. Finance gap hypothesis suggests that SMEs suffer from a shortage of financing, which is caused by information asymmetry (Ed Vos 2007, Berger and Udll, 1998). Behr (2011) mentioned that lending in developing economies, specifically lending to micro and small enterprises, is particularly affected by information asymmetries between borrowers and lenders. Thus, startups and expansion potentials cause difficulties in obtaining intermediate external finance.

The pecking order theory is one that was developed by Myers Sanders in 1984. It implies that the financing requirements of firms (usually SMEs) are catered for in a hierarchical order. The initial source of funds is internally generated. As the amount of funds required is increased, the next source is via the use of debt. Further increase in the need of funds leads to sourcing for external equity. Thus there tends to be a negative relationship between profitability and external borrowing by small firms. This further implies that the debt equity mix of a firm should be heavily dependent on the hierarchical financing decisions over time.

This theory thus maintains that businesses organizations always prefer to use internal funds. If it is not available, the organization will prefer to use debt as an external source of fund before it considers equity financing. Therefore, by simply examining a firm's debt equity mix, one can have a general understanding on the health of that organization. When managers issue new shares, the public believe that the managers have concluded that the firm is valued more than its actual worth and as such they want to quickly utilize the opportunity. This leads to the investors valuing these new stocks lower than before. The theory also implies that older firms should have more funds available to promote growth since they have had more opportunities to accumulate internally generated funds i.e retained earnings.

Financial growth theory is a theory that was developed by Berger and Udell (1998). According to them, as a business matures over the years, its financial obligations and financing options metamorphose having more information available to the public. According to them, firms that are smaller, younger and possess more ambiguous information must depend on initial internal funding, trade credit, or a type of financing called angel finance. (Angel finance is one that occurs when an individual or organization provides a limited amount of financial backing for a start-up business with more favourable repayment plan). As the firm grows, it qualifies for acquiring both venture capital and midterm loans as sources of both intermediate equity and intermediate debt respectively. Further aging of the firm makes it to become bigger and less informational murky. This thus qualifies the firm to have access to both public equity and long term loans as sources of both long term equity and long term debt respectively. The capital structure of SMEs is thus very different from that of bigger firms because SMEs rely more on informal financial market which limits the type of financing they are able to secure. The SMEs initial use of internal financing leads to a peculiar state of affairs whereby capital structure decisions are heavily dependent on the limited financing options. Therefore, SMEs possess varying capital structures and are financed by various sources at different stages of their development (Berger and Udell, 1998).

Financial intermediation theory was propounded by an early economist, Schumpeter (1912), who described financial intermediation as innovation finance. He further opined that this provided the entrepreneurs an access to funds which increased their expectations and new horizons to possible alternatives, thereby enhancing their performance. Innovation as an attribute of entrepreneur contributes to economic development. McKinnon and Shaw (1973) as cited in Imoughele and Ismaila (2013) opined the essence of the role of financial intermediation as an opportunity of inducing real growth through finance.

In 1973, Schumpeter stressed the role of credit in financing innovation as a key factor for performance and economic development. In a related study, Bencivegan and Smith (1991) emphasized the role of banks as a financial intermediation agents by channelling savings received from surplus units to productive investments through credit advances. Hence, without credit, the innovation opportunities may be handicapped and can hinder performance and economic growth. Therefore, it was concluded that non-availability of bank credits can be a hindrance to the performance of entrepreneurs.

Empirical Review

Lawal et al., (2019) examine the effect of bank credit on the performance of small and medium enterprise in Nigeria. Specifically, the study evaluated the relationship between Deposit Money Banks' (DMBs) credit variables such as banking sector credit, lending rate and savings and time deposit on performance of the SMEs. The study's population was the SMEs in Nigeria. The study employed secondary data obtained from the Central Bank of Nigeria's Statistical Bulletins for a period of twenty-five years (1992-2016). The data obtained were subjected to fully modified least square regression analysis. Findings reveal that banking sector credit and savings and time deposits with DMBs have a positive and significant effect on SMEs performance at 5% significance level (with pv of 0.0006 and 0.0459, respectively). However, lending rate has a negative and significant relationship with SMEs performance at 5% significant levels (0.0351).Based on the findings, the study concluded that DMBs credits have significant effect on SMEs performance in Nigeria. Therefore, DMBs should keep interest rate at its minimum as this will enhance the provision of adequate finance to expand SMEs operation which will thus have a significant effect on the performance of this sector.

Nagaya (2017) and Taiwo, Ayodeji and Yusuf (2012) among many others have looked into the relationship between SMEs and economic growth and came up with different and conflicting results which call for further investigation. Besides that, it is observed that majority of the studies applied primary data in the case of Nigeria. There are very few studies that used time series data. Thus, the present study plans to undertake the anatomy of the relationship between SMEs activities and economic growth using dataset for Nigeria. The study goes beyond the existing studies in two ways: firstly, it has applied more recent time series data and secondly, it considers wide specification and robust econometric techniques. On the basis of that, it provides fresh insight to the existing literature on the relationship between SMEs and economic growth.

Ojong, Arikpo and Ogar (2015) investigated the role of deposit money banks on the growth of SMEs in Yakurr Local Government Area of Cross River State, Nigeria. The study adopted survey research design, and further examined the degree of relationship between bank credit, multiple taxations and government policies on the growth of small and medium scale enterprises in Nigeria. The Pearson product moment correlation statistical technique was employed. The results revealed that bank credit had a significant relationship with the growth of SMEs. Multiple taxations and government policies were found to have significant effect on SMEs growth. The authors suggested deposit money banks should be encouraged to increase the volume of loanable funds to the SMEs, while elimination of multiple taxation, reduction in corporate taxes and the strengthening of government policy framework were recommended as these will impact significantly on the growth of SMEs in Nigeria.

Ayuba, and Zubairu (2015) analyze the impact of banking sector credit on the growth of small and medium enterprises (SME's) in Nigeria for the period of 1985 to 2010 using descriptive statistics. The study reveals that banking sector credit has significant impact on the growth of small and medium enterprises in Nigeria as it has positive impact on some major macro-economic variables of growth such as inflation, exchange rate, trade debts and so on. The study therefore recommends that financial lending institutions should relax the stringent conditions associated with credit facility in the funding of SMEs in Nigeria so as to encourage easy accessibility of loans which will help in improving SMEs financing and growth.

Uzonwanne (2015) analyses deposit money banks and financing of small and medium scale enterprises in Nigeria over the period of 1995 to 2012. The paper analyses data in pursuit of its objectives using descriptive statistics and finds from the analysis that deposit money banks in Nigeria have been lacking in the financing of small and medium enterprises activities. On the basis of the findings, the study recommended deposit money bank stability and sustainability such that the monetary authority should initiate policies that would redirect the channel of deposit money banks' credits so as to meet the borrowing needs of at least 65% of the medium and small scale enterprises in the economy. This it is argued will help to boost economic activities within the country because lack of capital retards investment.

Methodology

The study employed the ex-post factor research design. The study makes use of secondary data to determine the influence of bank credit on the growth of Small and medium enterprises in Nigeria. The time series data was source from Central Bank Statistical bulletin from the period of 1992 to 2022. The explanatory variables includes bank credit, lending rate and saving and time deposit while the dependent variables small and medium scale performance.

Comment [NN7]: The data collection procedure and analysis procedure poorly discussed. How many SMEs were selected? How many banks were selected? Have they all taken credit facility from Banks? Does Central bank maintain separate stats for bank loan disbursements to SME sector?

The model specification includes;

This study model is specified as below:

SMEP= (bank credit to SMEs, Savings and Time Deposit, and Lending rate) ………(1)

SMEP = (BCSME, STD, LNDR) …………… (2)

SMEP= $a_0 + a_1$BCSME + a_2STD + a_3 LNDR + μi

Restated as a logarithm

LnSMEP = $a_0 + a_1$LnBCSME + a_2LnSTD + a_3LnLNDR +μi

Where:

Ln = Natural Logarithm

SMEP= SMEs performance

BCSME= Banks' credit to SMEs

STD= Savings and time deposits

LNDR = Lending rate

a_0= the intercept/ constant

$a_1 - a_4$ = Slopes or coefficient of the explanatory variables

μi= error term

On the a priori expectation, it is expected that $a_1$and a_2 will be greater than zero, hence they will exert a positive influence on the SMEs performance.

Findings and Results

Data Analysis

Table.1: Descriptive statistics

	Loans	**Savings**	**Lending Rate (%)**	**SME Output**
Mean	32799.97	4133.529	18.55889	18097.12

Comment [NN8]: What is the metric? In terms of ₦?

Median	25713.70	1316.957	17.95000	16310.52
Maximum	90176.50	14822.20	29.80000	33131.49
Minimum	10747.89	43.43880	13.54000	7572.640
Std. Dev.	21528.29	4892.845	3.160080	8550.337
Skewness	1.034751	0.878125	1.851854	0.346144
Kurtosis	3.533752	2.293213	7.432160	1.611403
Jarque-Bera	5.138695	4.031955	37.53168	2.708397
Probability	0.076585	0.133190	0.000000	0.258154
Sum	885599.1	111605.3	501.0900	488622.2
Sum Sq. Dev.	1.21E+10	6.22E+08	259.6387	1.90E+09
Observations	27	27	27	27

Source: Author's computation (2020) Using E-views 8

Comment [NN9]: Pls revisit your method section. It indicates data upto 2022

Table 1 revealed that the average loan and advances over the period in Nigeria between 1992 and 2018 was ₦32,799.97 million with a minimum loan of ₦10,747.89 and a maximum of ₦90,176.50. The average savings over the period in Nigeria between 1992 and 2018 was ₦4,133.52 million with a minimum loan of ₦43.43 and a maximum of ₦14822.20. Similarly, the average lending rate within the period was 18.56% with a minimum loan of 13.54% and a maximum of 29.85%. The average SME output for the selected period was ₦18,097.12 with a minimum of ₦7,572.64 and a maximum of ₦33133.4 billion. The Jarque-Bera statistics showed that all the data series for credit financing and SMEs output in Nigeria were normally distributed for further analysis.

Similarly, the p value of all estimates and results which represent the probability of observing a sample value as extreme as the value actually observed, given that the null hypothesis is true served as a guide for accepting/rejecting null hypothesis at various stages in the analysis by comparing it to significance level.

This study examined the unit root test on the selected variables using the root test and the results are presented below:

Table.2: Augmented Dickey Fuller (ADF) Unit Root Results

Variables	**Level**	**Prob.**	**First Difference**	**Prob.**	**Stationarity**
SME Growth	-6.759701	0.0000			I(0)
LogLoan	-1.730051	0.4051	-4.865453	0.0007	I(1)
Logsavings	-1.966421	0.2988	-3.781840	0.0088	I(1)

Lending rate	-5.982088	0.0000			I(0)

Source: Author's computation (2020) Using E-views 8

Table.2 presents the results of ADF unit root results for the levels of the annual time series data between 1992 and 2018. The results denotes rejection of the unit root hypothesis at the 5% level of significance. The ADF statistics were generated with a test for a random walk against stationary AR (1) with drift and trend with maximum lag of 6. The basis for the ADF test is the null hypothesis of non-stationarity by assuming common unit root process and individual unit root process. To reject this hypothesis, each accompany statistics probability must be less than or equal to the specified level of significance (0.05).

Comment [NN10]: Pls revisit your method section. It indicates data upto 2022

Comment [NN11]: Why so many contradictions?

Comment [NN12]: Actually what does this mean?

Table 3: Pairwise Correlation Matrix for the specified variables

	LogLoan	**Logsavings**	**lendingrate**	**SME Growth**
LogLoan	1.000000	-0.501282	0.309370	-0.484355
Logsavings	-0.501282	1.000000	-0.425121	0.921696
Lendingrate	0.309370	-0.425121	1.000000	-0.432799
SME Growth	-0.484355	0.921696	-0.432799	1.000000

Source: Author's computation (2020) Using E-views 8

The table.3 shows that the pairwise correlation matrix between each of the specified variables which revealed a negative association between loan & advances, lending rate and measures of SME growth. Similarly, a strong positive connections are observed between savings and SME growth. Having established the common features of the data obtained for analysis, the study proceed to data analysis and the result of Auto-Regressive Distributed Lag (ARDL) analysis is presented in the table 4 below:

Table 4: Auto-Regressive Distributed Lag (ARDL) Result

Dependent Variable: SME Growth				
Method: ARDL				
Variable	**Coefficient**	**Std. Error**	**t-Statistic**	**Prob.***
SME Growth (-1)	0.458549	0.208752	2.196620	0.0394
LogLoan	0.002344	0.040125	0.058410	0.9540
Logsavings	0.883333	0.345785	2.554571	0.0185
lendingrate	-28.55455	359.4994	-0.079429	0.9374
C	6977.494	6997.963	0.997075	0.3301

R-squared	0.875393	Mean dependent var	18407.55
Adjusted R-squared	0.851658	S.D. dependent var	8563.095
S.E. of regression	3298.093	Akaike info criterion	19.21112
Sum squared resid	2.28E+08	Schwarz criterion	19.45306
Log likelihood	-244.7445	Hannan-Quinn criter.	19.28079
F-statistic	36.88235	Durbin-Watson stat	1.912240
Prob(F-statistic)	0.000000		

Source: Author's computation (2020) Using E- views 8

Table 4 shows the ARDL result coefficients, standard error, t-statistics and probability values for all the selected variables. The result coefficients shows the influence of specified measures of credit financing such as loans & advances, savings and lending rates. It is observed that a unit change in variable such as lending rates will result into a decrease in the level of SME growth in the long run. Similarly, it is observed that a unit change in variable such as loans and savings will result into an increase in SME growth in the long run.

The corresponding values of t-statistics and probability implies that only saving contribute significantly towards SME growth in the long run at 5% level of significance. Similarly, the coefficient of determination (R-square) value of 0.8753 indicates that 87.53% of variation in SME growth are attributable to changes in credit financing variables such as loans & advances, savings and lending rates. Similarly, the Durbin Watson statistics value of 1.9122implies that there is an evidence of autocorrelation in the trend of the data analysed.

Comment [NN13]: There is no auto correlation effect ryt?

There is no significant relationship between bank loan and SME growth in Nigeria. From the preceding analysis and the regression results in table 4, loans with a coefficient value of 0.002344and t-statistics of 0.058410which is insignificant at 5% level of significance shows that bank loan has a positive but insignificant relationship with SME growth in Nigeria. Loans with a coefficient value of 0.883333 and t-statistics of 2.554571which is significant at 5% level of significance shows that savings has a positive and significant relationship with SME growth in Nigeria.

Comment [NN14]: What about literature?

Discussion of findings and recommendations

This study examined the influence of the relationship between credit financing and the growth of selected small and medium enterprises in Nigeria between 1992 and 2018. The results of the analysis showed that the specified variables such as lending rates have a negative but insignificant influence on the growth of selected small and medium enterprises within the period. This finding confirm to the result of Dauda (2019). However, bank loan has a positive and insignificant influence on the growth of small and medium enterprises in Nigeria. This findings confirm with the result of Dada (2014) but go against Ojong (2015). And savings have a positive and significant influence on the growth of selected small and medium enterprises in Nigeria within the period under investigation. This finding goes in line with the study of Lawal (2019).

The result showed the importance of changes in bank loans, savings and lending rates on the growth of selected small and medium enterprises and it showed that these variables often create a long run influence SME growth in Nigeria. Similarly, the coefficient of determination showed the predictive power of the model as well as the possibility of autocorrelation is minimal in the pattern of the data set used in the analysis. Thus, the study revealed that only savings exact a positive and significance influence on the growth of selected small and medium enterprises in Nigeria within the period investigated. From the above findings, the research recommended the following Interest rates on credit financing granted to SMEs should be kept at minimum, as it was found that high-interest rates could impede performance. Adequate savings should be mobilized by offering an incentive rate, as this will enhance the flow of funds from surplus to deficit units of the economy. Thus, an adequate fund will be available for activities of the SMEs. Bank credit financing should be encouraged to make available small and medium term loan and ensure consistent monitoring of credit is administered, as this would resolve the problem of loan diversification and contribute significantly to SMEs performance.

Comment [NN15]: Practically what does this mean? I suggest to revisit your dataset again and redo the analysis and test it

Comment [NN16]: Pls compare with literature

Comment [NN17]: Please revisit your results

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