AN INVESTIGATION OF THE CONTRIBUTIONS OF MICROFINANCE BANKING INSTITUTION TO CAPITAL FORMATION IN NIGERIA
(1992-2010)

BY

UDEOGU EBERECHUKWU GRACE
EC/2009/728

A RESEARCH PROJECT SUBMITTED IN PARTIAL FULFILLEMENT OF THE REQUIREMENTS FOR THE AWARD OF BACHELOR OF
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FACULTY OF MANAGEMENT AND SOCIAL SCIENCES
CARITAS UNIVERSITY AMORJI-NIKE, EMENE,
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TITLE PAGE

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APPROVAL PAGE

This is to certify that this project was undertaken by UDEOGU

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DEDICATION

This work is dedicated to God Almighty for his divine assistance, favor, protection in carrying out this study and also for being there for me throughout my stay in the university and also to my parents H.R.H. IGWE S.C.O. UDEOGU [F.C.A.I.] AGU GBURU GBURU 1 OF EMEORA NEKE and my evergreen loving mom OGOEZE EUCHERIA UDEOGU who with all patience and understanding took immeasurable pains to see me through my academic pursuit so as to attain this level of educational success and to OUR LADY OF PERPETUAL HELP for being there for me throughout my stay in the university.

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My thanks goes to Barr. P.C. Onwudinjo the head of department of Economics, Caritas University.

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Will not forget to appreciate the reason why I came to be in the persons of Late Elder Udeogu Nnamani [Onyeishi Umu-Uhuta Neke] grand dad and Late Mrs. Nwaeze Udeogu [Nee Agbo Nnaji Okaria] grand mom, and late Chief Elias Okpo [Nwa Agabah] grand dad and Mrs. Florence Okpo [mama eha]

My thanks goes to my siblings Princess Ndidiamaka Ann [nwaeze Udeogu], Princess Chinenyenwa Perpetual [nwa mummy], Prince Amuche [Ammynido de neatest] and the last but not the least Prince Chinonso [cash money] for their prayers and support throughout my stay in school.

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ABSTRACT

This research study concerns itself basically with the investigation with microfinance bank institution to capital formation in Nigeria, in analyzing this research study, unitary test was adopted and the instrument used for obtaining the data is secondary data from CBN statistical bulletin. The information collected from the secondary data, helps the researcher to analyse how micro-finance bank work and meet the expectation of the government and the people. Having the dependent variable as gross fixed capital formation testing the strength of independent variables inflation, loans and advances and interest rate which shows 65 percent change in the dependent variable. The researcher therefore went ahead to recommend that the importation of goods which can be produced in Nigeria should be banned as this will give our indigenous investors the zeal and challenge to do more exploits in research. Finally the researcher therefore concluded that financial support to micro-businesses, small and medium scale industries SMIS in developing countries like Nigeria.

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CHAPTER ONE

1.0   INTRODUCTION

1.2   BACKGROUND OF THE STUDY

Microfinance has emerged as an effective strategy for poverty reduction. Across developing countries (Nigeria for example) micro, small and medium enterprises are turning to microfinance institutions (MFIS) for an array of financial service-microfinance is acknowledged as one of the prime strategies to achieve the millennium development goals (MDGs)- access to sustainable financial service enable owners of micro enterprises to increase their capital base, build assets and reduce their vulnerability to external stocks. Access to financial services enable poor household to move from everyday struggle for survival to planning for the future, investing in better nutrition their children's education, health and empowering women especially.

However, the potency of microfinance as a development strategy is contingent upon the existence of microfinance institutions which:

1. Have adequate outreach and more impact on poverty

2. Achieve financial and operating self-sufficient

3. Deliver responsive services to micro and small enterprise

Microfinance is the study of loans, savings and other basic financial services to the poor who are traditionally not served by the conventional financial institution.

These owners of micro and small enterprise require a diverse range of financial instruments to meet working capital requirement, build assets, stabilize consumption and shield themselves against risk. According to Ehigiamusoe (2008) microfinance primarily focuses on alleviating poverty through provision of financial services to the poor or owners of micro enterprises. Services users include artisans, small holder farmers, food processors petty traders and other persons who operate micro enterprises according to (Okereke et al 2009). The financial services include working capital loans, consumer credit, savings pension etc. in practice, microfinance is much more than disbursement management and collection of little bits of loans.

Microfinance is not charity organization despite its application as "poverty lending". Primarily microfinance seeks to create access to credit for the poor who ordinarily are locked out of financial services in the formal financial market for reasons of their poverty that is lack of command over assets. If therefore places

obligation on the borrowers for proper utilization and complete repayment of the borrowed amount even at commercial interest rate.

Microfinance is not new especially history we come across schemes and social arrangement, which enable people to poor their financial resources for on-ward distribution to co-operating and needy individual. Example includes "adachi" and several variants of "esusu". Nigerian microfinance institutions have also intergraded best practice of traditional schemes into the operational procedures.

1.2   STATEMENT OF THE PROBLEM.

Although microfinance services have Endeavour to offer financial services to the vulnerable groups, (youth, women especially), their impact on the economic activities of the beneficiaries still remain low due to its high operating cost, repayment problem, in adequate experienced credit staff, client apathy and dropout, internal control challenges etc. for instance the percentage dropout rate of FINCA wobulenzi beneficiaries stands at 33% on average (FINCA internal annual management report 2004).

Some dropout may be due to improvement on welfare of the bank or the interest rate while in other cases some have lost –even the little they used to own (Nakalnesi, 2003) this therefore sets the basis for the study.

1.3   OBJECTIVES OF THE STUDY

The study was guided by the following objectives:

1. To examine the nature of financial services offered by microfinance institutions to the rural communities

2. To identify the indicators of growth in economic activities of microfinance beneficiaries in Nigeria.

3. To establish the contribution of microfinance banking to capital formation in Nigeria.

4. To design appropriate strategies that will increase the outreach of microfinance institutions so as to enhance economic development and growth in Nigeria.

5. To solve the problems of inadequate experienced credit staff, client apathy and dropout, high operating cost repayment problems etc.

1.4   Research Questions

The following research questions are formulated to enable us find lasting solutions to the problems of this study:

1. Of what importance are the contributions of microfinance banks?

2. How does a microfinance bank credit a small and medium scale enterprise on capital formation?

3. Do microfinance banks enhance individual household ability to accumulate assets and create wealth?

4. Is it important for microfinance banks to aid in the facilitation of rural transformation?

5. How do microfinance banks engage in making finance assessable to enlarge segment of the Nigerian population?

6. How do microfinance banks create capital?

1.5   HYPOTHESIS FORMULATION

For a purposeful data collection and interpretation the following hypothesis are hereby formulated

Hypotheses 1

Ho: Microfinance banks loans and advances to rural people have not contributed much to capital formation

Hi: Microfinance banks loans and advances to rural people have contributed much to capital formation

Hypotheses 2

Ho: Microfinance bank credit to small and medium scale enterprise of agriculture and fishery don't have much impact on capital formation

Hi: Micro finance bank credit to small and medium scale enterprise of agriculture and fishery have much impact on capital formation.

Hypotheses 3

Ho: Microfinance bank investments are not good tools for the formation of capital.

Hi: Microfinance bank investments are of good tool for the formation of capital

1.6 SIGNIFICANCE OF THE STUDY

Poverty is a major challenge facing Nigeria as a country. Many people continue to suffer deprivation even as reforms continue successful. This condition is being addressed to avoid a divide that can engulf Nigeria as a country and the only way to curtain this divide is by expanding opportunities to the poor through microfinance.

Microfinance itself is not a new phenomenon in the Nigerian society as evidence by some cultural economic activities like the "Esusu", "Aso", "Otataje", etc. which were practiced to provide funds for producers in our rural communities. What is current however is the effort of the government of Nigeria to modernize micro financing in our rural and urban communities so as to improve the productive, capacity, enhance their economic standing which alleviate the level of poverty and aggregate to improve development of the national economy. Therefore the significance or importance of this research is to look at how micro financing through the help of the government can help improve the lives and standard of living of individuals or citizens in the rural and urban areas.

There by helping to alleviate poverty and ensuring economic development of the nation at large.

1.7   SCOPE OF THE STUDY (1992-2010)

The research work study expected to appraise the contributions of microfinance banking institution to capital formation in Nigeria. As a result, all works microfinance banks instituted at Mberi in Owerri was chosen as a case study out of the numerous microfinance banks in Imo state.

1. Time: This constitutes a major problem for the research due to the fact that the study was carted out during the academic period, it became a huge problem attending lectures and going about the organization of the study.

2. Lack of information: there was also difficulty in getting the required information especially from workers of the firm. Also laying hands on literatures that has treated these matters was also an impediment to the flow of the required information.

3. Inadequate materials: this constitutes a hindrance to an effective research work. The insufficient supply of literatures such as books, journals was also

a problem. Even when seen, they are either out dated or out of use for referencing purpose.

4. Financial resources: Cost implication on conducting and presenting this research work was enormous. Buying materials needed for this study cost a lot.

Notwithstanding these constraints, the research was well conceived and packed to serve the purpose of which it is intended, which is to look at the various contribution of microfinance banking institutions of capital formation in Nigeria.

1.9   ORGANIZATION OF THE STUDY

In the course of achieving the stated objective of this study, this work has been arranged under five chapters to deal with the relevant issues f the topic.

Chapter one gave an average of the background of the study significance of the study, the limitation, scope of the study, organization of the study and definition of terms.

Chapter two reviews the relevant literature by explaining the conceptual framework of the topic in question. Chapter three contains the research

methodology used in the research including the design, source of data and method of data analysis, while chapter four dealt with the presentation and analysis of data, which highlighted the data collection, the data was properly analyzed and discussed therein.

Finally chapter five dealt on the summary of findings, conclusion and recommendations. Hence bibliography and relevant areas for further reading inclusive in the research.

1.10 DEFINITION OF TERMS

Engle: To surround, cover some body or something completely

Constraint: A thing that limits or restricts something or your freedom to do something

Alleviation: To make something less sever

Potency: The power that somebody or something has to affect your body or mind.

Vulnerability: Week and easily hurt physically or emotionally

Disbursement: To pay money to somebody from a large amount that has been collected for purpose

Utilization: To use something especially for a particular purpose

Sustainability: Involving the use of natural product and energy in a way that does not harm the environment or that can continue or continued for a long time.

Dequincy: Bad or critical behaviour, usually of young people

Appellation: A name or title

CHAPTER TWO

2.0   LITERATURE REVIEW

2.1   INTRODUCTION

Microfinance has been so much in the news recently that we are tempted to assume that the concept of microfinance is a familiar one. This research therefore sets out to look at the various contributions of microfinance banking institutions to capital formation in Nigeria. Specifically looking at the major constraints to effective delivery of microfinance services in Nigeria and identifying key task that policy make should accomplish to render microfinance services more assessable and affordable.

Banks are identified as the most dependable microfinance provide in Nigeria. But banks capacity to provide microfinance services effectively and efficiently is constrained by high transactions cost, high cost of obtaining (their) seed capital, and inadequate institutional support.

Against the background of the need to ensure that micro finance is accessible and affordable, the central bank of Nigeria is currently per-occupied with macroeconomic stabilization. These development roles of the CBN are

largely ignored. It is argued in this research work that the current approach adopted by the CBN lacks microfinance foundations as it ignores the high operational cost and risk that private banks face in Nigeria- besides, it is difficult for private banks to source long term seed capital, independently, in a fiscally centralized economy. Where the federal prefers to reduce its active involvement in the real sector without relinquishing its dominance in the sharing of exert earnings and other collectibles-besides inflows of foreign funds and uncertain and the domestic capital market is still poorly developed.

2.2 background of the study

2.2.1 MICROFINANCE AND MICROFINANCE BANKING

A policy framework called microfinance policy, regulatory and supervisory framework for Nigeria articulated by CBN (2005:2) defines microfinance as the provision of financial services to very small business, i.e. micro-enterprises, which are often unable to benefit from the services of conventional financial institutions.

The central bank of Nigeria (CBN) in the policy frame work outlines three distinguishing features of microfinance- They are;

1. The smallness of loans advanced and /or savings collected

2. The absence of asset based collateral and

3. Simplicity of operation

Microfinance has to do with financial needs of the business activity of the many very small business operation in the economy and because of the smallness of the loans often provided, such other alternative terms microfinance loans and microcredit are sometimes used. Microfinance banking therefore describes the activities of the financial institution involved in the provision of microfinance, including mobilization of needed funds to clarify matters further a regulatory and supervisory guidelines for microfinance banks in Nigeria, articulated by CBN (2005:3) defines a microfinance bank (MFB) as any company licensed to carry out the business of providing microfinance services, such as savings, loans domestic fund transfer, and other financial services that are needed by the economically active poor, micro, small, medium enterprises to conduct or expand their business.

The definition spells out who should benefit from the services of MFBs namely the economically active poor i.e. people with "meager" means of livelihood, which are willing to undertake some form of business for the

improvement of their economic and social conditions. Given the large proportion of this category of persons on our country today MFBs should fill a very important gap in our development strategies.

2.2.2   EVOLUTION OF MICROFINANCE BANKING IN NIGERIA

The need for microfinance banking in Nigeria arose from the realization that the conventional financial institutions were not meeting the needs of major segment of the economy- The central bank for instance observed that the formal financial system provides services to about 35% of the economically active population while the remaining 65% are excluded from access to financial services (the guideline p.2). The financial needs of the excluded 65% of the economically active population were over the years met by the informal financial sector, including money lenders and credit unions- This had adverse consequences for the promotion of monetary stability and caused a rethinking that led to the microfinance policy.

According to Panline Nsa, the pioneer managing Director, first bank of Nigeria (FBN) microfinance bank speaking on the evolution of microfinance bank told "Guardian" (2011) that microfinance banking has been in existence for a long time in our society- she said that in the past, their used to be local collections at

the grassroots. But the CBN came out to formalize and bring in nearly all the money outside into formal system. If you ask people how much money is in circulation they are not likely to know because the people at the grassroots who are the formal financial institutions. So, the need for people to transact at the micro level resulted to the evolution of microfinance. There has always been microfinance transaction at the micro level.

2.3   OVERVIEW OF MICROFINANCE ACTIVITIES IN NIGERIA

The practice of microfinance in Nigeria is cultural rooted and dates back several centuries the traditional microfinance institutions provide access to credit for the rural and urban, low income earners. They are mainly the informal self help groups (ROSCAS) types. Other providers of microfinance services include savings collector and co-operative societies. The informal financial institutions generally have limited outreach due primarily to paucity of loan able funds.

In order to enhance the flow of financial services of Nigeria's rural area, government has, in the past initiated a series of publicly financial micro/rural credit programs and policies targeted at the poor notable among such programs were the rural banking programme, sectoral allocation of credits concessionary interest rate, and Agricultural credit guarantee scheme (ACGS). Other

institutional arrangement were the establishment of the Nigerian Agricultural and co-operative bank limited (NACB), the National Directorate of employment (NDE), the Nigerian Agricultural Insurance corporation (NAIC), the people bank of Nigeria (PBN), the community banks), and the family Economic advancement programme (FEAM). In year 2000, government merged the NACB with the PBN and FEAP to form the Nigerian Agricultural co-operative and rural development bank limited (NACRDB) to enhance the provision of finance to the agricultural sector. It also created the National poverty Eradication programme (NAPEP) with the mandate to providing financial services to alleviate poverty.

Microfinance services, particularly, those sponsored by government, have adopted the traditional supply –led, subsidized credit approach mainly directed to the agricultural sector and non-farm activities, such as trading, training, weaving, blacksmithing, agro-processing and transportation. Although the services have resulted in an increased level of credit disbursement and gains in agricultural production and other activities, the effects were short lived, due to the unsustainable nature of the programmers. Since the 1980s, non-governmental organization (NGOs) have emerged in Nigeria to champion the cause of the micro and rural entrepreneurs, with shift from the supply –led

approach to a demand – driven strategy. The number of NGOs involved in microfinance activities has increased significant increase times due largely to the inability of the formal financial by the low income groups and the poor, and the declining support from development partners amongst others. The NGOs are charity, capital lending and credit only membership based institutions.

They are generating registered under the Trusteeship Act as the sole package or part of their charity and social programmers of poverty alleviation. The NGOs obtain their funds from grants, tees interest on loans and contribution from their members. However, they have limited outreach due, largely, to unsustainable sources of funds. (Policy frame by CBN (2005:4).

2.4   JUSTIFICATION FOR THE ESTABLISHMENT OF MICROFINANCE BANKS

From the appraisal of ht existing microfinance oriented institutions in Nigeria, the following facts have become evident according to the policy frame articulated by CBN (2005:6)

1. **WEAK INSTITUTIONS CAPACITY**: The prolonged sub-optimal performance of many existing community banks microfinance and development finance

Institutions is due to incompetent management, weak internal control and lack of deposit insurance schemes other factors are poor corporate governance, lack of well defined operations and restrictive regulatory supervisory requirements.

2. **WEAK CAPITAL BASE**: the weak capital base of the existing institutions, particularly the community banks, cannot adequately provide a cushion for the risk of lending to micro entrepreneur without collateral. This is supported by the fact that only 77 out of over 600 community banks whose financial statements were approved by the CBN in 2005 had up ton20 million shareholder funds unimpaired by losses. Similarly, the NACRDB, with a proposed authorized share capital of N50. Billion, has N10 .0 billion paid up capital and only N1.3 billion shareholders funds unimpaired by losses, as at December 2004

3. **THE EXISTENCE OF A HUGE UN-SERVED MARKET**: the size of the un-served market by the existing financial institutional market is large. The average banking density in Nigeria is one financial institution outlet to 32,700 inhabitants. In the rural areas, it is 1-5700, that is less than 2% of rural households have access to financial services. Furthermore, the 8 lending microfinance institution in Nigeria were reported to have mobilized a total

savings of N222-6 million in 2004 and advanced N2.624 billion credit, with an average loan size of N8, 206-90. This translates to about 320,000 membership – based customers that enjoyed one form of credit or the other from the eight NGO-MFIs. Their aggregate loan deposit, when compared with those of community banks, represented percentages of 23-02 and 1-04, respectively. This reveals the existence of a huge gas in the provision of financial services to a large proportion of the active but poor and low income groups. The existing formal MFIs serve less than one million out of the over 40 million people that need their services. Also, the aggregate micro credit facilities in Nigeria account for about 0-2 percent of GPD and loss than one percent of the total credit to the economy. The effect of not appropriately addressing this situation would further exacerbate poverty and slow down growth and development

4. **Economic empowerment of the poor, employment generation and poverty reduction**: The baseline economic survey of small and medium industries (SMS) in Nigeria conducted in 2004 indicated that the 6,498 industries covered. Considering that fact that about 18.5million (28% of the available workforce) Nigerians are unemployed the employment objective/role of the SMIs is far from being realized one of the hallmarks of

the national (NEEDs) is the empowerment of the poor and the private sector, through the provision of the needed financial service to enable them engage in or expand their present scope of economic activities and generate employment. Delivering needed services as contained in the strategy would be remarkably enhanced through additional channels which the microfinance bank frame work would provide. It would also assist the SMIs in raising productive capacity and level of employment generation.

5. **The need for increase savings opportunity**: The total assets of the 615 community banks which rendered their reports, out of the 753 operating community banks as at end-December 2004, stood at 34 2 billion. Similarly their total loans and advances amounted to N11.4 billion while their aggregate deposit liabilities stood at N21.4 billion for the same period. Also as at end-December 2004, the total currency in circulation stood at n545-8 billion, out of which N456.6 billion or 84.12 percent was outside the banking system. Poor people can and do save, contrary to general misconceptions. However, owing to the inadequacy of appropriate saving opportunities, and products, savings have continued to grow at a very low rate, particularly in the rural areas of Nigeria. Most poor people keep their resources in kind or simply under their pillows-such methods of keeping

savings are risky, low in terms of returns, and undermine the aggregate volume of resources that could be mobilized and channelled to deficit areas of the economy. The microfinance policy would provide the development of appropriate (safe, less costly convenient and easily accessible) savings products that would be attractive to rural clients and improve the savings level of the economy.

6. **THE INTEREST OF LOCAL AND INTERNATIONAL COMMUNITIES IN MICROFINANCE**: Many international investors have expressed interest in investing on the microfinance sector. Thus, that establishment of a microfinance framework for Nigeria would provide an opportunity for them to finance the economic activities of low income groups and the poor.

7. **UTILIZATION OF SMEETS FUND**: As at December 2004 only N8.5 billion (28.5%) of the N28.8 billion small and medium enterprises Equinity investment scheme (SMEETs) fund had been utilized. Moreover, 10% of the fund meant for micro credit had not been utilized due to lack of an appropriate frame work and confidence in the existing institutions that would served the purpose. This policy provides and appropriate vehicle that would enhance the utilization of the fund.

2.4.1 The microfinance policy

1.   Policy Objectives

The specific objectives of this microfinance policy are the following

   i.   Make financial services accessible to a large segment of the potentially productive Nigerian population which otherwise would have little or no access to financial services.

   ii.   Promote synergy and mainstreaming of the informal subsector into the national financial system.

   iii. Enhance service delivery by microfinance institutions to micro, small and medium entrepreneurs.

   iv.   Contribution to rural transformation, and promote linkage programmes between universal/development banks specialized institution and microfinance banks.

2.   Policy targets

Based on the objectives listed above, the targets of the policy are as follows:

i.   To cover the majority of the poor but economically active population by 2020 thereby creating millions of jobs and reducing poverty

ii.   To increase the share of micro credit as a percentage of total credit to the economy from 0 -9 percent in 2005 to at least 20 percent in 2020, and the share of micro credit as a percentage of GDP from 0.2 percent in 2005 to at least 5 percent in 2020.

iii. To promote the participation of at least two third of the states and local government in micro credit financing by 2015.

iv.   To eliminate gender disparity by improving women's access to financial services by 5% annually and

v.   To increase the number of linkage among universal banks, development banks, specialized finance institutions and microfinance banks by 10% annually. (policy framework by CBN 2005.8)

2.4.2   **POLICY MEASURES AND INSTRUMENTS FOR THE ESTABLISHMENT OF MICROFINANCE BANKS**

Private sector-driven microfinance banks shall be established. The banks shall be required to be well capitalized technically and oriented towards lending,

based on the cash flow and character of clients. There shall be two categories of microfinance banks (MFBs), namely;

i.   Microfinance banks (MFBs) licensed to operate as a unit bank and

ii.   Microfinance banks (MFBs) licensed to operate in a state

The recognition of these two categories of banks does not prevent them from aspiring to having a national coverage, subject to their meeting the prudential requirements. This is to ensure an orderly spread and coverage of the market and to avoid, in particularly concentration in areas already having large numbers of financial institutions.

An existing NGO which intends to operate an MFB can either incorporate a subsidiary MFB, while convert into a MFB.

i.   MBF licensed to operate as a unit bank shall be community-based banks. Such banks can operate branches and /or cash centre's subjects to meeting the prescribed prudential requirements and availability of free funds for opening braches/cash centers. The minimum paid –up capital for this category of banks shall be N20.0 million for each branch.

ii.   MFBs licensed to operate in a state: MFB licensed to operate in a state shall be authorized to operate in all parts of the state (or the federal capital territory) in which they are registered, subject to meeting the prescribed prudential requirements and availability of free funds for operating branches. The minimum paid-up capital for this category of banks shall be N1.0 billion (CBN, 2005:14)

Microfinance banks are expected to register with the corporate affairs commission. Individual groups, community development associations, private can own a microfinance banks. Ownership must be wide spread. Universal bank can also set up a subsidiary or department to provide microfinance services. The policy allows the credit union membership based microfinance institutions to continue t exist. They are allowed to provide micro-credits to their members but should not mobilize deposit from the general public and will not come under the supervision preview of the CBN. Also the existing NGO, MFLs are allowed to convert to microfinance banks under the policy framework.

2.5 OPERATIONAL GUIDELINE FOR MICROFINANCE INSTITUTIONS.

The policy provides the broad goals and direction, while the framework gives the detailed guidelines for the operational requirement of licensed microfinance banks (MFBs). These include permissible and prohibited activities, ownership and licensing requirement accounting disclosure, growth path and support facilities. The unit banks are allowed to operate in one local government area which in the state if it has opened braches. Cash centers to cover at least 2/3 of the local government area of its operation.

A microfinance bank licensed to operate in a state can also open branches in 2/3 of the local government areas of its initial state of operations. The ultimate objectives is to promote an even spread of microfinance banks and avoid concentration already served areas and by so doing ensures extension of services to the target consumers.

The management team of a MFB and the board of directors must be professionally sound to ensure efficient management of the bank. Accordingly, the members of the boards of directors and management require CBN approval. Appropriate regulatory and supervisory framework has been put in place to achieve a balanced growth, promote transparency, control the risk faced by institutions engaged in microfinance and eliminate barrier.

To ensure safety of the depositor's fund provision has been made for the Nigerian deposit insurance corporation to provide deposit insurance up to N100, 000.00 to depositors of microfinance banks. Furthermore, general expect has been incorporated into the regulation framework. These include among others, compulsory investment in treasury bills, liquidity ratio, and capital funds adequately, minimum capital funds restriction on declaration of dividends, limits of lending to a single borrower and provision for classified assets.

2.5   PERFORMANCE EVALUATION OF MICROFINANCE INSTITUTIONS

Two major criteria, outreach and sustainability have been selected for evaluating the performance of MFLs (IGAP, 1996 and Yaron, 1997). Since then, many studies have been conducted using these criteria. Outreach is defined as the ability of a large number of clients (Youssoufou, 2002). The indicators of outreach performance include changes in number of clients, the percentage of female clients, total value of assets, amount to savings on deposit size, average credit size, number of branches etc. Sustainability on the other hand requires MFLs to meet all transaction costs, including loan losses, financial costs, administrative costs, etc. with some return on equity, which will ensure renewal and self sustenance. However, this study uses mainly of some economic

indicators because sufficient data was not available to analyze sustainability conditions.

OUTREACH PERFORMANCE

The demand for microfinance services is high and increasing in Nigeria but the exact amount is not known. The contribution lay –off of labour from both the public and private sectors since the introduction of the structural adjustment programme in 1986 and the growing number of graduates from schools and colleges is pushing a large proportion of the population into informal sector activation. Many micro enterprises are, therefore, springing out but without bank financial support. Also the domestic market is large, with over 130 million people in need of various goods and services, including financial services reflect the expansion of information sector activities and the exclusion of a large proportion of economically active population from the various financial services of the formal sector. Large volumes of financial transactions are carried out by microfinance institutions with little or no publicity around them.

Their operations are not explicitly captured in official financial statistics and their activities are hardly reported on by mass media. Yet their transactions impact directly on a large section of the population, especially the poor.

The mobilization of savings was not seen as an integral part of micro finance in the earlier years. The main sources of funding were the personal saving of members and grants from international organization. However, given the waning interest of donors the problem of financial sustainability has induced the operators to see the mobilization of domestic savings as being important to long term survival. However, their average values of savings were N25.3 million per MFl. Over the past decade, the activities of microfinance institutions have expanded significantly. The rising volume of financial transactions indicates that the low income group and indeed the poor and bankable in Nigeria. All they need is access and convenience which in the banks denied them. Also the raising volume of transactions MFLs can no longer be ignored by the monetary authorities. There is, therefore need for a policy framework that will regulate their activities and capture their operations directly for the official financial statistics.

2.6.2 ECONOMIC INDICATOR

The economic indicators are discussed for 2003. The willingness of the low income group to borrow and repay at seemingly high interest rate confirm the

view that their financial problem has more to do with access to funds than high interest –rates. Interest rate in the microfinance institutions are much higher than the prevailing rate in the banks, reflecting perhaps the perceived greater risks and higher operations costs which the MLFs have to bear. Yet the poor, the low income group reading patronize them. The average lending rate was much higher at 32.0 percent for the bank, the average prime and maximum lending rates were 19.5 and 21.6 percent in December 2003, respectively. Although bank rates were lower, the low income group did not have access them as they could not provide the required collateral. The average loan size of the MFLS was small at N8800, reflecting the small size of activities that are covered by microfinance in Nigeria. The credits range from N5,000 to N13,762, hence the main activities funded were petty-trading and micro hair dressing, sewing, low level agro-allied activities etc.

In line with the structure of lending rates, the average savings deposit rate was at 7.5 percent in 2003, which was significantly higher than the 3.5 percent recorded in the banking sector. The savings rate in the mf1s is therefore more attractive, hence their ability to mobilize lots of savings from the poor. However, reflecting the low income level of his clients, the average savings deposit size was small at N3707.30 in 2003. There is, however, wide variation among firms, as the

average saving size ranged from N1483.00 to N15, 000. These savings which the MFIs are mobilizing are not captured by the banks, owing to the associated high administrative cost. All the available data indicate that the poor are creditworthy. Despite the high level of interest rates, repayment rates were high, averaging 92 percent in 2003. The repayment rate was lower in the banking sector. It averaged 79 percent in 2002 and was much lower at 58.6 percent during the distress period of 1990-1995. The higher repayment rates in the microfinance sector were traceable to the collective responsibility of clients who are required to be in groups. Grouping of clients enhances the scarcity of credits because they jointly assume responsibility for repayment. A defaulting member jeopardizes the chances of other members in the group getting new loans, thus put pressure on one another to ensure repayment for the collective good. 9Source)

The MFIs were funded through a number of sources. Donations and grants from international organizations accounted for 7.0 & 1.9 percent, respectively. The need for financial sustainability makes it necessary that funding form equity and savings as well as other sustainable avenues should increase substantially to reduce the high dependence on aid and grants from abroad. Bank funding of MFIs in Nigeria should be given special consideration. The financial engineering of microfinance institutions has shown that the poor are good credit risks. The

increasing access of the poor to credit and their unmatchable repayment rates has turned the provisions of microfinance in a huge viable business. Thus commercial banks in Nigeria should begin to pay a large role in the provision of micro credit funding. The experiences in Bangladeshi Egypt and Kenya are very good examples, in which banks have done much to fund MFIs and micro enterprises. Also in Indonesia, the world fourth largest country, a single micro banking institution, Bank Rakyat Indonesia, serves about one third of the country's households through its micro banking system (Charisteneto, 2011).

The Banker's committee has taken a decision that 10 percent of the funds accruing to the small and medium industries equity Investment (SMIEIS) should be channelled to micro enterprises through registered microfinance Institution. Under the SMIEIS arrangement, bank in Nigeria agreed to set asides 10 percent of their pre-tax profit annually for equity Investment in small and medium industries. At the end of June 2004, over N24 billion had been set aside under the scheme, while less than N10 million had been invested. The micro finance institution can therefore access 10 percent of the total funds set aside which is now over. N2.4 billion Apart from providing a large volume of resources, the fund is fairly medium to long term in nature and this has the potential of positively changing the structure of the micro finance industry in Nigeria. With this

additional financing, the MFIs can finance activities in the real sector, particularly agriculture and manufacturing.

2.6.3   HOW MICROFINANCE OPERATES

Planet finance explains how micro finance operates "The two major lending models are joint (or grouped) micro loans and individual contracts. Individual contracts are the type of loans that most resemble traditional loans, a person receives a certain amount of money and must repay it within a relatively short period of time (a few week or a few months) taking the interest into account. The amount accorded for these types of loans is generally higher than that of joint loans. "Joint micro loans are granted to group of people who are jointly responsible for repaying the loan. Individual failures to pay (due to illness or a 'bad week') are avoided and group pressure services as a strong incentive in ensuring responsible behaviour by making loans to individuals within a lending circles.

The individual meet regularly, ostensibly creating a self-help group. In recruit, all the borrowers in the groups are responsible for making the loan repayment if a member defaults, so peer pressure is a very strong factor". The organization goes on to explain interest charges are necessary to differentiate microfinance from aid. The idea is to give people the means to help themselves.

When the microfinance model charges how rates of interest on small loans that were required to be repaid in a short period of time, the high rate of return, which planet finance said ranged from 117 percent to 847 percent in the Dominican Republic, attracted many players to be the world of micro finance. Those players, include companies such as "monanto, Citicorp, Infosys, ABN Amro, Icici, and even the United Nations and donors like ford foundation". Sharma said that companies have jumped in. Realizing that there is money in exploiting the helpless poor, private banks and companies and joined to earn profits from poverty". (Business Day pg. 30. May 9th 2011.

2.7   MICROFINANCE BANKING IN OTHER COUNTRIES

Kenya, Uganda, Sierra-Leone are in the forefront of the microfinance revolution in Africa. There are reports of what microfinance has done to change people lives in these countries through reduction in poverty and improvement in people's economic well being – other countries that have given priority to microfinance programmes include Afghan Istion, Egypt, India Madagascar Pakistan, Syria, and Tanzania.

In recognition of the importance of micro credit, the United Nations declared the year 2008 as the international years of micro credit which was celebrated in over 100 countries (including Nigeria) around the world. This was a

universal effort to build support for making financial services more accessible to poor and low income people. It was aimed at raising public awareness of the contribution of microfinance to economic growth and development.

In many countries, microfinance development is not only poverty alleviation programmes but a national and integrated growth and development strategy and is thus given conscious and adequate attention in their national development plans. Thus explains the recent interest the federal government of Nigeria, through the CBN and support of international bodies and donors, it showing in microfinance issues and programmes.

In South Asian countries and some other parts of the world, an organization known as Aga—khan Agency for microfinance (AKAM) worldwide is highly involved in microfinance activities its activities range from village lending co-operatives to self standing microfinance institution to full the designated microfinance bank. They operate in Afghanistan, Syria, Tanzania, Kenya, Egypt, Madagascar, Pakistan, India and Mali. In most of these countries, the microfinance initiatives are often part of wider integrated development strategies implemented with each country. In addition to providing financial services to the poor, other services such as business or technical advisory (training extension) services are provided. AKAM operates the first finance bank

(FMFB) in Afghanistan, Pakistan, and Tajikistan and in a number of other countries. These banks are formally regulated by the central bank of the countries in which they operates and direct their services to the poor and their micro and small enterprises. These banks reach beneficiaries through geographical widespread branches and mobile banks they offer services comparable to these of convention commercial banks. These services include credit savings payment services, money transfer, micro leasing and micro insurance among others. They also support small and medium enterprises (SMEs) reach a higher level of financial stability.

The array of financial services and products that microfinance banks of other countries (such as Pakistan, Afghanistan, India, Egypt etc) offer is continually expending to meet needs. Research are done to develop new services that are sustainable, appropriate and of high quality. Emphasis is placed on vulnerable group focusing on women in particular currently the range of services available for start-ups restates and the generating of current entrepreneurial and other income generating active. Project financed include farming inputs and machinery, livestock rearing and breeding, shoemaking, furniture, handicraft services and retail enterprises, cottage industries, tourism initiatives, internet cafes, and many other forms of entrepreneurial activity.

Health education, habitat and housing improvement, land acquisition and construction (social loan) also are provided.

MICRO INSURANCE:

Microfinance banks in many countries provide microfinance products to borrowers. In Pakistan, for example, two types as micro insurance policies are offered, often as bundle, with small fees of less than US$2 per annum, a policy in which the insurance company would pay the outstanding balance in case of death or permanent disability of borrower and a policy which provides a case pay-out to the family of a borrower for funeral related cost in the event of his or her death.

MICRO LEASING: In some countries, microfinance banks provide micro leasing services, enabling clients to purchase fixed assets and business equipment for productive purpose. They involve large capital expenditures and can be repaid within 6 months to three years.

SMALL BUSINESS LOANS: The most successful business will eventually evolve into small enterprises which are more sophisticated, employ people outside the proprietor's family and produce a broader range of quality products that are sold in large geographical areas. Microfinance institutions are ideally placed to reduce

financial gap that those budding small and medium enterprises face before reaching a scale more attuned to the mainstream financial market.

2.8   IMPROVING MICROFINANCE BANKING IN NIGERIA

Because of the promise that microfinance banks hold for the transformation of the economy and society, efforts must be made to make them work the policy framework and guidelines implementation is another issue entirely. It needs the political will and commitment on the part of government to make this programme a success.

The conversion of the community banks on to microfinance banks does not guarantee automatic efficiency of the institution as most of the internal weakness will still be present. The new capital requirement may solve the weak capital base but the problem of incompetent management must be addressed seriously if they are to meet the expectation of the nation.

The provisions of deposit insurance cover of N100,000.00 by NDK is a very big boost to the development and survival of microfinance banks whose objectives as outlined earlier are to reduce poverty and vulnerability of poor populations and economic and social exclusion. The achievement of such aims by the banks should be governed by the following principles:

RANGE OF SERVICES: To reduce the vulnerability of financial risk microfinance banks should after a range of service, online with the policy, guideline, including, educational loan, credit micro insurance, saving, housing credit among others- through careful targeting, monitoring and evaluation, microfinance banks can work to maximize the socio-economic benefits of their services on poor communities.

SUSTAINABILITY: The survival of MFBs, as other business will depend on their ability to cover the cost of their operations and ability to make reasonable benefits and profits. This will require attention to staff training and skills development especially in project evaluation and management. The major focus should be to enhance the quality of credit through clear and detailed lending procedures, well documented manuals properly trained staff and the use of best practices ensuring financial disciplines and cost control.

BUSINESS DEVELOPMENT SERVICES: Loans should be accompanied by training on basic concept so that the borrower can become financially disciplined and self reliant entrepreneurs. The ability of the emerging microfinance banks to bring financial services to the people who never had access to such services before would require the support of all the stakeholders in microfinance activities such

as the government, the central banks of Nigeria (CBN), microfinance institutions public sector poverty alleviation and donor agencies.

CBN will have to promote healthy competition and mainstreaming microfinance with formal intermediation. The microfinance institution/banks themselves will have to provide efficient and effective financial services to ensures recruitment and retention of qualified professional and adopt continuous training and capacity building programme to improve the skills to staff, remain transparent and protect customers deposit and strictly comply with the rules and regulation of the regulatory authorities. Donor agencies need to be encouraged to direct most of their assistance in form of subsidiary funds, donations and technical assistance to licensed MFB to promote orderly resources injection, transparency and synergy.

2.8.1 ORGANIC GROWTH PATH FOR MFBs ACCORDING TO THE POLICY FRAMEWORK

The policy recognizes that the current financial landscape of Nigeria is skewed against micro, small and medium enterprise (MSMES) in terms of access to financial services. To address the imbalance, this policy framework shall, promote an even spread of microfinance banks, their branches and activities to serve the un-served but economically active clients in the rural and urban areas.

The level of spread and saturation of the financial market shall be taken into consideration before approval is granted to an MFB to establish branches accessing the local government Areas and/or states, in fulfilment of the objectives this policy. Specifically, an MFB shall be expected to have reasonable spread in a local Government Areas or state before moving to another location, subject to meeting all necessary regulatory and supervising requirements stipulated in the guidelines. This is to avoid concentration already served areas and to ensure extension of services to the economically active poor, and to micro, small and medium enterprises.

In order to achieve the objectives of an organic growth path, a microfinance bank licensed to operate as a unit bank shall be allowed to open branches in the same state, subject to meeting the prescribed prudential requirements and availability of minimum free funds of N20.0 million for each new branch. In fulfilment of this requirement, an MFS licensed to operate as a unit bank can attain the status of a state MFB by spreading organically from one location to another until it covers at least two-third of the LDCs of that state. When an MFB has satisfactorily covered a state and wishes to start operations in another state, it shall obtain approval and be required to again grow organically

by having at least N20 million free funds unimpaired by losses for each branch to be opened in the new state.

An MFB licensed to operate in a state shall be allowed to open a branch in another state, subject to opening branches in at least two thirds of the local governments of the state it is currently licensed to operate in, subject to the provision of N20 million free funds and if in the view of the regulatory authorities, it has satisfied all the requirements stipulated in the guidance. The regulation to be issued from time to time shall be such that would encourage the organize growth path of the MFBs at all times.

However, an MFB may wish to start operatives as a state Bank from the beginning and therefore not wish to grow organically from branch to branch. Such an MFB may be licensed and authorized to operate in all areas of the state from the beginning subject to the provision of a total capital base of N1 billion. In other words, the preferred growth path for MFBs is the branch by branch expansion to became state Banks. But anyone wishing to start big as a state institution can do so subject to the availability of N1 billion and proven managerial competence.

2.9 THE CONTRIBUTIONS OF MICRFINANCE BANKING INSTITUTION OF CAPITAL FORMATION IN NIGERIA (THROUGH THE FUNDING OF SMALL AND MEDIUM SCALE ENTERPRISE (SMS), BACKGROUND)

There is growing recognition of the importance of small and medium enterprises (SMEs) in the development matrix to developing economics like Nigeria. Apart from their substantial employment and wealth creation potentials, SMEs also has the keys to transforming poor subsistence societies into developing or industrializing economics. SMEs equally contribute to sustaining development in many todays developed economic. In nearly all developed economic today, SMEs employ between 6 to 15 percent of the working population. This for example, translates to about 3.4 million people in the United Kingdom out of an estimated working population of 27 million persons. In Italy, 90 percent of all industrial firms are small business and absorb 84 percent to total employment. In Denmark, 92 percent of the manufacturing forms are SMEf employing about 43 percent of the work force (Banow, 1993:189). Besides, the economic emergence of newly industrializing economic like Taiwan, South Korea, South African, and Brazil and soon in the 1980s is generally attributed to the complementary role of the small and medium scale enterprises (Obadan and Agba, 2006:29).

However, the success of small and medium enterprises would depend among other things on how well SMEs are able to access cheap Investment funds, how well the delivery of microfinance services are regulated and monitored and how well SMEs have information of investment possibilities, emerging market opportunities and business linkages.

Although, the classification of SMEs sometimes includes fairly large firms, the concern of this study is with supply of microfinance to enhance wealth creation and ensure sustainable industrial development. In this regard, Udeaja and Ibe (2006:15) observed rightly that microfinance is the supply of loans, savings, and other basic financial services to the poor. The effective supply of affordable and readily accessible microfinance can create wealth and enhance industrialization. The major financial services that the poor require include loans, financial advisory services, information on existing incentives and opportunities and linkage to markets and raw material sources. Udeja and the Ibe (2006:19) microfinance in Nigeria include International donors, non-profit NGOs, co-operative, community based development institutions, commercial and state banks, microfinance banks insurance and credit card companies, wire services and post officers. Considering the low level of development of Nigerians financial system, few of the non-bank Institution are able to provide microfinance services

in a sustainable manner, leaving the task of banking institution principally microfinance banks, specializes and state sponsored banks, and universal (commercial) banks.

2.9.1 CLASSIFICATION OF SMEs IN NIGERIA

SME lack universal classification and definitions. Typically, the small-scale business is used to describe sole proprietorship concerns such as neighbourhood shops, cottage (artisan and craft) industries, restaurant and so no, while the term large-scale business is used to describe larger heavily capitalized firms. But between these extremes fall businesses that maybe considered as big or small, depending on the yardstick considered in Nigeria the definition and classification of SMEs strictly cover very small firms, with little or no space for growing indigenous firms many of which may be classified as large firms in Nigeria were for the purpose of state support classified as small firms in western Europe and North America.

In Nigeria, manufacturing, processing and servicing industries employing below 300 workers are generally defined as SMEs (Salako 2004:66) the national council of industries (NCL), in July 2001, made an attempt to define SME in order to guide the bank of industry (BOI) in its allocation of funds of different categories of enterprises. The classification is highlighted below.

MICRO/COTTAGE: This is an enterprise with capital investment of not more than N1.5 million (excluding land but including working capital) and / or a maximum of 10 workers.

SMALL SCALE: Consist of enterprises with capital investment of over N1.5 million but not more than N50 million (excluding land and including working capital) and workforce range of 11-100.

MEDIUM SCALE: This requires a capital investment of over N50 million but more than N200 million (excluding land but including working capital) and/or working range of 101-300.

LARGE SCALE: Comprise enterprise with capital investment of over N200 million (excluding land but including working capital) and/or work force of over 300. Lessons from the development experience of advanced economics reveal however that what may be considered as large firms in Nigeria under the small and medium industries equity investment scheme (SMEIEIS) classification were indeed classified as small business during the early stages of their development for example, the small scale business/enterprises administration (SBA) founded by the United state government in 1953, for the purpose of providing intermediate to long-term financing for small business that were unable to meet the terms of commercial banks used a broadened definition of small scale

business that embraced almost 99 percent of full time indigenous business as shown in the table below.

US SMALL SCALE BUSINESS AS DEFINED BY SBA

Category	Sales (& million)	Employment
Retail	2.8	-
Wholesaler	9.5-22	-
Construction	1.0-9.5	-
Manufacturing	-	0-1500
Agriculture	1.0	-

SOURCE: SBA rule and regulations:- Code of the federal regulation (Washington DLC. US government printing office, October, 1978) sector 121.3-10. These classifications notwithstanding, Barrow (1933) observed further that the American government was ready to classify very large firms as small business to serve her overall investment interest in 1966 for instance, the SBA classified American motors as small to enable the company to bid for certain government jobs. At that time, America motors ranked as the nations sixty. Third largest manufacturer, with 32,000 employees and sales revenues of $79 million. The SBA

justified it judgment by applying rave criteria for smallness, namely that a business is small, or should be seen as small when it does not dominate its industry, and American motors easily met that criteria. Many of the SBA's definition really cover medium scale business or enterprise. For example, a manufacturer employing 100 people probably has sales revenue in excess of $50 million a year, which makes the business large on any material sense (Barrow, 1993:50).

Similar considerations that allowed fairly large firms to gain state support and subsidies were applied in the United Kingdom and France in the 1960s. In the United Kingdom, a committee was set up in July 1960 under the chairmanship of J.E Bolton to consider the state of small firms in the national economy, the facilities available to them, and to make recommendations. Small-scale industries or firms were at first stage defined as those with less than 200 employees. The committee found this definition of restrictive and decided to broaden it to include firms with relatively small share its market and having to be run by its owner and not a subsidiary of larger or large-scale firm. This qualification admitted several large firm into the class of SMEs and rendered them eligible for financial support and government patronage. These lessons support strongly the need for the reclassification of SMEs in Nigeria to include all indigenous firms,

and the creation of a nationally managed framework for financial support and direct government patronage so that these firms can flow successfully and become more able to contribute meaningfully to the country's development.

2.9.2   THEORETICAL FRAMEWORK FOR THE FINANCING OF SMEs

The dominant theoretical perspective on industrialization after World War II favoured the Keynesian-type heavy investment large-scale industrialization (LS1) strategy. The argument in support of the LSI strategy focused on Adam Smith's belief that large scale industries can deepen specialization and broaden the scope for division and labour and hence enhance production efficiency.

Accordingly, the ISI strategy pervaded not only the market economics of Western Europe and the USA, but also the central and Eastern European planned economics (including the defunct USSR). The ISI Paradigm held sway while the global economy experienced the post World War II boom and dominants economic thinking linked the economic boom to the LSI strategy. (Obadan and Agba, 2006:24, Essia, 2005:77).

But as argued in Essia (2005:78) the post World War II economic boom was not necessarily an outcome of adoption of the LSI strategy. Household incomes increased in the War year but were hardly spent due to the War. So after the war, personal saving was high; causing demand for consumption goods to

increase. Firms responded by investing in new plants and equipment, and hired more labour to expand production to meet increases in consumption demand. This created a large business demand for new capital, raw material, and labour. The total spending of government and private operators remained high. The other possible explanation of the boom all ording to Essia (2005) was the huge spending of the marshal plan the fallen European Economics were treated with huge doses of heavy investment spilled into demand for production inputs and raw material. The code war that followed world war II equally promoted heavy spending on both sides. The soviet bloc pitched its tent on contest with the western allies as led by the US. Each side tried to woo the power nations into their camps the competition that ensued was mainly for markets, cheap raw materials sources and cheap labour to service their respective industries. On both sides, Keynesian prescriptions reached centre stage, the focus was on accumulation of capital as the major driver of economic growth for the poor economics, Keynesian doctrine of capital accumulation was incorporated into the so called development economic depression as was originally conceived all problems, including eradication of poverty and under development. It was with such considerations that poor countries including Nigeria adopted the import substitution industrialization (ISI) strategy in the 1970s and early (1980s Global

economic down turn that began gradually in the 1970s and culminated into global economic depression in the 1980s and 19905 contributed immensely to the current change in focus from LSI to SME as the bedrock of development. Writers like birth (1979) and Barrow (1998) have drawn on lessons from the economic history of today's advanced economics to show that it is more sustainable for today's poor countries to focus on the sustainable development of SMEs to provide the basic for sustaining industrialization. Against this background, the core challenges SMEs faces in Nigeria related to poor delivery of microfinance services. More specifically these include weak regulatory capacity, high interest rate, and ignorance of business possibilities and requirement (Salako, 2004:69, Obadan and Agba, 2006:46, Udejia and Ibe, 2006:52) Udeaya and Ibe (2006:53) particularly summarize the major challenges for supply of microfinance services as including:

1. **INADEQUATE SUPPLY OF MICROFINANCE:** Effective supply of microfinance is hampered by weak capacity to repay loans and grow their finance. Microfinance providers are often compelled to target the rich due to the repayment incapacity of the poor.

2. **HIGH COST OF FUNDS:** Microfinance institutions obtain funds at interest rates that are often higher than the specified credit caps on lending to the poor.

3. **HIGH COST OF TRANSACTION:** This is caused largely by difficult operational conditions, poor public energy and communication infrastructures and sundry moral hazards, which raise the effective cost of providing microfinance over and above what the poor can affords.

4. **WEAK INSTITUTIONAL SUPPORT:** This renders government support programmes largely inaccessible to the intended beneficiaries. This also increases the operational risk of fund providers.

5. **WEAK SUPERVISORY AND REGULATORY CAPACITY OF THE CBN**

   Banks often violate some of the prudential monetary and interest rates cape without prompt detection by the CBN. Historically; the banking system has been the major source of investment fund for development. In addition to financial intermediation, banks can assess the viability of project and monitor same to ensure that borrowers repay their loans as required.

Historical realities also point to the fact that banks received substantial institutional support from government to enhance their capacity to finance business for the poor. While the advanced economic may not need such primary forms of support.

Epstain (2006:61) observed rightly that historically, central banks combine the role of financing and promoting investment directly with managing exchange rate for him, the current rico-libral approach that encourages central bank of today's advanced economics supported the indigenous enterprises in their respective countries. The current situation in Nigeria requires nothing less than, the direct involvement of the C.B.N. in financing SMEs. Banks in Nigeria generally consider lending to the manufacturing sub-sector very risky and would naturally prefer lending for commercial ventures with shorter payback period.

2.9.3   A CENTRAL REGULATORY AUTHORITY

The regulatory foundation is a key function of the C.B.N. The C.B.N. performs this function by providing monetary and prudential guidelines against which banks should be inspected regulatory to ensure strict compliance since its establishment the C.B.N has had the broad mandate of

1.   Maintaining domestic price stability.

2.   Reducing pressure on external reserves.

3.   Ensuring exchange rate stability, and

4.   Promoting employment and economic growth.

Before the structural adjustment programme (SAP) (1986:1993) the main objectives of the C.B.N were price stability, stimulating output and employment and a healthy external balance the same overriding objectives were still applicable during the SAP reform ear, although with the additional goal of inducing the development of a monetary stability and a sound financial normally do better when their activities are monitored to ensure that the desired policy expectations are attained with economy of time and effort for instance, it is important to determine if banks actually observe the prudential guidelines and support programmes for SMEs. Evaluation of policy implementation outcomes would provide the basis for future reviews to ensure that specific policies are rendered more relevant for achieving the desired goals.

The proposed central monetary authority would in addition to the core central banking function of macroeconomic stabilization and research, extend its efforts towards stabilizing the micro-economy, through monitoring and evaluation of industrial finance support programmes so as to ensure that its macro-economic policies have the appropriate microeconomic foundations.

Accordingly, the central monetary authority would regulate the macro economy, manage exchange rates, monitor and evaluate the flow and utilization of development finance, undertake regular banks inspection and formulate research based monetary policies and credit guidelines. The main purpose of reform is to ensure that all banking and non-banking financial institutions conduct their operating in accordance with the well research and realistic monetary and prudential guidelines. The central monetary authority as proposed is intended also to harmonize macroeconomic stabilization (the core goal of the CBN at present) with realistic micro economic foundation. At present, the regulatory of activities of the central bank are essentially macroscopic with little or no microeconomic foundations.

2.10   EFFECTIVE CREDIT SUPPLY OF MICROFINANCE

In Nigeria, fiscal powers are largely centralized in the federal government. The federal government has largest share of the federation account, in addition to determining where excess funds and resources should be domiciled. The focus of many scholars in this regard is either on how to decentralized existing fiscal structures, or on elaborating the inequities of the current system (as its against the tenets of true federalism) (Adesopo, Agboola and Kinlo 2004:2) little

consideration is given to know some of the resources of the federal government to be channelled into the provision of seed capital to banks at very cheap interstate for funding SME. The framework conceived here should enable the federal government to gainfully employ its fiscal operations for making wealth transfer through the banking system for the development of SMEs. Such an institutional support mechanism can harmonize fiscal policies with monetary policies and provide sound microeconomic foundations for the macroeconomic goals of the C.B.N. Libertine and Reveli (2004) stress the need for such a general equilibrium approach to microeconomic management because co-ordination of fiscal and monetary policy is beneficial to ensure a smooth performance of monetary policy-indeed, it complements arguments in favour of central bank independence because an incoherent fiscal policy can force the central bank to give up its independence and monetize the debt.

Providing direct financial support to SMEs can be seen as one of the development roles of CBN. Currently, the mission of CBN includes issuing currency within Nigeria, managing the country's external reserves, preventing inflation, preserving stability of the exchange value of one nation's currency, maintaining domestic monetary stability, promoting a safe financial system and acting as the fiscal agent to the government and a banker to banks. Monetary

and fiscal policies are therefore linked necessarily to the extent that the CBN finance the portion of government budgets that are not taken up by the private sector. However, the task of ensuring that private banks receive seed capital for onward lending to SMEs at affordable low rates as practices in many of today's advanced economic during the early days of their development, is currently not ignored by the CBN. Yet it funds for investment is a major constraint to economic development in Nigeria at present.

But historians of central banking would admit that many central banks in the developed and developing world have from time been funding investment in key economic sectors directly (Epstein, 2006).

Against this background, the current best practice tends to narrow the role of central banks. The main components of the current order are:

1.   Central bank independence

2.   A focus on inflation fighting (including adopting formal inflation targeting) and

3.   The use of indirect methods of monetary policy (that is short-term interest rates as opposed to direct methods such as credit ceilings). These principles have far reading implications. First, independence implies that the central bank should not be subject to pressure to finance government deficits. Second, the focus on

inflation means that the central bank should not be concerned with other goals such as promoting full employment, supporting, industrial policy, or allocating credit to sectors of special social need, such as housing. Third, the central bank should not manager exchange rate through monetary policy and certainly not through using controls on capital flows. The pursuits of indirect instrument of monetary control means that the central bank should not use credit allocation techniques Such as subsidized interest rate, credit ceilings, and capital controls to affect either the quantity or the allocation of credit. These tenets are being promoted not only in developed countries but also with great vigor in the developing world (blinder 1998, 2004, Epstein 2003; Bernake et al 1999, good hart et al, 1994, Sylla et at; 1999). But as Epstein (2006:99) rightly observed these best practices are highly idiosyncratic in the sense that they differ from historically dominant theory and practice of central banking in newly developed countries and in advanced economics, notably United Kingdom, United States, France and Germany.

Throughout the early and recent history of central banking in the US, England and the developed Europe generally, financing governments managing exchange rates and supporting economic sector by using direct methods of intervention have been among the most important task of central banking. Indeed central

banks were principally agents of development in today's advanced economics. Financing government and managing exchange rate was the key of central banks for centuries. This is not to deny the important goal of price stability and monetary stabilization that the early central banks pursued.

Even after world war II central banks in England, US and France were macro-economic oriented, they maintained the gold standard, and controlled inflation but also engaged in sectoral policies to support medium term and long term financing of industry. Before world war I the central bank in France particularly accumulated and disturbed – large amount of long term credit so that local firms in France could catch up with England. Japanese's firms also received substantial financial support from its central bank. These central banks at various, times in the early history of their economic, directly accumulated funds and channelled them towards the development of their indigenous business.

Supporting SMSs directly using subsidized interest rate, legal restrictions and moral suasion to promote the core technology sectors and industries with low export were generally the task of central bank in western Europe during the early period of their development. These support measures were usually explained simply. So ways of redistributing income in favour of the weaker

sectors so that the entire economy can grow maximally (Greider, 1987:138). These central banks engaged in "Industrial policy" or selected targeting" and it contributed immensely to their early development.

Banks remain the most dependable channels through which government and donors can provide financial support to enhance delivery of microfinance services. But it should be understood that banks are essentially profit seeking organizations, and hence their lending cannot be lower than the cost of obtaining their seed capital.

It is unfair to blame banks for the poor financing of SMEs where there are no institutional arrangement in plate that allow microfinance providers to obtain seed capital at cheap rate. Hence it is proposed here that a set of bankers/ government banks be created out of the existing CBN to specialists in bankers/government banks function of the current CBN.

The reserve banks should profitability carryout primary banking functions to government MDAs and all categories of banking institutions in addition to its traditional banking functions, the reserves, surpluses and other passive cash balances of the different arms of government should be made available as seed capital to the reserve banks for onward lending at very low interest rate to

microfinance providers, so that they can in turn tend to indigenous business at low interest rates as would be inspected and monitored by the central monetary authority. The proposed reserve banks can still, in the process make reasonable profits to support themselves, other agencies of the CBN and the federal government.

2.10.1 MARKET MAKING AND INVESTMENT FACILITIES

Market making and investment facilitation are essential for the promotion of SMEs. Prospective business needs information on available market and markets prospect for their produce. Small investors also need local and international links to raw material sources. Innovations, offshore investment possibility and linkage to other firms Prior to the initiation of SAP (1961), investment and trade promotions were undertaken by the defunct produce boards, multinationals (like UAC, John Holt etc), producers cooperatives, and the various chambers of commerce and industries, apart from providing local producers with the vital investment information and extension services, these bodies in various ways acted as buyers – of – last resort for SMEs, particularly small farmers. With SAP reforms of boards were dissolved. Produce marketing processing was decentralized, leaving small business without any form of

organized support or leverage. The chambers of commerce are still inexistence, but are generally weakened by the absence of complementary institutions with strong financial right.

Success in promoting SMEs now requires the creation of a strong and credible national base (as internally well linked) institution for bulk buying, export- import facilitation trade and investment promotion and business information management generally. The task of market making and investment facilitate reform tripped.

In other words, an agency can be erected out of the present CBN to perform this all important role of investment, largely unorganized and disposed, success in developing them would require government to be directly involved in market making, project and facilitation. It would be needful to establish such a high level micro investment facilitating agency as permanent agency of the CBN such agency should operate like the small and medium industries development corporation (SMIDEC) of Malaysia, the small and medium industry promotion corporation (SMIPC) of south Porea, and the Ntsika Enterprises promotion agency of South Africa (Obadan and Agab, 2006: 101) its main function should be to produce information, linkages and innovations that are relevant for the

competitiveness of indigenous firms, which by the broad definition of the US SBA. Include all indigenous firms.

2.11 LEGAL FRAMEWORK FOR THE SUPERVISION OF MICROFINANCE BANKS

Licensing and supervision of microfinance bank: The licensing of microfinance banks shall be the responsibility of the central bank of Nigeria. A licensed institution shall be required of add "microfinance bank" after its name. All such names shall be registered with corporate Add airs commission (CAO), in compliance with the companies and Allied matters ACE (CAMA) 1990. Establishment of a National microfinance consultative committee. A national microfinance consultative committee (NMFCC) shall be constituted by the central bank of Nigeria (CBN) to provide direction for the implementation and monitoring of this policy. Membership of the committee shall be determined from time to time by the CBN. The microfinance support unit of the CBN shall serve as the secretariat of the committee.

Credit Reference Bureau: Due to the peculiar characteristics of microfinance practice, a credit reference bureau, which shall provide information on microfinance clients and aid decision making, as desirable. In this regard, the present credit risk management system in the CBN shall be expanded to serve the

needs of the microfinance section. Rating agency: the CBN shall encourage the establishment of private rating agencies for the sub-sector to rate microfinance institutions especially those NGO-MFLs which intend to transform to microfinance banks. Deposit-insurance scheme: since MFBs are deposit- taking institutions and in order to reinforce public confidence in them. NFBs shall qualify for the deposit insurance corporation (NDIC)

Management certification process: in order to bridge the technical skills gap, especially among operators of microfinance banks. The policy recognizes the need to set up an appropriate capacity building programme for MFBs. The CBN shall put in place a microfinance bank management certification process to enhance the acquisition of appropriate microfinance operational skills of the management term of MFBs. A transition period of twenty four (240 months shall be allowed for the take – off of the programme, with effect Apex Association microfinance institution. The establishment of an apex association of microfinance institutions to promote uniform standards, transparency, good corporate practices and full disclosures in the conduct of MFL business shall be encouraged.

Linkage programme. The policy recognizes the importance of the provision of wholesale funds for microfinance banks to expand their outreach, pursuant to t his, the CBN shall work out the modalities for fostering linkage between universal development banks specialized finance institutions and the microfinance banks to enable the latter source for who lease funds and refinancing facilities for on-lending of their clients. Establishment of microfinance development fund: in order to promote the development of the sub-sector and provide for the whole sale funding requirements of microfinance banks, a microfinance sector development fund shall be set up. The fund shall provide necessary support for the development of the sub-sector in terms of refinancing facility, capacity-building and other promotional activities. The fund would be sourced from governments and through soft facilities from the international development financing institutions as well as multi lateral and bilateral development institutions.

Prudential requirement: the CBN recognizes the peculiarities of microfinance practice and shall accordingly put in place appropriate regulatory and prudential requirement to guide the operations and activities of the microfinance banks.

Disclosure of sources of funds: (licensed MFBs shall be required to disclose their sources of funds. In compliance with the money laundering prohibition Act 2004.

Corporate government for microfinance banks: the board of directors of MFBs shall be primarily responsible for corporate governance in the microfinance banks. To ensure good governance of the banks. The board of directors shall be responsible for establishment strategic objectives. Policies and procedures that would guide and direct the activities of the banks and the means to attain same, as well as the mechanism for monitoring management's performance. Thus, while management of his day-today affairs of the banks shall manage the team, the board of directors shall, however be responsible for monitoring and overseeing management's actions. Consequently, the licensed microfinance banks shall be expected to operate under a diversified and professional board of directors (CBN, 2005)

CHAPTER THREE

3.0 RESEARCH METHODOLOGY

3.1 OVER VIEW

This chapter focuses on the disclosure of the various sources of data to this work together with the methods used in the date collection, and the analysis of the said data in addition, how the uses of these methods led to the appropriate solution to the research. The hypothesis stated in the first chapter will be shown .furthermore; the procedure for the regression will vividly be estimated in this chapter.

For the purpose of this study, data were collected from only secondary source. This has to do with extensive use of libraries, especially published material s. This technique provided the researcher a great deal of genera l information concerning the subject matter. In exploiting this technique the researcher consulted mostly professional books in the field of banking and finance, economics, statistics and business and financial publications.

The Imo state micro finance banks, caritas university library, banks of Nigeria website were extensively utilized including the CBN statistical bulletin. Materials obtained from these were used both in literature review and other analytical aspects of this study.

3.2 THE MODEL

The descriptive and inferential methods of analysing data are used in this study. The major tool of analysis is the multiple regression analysis. it expresses a linear relationship between a dependent variable Y and Independent variable

In   other words, it is assumed that X 1, X2 and X3 jointly determines the values of Y. This relationship maybe written mathematically as

$Y = \alpha_0 + \alpha_1 \times 1 + \alpha_2 X_2 + \alpha_3 X_3 + Ecm{-1} + \mu$

Where α_0, α_1, α_2 and α_3 are three unknown parameter to be determined and μ is known as the error term.

3.2.1 SPECIFICATION OF THE MODEL

The three variables linear model specifies a linear relationship between the dependent variable Y and three explanatory variable X1, X2 and X3 which can be written as;

α_0= constant and intercept

α_2= co-efficient

μ= error term

$Y_1 x_1$, x_2 and x_3 are derivation forms, then it becomes $y = y_1 x_1 + \mu_2 x_{2i} + \mu_3 x_{3i} + \mu$

Taking the observation on $Y_1 x_1 + Y_2 x_2$ and $Y_3 x_3$ we obtained estimated

regression line Y given by $Y_1 = \alpha_1 x_1 + \alpha_2 x_2 + \alpha_3 x_3$............... (1)

Where α_1, α_2 and α_3 are estimated Parameters

Given that

$Y_1 = \alpha_0 + \alpha_1 x_1 + \alpha_2 x_2 + \alpha_3 x_3 + \mu$

Where

Y= Gross fixed capital formation

X1= loans and advances sector

X2= INF

X3= INT

3.3 ECONOMIC APRIORI TEST

As regards economic theory, economic test will be used as the impact of each explanatory variable on the explained variable based on their economic apriori expectation. In other words, the signs of the co-efficient would be compared with the apriori expectations.

Reject the H0 (null hypothesis) if the T calculated is greater than T table as the X level of significance and hence conclude that the relationship exists between Y and X1 and Accepted thus, -t cal > t-table.

Accept thus, H0 (null hypothesis) if the F table is greater than F calculated i.e. F table > F cal. Otherwise H0 is rejected.

3.4 EVALUATION TECHNIQUES

The result of the regression would be evaluated so as to determine their reliability in order to achieve this we will make use of two tests namely, first order statistical test and second order econometric test.

3.4.1 **STATISTICAL TEST (FIRST ORDER)**

Under the statistical test we will test for the goodness of fit R^2, the individual significance of each regress using the t-test and finally significance of the regression model using f-test.

3.5 ECONOMETRICS TEST (SECOND ORDER)

Econometric test will be used for empirical verification of the model. This will range from test including autocorrelation, normality heterocedasticity, co integration and multicollinearity.

3.5.1 Autocorrelation: The classical linear regression model assumes that autocorrelation does not exist among the disturbance terms. In order to find out where the error terms are correlated in the regression we will use the Brush-Godfrey serial correlation test. Brush-Godfrey test is test for detecting autocorrelation. It allows for autoregressive (AR) and among average (MA) error structures. It was jointly developed by Breush and Godfrey (Gujarati 2004).

3.5.2 Normality Test: This test will be conducted to find out if the error terms are normally distributed with zero mean and constant variance. The jarque Bera test will be used for the normality test in time series.

3.5.3 Heterocedasticity Test: occurs when the variance of the error term additional to the chosen values of the explanatory variables is not contained. In order to test heterocedasticity and specification bias, the gross product terms will be introduced among auxiliary regressions.

3.5.4 Co-Integration Test: This test will be employed to establish whether long-run relationship exist between the dependent variable and the regression line.

3.5.5 Multicollinearity Test: Occurs when the explanatory variables are correlated with each other. In other to detect this we shall make use of the correlation matrix.

CHAPTER FOUR.

PRESENTATION AND ANALYSIS OF RESULT.

4.1   Battery Test:

4.1.1   Unit Root Test Analysis:

An attempt was made to investigate the time series characteristics of the variables {DX1(loan and advances),DX2(inflation rate),DX3(interest rate) of the model in this study. A variable is stationary when it has no unit root which is denoted in literature as I (0). A non-stationary variable can have one or more unit roots and denoted as I (d), d is the number of unit roots that the variable must be differenced in order to make it stationary. Similarly, if a time series has to be differenced twice (i.e. take the first difference of the first difference) to make it stationary, we call such a time series integrated of order 2.

At normal level, none of the variables is stationary, so we test at the first differential.

Variable	Order of integration.
GFCF	I (1)
DX1	I (1)
DX2	I (1)
DX3	I (1)

As can be deduced from the table above, all the variables are stationary at the first difference for each of the forms of estimation. This implies that DX1 {loan and advances}, DX2 {inflation rate}, DX3 {interest rate}, GCFC {gross fixed capital formation} are integrated of first order one i.e. I (1). So we suspect co-integration between the dependent and independent variables.

4.1.2 <u>**Co-integration Test: Long-run analysis unit root test for residual from the estimated regression at level form.**</u>

We have assumed that all the variables are of the same order of integration i.e. I(1), in order to carry out further tests, we then run an ordinary least square regression of the variables on levels and test for co-integration by testing the residual.

Unit root tests   1992(4)   to   2010(4)

Critical values: 5% = -1.945   1% = -2.595.

	t-adf	ä	Lag	t-lag	t-prob.
Residual	-2.3248★	2.7647e+005	2	-1.7532	0.0840
Residual	-3.5291★★	2.8048e+005	1	-2.2091	0.0304
Residual	-6.2127★★	2.8794e+005	0		

From the table, we can conclude that the variables are not co-integrated.

4.2 Presentation and Interpretation of Result:

Dependent variable: Gross Fixed Capital Formation

Method: Ordinary Least Square.

Period of study: 1992 – 2010

Included Observations: 75

Variable	Coefficient	Standard error	t-statistics	t-prob.	PartyRỳ
Constant	21787	32350	0.673	0.5028	0.0064
DX1	42.501	4.8456	8.771	0.0000	0.5236
DX2	-3129.9	3793.0	-0.825	0.4121	0.0096
DX3	29042	11454	2.536	0.0135	0.2999

$R^2 = 0.65433$ $F\{4, \ 70\} = 33.126 \ \{0.0000\}$ $\grave{a} = 276974$

DW = 2.00   RSS = 5.370005143e+012 for 5 variables and 75

observations.

From the above, the interpretation of the result as regard the coefficient of various regressions is stated as follows:

The value of the intercept which is 21787 shows that the Nigerian economy will experience a 21787 increase when all other variables are held constant.

The estimate coefficients which are 42.501 {DX1} shows that a unit change in LOAN AND ADVANCES will cause a 42.501% increase in GFCF,-3129.9 {DX2} shows that a unit change in INFLATION RATE will cause a -3129.9% decrease in GFCF, 29042 {DX3} shows that a unit change in INTEREST RATE will cause a 29042% increase in GFCF.

4.3   Economic Apriori Criteria:

The test is aimed at determining whether the signs and sizes of the results are in line with what economic theory postulates. Thus, economic theory tells us that the coefficients are positively related to the dependent variable, if an increase in any of the explanatory variables leads to a decrease in the dependent variable.

Therefore, the variable under consideration and their parameter exhibition of a priori signs have been summarized in the table below.

This table will be guarded by these criteria

When $\beta > 0$ = conform.

When $\beta < 0$ = not conform.

Variables	Expected signs	Estimate	Remark
DX1	+	$\beta > 0$	Conform
DX2	-	$\beta < 0$	Does not conform
DX3	+	$\beta > 0$	Conform

From the above table, it is observed that all except DX2 conforms to the economic theories.

A positive relationship which exists between DX1, DX2 and DX3 (gross fixed capital formation) indicates that an increase in DX1and DX2 will result in a positive change in the Growth Rate of Gross fixed capital formation. This conforms to the priori criteria because an increased or high DX1 and DX2 over the years will increase Inflation in the economy.

4.4   Statistical Criteria {First order test}

4.4.1. Coefficient of Multiple Determinants {R^2}:

The R^2 {R-Squared} which measures the overall goodness of fit of the entire regression, shows the value as 0.65433 = 65.433% approximately 65%.   This

indicates that the independent variables accounts for about 65% of the variation in the dependent variable.

4.4.2. The Student's T-test:

The test is carried out, to check for the individual significance of the variables. Statistically, the t-statistics of the variables under consideration is interpreted based on the following statement of hypothesis.

H_0:   The individual parameters are not significant.

H_1:   The individual parameters are significant.

Decision Rule:

If t-calculated > t-tabulated, we reject the null hypothesis $\{H_0\}$ and accept the alternative hypothesis $\{H_1\}$, and if otherwise, we select the null hypothesis $\{H_0\}$ and reject the alternative hypothesis $\{H_1\}$.

Level of significance = α at 5% =

$$= 0.025$$

Degree of freedom: n-k

Where n: sample size.

K: Number of parameter.

The t-test is summarised in the table below:

Variables {t-value}	t-tab	Remark
DX1 {8.771}	± 1.980	Significant
DX2 {-0.825}	± 1.980	Insignificant
DX3 {2.536}	± 1.980	Significant

The t-statistics is used to test for individual significance of the estimated parameters {β_1, β_2, and β_3}.

From the table above, we can deduce that DX1 {8.771} and DX3 {2.536} are greater than 1.980 which represents the t-tabulated implying that DX1 and DX2 are statistically Significant.

On the other hand, the intercept {0.673} and DX2 {-0.825} are less than the t-tabulated {±1.980} signifying that the intercept and DX3 are statistically insignificant.

4.4.3. F-Statistics:

The F-statistics is used to test for simultaneous significance of all the estimated parameters.

The hypothesis is stated;

$H_0: \beta_1 = \beta_2 = \beta_{3=0}$

$H_1: \beta_1 \neq \beta_2 \neq \beta_{3=0}$

Level of significance: α at 5%

Degree of freedom: $V_1 = k-1$ $V_2 = N-K$

Decision Rule:

If the f-calculated is greater than the f-tabulated {f-cal > f-tab} reject the null hypothesis {H_0} that the overall estimate is not significant and conclude that the overall estimate is statistically significant.

From the result, f-calculated {33.126} is greater that the f-tabulated {2.68}, that is, f-cal > f-tab. Hence, we reject the null hypothesis {H_0} that the overall estimate has a good fit which implies that our independent variables are simultaneously significant.

4.5   Econometrics Criteria.

4.5.1. Test for Autocorrelation:

One of the underlying assumptions of the ordinary least regression is that the succession values of the random variables are temporarily independent. In the context of the series analysis, this means that an error {Ut} is not correlated with one or more of previous errors {U_{t-1}}. The problem is usually dictated with Durbin-Watson {DW} statistics.

The durbin-watson's test compares the empirical d* and du in d-u tables to their transforms {$4-d_L$} and {$4-d_U$}.

Decision Rule:

- If d* < D_L, then we reject the null hypothesis of no correlation and accept that there is positive autocorrelation of first order.

- If $d^* > \{4-d_L\}$, we reject the null hypothesis and accept that there is negative autocorrelation of the first order.

- If $d_U < d^* < \{4-d_U\}$, we accept the null hypothesis of no autocorrelation.

- If $d_L < d^* < d_U$ or if $\{4-d_U\} < \{4-d_L\}$, that test is inconclusive.

Where: d_L = Lower limit

                  D_U = Upper limit

                  D^* = Durbin Watson.

From our regression result, we have;

$D^* = 2.00$

$D_L = 1.543$

$D_U = 1.709$

$4-d_L = 2.457$

$4-d_U = 2.291$

<u>Conclusion:</u>

Since d_L {1.543} < d*{2.00} < d_U {1.709} or if {4-d_U} {2.291) < {4-d_L}{2.457}, that test is inconclusive.

4.5.2. Normality Test for Residual:

The Jarque-Bera test for normality is an asymptotic, or large-sample, test. It is also based on the ordinary least square residuals. This test first computes the skewness and kurtosis measures of the ordinary least square residuals and uses the chi-square distribution {Gujarati, 2004}.

The hypothesis is:

H_0 : $X_1 = 0$ normally distributed.

H_1 : $X_1 \neq 0$ not normally distributed.

At 5% significance level with 2 degree of freedom.

JB = + = 34.181

While critical JB > {$X^2_{\{2\}}$df} = 5.99147

Conclusion:

Since 34.181 > 5.99147 at 5% level of significance, we reject the null hypothesis and conclude that the error term does not follow a normal distribution.

4.5.3. Test for Heterocedasticity:

Heterocedasticity has never been a reason to throw out an otherwise good model, but it should not be ignored either {Mankiw Na, 1990}.

This test is carried out using White's general heterocedasticity test {with cross terms}. The test asymptotically follows a chi-square distribution with degree of freedom equal to the number of regressions {excluding the constant term}. The auxiliary model can be stated thus:

$Ut = \beta_0 + \beta_1 DX1 + \beta_2 DX2 + \beta_3 DX3 + \beta_4 DX1^2 + \beta_5 DX2^2 + \beta_6 DX3^2 + Vi.$

Where Vi = pure noise error.

This model is run and an auxiliary R^2 from it is obtained.

The hypothesis to the test is stated thus;

$H_0: \beta_1 = \beta_2 = \beta_3 = \beta_4 = \beta_5 = \beta_6 = 0$ {Homocedasticity}

$H_1: \beta_1 \neq \beta_2 \neq \beta_3 \neq \beta_4 = \beta_5 \neq \beta_6 = 0$ {Heterocedasticity}.

Note: the sample size {n} multiplies by the R^2 obtained from the auxiliary regression asymptotically follows the chi-square distribution with degree of freedom equal to the number of regressions {excluding constant term} in the auxiliary regression.

Decision Rule:

Reject the null hypothesis if $X^2_{cal} > X^2$ at 5% level of significance. If otherwise, accept the null hypothesis. From the obtained results, $X^2_{cal} = 46.184 > X^2 0.05 \{8\} = 15.5$ we therefore accept the alternative hypothesis of heterocedasticity showing that the error terms do not have a constant variance and reject the null hypothesis showing that the error terms have a constant variance.

4.5.4   Test for Multicollinearity:

The term Multicollinearity is due to Ragnar Frisch. Originally it meant the existence of a "perfect" or exact, linear relationship among some or all explanatory variables of a regression model. The tests were carried out using

correlation matrix.   According to Barry and Feldman {1985} criteria; "Multicollinearity is not a problem if no correlation exceeds 0.80".

	DY	DX1	DX2	DX3	REMARK
DY	1.000				-
DX1	0.6767	1.000			Nm
DX2	0.07107	0.1820	1.000		Nm, Nm
DX3	0.4707	0.4077	0.07393	1.000	Nm, Nm, Nm

Where M = Presence of multicollinearity

Nm = No multicollinearity.

From the above table, we can conclude that multicollinearity does not exists in all the variables.

CHAPTER FIVE

5.0 SUMMARY, CONCLUSION AND RECOMMENDATION

5.1 SUMMARY OF RESEARCH FINDINGS

After a careful and detailed finding on the investigation of the contributions of microfinance banking institution to capital formation in Nigeria, the researcher summarizied as follows;

Obviously, it was discovered that increased access to finance result to financial deepening, causes growth and improves income distribution, which will lead to capital formation. Furthermore, this research has shown that increase in individual income dose result to increased level of education, healthcare for the poor e.t.c. This therefore explains why global attention in development has shifted to development of small business, since their success is very necessary for poverty alleviation and balance industrial growth and development. And also since many small businesses belong to the poor, inadequate finance is a major constraining factor to their sustainability and growth. In the course of this study, it was also revealed and noticed that for microfinance banks to succeed and meet the expectations of government and the people, microfinance banking institution

will have to be well versed in state of the art-practice in government and must have adequate capital structure, good system and management information system. Microfinance is all about the provision of financial services to small business which conventional finance institution were unable to finance. So far, according to this research work the general observation of microfinance banks is that, their interest is high in comparison with conventional banks. it was also observed that all microfinance banks are operating as unit banks and this does not enhance the deepening of the microfinance activities and a good outreach. it was also discovered that for microfinance banks to succeed and meet the expectations of the government and people, in terms of capital formation, microfinance banks should have adequate capital structure and strategic planning.

In a nutshell, the study investigates the impact of microfinance banking to capital formation in Nigeria. Its level of importance, their role to economic development, their relevance to rural development, hypothesis was formulated and tested and result of these text revealed that;

1. Microfinance bank loans and advances to rural people have contributed to capital formation.

2. Microfinance bank credit to small and medium scale enterprise decreases the level of inflation in the economy.

3. Microfinance bank investment is a good tool for the formation of capital due to low interest rate.

4. Microfinance bank loan and advances, inflation rate, interest rate jointly have impact on gross fixed capital formation.

5.2 CONCLUSION

One of the things that is evident from this research work is that microfinance business and in particular small and medium scale enterprise [SME] is critical to rapid economic development. It is in fact, said to hold a major key to the emancipation of developing countries [Nigeria for example] from technology. To this end, and given the backwardness of most developing countries especially by Nigerians, it is recommended that more effort should be made to improve the rate of development and granting of financial support to micro business and SMIS. The central bank of Nigeria [CBN] policy initiative of microfinance is a welcome development. Adequate efforts should be made specially to Nigeria, to diversify its economy in order to reduce its high dependency on primary products. This will pave way for broad base economic growth that will bring about tremendous reduction in absolute poverty or even efforts should also be directed towards boosting the manufacturing sector where many entrepreneurs are carrying out small scale industries. Finally, the initiative by the government to make financial services accessible to a large segment to potentially productive Nigeria population who are currently not being served by the formal financial sectors will enhance them to engage in profitable and long term sustainable

business activities that will result in increase in individual household income, which will therefore lead to the growth and development of the Nigerian economy at large.

5.3 RECOMMENDATION

Against the background of the foreign theoretical elucidation for poverty to be eradicated, unemployment reduced and industrialization too, indeed take place in Nigeria , the following policy options towards business and capital formation through proper microfinance should be adopted;

1. Importation of goods, which can be produced in Nigeria, should be strongly banned. This will give our indigenous investors, engineers and manufactures the zeal and challenge to do more exploits in research.

2. The current CBN should be unbundled in to the three core development finance institutions namely a central monetary regulatory policy to bankers/government banks and a national investment facilitating/market marking institutions. The CBN along such specialized lines will promote efficiency and ensure that microfinance policies have the appropriate microfinance foundations.

3. In view of poor record performance and impact of financial subsidies in the past, future attention should be shifted towards non cash subsidies such as efficient and low priced infrastructure for improved micro business performance.

4. There is the need to have a clear vision and mission on the policy. This is a double edge sward it helps to have a well focused professional board that have the policy at heart.

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