

## **Bank Lending To Small And Medium Scale Enterprises And Its Implication On Economic Growth In Nigeria**

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**ABSTRACT:** There has not been unanimity on the effect of small and medium scale enterprises lending on economic growth in Nigeria. It is based on this, the study employed time series data from 1992 to 2013 to examine the impact of small and medium scale enterprises (SMEs) lending on economic growth in Nigeria using Augmented Dickey-Fuller (ADF) unit root test, Johansen cointegration test and vector error correction model techniques. The unit test results indicated that all the variables were non stationary at level but became stationary after first difference. The Johansen cointegration test showed evidence of long run relationship between small and medium scale enterprises lending and economic growth. The vector error correction model results revealed that lending to small and medium scale enterprises leads to economic growth in Nigeria. Also, the study found that bank lending rate does not impact on SMEs lending in Nigeria. The implication of these results is that lending to small and medium scale enterprises is crucial to the growth of Nigerian economy. The policy recommendation is that SMEs should be redefined in order to have greater access to fund, lowering of bank lending rate from the prevailing rate; stringent collateral security requirement should be relaxed to increase SMEs access to formal financial institutions, and encouragement of financial institutions to lend to SMEs by providing guarantees, interest rate subsidies. These will enhance credit availability to SMEs which will boost their productivity.

**Keywords:** Small and medium scale enterprises, lending, economic growth and Nigeria

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### **I. INTRODUCTION**

The prevailing economic condition of 1970s and early 1980s in Nigeria was responsible for the adoption of industrialization strategies based on large scale production. This derives from the fact that numerous large scale industries were set up during the rehabilitation programme of the post-war era of 1970s. These industries were capital intensive and required the importation of heavy machines and technical manpower to man these capitals. These unchecked importations asserted negative impact on foreign exchange earnings in Nigeria.

However, due to the inherent problems associated to the poor performances of the large scale enterprises in Nigeria, it becomes imperative for government to devise a means to promote and propagate small and medium scale enterprises (SMEs) as a panacea to achieve self-reliant and sustainable economic growth within the country. This was embedded in the third National development plan which clearly specified the development and promotion of small scale industries as a strategy for job creation. Small and medium enterprises have been identified to be pivotal for sustainable growth of the economies of many countries (Ariyo, 2005). It is expected to create jobs at relatively low capital, enhances the production of goods and services, reduces the level of inequality, and bolster the growth of human capital required for future industrialization (Ariyo, 2005).

Most of the developed economies have recognized the role of SMEs in industrial restructuring and went further to formulate and adopt national financial policies for the growth of SME. However, the relevance of SMEs in solving the macroeconomic problems is hampered by the absence of adequate capital, inability to access fund from financial agencies (Schneider, 2002). More so the high cost of borrowing and inaccessibility of funds have remained serious factors inhibiting availability of fund, thus resulting to the early death of small and medium scale enterprises (Mambula, 2002). The unavailability of credit has been identified as a challenge bedevilling the performance of business enterprises particularly the SMEs in Nigeria. Previous studies on Nigeria have identified source of formal and informal finance available to SMEs (Gelinias, 1998 and Aruwa, 2004). They posited that development banks as well as commercial banks are the major sources of formal funds

for SMEs. The findings also identified loans from cooperative societies, relatives and friends as informal credit at the disposal of SMEs in Nigeria.

In Nigeria, many micro finance agencies have been set up to promote the growth of SMEs in Nigeria. In 1962, Nigerian Industrial Development Bank (NIDB) was established while Rural Banking Initiative (RBI) was set up 1977. Also set up were Agricultural Credit Guarantee Scheme Fund (ACGSF) and Nigerian Agricultural Cooperative Bank to enhance lending to agriculture and SMEs. In order to cushion off the negative impact of structural adjustment programmes in mid-1980s, government set up National Economic Reconstruction Fund (NERFUND) to give SMEs a concessionary long-term loan of five to ten (5 – 10) years (Ogujiuba et al 2004).

Within the period of 1990 to 1998, 214 small and medium scale enterprises received a total intervention of US\$144.9 million. By 1978 and 2011, the ACGSF provided total loan to the tune of ₦43.12 billion to 701,000 SMEs. In addition, to complement the indigenous financing of SMEs, government secured World Bank loan to the tune of US\$270 which was given to SMEs through participating commercial banks in the country. To further boost the source of finance to SMEs, government in 1991 set up community banking scheme to enhance rural development and to provide start-up capital to smallholders. Also, the people's bank and Family Economic Advancement Programme (FEAP) were established in 1997. In 2002, government merged the NERFUND and NIDB to Bank of Industry to provide loan at interest rate of 10 percent to the industrial sector and SMEs.

Apart from the foregoing, Central Bank of Nigeria established a number of SME-financing schemes to encourage the growth of SMEs in Nigeria. For instance, in 2002, Refinancing and Rediscounting Facility scheme was set up at concessionary rate to provide temporary relief to banks that provide loans for long-term production. In the same year CBN and Bankers' Committee also established Small and Medium Industries Equity Investment Scheme (SMIEIS) which mandated commercial banks to earmark 10 percent of their profit-before-tax annually for financing of small and medium scale enterprises (Ogujiuba et al, 2004).

Many other intervention schemes were established to provide long term or specialized funds for the promotion of SMEs in Nigeria. These include Microfinance Initiative (MFI) set up in 2005. In 2010, CBN in her quest to provide adequate fund for SMEs set up ₦200 billion intervention funds to finance SMEs that engaged in manufacturing. Also, ₦300 billion airline and off grid power fund were earmarked to support SMEs clusters. However, these projects were characterized by non-repayment of loans and failure to achieve the stated objectives. This is because the policies were fostered by government in form of credit allocation, subsidies and interest ceilings. These may have lead to deterioration of credit available to SMEs in Nigeria.

However, despite government impressive policies and intervention to encourage the growth of small businesses in Nigeria, the share of manufacturing sector as a ratio to gross domestic product still remains dismal. The sector contributed only 7 percent to the GDP within the periods of 1970 - 1979 (Odedokun, 1981). For instance, in 2004, only 10 percent of firms managed by members of manufacturing association of Nigeria were totally operational. It is also reported that 70 percent of SMEs in Nigeria are on the verge of collapse (Joshua, 2008). This situation was worsen by shrink of manufacturing sector share to gross domestic product to the tune of 4.19 percent and 48.8 percent decline in industrial capacity utilization (NBS, 2009). This has shown that the economy is in trouble given the fact that this sector is critical agent of economic advancement of the country.

It is worrisome that the challenges of SMEs continue to prevail in spite of the government's efforts and interventions designed to promote their contribution to economic growth (Onugu 2005 and Ogechukwu 2006). The sector is still characterized with a lot of challenges which include reluctance of banks to grant loans to SMEs due to unavailability of reliable information on borrowers, poor book keeping, poor accounting standard and low transparency of operations, lack of discipline in the use of credit facilities, the perception of the SME sector as risky, and difficulties in enforcing loan contracts, high rates of loan diversion, inability to carry out feasibility studies and absence of collateral security (Ogujiuba, et. al., 2004). These challenges are associated to the environmental factors and the characteristics of the small and medium scale industries (Onugu, 2005). It is disappointing that these challenges are still prevalent in the country as reflected by the prevailing decline in standard of living, low per capita income and high rate of unemployment. It is as the result of this, the study empirically examined the effect of commercial bank loan to small and medium scale enterprises on economic growth in Nigeria.

## **II. REVIEW OF LITERATURE**

### **2.1 Conceptual Framework**

Small and medium enterprises (SMEs) are different kind of firms that could be found in different business activities across the country. They include artisans producing local agricultural implements, the coffee shop owners, tailor shop owners, iron fabricators, road side mechanics, small transport firm, the internet café, small engineering or software firm and a medium-sized automotive parts manufacturer. Some of the SMEs

produce for domestic market or for foreign markets. They can be found in rural, urban, regional, national or international level and the owners may be poor or rich.

There is no universally accepted classification of small and medium scale enterprises (SMEs). The definition differs across countries. This is due to the difference in socio-economic factors across the countries. For instance, Nigerian Small and Medium Industries Equity Investment Scheme (SMIEIS) of 1998, regarded SMES as enterprises that has a total capital outlay between ₦1.5million to ₦200 million. This includes the working capital but excluding cost of land. To Nigeria's national Council on Industry; SME is seen as an enterprise that employed at least 10 and a maximum of 300 employees (Udechukwu, 2003).

European Union defines SMEs as an enterprise that has not more than two hundred and fifty employees and total turnover of not more than €50 million. It also maintained that the share of the enterprise in another enterprise(s) should not be more than 25 percent. According to World Bank (2006), medium enterprise is an enterprise which employs a maximum of 300 employees with a maximum of 15 million dollars annual turnover. World Bank went further to say that small enterprise consists of less than fifty employees with annual turnover of not more than \$3 million. Therefore, it referred to small-enterprises as firms who employed a maximum of 10 persons with annual turnover of \$100,000 dollars.

The Companies Act 2006 of United Kingdom refers to small scale company as a firm employing less than or equal to fifty workers with a maximum turnover of 5.6 million pounds and a statement of account at maximum of 2.8 million pounds. The Act also defined a medium scale company as a firm employing maximum of two hundred and fifty workers, maximum of 22.8 million pounds turnover and maximum of 11.4 million pounds balance sheet. The definitions vary across Europe, OECD and developing economies. In developed countries of Europe SMEs employ between 200 – 250 employees except in the case of Japan that has 300 workers and the USA with 500 workers. The statistical classification of enterprises differs virtually from country to country and normally depended on firm's assets and number of people on their employment (Hallberg, 2000). He noted that the firm's employees lower limit range from 5 – 10 workers while the upper limit for small scale firms range from 50 – 100 workers. In addition, the medium scale firms have the upper limit range of 100 - 250 workers. Based on this statistical definition, it is extremely difficult to compare the size spread of SMEs across the countries of the world.

In some countries, small firms that employ less than 10 workers are referred to as micro enterprises. These firms are always found in the informal sectors across countries. In the comparative analysis of the twenty two transition economies between 2000 and 2002, Schneider (2003) discovered that informal sector of the economies contributed a total of 16.7 percent of the GDP in OECD, 29.2 percent of GDP in Europe and 44.8 percent of GDP in the former USSR.

In line with the federal government budget of 1990, SMEs defined as an enterprise having maximum turnover of ₦500, 000 per annum. It also defined it as firms with capital outlay of not more than two million naira or total of five million naira including cost of the landed property. Therefore, the term SMEs is relative and mainly determined by the nature of business activities and geographical locations of the firms (Umar, 1997).

According to Ebiringa (2011), the 13<sup>th</sup> meeting of National Council of industry posited that micro and cottage firms are firms that have total work force of less than or equal to ten employees and capital outlay of fewer than ₦1.5million excluding cost of landed properties. The council defined micro-enterprise as a firm with workforce size between 11 - 100 employees and a total capital outlay fewer than ₦50million in exclusion of the cost of landed properties. It also refers medium-sized firm to a firm that has workforce between 101 - 300 employees and a total capital outlay of not less than ₦50 million but fewer than ₦200million excluding the cost of landed properties.

## **2.2 Theoretical Review**

The assumption is that an effective and efficient financial system determines the level of productivity. SMEs play crucial role in economic growth of any nation if there is availability of bank lending. This shows that banking system is pivotal to the development of SMEs. There are a lot of factors that could affect effective and efficient lending by financial institutions (Ohanga, 2005). Therefore, Information asymmetry arises when firm owners have adequate information with regards to the risks and prospect of their business than the lending institutions. According to the information asymmetric theory, the lenders given the available information about the business risk may increase the lending rates in excess of the required risk.

The lending theory is of the view that lending markets can reduce lending to credit ratio where small and medium enterprises accepted loans with high interest rate. This implies that increasing cost of borrowing will make it impossible for firms to engage in any type of business project. Information asymmetry is appropriate to SMEs especially due to its relative size that made it unattractive for lending institutions as a result of their inability to effectively determine the risk inherent to small enterprises (Ohanga, 2005).

Eriki & Inegbemor (2009) identified inadequate finance as the commonly reason behind the inability of SMEs to increase economic growth, create expected jobs, enhance transfer of technology, and enhance local

contents required to work in foreign-owned enterprises in Nigeria. A similar study by Abereijo & Fayomi (2005) identified insufficient fund to SMEs arising from their inability to raise capital from formal financial institutions is associated to the fact that insufficient assets, high mortality rate, low capitalization and volatility of SMEs business. However, Okpara & Pamela (2007) disagree with the above assertion. They identified improper record keeping, unavailability of capital, corruption, lack of manpower and infrastructural facilities, mismanagement as responsible for the poor performance of SMEs across the country. Also identified impediments to SMEs include unavailability of fund to embark on research, inability to separate the business account from the personal account and poor demand for goods and services. Herrington et al. (2009) highlighted that poor funding is a major problem facing entrepreneurs particularly in Nigeria and Africa in general. They study went further to state that lack of financial support is the second most inhibiting factor followed by poor education and training as responsible for the failure of businesses in Nigeria.

Pecking order theory posited that with information asymmetry, firms are likely to fund themselves first from the retained earnings and then procure bank loans rather than first raising money through equity. It posited that prevalence of asymmetric information encourage SMEs to initially embark on self-financing through plough back profit and later seek bank loan rather than raising loan through equity. It stated that decision to take debt instead of issuing equity is a function of order of financial decision taken over time. In his study, Hanger (2005) is of the view that if a firm is faced with increasing cost of borrowing, it will be propelled to look for alternative sources of funding.

It has been established that small scale enterprises stimulate and propagate indigenous entrepreneurship, boost employment generation, enhance per capita income and investment and bolster local content development (Sule, 1986 and World Bank, 1995). It enhances resource utilization and reduces rural-urban migration through their ability to spread to different regions and areas of the economy. In addition, SMEs contribute to the growth of industrial activities by providing intermediate and semi-intermediate goods required by large scale enterprises. This is evidence in perceived interest of developing countries in promoting small enterprises (Ekpenyong & Nyong, 1992). To this end, Akabueze (2002) stated that it was generally established that finance is a significant determinant of economic growth of any economy.

Signalling theory is predicated on provision and analysis of information with regards to business enterprises to the capital market. The information provided on the business enterprises gives an insight on the terms and amount of loan to be made available to those firms. In other words, the flow of information between the business firms and capital market is determined by the flows of funds between enterprises (Emery et al, 1991). There is no general consensus on how signalling theory enhance credit availability to SMEs. Emery, et al (1991) in support of this assertion opined that there has not been unanimous view on how signalling theory provides insight or connection with SME financial management. In his study of SMEs and signal theory, Keasey et al (1992) argued that SMEs disclosure of their earnings forecast is positively significant to equity detainment by the owners, net proceeds from equity issues, choice of financial adviser, and the pricing level. It is seen to give clear understanding of how SMEs finance is managed (Emery et al, 1991).

The classical school is of the view that interest determines savings and investment. They asserted that aggregate investment has a negative relationship with interest rate. But this assertion tends to be weak since investment is said to be fairly interest-inelastic due to the fact that it is influenced by investor's expectation and its yield is estimated within a particular range. Therefore, a unit rise in the cost of borrowing will have little or no long term effect on the firm's performances. To the neo-classical theory, interest rate is the function of marginal efficiency of capital and savings. That is, demand and supply. A rise in Savings which is not influenced by the rate of interest will reduce the cost of borrowing which will increase the level of borrowing. This is due to the fact that any addition to investment will lead to diminishing return which will probably influence firms to move away from labour-intensive technique of production to adopt the use of heavy machines in production.

Keynes posited that supply of money determines the level of interest charged on loans. To him equilibrium rate of interest is the rate at which money supply is proportional to money demand. The modern view of interest rate, according to Hoff & Stiglitz (1990) is based on the imperfect information. The empirical studies on this modern view show connection between SMEs loans and some other factors of demand and supply of money. For instance, Funkor (2000) identified factors such as exchange rate, bank rate, inflation rate, intermediation cost, credit risk and Treasury bill as determinants of the growth of SMEs.

The classical theory also tries to show that availability of loan narrows the gap between firm's available capital and the needed capital. Firm's demand for loans is due to the imbalance between available financial assets and required assets of firms. Aryeetel et al (1994) classified demand for loan into three. It includes perceived, potential and revealed demand for credit. Perceived demand is a situation where a firm has finance as a constraint and therefore demand for cash. Potential demand is the demand for cash which is not achieved as a result of institutional barriers and market imperfections, while revealed demand is the application for cash at a particular rate of interest. The revealed demand for cash is crucial to both the money lenders and

borrowers, thus further explanation is paramount since application for loan does not necessarily mean effective demand. As a result of this, Gale (1991) viewed effective demand to be the total credit the financial system is willing and ready to lend to the investors.

Inadequate credit has been discovered to hamper SMEs from expansion or engaging in productive activities. High interest rate and bureaucracy may be associated to the limited access to bank credit. This assertion is in accordance to the first school which believed that high interest rate is inimical to the growth of SMEs. Boon (1989) argued that high rate is a constraint to the demand for credit. In their separate studies, Steel & Webster (1992) and Nissanke & Aryeetey (1995) asserted that deregulation of credit sector has not enhance availability of loans to SMEs. The study point out that contractionary monetary policy reduces SMEs access to loans. Steel & Webster (1989) summarized that the inability of small firms to improve their working capital and finance new investment have posed a stumbling block to the growth of SMEs.

### **2.3 Empirical Review**

Many works have supported the relevance of finance to the growth of SMEs. The level of credit availability has significant impact on the growth and development of SMEs across the globe (Khalizadeen-Shirazi, 1971, Akambi & Joseph, 2013). Butter & Linter (1945) argued that the growth of the firm is determined by the level of credit available to it. Therefore, finance is crucial for the growth and survival of SMEs. With regard to this, Oliveira & Fortunata (2005) used OLS and GMM-system technique in their study of survival of firms in manufacturing sector in Portugal within a period of 1990 and 2001. The study reports that the growth of firms in manufacturing sector is impeded by poor access to credit.

Osoba (1987) in his own study of some developing economies posited that the amount of credit at the disposal of SMEs determines its growth. In a related study, Yue & Ma (2008) in their study of the level of innovative technology available to SMEs reported that the growth of SMEs determines the level of technology and R&D available to them. Dauda (2006) in his study of credit intermediaries in post SAP period and the growth of Nigerian economy employed VAR Granger Causality analysis on annual data from 1986 to 2003. It finds out that post SAP reforms positively enhances the growth of the economy. It also reported that credit granger cause growth. This indicated that credit from banks promote the output of Nigeria. Obasan, et al (2011) in his study employed simple linear regression analysis to analyse SMEs and output of Nigeria for the period 1980 to 2008. The result shows that growth of SMEs has positive impact on output of Nigeria.

In a related study, Akingunola (2011) employed Spearman's Rho test to analyse the impact of SMEs and output growth of Nigeria from 2002 to 2009. The result showed that SMEs have positive impact on investment growth in Nigeria. Onyeiwu (2011) employed OLS and ECM to analyse SMEs and Nigerian output growth using quarterly data from 1994 to 2008. The results reveal that SMEs loans positively effects GDP. Also, the study argued that SMEs finance has long-run effect with Nigerian GDP.

Muritala et al (2012) employed multi-methodology techniques to analyse small and medium enterprise on output growth found out that SMEs has significant impact on output in Nigeria. Also, the study identified that poor credit facilities, mismanagement, corruption, unskilled manpower, lack of infrastructure, etc inhibit the growth of small and medium scale enterprises in Nigeria. In a similar study conducted in Scotland, Gavin (2000) found out that debt and equity are main source of business finance.

Carl (2001) in his study of the survival of small firm in developing countries posited that financial assistance to SMEs led to its survival in Africa and Latin America. While Godfried & Song (2000) in their investigation of financial mode available to SMEs in Ghana employed probit models. The study reported that small firms make use of credit from informal sector than credit from banks. Also, it established that many small firms relied on informal credit to finance their business. Furthermore, it revealed that credits from banks are more available to high profit making SMEs than low profit making SMEs. Their findings is in tandem with Ojo (1995) who analysed the importance of informal source of loan to the growth of small firms in Lagos State found out that informal source of credit contributed 60 percent of the overall source of financing.

Okpara & Pamela (2007) disagree with Ojo (1995) but identified factors such as inadequate capital, mismanagement, inexperience poor infrastructural facilities, poor human development, and unavailability of statement of account and corruption as responsible for the death of SMEs in Nigeria. They went further to reveal that poor market research, low demand for goods and unnecessary withdrawal of money from the business account for personal use also lead to small business failure in the country. Oluba (2009) in his study of the contribution of SMEs to an economy of developing countries identified employment generation, enhanced raw materials utilization, rural development, entrepreneurship development, raising of domestic savings, relationship with large firms, evenly spread of investments are responsible for the growth of SMEs in developing economies.

Laderman (2008) established that lending has positive relationship with firm's level of competition which is in line with the findings of previous empirical studies of other works conducted by Metropolitan Statistical Area. The result revealed that competition among the firms will make them reduce the price and as well as increase the supply of their product in order to increase sales. Similarly, Cetorelli & Strahan (2006) in

their study of competition among lending institutions and industrial distribution of firms find out that external source of finance increases bank's competition. This is determined by the ratio of small firms in the industry.

In their study of entrepreneurship as a solution to improving productive output of Nigeria, Ogunsiyi & Ladamu (2010) highlighted that sustainable growth, pool of resources, people, market, capital, technology and organization are responsible for growth. They went further to say that these factors enhanced the relevance of entrepreneurial orientation. Furthermore, Deakins & Fred (2009) argued that entrepreneurship and small business are the main cause of innovation in both developed and developing countries.

Marsh (2009) pointed out that lending to small firms is too risky due to the fact that collateral are not always available to SMEs to tender before the lending institutions and this posed a big challenge to SMEs growth in Nigeria. To Chepkwony et al (2009) the promotion of micro enterprises is due to the fact that it propagates economic growth and development in developing countries. However, Garlick (1997) identified capital as the challenge facing small and medium scale enterprises. In their study of the SMEs and its impact on output growth of Lithuania, Asta & Zaneta (2010) noted that decision-making model and integrated based financial system is needed to be effectively promoted. The study also posited that integrated accounting standard and reliable index of development enable SMEs to take decision. Adolphus (2011) employed multiple regression of ordinary least square techniques to analyse the relationship between bank management, rural access to credit and SMEs in Nigeria from 1992 to 2007. The study finds out that total credit has positive impact on rural credit availability.

In their own study, Hassan & Olaniran (2011) adopted survey design to examined role of assistance institutions in the growth of SMEs concentrated in the industrial areas of Osogbo in Nigeria. The study sampled a total of 340 respondent consisting respondents from private sector, trade union and students. The study finds out that assistance institutions enhance the performance of SMEs and entrepreneurship in Nigeria. Finally, the study recommends the commercialization of products from the industrial area in order to meet the demand expectation of the consumers and improves SMEs access to credit.

Bari, Ali & Haque (2005) in their examination of the key constraints faced by the SMEs sector in Pakistan highlighted that excessive government regulation, weak technological base, poor access to credit, arbitrary and exploitative tax system, and the lack of business support services are the main factors hindering the growth of SMEs in Pakistan. Dionco et al. (2006) examined the promotion strategy of SMEs in Lagos state using descriptive analysis. The result reveals that promotion strategy enhances small scale industries in the area of information service, training, technical, extension, technology adaptation and commercialization. The study concluded that low level awareness to these programs deny SMEs chances to make use of these services. This drastically affects growth and development of SMEs in Nigeria. Adams (2007) opined that no country will achieve sound industrialization without well developed SMEs in a country. They concluded that SMEs constitute 75 percent of the industrial set-up as well as contributed 60 percent employment opportunities in the economy.

Moktan (2007) in the study of challenges facing small businesses in Bhutan surveyed a total of 168 SMEs. The study found that restrictive business regulations, finance and infrastructure are the major constraint facing the growth of SMEs. Finally, the study concludes that severity level of constraints in urban and rural districts has significant influence on size of SMEs. Asikhia (2009) used factor analysis, correlation, regression and simple percentage on primary data to examine the views of firm owners towards micro-financing. The study opined that the action of entrepreneurs depends on the prospect they have before establishing relating with the bank.

Aremu & Adeyemi (2011) in their examination of the influence of SMEs on GDP growth indicated that most of SMEs die within the period of 5 years of its existence in Nigeria. The study also, posited that smaller percentage of SMEs windup within 6 and 10 year of its set up but only between 5 and 10 percent of young SMEs survive in Nigeria. The study identified factors that are responsible for the failure of small business in Nigeria. These factors are: irregular power supply, inadequate fund, poor available infrastructure, and poor knowledge of the market. It also include improper book keeping or poor records, poor business strategy, inability to separate business revenue from the profit, unavailability of plant and machinery, unavailability of man power and cut-throat competition (Basil, 2005).

In their joint study, Chidi & Shadare (2011) empirically examined SMEs and human capital development in Nigeria. The study discovered that human capital has significant impact on Nigerian SMEs. The study advocated for an improvement in human capital need of SMEs in Nigeria. If enhanced, it will encourage the growth of SMEs in the country. Ismaila (2012) in his examination of SMEs and generation of employment in Nigeria employed the Binomial statistical analysis. The study found out that SMEs have not reduced the level of unemployment due to its inability to access to adequate capital. The study also discovered that almost all the SMEs sampled depend on fund from the informal sector as sources of finance to start their business. Afolabi (2013) employed ordinary least square to investigate small firms finance and output of Nigeria for the period of 1980 to 2010. The study reveals that wholesale and retail trade output, banks lending and exchange rate have

positive impact on output growth in Nigeria but lending rate has negative impacts on economic growth. It asserted that bank lending promote output growth of Nigeria.

#### **2.4 Gaps/Summary of Empirical Review**

In some of the previous empirical studies reviewed, it was discovered that some of the studies such as Khalizadeen-Shirazi (1971), Butter & Linter (1945), Osoba (1987), Gerther & Gilchrist (1991), Ekpenyong (1997), Odetola (1997), Okraku & Croffie (1997), Ogun & Anayanwu (1999), and Davies et al (1993), were obsolete and may not effectively reflect the future since there have been some recent policies enacted to enhance the growth of small firms in Nigeria. These policies may have undermined the usefulness of these studies. Some studies conducted such as Carl (2001) and Godfried & Song (2000) employed panel data approach on the survival of SMEs in Africa and Latin America. However, this study cannot effectively access the Nigerian economy since these studies are not country specific. Most of the empirical works reviewed failed to consider the endogeneity of the production function. Such studies are subject to simultaneity bias. Such as studies include Obasan et al (2011), Akingunola (2011), Muritala et al (2012), Godfried & Song (2000), Opkara & Pamela (2007) and Adolphus (2011). Some of these studies used either ordinary least square (OLS) or ANOVA after affirming the presence of unit root. Such studies will result to spurious regression since they fail to consider the stationarity of the variables. Similarly, Akingunola (2011) used Rho test in his study while some of other studies used a two to a four variable models. Studies of this type are subject to specification error. This study differs with the previous studies in that it considered the endogeneity of the producing function by using vector error correction model, it also considered the stationarity of the employed variables using ADF test, and the scope of the study has be extend to 2013. Scholars work reviewed did not include GEXP (government expenditure) in the variables that could impact on the performance of small business financing in Nigeria.

### **III. METHODOLOGY**

#### **3.1 Model Specification**

The model formulated in this study takes after Thorsten (2003) which was based on neo-classical growth theory. The model that provides the overall theoretical framework and estimating equation is derived from the Cobb-Douglas production function (Jones, 2002):

$$Y = F(K, L) = AK^\alpha L^\beta \quad (1)$$

where SMEs produce output Y using capital stock K and labour L in t year, which is written in logarithm form as:

$$\ln Y_t = \beta_0 + \beta_1 L_t + \beta_2 K_t + u_t \quad (2)$$

where, t denotes the time index. The parameter Y stand for output and L is human capital and K is grant or loan received by SMEs. To determine the functional form of the relationship between SMEs lending with output growth within the period under review, the study modified the above equations as follow:

$$Y = \alpha_i + \beta_i \text{SME}_i + \varepsilon_i \quad (3)$$

where Y is the GDP, SME is the commercial bank loans to SMEs and  $\varepsilon$  is error term. The equation 3 is built upon to include other variables such as government expenditure, money supply, exchange rate and bank lending rate in order to avoid the specification problems, therefore the model is presented in its functional form as

$$GDP = f(SML, GEXP, M_2, EXR, BLR) \quad (4)$$

Therefore, equation 4 is expressed in log linear form to achieve the objective one of the study as

$$\log GDP_t = \alpha_0 + \alpha_1 \log SML_t + \alpha_2 \log GEXP_t + \alpha_3 \log M_{2t} + \alpha_4 EXR + \alpha_5 BLR + \varepsilon_t \quad (5)$$

where GDP is Gross Domestic Product, SML is Small and medium scale Loans, GEXP is Government Expenditure defined as summation of government total expenditure on education, health, agriculture, manufacturing, defence and administration.  $M_2$  is money supply expressed as money circulating outside bank plus demand and time deposit, EXR is Exchange Rate which is the exchange rate of Naira to United State of American dollar; BLR is bank lending rate defined as the rate at which commercial banks lend to the public and Parameters are,  $\alpha_0, \alpha_1, \alpha_2, \alpha_3, \alpha_4, \alpha_5$   $\varepsilon_t$  is error term and log represent logarithm. From the above specification model, GDP is the dependent variable with small and medium scale loans (SML), government expenditure (GEXP), money supply ( $M_2$ ), exchange rate (EXR) and bank lending rate (BLR). Exchange rate and bank lending rate are expected to have negative a priori sign while SMEs loan, government expenditure and money supply are expected to have positive a priori signs.

#### **3.2 Source of Data**

The study employed the time series data from 1992 -2013. The statistical data for GDP, commercial bank loan to SMEs, Government expenditure, money supply, exchange rate and bank lending rate were sourced from Central Bank of Nigeria Statistical Bulletin of 2009 and 2011, and Annual report of National Bureau of Statistics, 2013.

### 3.3 Estimation Procedures

The estimation procedure adopted in the research depends on the aspect of the research under study. Since it is a quantitative study that involves the use of annual series data over a given period, the study begins with the test of unit root test, followed by tests of cointegration, VECM and granger causality techniques. The unit root test is first conducted using Augmented Dickey-Fuller unit root test (ADF) to ensure the robustness of the result. The test helps to determine whether the variables are stationary or non-stationary. It was conducted with intercept and trend which is specified below as.

$$\Delta Y_t = \alpha + \beta_t + \delta Y_{t-1} + \alpha_i \sum_{i=1}^m \Delta Y_{t-1} + \epsilon_t \quad (7)$$

From the above equation, if the series has unit root, it is said to be non-stationary but the absence of unit root indicates that the series is stationary. However, if non-stationary, there is possibility of cointegration in the model. Since the series were non-stationary, the study proceeded to determine the presence of cointegration among the variables using Johansen Cointegration test on the model specified as

$$\lambda_{max} = \sum_{i=r+1}^n \ln(1 - \lambda_i) \quad (8)$$

$$\Lambda_{max} = -T \ln(1 - \lambda_{r+1}) \quad (9)$$

The null hypothesis of no cointegration is rejected if the trace and maximum-eigen statistics are greater than their respective critical values and conclude that cointegration exist among the variables but the null hypothesis is accepted if the trace and maximum-eigen statistics are less than their critical values which conclude that there is no cointegration among the variables in the model. Having established evidence of cointegration, the one year lag of error correction term (ECT(-1)) is integrated into the model to help determine the presence of short run relationship between SMEs lending and output growth. The VECM is specified below as

$$\begin{aligned} \Delta \log GDP_t = & \alpha_0 + \sum_{i=1}^p \beta_i \Delta \log GDP_{t-1} + \sum_{i=1}^p \delta_i \Delta \log SML_{t-1} + \sum_{i=1}^p \gamma_i \Delta \log GXP_{t-1} + \sum_{i=1}^p \vartheta_i \Delta EXR_{t-1} \\ & + \lambda_i \sum_{i=1}^p \Delta BLR_{t-1} + \theta_1 ECT_{t-1} + \epsilon_t \quad (10) \end{aligned}$$

$$\begin{aligned} \Delta \log SML_t = & \alpha_0 + \sum_{i=1}^p \beta_i \Delta \log GDP_{t-1} + \sum_{i=1}^p \delta_i \Delta \log SML_{t-1} + \sum_{i=1}^p \gamma_i \Delta \log GXP_{t-1} + \sum_{i=1}^p \vartheta_i \Delta EXR_{t-1} \\ & + \lambda_i \sum_{i=1}^p \Delta BLR_{t-1} + \theta_1 ECT_{t-1} + \epsilon_t \quad (11) \end{aligned}$$

Where, ECT<sub>(t-1)</sub> is the error correction term lagged one period. Therefore, vector error correction model (VECM) is employed in the estimation of the SMEs loans model because of its robustness in estimation of cointegrating vectors. VECM is built to accommodate the endogenous variables to meet their cointegrating equation, while allowing for short run adjustment. This serves as motivation for the choice of VECM techniques.

### 3.4 Post Estimation Tests

The diagnostic tests such as serial autocorrelation, Autoregressive Conditional Heteroskedasticity and Ramsey's RESET Test were employed in the analysis of the study to determine the robustness of the model. The tests were carried out to check the presence of autocorrelation in the disturbance using Breusch-Godfrey test. The Ramsey regression RESET test was employed to determine the functional form of the model while autoregressive conditional heteroscedasticity (ARCH) was used to find out whether the regressors were homoscedastic and independent of one another. The null hypotheses of these tests were carried out at 5 percent significance level. The insignificance of these tests indicates the acceptance of null hypotheses of no autocorrelation, no functional form problem and that the regressors are homoscedastic.

Also, CUSUM tests were applied to trace the point of change. It was first used in quality control which was later used in a study that involves analysis of data that occurred over a period of time since these data react to institutional polices and other social factors. Its simplicity makes it useful in estimation and analysis cause of changes.

#### IV. RESULTS

The results of the tests such as unit root test, co-integration test, VECM test, and post diagnostic tests such as Breush-Godfrey serial correlation LM test, Ramsey RESET test and Autoregressive conditional heteroscedasticity were presented in this chapter.

##### 4.1 Result of Unit Root Test

**Table 3: Augmented Dickey-Fuller Unit Root Test Results**

Variables	Sig. level		Sig. level		lag length	Remark	Decision
	level	(5%)	1 <sup>st</sup> diff	(5%)			
RGDP	-1.831078	-3.0521	-3.987388	-3.7347	1	I(1)	Stationary
SML	-1.219223	-3.7119	-3.845164	-3.7347	1	I(1)	Stationary
GEXP	-2.11494	-3.7119	-3.955480	-3.7347	1	I(1)	Stationary
MS	-3.041680	-3.7119	-4.384208	-3.7347	1	I(1)	Stationary
EXR	-1.527957	-3.7119	-4.743073	-3.7347	1	I(1)	Stationary
BLR	-1.765484	-3.7119	-4.448399	-3.7347	1	I(1)	Stationary

Source: Author’s calculation, 2013 using Eview 7.0 version

In order to empirically investigate SMEs lending and output growth of Nigeria, the study first begin with checking the stationarity of the employed series using ADF unit root test. For instance, if the t statistic value is much more in negative than the critical values, then reject the null hypothesis and conclude that the series is stationary but if the value of t-statistic is much less in negative than the critical value and conclude that the series has unit root or non-stationary. Tests for the stationarity of the variables were presented in Table 3 below. However, the null hypotheses were rejected at 5 percent significant level. This shows that all the variables under investigation using ADF are non-stationary at level. In the other hand, the stationary states of the time series were achieved after differencing the series once. That is first differencing. Therefore, the series were said to be integrated of order one I(1) at 5 percent significance level. This indicates that the test failed to reject the null hypothesis of non-stationary. This means that the null hypotheses that the series are stationary at level form were rejected and concluded that the series have unit root.

##### 4.2 Cointegration Test Results

Having confirmed that all the variables are non-stationary; the study proceeded to extract residuals and tested it for presence of unit root. The residual from the regression were tested for stationarity using ADF test. The result indicated that the residual is stationary showing evidence of co-integration. Also, Johansen Co-integration test was equally employed to determine the presence of cointegration in the model. Having established that all series were integrated to order one and are non-stationary, the co-integration test was conducted at 5 percent significant level. However, if the trace statistics or the Likelihood ratio is greater than the critical value at both 5 percent and 1 percent significant level, then reject the null hypothesis and conclude that there is cointegration within the model. The co-integration test results were presented in table 3. the result of the Johansen co-integration test conducted under the assumption of linear deterministic trend with its likelihood ratio (L.R) test indicate six (6) co-integration equation(s) at 5 percent and 1 percent significance level, having the likelihood ratio value in absolute term greater than 5 percent and 1 percent critical values respectively. In other words, the implication of this result is that there is a long-run equilibrium relationship between the dependent variable and explanatory variables. This indicated that there is a long-run steady-state relationship between commercial bank lending and GDP in Nigeria.

**Table 4: Johansen Co-integration Test Results**

Eigenvalue	Likelihood Ratio	5 percent Critical value	1 percent Critical value	Hypothesized No of CE(s)
0.955832	150.0849	102.14	111.01	None**
0.876168	93.92941	76.07	84.45	At most 1**
0.695277	56.33055	53.12	60.16	At most 2*
0.581949	34.94020	34.91	41.07	At most 3*
0.506124	19.24149	19.96	24.60	At most 4
0.304762	6.543029	9.24	12.97	At most 5

Note: \* and (\*\*) denotes rejection of the null hypothesis at 5 percent and 1 percent significances level. L.R. test indicates 4 cointegrating equation at 5 percent significance level.

Source: Author’s calculation, 2013

**4.3 Result of Vector Error Correction Model (VECM)**

Using VECM, the estimates are presented in its linear form below as

$$GDP_t = -0.602 + 0.990RGDP_{t-1} - 0.067SML_{t-1} - 0.029GEXP_{t-1} - 0.022MS_{t-1} + 0.007EXR_{t-1} - 0.037BLR_{t-1} - 0.435ECT_{t-1} + e_t$$

S.E (1.0621) (0.0834) (0.0280) (0.0269) (0.0200) (0.0292) (0.0810) (0.0945)  
t-stat (-0.5671) (11.8770) (-2.3904) (-0.0900) (-1.0774) (0.2537) (-0.4127) (-3.3654)  
p-value [0.5832] [0.0000] [0.0375] [0.3013] [0.3006] [0.8048] [0.6885] [0.0312]  
R = 0.992654 R = 0.987512 D. W. = 2.139575 F-stat = 193.0497 Prob(F) = 0.000000

From the vector error correction model results above, lagged GDP, government expenditure (GEXP), money supply (MS) significantly impact economic growth in Nigeria within the specified period. These variables have p-values less than 0.05 indicating that they are statistically significant. The numerical sign of the estimated variable (small and medium enterprises loan) has a negative influence on GDP and it is statistically significant since the p-value of 0.0375 is less than 0.05. This means that SMEs loan significantly impact negatively on economic growth in Nigeria. The negative sign of the coefficient of government expenditure to the tune of -0.029 indicated that government expenditure over the years has negative effect on economic growth of Nigeria. However, the coefficient of money supply (MS) and bank lending rate (BLR) have negative relationship with the dependent variable (Gross Domestic Product). The negative sign of the coefficient of money supply and the positive sign of exchange rate indicated non-conformity to theoretical a priori expectation while negative sign of banking lending rate conforms to the negative a priori expectation. The coefficient of ECT has the expected negative a priori sign and it is statistically significant. The coefficient of ECT of -0.435 is statistically significant which indicated that SMEs will add only 43 percent to the growth of GDP per year for equilibrium to be restored in the long run. However, it will act to correct any derivations of the dependent variable by adding 43 percent till when equilibrium is restored. . The error term, e<sub>t</sub>, is retained in the estimated model to accommodate any differences between the explanatory variable with their respective coefficients.

The p-value of F-statistic of 0.00000 indicated that small and medium enterprises loans (SML) and other explanatory variables have joint impact on output growth in Nigeria. These entail that the current level of economic growth in Nigeria has been influenced by the level of small and medium scale loans as well as level of government expenditure, money supply exchange rate, and bank lending rate in Nigeria. Meanwhile, the computed Durbin-Watson statistic of 2.139575 indicated no autocorrelation among the residual in the model. However, the coefficient of determination R-Square has the value of 0.992654. This shows that about 99 percent change in GDP has been influenced by level of SMEs loan in Nigeria. This shows that SMEs loans account for the 99 percent variation in GDP, while the remaining 1 percent was due to other variables not captured by the model but represented by the error term, of the model. Thus, by the nature of this R<sup>2</sup> 99 percent result, we concluded that the model has a good fit.

**4.4 Post Estimation Test Results**

The study applies a number of post estimation tests as presented in Table 5. The tests were carried out to check the presence of autocorrelation in the disturbance using Breusch-Godfrey test. The Ramsey regression RESET test was employed to determine the functional form of the model while autoregressive conditional hetroscedasticity (ARCH) was used to find out whether the regressors were homoscedastic and independent of one another. The null hypotheses of these tests were carried out at 5 percent significance level. The insignificance of these tests indicates the acceptance of null hypotheses of no autocorrelation, no functional form problem and that the regrssors are homoscedastic.

**Table 5: Diagnostic Test Results**

Test	F-stat	obs	p-value
Breusch-Godfrey test	0.918698	18	0.433440
Ramsey RESET Test	6.375899	18	0.530125
ARCH Test	0.879774	17	0.363122

Source: Author’s calculation, 2013

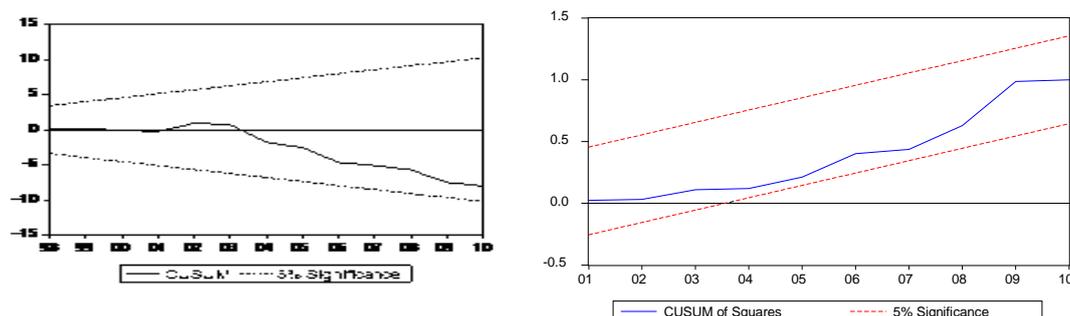
From the above table 6, the null hypothesis of no serial autocorrelation was tested using Breusch-Godfrey test at 5 percent level of significance. Since the p-value of 0.433440 is greater than the hypothetical p-value of 0.05, the study accepts the null hypothesis of no serial autocorrelation. However, it was concluded that autocorrelation does not exist in the disturbance term. Thus, this confirms that model satisfied the zero covariance assumption of Ordinary Least Square (OLS) Techniques indicating that the model is the best linear unbiased estimator whose estimates possess the desirable properties of unbiasedness, efficiency and consistency. Testing the null hypothesis of no specification bias or functional form problem exist within model. Ramsey RESET test was applied at 5 percent level of significance. However, since the p-value of 0.530125 is greater

than the hypothetical p-value of 0.05, the study accepts the null hypothesis and concluded that there are no functional form problems within the model. This showed that the model is not well specified.

The study also showed that the errors are homoscedastic and independent of the regressors indicating that the errors are independently distributed at random variant with zero means and constant variances. These results prove that the model complied with the BLUE assumption of Ordinary Least Square Techniques (OLS).

The CUSUM test is the measure of structural stability of a system of equations. The CUSUM test was based on the cumulative sum of the equation errors in regression. It presents graphically the cumulative sum of errors together with critical lines of 5 percent. The equation parameters are not considered stable if the whole sum of recursive errors gets outside the two critical lines.

To Brown et al (1975), CUSUM test determines the systematic variation in the coefficients of any analysis while CUSUMQ measures the consistency of the estimated parameters. From the graph below, it reveals that the lines of CUSUM and CUSUMQ lie within 5 percent critical boundaries, thus indicating that the long run stability of the parameter estimates of SMEs lending on economic growth in Nigeria.



## V. DISCUSSION

The result shows that the commercial bank loan to SMEs has significant impact on GDP growth in Nigeria within the period under review. The result also established that SMEs loan has a negative influence on national output growth. The coefficient of SMEs loan of -0.067031 indicated that one percent increase in SMEs loan resulted in 6.7 percent decline in economic growth in Nigeria though not statistically significant. This is not in line with pecking order theory which hypothesis that lending to SMEs only when they might have exhausted their internal finance. This makes it imperative for SMEs to seek for fund from banks to close the plough back profit- future investment outlay gap.

The negativity of the SMEs loan on economic growth might be due to high borrowing cost, deterioration of the share of SMEs loans to total banks loan to private sector which was more pronounce in 1996 as a result of prohibition of 20 percent compulsory fund to SMEs. Also, the negative impact of SMEs lending on economic growth might be as a result of the fact that the SMEs funding are mainly from informal sources and the inability of banks to significantly lend to SMEs in Nigeria, thus the poor contribution of SMEs to output growth of the country. The SMEs inherent problems have discouraged many banks to develop interest in financing SMEs. Tough lending conditions have served as bottleneck to accessing funds from formal lending institutions by SMEs. This finding is in tandem with the previous studies such as Ekpenyong (1997), Okraku & Croffie (1997), Odetola (1997), Garlick (1997), Gerther & Gilchrist (1991), Muritala etal (2012) and Ismaila (2012) who maintained that SMEs do not lead to economic growth due to her inability to obtain adequate funding from formal financial institutions. Nevertheless, the finding contradict studies such as Aremu & Adeyemi (2011), Adolphus (2011) and Afolabi (2013) that SMEs encourage economic growth in Nigeria.

The negativity of the government expenditure indicated that increase in government expenditure over the years have not improved the performance of SMEs in Nigeria. Increase in public expenditure theoretically supposed to increase the availability of finance to the SMEs which invariably will result to increase in economic growth. However, this does not hold for Nigeria due to the fact that stringent measures might have deterred SMEs investor to access finances meant for it development. This has made SMEs entrepreneurs to rely on finances from informal institutions.

The significance of money supply showed that money supply has significant impact on economic growth in Nigeria. The negative sign of money supply indicated that increase in money supply decrease availability of finance to SMEs. One percent increase in money supply will reduce credit availability to SMEs to the tune of 2.58 percent. However, as money supply increase, economic growth will decrease which will adversely affect availability of finance to SMEs.

The exchange rate and bank lending rate have insignificant impact on economic growth. These were supported by the coefficients of exchange rate and bank lending rate of 0.00741 and 0.036986 respectively. Therefore, one unit change in exchange rate and bank lending rate resulted in 0.74 percent and 3.7 percent

increase in economic growth respectively, though not statistically significant. The insignificant of exchange rate and bank lending rate may have affected the availability of adequate fund for the growth of SMEs in Nigeria. However, the insignificance of SMEs lending to economic growth showed that despite all the government policies aimed at promoting the growth of SMEs and recent economic growth in Nigeria, the share of SMEs to national output has been dwindling. This led to decline in standard of living, low per capita income and high rate of unemployment in Nigeria. The finding is in tandem with Muritala et al (2012) and Ismaila (2012). The finding is in contrast with Afolabi (2013) who earlier found that exchange rate is among the factors that encourage availability of loans to SMEs in Nigeria.

The cointegration result shows the evidence of long run relation between SMEs lending and economic growth in Nigeria. This showed that in the long-run, SMEs will impact on economic growth in Nigeria. In the long run, all the factors that impeded the availability and accessibility of adequate fund for the growth of SMEs will all vary. That is, those factors such as stringent collateral securities demanded by banks, rising borrowing cost and drastic decline in the SMEs loans to banks' total loan ratio will be overcome. These will result in improvement in both formal and informal source of fund. However, once the challenges are overcome the growth of SMEs will lead to increase in economic growth which will solve the macroeconomic problems in Nigeria. Improved funding will enable SMEs to engage in large scale production in order to lower the cost production and to enjoy economic of scale. As the SMEs enjoy economics of large scale production, there will be increase in output. This will lead to increase in income, improved standard of living, high per capita income and drastically reduce the unemployment. The finding is in line with Aremu and Adeyemi (2011), Adolphus (2011) and Afolabi (2013).

## VI. CONCLUSION

The study examined SMEs lending and economic growth in Nigeria. The growth of SMEs has played a vital role on the economic growth of many countries. Some of the empirical studies reviewed were not unified on the effect of SMEs on economic growth. In order to effectively carry out this study, the researcher employed vector error correction techniques and pair-wise granger causality test on the annual data collated from 1992 to 2013. The results of the study indicated that SMEs lending has significant negative relationship with economic growth in Nigeria. Also, uni-directional relationships run from gross domestic product to SMEs lending and no causal relationship between government expenditure and gross domestic product in Nigeria.

SMEs have not played the significant role they are expected to play in Nigerian economic growth and development. Driven by the findings in the study, SMEs in Nigeria have a long way to go for the sector to be productive and play its role in economic growth and development in Nigeria. This study, therefore concluded that SMEs in Nigeria are performing below expectation due to their inability to source for fund in formal institutions. This might be attributed to stringent bank lending conditions, poor government policy and implementation among others. These have impacted negatively to the growth of SMEs and Nigerian economy in general.

## VII. RECOMMENDATIONS

The following policy recommendations were made based on the findings of the study.

- The SMEs should be redefined in a way to ease access to loan with less stringent measures.
- The cost of borrowing should be lowered to a single digit rather than borrowing at prevailing interest rate. This will encourage SMEs to borrow from the formal financial institutions.
- Stringent collateral security requirement should be relaxed to ease SMEs access to fund from formal financial institutions.
- Lending institutions should be guaranteed against risk that might manifest in the course of granting credit to SMEs.

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