

Informal Financial Institutions and Small and Medium Scale Enterprises Performance in Akoko South West Local Government, Ondo State

Oluwole, F.O. & Oluwagbemigun, O.

Department of Banking and Finance, Adekunle Ajasin University Akungba-Akoko, Ondo State, Nigeria

Abstract: *Though the provision of finance for small and medium scale enterprises has been vested on the formal financial institutions like commercial banks and microfinance institutions, focus has shifted from these institutions to informal institutions in the recent years. This study investigated the effect of informal financial institutions and small and medium scale enterprises (SMEs) performance in Akoko South West Local Government Area of Ondo State. Two hundred (200) copies of the questionnaires were administered using simple random sampling technique to. Multiple regression model was adopted to analyze the data. The result showed that credit from family and friends and credit from money lenders had negative effect on the growth of small and medium scale enterprises with coefficients of -0.124 and -0.363 respectively. Also, cooperative credit and credit from business angels had positive effect on the growth of SMEs with coefficients of 0.562 and 0.087 respectively. It was suggested thus, government should formulate easy and tax-free policies that will strengthen the informal financial institutions in order to increase the availability of credit to SMEs in Akoko South West Local Government Area of Ondo State in particular and Nigeria as a whole.*

Keywords: Credit, informal finance, performance, SMEs

I. Introduction

Finance remains an important tool to increase the growth and performance of businesses including small and medium scale enterprises. This is because finance is required for undertaking different business activities from the purchase of raw materials and other assets to the payment of employees' salary among others. Thus, providing adequate finance for business survival is the major focus of government and policy makers in developing countries like Nigeria (Susan & Obamuyi, 2018).

SMEs play important role in industry countries including Nigeria. For instance, SMEs may create employment opportunities, generate foreign earnings and contribute to economic growth (Owenvbiugie & Igbinedion, 2015; Ofeimun, Nwakoby & Izekor, 2019). While the provision of finance for the growth of small and medium scale enterprises has been vested on the formal financial institutions like commercial banks and microfinance institutions, focus has shifted from these institutions to informal institutions in the recent years. This is because of the imperfections of the formal financial market and their inability to meet the financing need of small-scale businesses located mostly in rural areas (Fanta, 2015). Informal financial institutions are traditional institutions that operate savings scheme mainly for the mutual benefits of their members. Hanedar, Altunbas and Bazzana (2014) defined informal financial intermediation as financial transactions that occur outside official financial institutions and that are not regulated by governmental authorities.

Informal financial institutions provide savings and credit services in order to meet the financial needs of their members who are mostly small-scale business operators and farmers. There are various sources of informal credit which include credit from family/friends, moneylenders, rotating savings and credit organizations (ROSCAs), loan sharks, indigenous savings and credit clubs, informal credit unions, and savings collectors (Forkuoh, Yao, Emmanuel & Isaac, 2017). The informal intermediation arrangements operate under different names in Nigeria such as Esusu or Ajo among the Yorubas of Western Nigeria, Etoto for the Igbos in the East, Adashiin the North for the Hausas and Cooperative and Credit Thrift Societies which are found in all the rural and some urban communities in Nigeria. The key features of these informal schemes are savings and credit components, informality of operations, absence of collateral, closeness to borrowers' and lower interest rate in relation to the formal banking sector institutions.

In spite of the developmental role of small and medium scale enterprises in Nigeria, the sector has continued to experience setbacks in terms of productivity and development. According to Zirra and Charles (2017); Nelson, Paul and

Olumorin (2020) some of these problems include; lack of access to credit, insufficient capital, inadequate market research, lack of business strategy, inexperience, cut-throat competition, as well as inadequate entrepreneurial skills with lack of finance and access to credit playing leading role. Olowe, *et al.*, (2013); Ofeimun, Nwakoby, and Izekor (2018); Adekunle, *et al.*, (2018); Yusufu, Suleiman and Saliu (2020) asserted that the contributions of small and medium scale enterprises to the growth of Nigerian economy have not been greatly felt because majority of SMEs in Nigeria do not reach the growth stage of their life cycle due to lack of access to finance.

Although studies have examined the effect of financial institutions on the performance of SMEs, majority of these studies mainly focused on the effect of formal financial institutions on SMEs in Nigeria. For example, Aliyu and Bello (2013); Somoye (2013); Obansan and Arikewuyo (2012); Imoughle and Ismaila (2014); Ayeni-Agbaje and Osho (2015); Zirra and Charles (2015); Ayuba and Zubairu (2015); Owenvbiugie and Igbinedion (2015); Oke and Aluko (2015) examined the impact of banking sector credit on small and medium scale enterprise. Also, Ndife (2013); Akingunola, Adekunle, Adegbesan and Aninkan(2013); Adeoti, Gbadeyan and Olawale (2015); Obokoh, Monday and Ojiako (2016); Danjuma (2017); Ofeimun, *et al.*, (2018); Aladejibi (2019); Yusufu, *et al.*, (2020) examined the effect of microfinance credit on small and medium scale enterprises.

Few studies have focused on the effect of informal financial institutions on the performance of SMEs with studies mainly done in developing countries (Fanta, 2015; Mungiru & Njeru, 2015; Forkuoh, *et al.*, 2017). Furthermore, Yelwa, *et al.*, (2017) only focused on the effect of informal financial institutions on poverty alleviation. Thus, this investigated the effect of informal finance on the performance of SMEs in Akoko South West Local Government Area of Ondo State, Nigeria.

II. Literature Review

This study will rely upon the Ex-post and Ex ante theory. The Ex-post and Ex ante theory juxtaposed the reasons why formal financial institutions like commercial banks are unable to meet the financial need of small and medium scale enterprises in most developing countries like Nigeria. The theory asserted that formal lending requires adequate information and collateral in order to offset the risk associated to small and medium scale business. These stringent conditions make small and medium scale enterprises operators or owners to prefer informal finance to formal finance. Moreover, informal lenders do not require collateral because they are close to small and medium scale enterprises operators and have adequate information about the borrowers. Thus, informal lending thrives on the close relationship between the lender and borrower which makes formalities and other conditions being required by formal lender like commercial banks to be minimal.

Studies have been conducted on the linkage between finance and small and medium scale performance in Nigeria. The study of Adebayo (2015) examined the effect of informal financing option on rural SMEs growth in Kwara State. The study employed regression technique to analyze the data collected from 125 respondents through questionnaire and it was found that that informal financing option is germane to improving rural SMEs as it contributed positively to business expansion, provide more jobs and ultimately reduce high rate of poverty in the rural communities.

Yelwa *et al.*, (2015) investigated the relationship between informal financial sector activities and poverty alleviation in Nigeria. A multivariate panel data approach was used with data from 150 informal sector operators in Gwagwalada area council-FCT. Data was collected using structured questionnaire and analyzed using descriptive statistics and multiple regression technique. The findings revealed that informal financial sector operators have a positive and significant impact on poverty alleviation in Nigeria; while poverty-mentality, illiteracy, high inflation, low infrastructure, access to credit, social safety nets and information dissemination are the major problems encountered by these institutions.

Forkuoh, *et al.*, (2015) examined the effect of informal financial services on SMEs financing in Ghana using primary data through the distribution of questionnaire to two hundred respondents from which one hundred and eighty-seven respondents was used and analyzed using descriptive statistics and stepwise regression technique. The results showed that SMEs have easy access to informal finance, but the major challenges SMEs face when accessing the funds are the limited size of the loan and how to meet the demands of the lenders.

Mungiru and Njeru (2015) assessed the effect of informal finance on the performance of SMEs in Kiambu County. The study employed descriptive research design to collect information from 95 randomly selected respondents using primary data through questionnaire which was analyzed using correlation and multiple regression analysis. The study found that self-help group finance, family and friends finance and trade credit finance had positive influence on the performance of SMEs while shylock finance sources had negative influence on the performance of SMEs.

Hanedar, *et al.*, (2014) investigated the use of informal credit by the SME among countries. The study used generalized Linear Model (GLM) technique to analyze the data of countries selected from both developed and developing countries. It was found that those credit-constrained SMEs rely on informal credit of any type. In addition, it

was revealed that the size and the age of the firm and whether the firm has a payment overdue determine their use of informal credit while the quality of the legal system is the most significant country-level factor that determines the usage of informal credits among countries.

Ofeimun, *et al.*, (2018) investigated the effect of microfinance bank on small businesses in Nigeria from 1990 to 2015. Base on the regression result, it was found that micro loan had significant and positive relationship with small business growth.

Aladejebi (2019) assessed the impact of microfinance banks on the growth of SMEs in Lagos metropolis. Questionnaire was used to collected data from 209 respondents. It was discovered that microfinance banks had significant effect on SMEs.

Yusufu, *et al.*, (2020) examined the relationship between micro finance bank and the growth of small medium enterprises in Nigeria. Data were collected from 100 SMEs operating Abuja analyzed with simple linear regression. Findings revealed that micro finance banks domestic fund transfer services contribute to the growth of small and medium enterprises.

Methodology

The population for this study comprised of all SMEs operating in Akoko South-West Local Government Area of Ondo state. There are about 250 SMEs operating in the study area according to the Ministry of Commerce and Industry (2017). Samples are taken using Yamane (1968) formulae and 200 sample size was employed. This sample size was further subdivided into 7 districts so as to cover the entire Akoko region. These districts are Akungba, Supare, Ikun, Oba, Oka, Iwaro, and Eti-oroAkoko.

III. Model Specification

This study employed multiple regression model to examine the effect of informal finance on the growth of small and medium scale enterprises. The model is given as:

$$SMEsG = f(CFF, CC, CBA, CML) \tag{1}$$

The econometrically model is given as:

$$SMEsG = \beta_0 + \beta_1CFF + \beta_2CC + \beta_3CBA + \beta_4CML + \epsilon \tag{2}$$

Where:

SMEsG = Growth of Small and Medium Scale Enterprises

CFF = Credit from Family and Friends

CC = Cooperative Credit

CBA = Credit from Business Angels

CML = Credit from Money Lenders

ϵ = is the error term

$\beta_1 - \beta_4$ are the various intercepts

Method of Data Analysis Test of significance

This study employed multiple regression technique to examine the effect of informal finance on the growth of small and medium scale enterprises. The significance of the effect of credit from family and friends, cooperative credit, credit from business angels and credits from money lenders on growth of small and medium scale enterprises was tested at 95% level of confidence using t-test and F-test.

Data Analysis and Interpretation

Table 1: Model Summary

Model	R	R Square	Adjusted Square	R	Std Error of the Estimate	Durbin Watson
1	.620 ^a	.876	.758		3.18301	1.928

Source: Researchers' Computation, 2020

Table 1 presents the model summary of the regression result. From table 1, the correlation (R) value of 0.0620 or 62% indicates positive relationship between informal financial institutions and the growth of small and medium enterprises. The adjusted R Square value of 0.758 or 75.8% implies that 77.58% changes in the growth of small and

medium enterprises are explained by credits from family and friends, cooperative credits, credits from business angels and credits from money lenders while the remaining 24.2% of variations are caused by other determinant factors of small and medium enterprises growth which are not captured in the model. Finally, the Durbin- Watson value of 1.928 entails the absence of auto correlation in the result since the Durbin-Watson value is close to 2.

Table 2: Anova

Model	Sum of Square	Df	Mean Square	F	Sig
Regression	390.466	4	97.617	9.635	.000 ^b
Residual	1823.674	180	10.132		
Total	2214.141	184			

Source: Researchers' Computation, 2020

Table 2 shows the F-statistic value of regression to test the overall significance of the independent variables in explaining the dependent variable. The F-statistic value is given as 9.635 with the corresponding significance value of 0.000 which is significant at 5%. This implies credit from family and friends, cooperative credits, credits from business angels and credits from money lenders have joint and significant effect on the growth of small and medium enterprise

Table 3: Coefficients

Model	Coefficients	T-test	Sig.
(Constant)	15.616	5.057	.000
CFF	-.124	-1.160	.248
CC	.562	4.244	.000
CBA	.087	2.604	.010
CML	-.363	-4.096	.000

Source: Researchers' Computation, 2020

Table 3 shows the regression coefficients of the relationship between each of the independent variables and the dependent variable. The result shows that credits from family and friends has negative and insignificant effect on the growth of small and medium enterprises with coefficient of -0.124 which implies that a unit increase in credits from family and friends will lead to 0.124 unit fall in the growth of small and medium enterprises. The t-statistic value is given as -1.160 with a corresponding probability value of .248 which is insignificant at 5%. This lead to acceptance of the null hypothesis that credit from family and friends has no significant effect on the growth of small and medium scale enterprises in Akoko South West Local Government Area of Ondo State, Nigeria .

IV. Discussing of Findings

This study examined the effect of informal sector credit and SMEs performance in Akoko South West Local Government Area of Ondo State. Based on findings, it was revealed that credit from family and friends had negative and insignificant effect on the growth of small and medium enterprises. The implication of this finding is that inability of small and medium scale business operators to access credit from family and friends will lead to fall in growth. This result is not in line with the findings of Adebayo(2015);Yelwa *et al.*, (2015); Mungiru and Njeru(2015) who found that family and friends finance had positive effect on performance of SMEs.

This study revealed that cooperative credit had positive and significant effect on the growth of small and medium enterprises. This implies that increase in the flow of credit from c

ooperative societies is germane for enhancing growth of small and medium scale enterprises. This is due to the fact that cooperative societies have the capacity to pull large funds from their members and lend at lower rate to members in order to support their business activities. These findings conformed to the results of Mungiru and Njeru(2015);Yelwa *et al.*, (2015); Samawi *et al.*, (2016) that credit from cooperative societies such as help group and contribution peer group contribute positively to the growth of small and medium scale enterprises.

Furthermore, credit from business angels was found to have positive and significant effect on the growth of small and medium enterprises. This may result from the fact that business angels and philanthropies have been supporting the activities of small-scale business in the recent years. Business angels are able to provide large financial support to small business owners and entrepreneurs who are in need of startup capital and money for running daily activities of business at little or no interest rate. This corroborates with findings of Yelwa *et al.*, (2015); Mungiru and

Njeru (2015) who established that financial support from business angels improve the performance and growth of small and medium scale enterprises.

Finally, it was established that credit from money lenders had negative and significant effect on the growth of small and medium enterprises. This is due to the fact that many small-scale business owners see credit from money lenders as involving high formalities and collateral. Also, the interest rate charged by money lenders is high which in most cases make it difficult for the borrowers to repay both the principal and interest as at when due thereby leading to forfeiture of collateral and other valuable assets. This result is supported by the empirical findings of Mungiru and Njeru (2015) who found that credit from shylock finance sources and money lenders had negative effect on small and medium scale enterprises growth. However, the result is not in line with the result of Adebayo (2015) whose findings revealed that loan from money lender such as mobile banker had positive effect on small and medium scale enterprises growth.

V. Conclusion and Recommendations

This study discovered credit from family and friends and credit from money lenders to impede the growth of small and medium enterprises while cooperative credit and credit from business angels enhance growth of small and medium enterprises in Akoko South West Local Government. It was thus concluded that informal financial sector has the capacity to stimulate the growth of small and medium enterprises. Therefore, the study recommends that credit from family and friends should flow to SME holders so as to improve economic prosperity. Also, government should disburse more fund to SME through cooperative societies even as business angels and money lenders' activities are encouraged to be checkmated by the government.

References

- [1.] Adebayo, P.O. (2015). Developing informal financing option for rural SMEs growth: A case of selected local government areas of Kwara State, Nigeria. *International Journal of Management Sciences and Business Research*, 4(9), 74 - 84.
- [2.] Adekunle, O.E. Obagunwa, T.O., Adodo, F.L. & Olanipekun, L.N. (2018). Environmental factors, globalization and small and medium scale enterprises performance in Akure Metropolitan, Ondo State. *International Journal of Advance Research and Innovation Ideas in Education*, 4(4), 1019 - 1024.
- [3.] Adeoti, J.O., Gbadeyan, R.A. & Olawale, Y.A. (2015). The impact of micro-finance institutions credit on the survival of small- and medium-scale enterprises in Irepodun LGA of Kwara State, Nigeria. *The Pacific Journal of Science and Technology*, 16(2), 179 -188.
- [4.] Akingunola, R.O., Adekunle, O.A., Adegbesan, K.J. & Aninkan, O.O. (2013). Microfinance banks and entrepreneurship development in Nigeria: A case of Ogun State. *European Journal of Business and Management*, 4(28), 100-111.
- [5.] Aladejebi, O. (2019). The impact of microfinance banks on the growth of small and medium enterprises in Lagos metropolis. *European Journal of Sustainable Development*, 8(3), 261-274.
- [6.] Aliyu, S.M. & Bello, G.B. (2013). An assessment of the contribution of commercial banks to the growth of small and medium scale enterprises in Nigeria. *International Journal of Research in Social Sciences*, 2(4), 47-55.
- [7.] Ayeni-Agbaje, A.R. & Osho, A.E. (2015). Commercial banks role in financing small scale industries in Nigeria (A study of First Bank PLC. Ado-Ekiti, Ekiti State). *European Journal of Accounting Auditing and Finance Research*, 3(8), 51-76.
- [8.] Ayuba, B. & Zubaru, M. (2015). Impact of banking sector credit on the growth of small and medium enterprises (SME's) in Nigeria. *Journal of Resources Development and Management*, 15(1), 1-9.
- [9.] Ayyagari, M., Juarros, P., Martinez, M.S. & Singh, S., (2016). *Access to finance and job growth: Firm-level evidence across developing countries*. World Bank Policy Research Working Paper 6704, Washington, DC: The World Bank.
- [10.] Danjuma, D.Z. (2017). Impact of microfinance services on performance of small and medium scale enterprises (SMEs) in Zaria Metropolis. *Scientific Research in Social Sciences & Management Studies*, 2(1), 49-65.
- [11.] Fanta, F.B. (2015). Informal finance as alternative route to SME access to finance: evidence from Ethiopia. *Journal of Governance and Regulation*, 4(1), 94 - 102.

- [12.] Forkuoh, S.K., Yao, Y., Emmanuel, A. & Isaac, Q. (2017). Informal financial services, a Panacea for SMEs Financing? A case study of SMEs in the Ashanti Region of Ghana. *American Journal of Industrial and Business Management*, 5, 779-793
- [13.] Hanedar, E.Y., Altunbas, Y. & Bazzana, F. (2014). Why do SMEs use informal credit? A comparison between countries. *Journal of Financial Management Markets and Institutions*, 2(1), 65-86.
- [14.] Imoughele, L.E. & Ismaila, M. (2014). The impact of commercial bank credit on the growth of small and medium scale enterprises: econometric evidence from Nigeria (1986 - 2012). *Journal of Educational Policy and Entrepreneurial Research*, 1(2), 251 - 261.
- [15.] Ministry of Commerce and Industry (2017). *Business survey*. Ondo State.
- [16.] Mungiru, J.W. & Njeru, A. (2015). Effects of informal finance on the performance of small and medium enterprises in Kiambu County. *International Journal of Scientific and Research Publications*, 5(11), 338- 362.
- [17.] Musa, G.G. & Aisha, U. (2012). Financing small and medium enterprises: A challenge for entrepreneurial development in Gombe State. *Asian Journal of Business and Management Science*, 2(9), 12-23.
- [18.] Naude, M.J. & Chiweshe, N. (2017). A proposed operational risk management framework for small and medium enterprises. *South African Journal of Economic and Management Sciences* 20(1), 1-10.
- [19.] Ndife, C.F. (2013). The impact of micro credit institutions on the development of small and medium enterprises in Anambra State. *Journal of Business and Management*, 14(5), 75-81.
- [20.] Nelson, G., Paul, O.C & Olumorin, M.O (2020). Microfinance bank and growth of small and medium scale enterprises (SMEs) in Bida Metropolis of Niger State, Nigeria. *KIU Interdisciplinary Journal of Humanities and Social Sciences*, 1(1), 1-15
- [21.] Obansan, K.A. & Arikewuyo, K.A. (2012). The effect of pre-post bank consolidation on the accessibility of finance to SMEs in Nigeria. *Business and Management Research*, 1(3), 108-120.
- [22.] Obokoh, L.O., Monday, J.M. & Ojiako, U. (2016). Microfinance banks and small and medium sized enterprises access to finance: the Nigerian experience. *Banks and Bank Systems*, 2(4). 110-124
- [23.] Ofeimun, G. O., Nwakoby, C., & Izekor, O.A. (2018). Effects of microfinance banks on small businesses' growth in Nigeria. *IIARD International Journal of Economics and Business Management*, 4(4), 15-25.
- [24.] Ogujiuba, K. Fadila, J. & Stieger, N. (2013). challenges of microfinance access in Nigeria: Implications for entrepreneurship development. *Mediterranean Journal of Social Sciences*, 4(6), 611-618.
- [25.] Oke M.O. & Aluko, O.A. (2015). Impact of commercial banks on small and medium enterprises financing in Nigeria. *Journal of Business and Management*, 17(4&I), 23-26.
- [26.] Olowe, F.T, Moradeyo, O.A. & Babalola, A.T. (2013). Empirical study of the impact of microfinance banks on smes growth in Nigeria. *International Journal of Academic Research in Economic and Management Sciences*, 2(6), 116 -127.
- [27.] Owenbiugie, R.O.&Igbinedion, V.I. (2015). Role of finance on the growth of small and medium scale enterprises in Edo State of Nigeria. *Journal of Educational and Social Research*, 5(1), 241-248.
- [28.] Samawi, G.A., Mdanat, M.F., Yosef, F.A. & Abutayeh, B.K. (2016). Formal versus informal financing of SMEs in the Libyan context: The case of Gharian City. *Journal of Business and Economics*, 7(7), 1137-1146.
- [29.] Somoye, R.O.C. (2013). The impact of finance on entrepreneurship growth in Nigeria: A co-integration framework. *ACRN Journal of Entrepreneurship Perspectives*, 2(2), 21-45,
- [30.] Sussan, M. U. & Obamuyi, T. (2018). The impact of microfinance banks on entrepreneurship development in Nigeria. *Journal of Business and Economic Development*, 3(2), 51-61.

- [31.] Wahab, K. & Abdesamed, K. (2012). Small and medium enterprises (SMEs) financing practice and accessing bank loan issues: The case of Libya. *World Academy of Science, Engineering and Technology, International Science Index*, 6(12), 1404-1409.
- [32.] Yamane, T. (1968). *Statistics: An introduction analysis*. Harper & Row.
- [33.] Yelwa, M., Omoniyi, A.E. & Obansa, S.A.J. (2017). Analysis of the relationship between informal financial institutions and poverty alleviation in Nigeria: A multivariate panel data approach. *The International Journal of Social Sciences and Humanities Invention*, 4(7), 3657-3665.
- [34.] Yusufu, O.S., Suleiman, O. & Saliu, H.T. (2020). Effect of micro finance bank on the growth of Small and Medium Enterprises in Nigeria. *KIU Interdisciplinary Journal of Humanities and Social Sciences*, 1(2), 127-142
- [35.] Zirra, C.T.O. & Charles, J.M.I. (2017). The impact of SMEs financing on business growth in Nigeria: A Study of Keffi and Mararaba Metropolis. *International Journal of Innovation and Economic Development*, 3(2),44-55