

# Microfinance Banks and Economic Development in Nigeria (2013-2023)

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## ABSTRACT

This study examines the effects of microfinance banks on Nigeria's economic development, specifically examining HDI, investments, loans, and deposits. Utilizing multiple regression analysis on data from 2013 to 2023, the study aims to assess how microfinance investments, loans, and deposits influence Nigeria's economic development. Data from all micro finance banks were sourced from the Central Bank of Nigeria's Statistical Bulletin and Annual Reports. The results indicate that In contrast, microfinance loans have a negative, insignificant effect on HDI. Deposits from microfinance have a positive and insignificant effect on HDI. microfinance investments have a positive and significant effect on HDI. The study suggests that microfinance institutions should focus on investments in social sectors, such as education, healthcare, and housing, to foster human development. This study also questions the general assumption that microfinance consistently enhances economic and human development, emphasizing the importance of context-specific factors like financial literacy for effective microfinance outcomes.

**Keywords:** Microfinance Banks, Economic Development

## INTRODUCTION

Microfinance banking in Nigeria plays a crucial role in enhancing the financial well-being of low-income individuals, including self-employed artisans, street vendors, small-scale farmers, and others. Microfinance essentially aims to build a financial system that effectively meets the needs of the economically disadvantaged (Ihegboro, Iyke-Ofoedu, Obiora-Okafo, Obiora, 2023). It serves as a powerful tool in the fight against poverty, both in Nigeria and globally. Increasingly, economic literature and policymakers agree that microfinance banks significantly contribute to economic growth and inclusive development in developing nations (Hyeladzira, 2020). This is due to the fact that microfinance provides financial services to low-income earners who are often excluded from conventional banking due to high transaction costs, perceived risks, and lack of collateral. The establishment of microfinance institutions in Nigeria was driven by the need to provide financial services to underserved populations, prompting the government to create alternative financial systems tailored to low-income earners (Rai, 2016). Nowadays, microfinance has become central to economic development strategies worldwide, offering positive benefits to small businesses by providing microcredit facilities (Hyeladzira, 2020). Small and Medium-sized Enterprises (SMEs), in particular, have gained recognition for their role in driving economic growth in Nigeria, as they form the backbone of the nation's economy. According to the United Nations (2024), Nigeria's population stands at around 234 million, with approximately 72% (168 million people) living below the poverty line, defined as earning less than US\$1.25 per day. Among the adult population (aged 18 and over), totaling 84.7 million, 70% reside in rural areas, with a gender distribution of 51% male and 49% female. The country faces challenges from a rapidly growing population, a rising unemployment rate, and increasing youth discontent, creating significant obstacles for the government in providing adequate employment. A robust national financial system is crucial for advancing national economic development, especially in the context of globalization, where the primary challenges for developing countries are fostering economic growth and reducing poverty.

In Nigeria, limited credit access has historically hindered production, as many individuals lack access to

formal financial services, including loans and savings options. This financial exclusion contributes to a savings gap, making it difficult to fund investments needed for growth from domestic savings alone (Walker, 1999). To address this issue, successive Nigerian governments have launched programs targeting the unbanked and financially underserved, aiming to support low-income economic sectors. Initiatives have included the Agricultural Development Programs (ADPs), National Directorate of Employment (NDE), and Better Life for Rural Dwellers, later renamed Family Support Programs, along with other entities like the Directorate of Food, Roads, and Rural Infrastructure (DFRRI) (Hyeladzira, 2020).

Further attempts to provide micro-credit services included the rural banking scheme (1977-1990), People's Bank (1987-1990), and Community Bank (1990-2007). While these programs had the potential to drive economic improvement by reducing poverty, creating jobs, and enhancing development, they faced numerous obstacles, ultimately preventing them from achieving their objectives. Despite the launch of a microfinance policy in 2005, many of these initiatives were eventually discontinued.

This study, therefore, aims to examine the extent to which microfinance banks and their performance have impacted Nigeria's economic development.

### **Objectives of the Study**

The overall objective of the study is to examine the effect of Microfinance banks on economic development in Nigeria. The specific objectives include the following:

- i. To analyze the effect of microfinance investments on economic development (HDI) in Nigeria.
- ii. To evaluate the effect of microfinance loans on economic development (HDI) in Nigeria.
- iii. To assess the effect of microfinance deposit on economic development (HDI) in Nigeria

## **REVIEW OF RELATED LITERATURE**

### **Conceptual Framework**

#### **Microfinance**

The microfinance scheme is a platform aimed to deliver financial services to the active poor and the unbanked so as to alleviate their standard of living. Wanchoo (2007) defines microfinance as any activity that includes the provision of financial services such as credit, savings, and insurance to low income individuals who either fall below the nationally defined poverty line or fall just above that, with the goal of creating social value. The creation of social value means making efforts in direction to poverty alleviation, enhancing wellbeing chances for the poor by providing capital for micro-enterprise, encourage savings culture of the poor so that current problems and future risks could be curtailed.

#### **Concept of Economic Development**

Economic development is a process of structural transformation with continuous technological innovation and industrial upgrading, which increase labor productivity, and accompanied improvements in infrastructure and institution, which reduce transaction costs (Lin, 2017). It is the process through which economies are transformed from ones in which most people have very limited resources and choices to ones in which they have much greater resources and choices.

#### **Theoretical Framework**

The study is based on the supply-leading theory, which emphasizes that the depth of the financial system is a critical driver of economic growth. This theory suggests that the expansion of the financial sector enables optimal resource allocation. In the context of this study, it indicates that the economic development of a country is influenced by the financial strength of Microfinance banks. McKinnon (1973) and Shaw (1973) argue that a well-developed financial sector reduces transaction and monitoring costs, as well as information asymmetry, thereby enhancing financial intermediation. With a developed financial system, it becomes easier

to create and access financial services in anticipation of real-sector demand.

### Empirical Review of Related Studies

Ihegboro, Iyke-Ofoedu, Obiora-Okafo, and Obiora (2023) analyzed the effect of microfinance institutions on Nigeria's economic growth from 1992 to 2019. Their findings indicated that microfinance loans positively affect short-term economic performance by improving per capita consumption. However, these loans have a limited long-term effect on economic growth, though long-term investments by microfinance institutions significantly influence economic outcomes. Adewale et al. (2022) explored the impact of Nigerian microfinance banks on economic growth using data from the Central Bank of Nigeria and National Bureau of Statistics. Their analysis, using ARDL and Unit Root tests, revealed that microfinance banks contribute significantly to Nigeria's economic growth.

Onyele and Onyekachi-Onyele (2020) explored the connection between microfinance banking and poverty reduction, which is widely recognized in finance literature. As a tool for reducing poverty, microfinance aims to increase financial access for economically active, low-income individuals. This study evaluated the impact of microfinance banks (MFBs) on poverty reduction in Nigeria from 1992 to 2018 using the Autoregressive Distributed Lag (ARDL) model for regression analysis. The results revealed a long-term relationship between poverty levels and MFB activities, with long-term data suggesting that the loans-to-deposit and liquidity ratios of MFBs contributed to poverty reduction. However, in the short term, MFBs showed limited impact on poverty reduction, despite significant variable coefficients within a year.

Zaman, Uddin, and Hossain (2020) investigated how microfinance services in Bangladesh influence poverty reduction, finding that microcredit significantly impacted poverty alleviation. Additionally, training, microinsurance, and savings played roles in Bangladesh's poverty reduction efforts. Tafamel (2019) studied the effect of microfinance on poverty alleviation and entrepreneurship in Nigeria, surveying 200 micro and small businesses in Edo State. Findings indicated a positive, significant relationship between microfinance institutions and poverty alleviation, while the link between entrepreneurial activity and poverty reduction was positive but not significant.

Other studies include Apere (2016), who analyzed microfinance banks' role in economic growth in Nigeria from 1992 to 2013 using an error correction model. The study found that MFB loans and domestic investment positively impacted economic growth, highlighting the need to increase loans to enterprises for growth. Ifionu and Olieh (2016) examined microfinance banking from 2005 to 2014 in Nigeria, using deposits and loans to represent MFB activities, with the Human Development Index as a measure of economic development. Results showed that deposits were key to MFB operations and contributed positively to development, while loans had a negative effect, potentially due to high interest rates and other economic challenges. Akpan and Nneji (2015) assessed the role of microfinance banks in supporting small and medium enterprises (SMEs) in Nigeria. Their results showed that MFBs significantly promoted an environment conducive to SME growth, with positive impacts from both financial (loan size, duration) and non-financial (networking) factors.

Ademola and Arogundade (2014) evaluated the impact of microfinance on economic growth in Nigeria, stressing on its primary role of poverty reduction and small scale enterprise financing. Deposit Liabilities, Loans & advances of microfinance banks were used to proxy the activities of microfinance institutions in Nigeria while Gross Domestic Product was used as a proxy for economic growth. Using Ordinary Least Squares method, they found that assets and deposit liability has an insignificant impact on economic growth while loan and advances to the public has a significant impact on economic growth. Thus, the overall significance of the model shows that the activities of the microfinance banks cannot be overemphasized in the pursuance of a sustained economic growth in Nigeria. Olowe, Moradeyo and Babalola (2013) studied the impact of microfinance on the growth of small and medium enterprises (SMEs) in Nigeria, and found that financial services offered by the MFBs have favourable significant impact on MSEs growth while loan has a favourable impact on SMEs growth but not statistically significant. That is, the loan tenor is too short to show a significant impact on the SMEs growth. They also found that high interest rate, collateral and frequency of loan repayment could paralyze the growth of SMEs in Nigeria. On the other hand, Okwoli, Abubakar and Abubakar, (2013) conducted a study on the role of MFBs in rural transformation and development in Nigeria,

and explained the performance of MFBs and the risk they are exposed to across various size categories of the institutions. They found that MFBs were generally profitable over recent years. However, the small size MFBs seems to have significant operating inefficiencies. Above all, microfinance banks have performed well in many cases better than the larger banks in managing rural economy. Thus, the study concludes that microfinance policy and programmes are good empowerment measures which if properly managed would go a long way in improving the condition of lives of the rural dwellers.

Nwankwo and Abah (2013) analyzed the effect of microfinance on rustic change in Nigeria utilizing elucidating research procedure and figured out that microfinance bank in country region has affected on changing the existence of people in the general public. The discoveries of the review show that miniature money has influenced decidedly on the rustic poor by giving credit and advances to agribusinesses, speculation valuable open doors, investment funds assembly, and credit conveyance.

Abiola (2011) in his study used the financing constraints approach to assess the effect of microfinance on access to credit for micro businesses in Nigeria. The result showed that there is an improved access to loan in locations where MFBs offers more provision of financial services because investing in local micro businesses was less sensitive to availability of internal funds in unconstrained location, than investment in micro businesses in locations where its activities were inadequate or not in existence.

Olakojo and Olanipekun (2011) empirically examined the effect of microfinance banks on the Nigerian economy. They employed pooled regression and ordinary least square econometric technique on annual time series data for the period 1992-2008. The empirical findings show that the current level of sectoral output is positively influenced by loan and advances from the banking sector. However a sectorial and using OLS reveals that while loan and advances from microfinance banks positively affect output of manufacturing, mining, and quarrying sector, the same could not be established for the agricultural sector. They concluded that microfinance banking is very critical to the wellbeing of the economy as it does not only provide financial assistance to small and medium scale enterprises but also to the real sector of the economy, thereby fast tracking economic growth in Nigeria.

Babajide (2011) concentrates on the impacts of miniature supporting on miniature and little undertakings (SMEs) in South West Nigeria utilizing Demonstrative Test Kaplan Meier Guage, Peril model and various relapse examinations. The review shows that microfinance improves the endurance of private ventures in South West Nigeria, that microfinance doesn't upgrade the development and extension limit of MSEs in Nigeria, that microfinance influences fundamentally fair and square of efficiency of MSEs administrators in South West Nigeria and that the arrangement of non monetary assistance by microfinance upgrades the exhibition of miniature and little undertakings (MSEs) in Nigeria.

## RESEARCH METHODOLOGY

This study adopts the *ex post facto* design, The data for this research was obtained mainly from secondary sources; particularly from the various publications of the Central Bank of Nigeria (CBN) statistical bulletin, and the National Bureau of Statistics.

### Model Specification

The study looked at The Effect of Microfinance Banks on the Economic Growth and Development in Nigeria, the study adapted and modified the model used by Ihegboro, , Ofoedu, Obiora-Okafo, and Obiora, (2023) titled The Effect of Microfinance Banks on the Economic Growth: Evidence from Nigeria and their model is stated thus;

$$GDP = f (DEP, LOANS, INVEST)$$

Where;

GDP = Economic Growth

DEP = Microfinance Deposits

LOANS = Microfinance Loans

INVEST = Microfinance Investment

However, our model for the study is stated thus

$HDI = f(MFL, MLD, MFI)$

Where;

MFL = Microfinance Loans

MLD = Microfinance Deposits

MFI = Microfinance Investment

HDI = Human Development Index

Hence, the functional model of the study is stated thus;

$HDI = f(MFL, MLD, MFI)$

The econometric model of the study which accounts for the constant term, the regression coefficients, and the error term is stated below

$HDI = \alpha_0 + \alpha_1 MFL + \alpha_2 MLD + \alpha_3 MFI + \mu_t$

$\alpha_0$  is the intercept or the constant term, the value of HDI are not explained by the independent variable.  $\alpha_1$ ,  $\alpha_2$ , and  $\alpha_3$  are the coefficients of the regression.  $\mu_t$  is the error term of the regression.

### Description of the Variables

This research study examines the effect of Microfinance Banks on Development in Nigeria. The dependent variable in this study is Human Development Index. while the independent variables are Microfinance Loans, Deposits, and Investment.

**Human Development Index (HDI):** HDI is a composite statistic used to measure a country's social and economic development. It considers three key dimensions: life expectancy (health), education level, and per capita income. A higher HDI value indicates better quality of life and overall human development. It is often used to assess the impact of economic policies on the well-being of a country's population.

**Microfinance Loans:** A microfinance bank loan is a small-scale financial product provided by microfinance institutions to individuals or small businesses who may not qualify for traditional bank loans. These loans are typically aimed at promoting entrepreneurship and economic growth, with flexible terms and lower collateral requirements, helping underserved populations access credit.

**Microfinance Deposit:** A microfinance bank deposit refers to funds deposited by individuals or businesses in a microfinance institution, often in the form of savings accounts. These deposits allow depositors to earn interest while providing the institution with capital to lend to borrowers.

**Microfinance Investment:** Microfinance investment involves providing financial services to individuals and small businesses that lack access to traditional banking systems. It aims to empower low-income individuals, particularly in developing countries, by facilitating access to capital, savings, and insurance products. This approach not only promotes entrepreneurship but also helps alleviate poverty and improve living standards

Table 1

	HDI	MFL	MLD	MFI
Mean	0.547091	466.1873	413.8127	408.3682
Median	0.534000	300.2000	296.3700	250.0000
Maximum	0.623000	1500.000	1027.000	1260.300
Minimum	0.519000	166.2900	149.7900	118.5200
Std. Dev.	0.038067	392.2959	286.0441	349.7070
Skewness	1.541310	1.794807	1.012587	1.601965
Kurtosis	3.556229	5.459015	2.823230	4.267729
Jarque-Bera	4.497138	8.677204	1.894100	5.441473
Probability	0.105550	0.013055	0.387884	0.065826
Sum	6.018000	5128.060	4551.940	4492.050
Sum Sq. Dev.	0.014491	1538961.	818212.1	1222950.
Observations	11	11	11	11

Source: Computer analysis using E-views 11

Table 1 shows the descriptive statistics results for the entire study sample. The descriptive statistics provided for various economic indicators in Nigeria (HDI, Microfinance Loans (MFL), Microfinance Deposits (MLD), and Microfinance Investments (MFI)) offer a detailed summary of the distribution, central tendency, and spread of these variables over 11 observations.

The mean values show the average figures across the dataset, HDI at 0.547, MFL at ₦466.19 billion, MLD at ₦413.81 billion, and MFI at ₦408.37 billion. The median values often considered a better representation of the central tendency when data is skewed showed HDI at 0.534. For microfinance variables, the median figures are ₦300.20 billion for MFL, ₦296.37 billion for MLD, and ₦250.00 billion for MFI. These median values suggest that while the average for MFL and MLD is higher than the median, a few large outliers are increasing the mean. The maximum and minimum values reflect the range and variability within the dataset. HDI had a narrow range from 0.519 to 0.623. For microfinance, the largest MFL was ₦1,500 billion, and the largest MLD was ₦1,027 billion, indicating significant peaks in these values. Standard deviation measures the spread of the data. In contrast, HDI has a small standard deviation of 0.038, indicating stable human development levels. For microfinance, the standard deviations (MFL: ₦392.30 billion, MLD: ₦286.04 billion, MFI: ₦349.71 billion) reflect substantial variability, meaning the data has significant fluctuations from the mean. Skewness reveals the asymmetry of the data distribution. HDI's positive skewness (1.541) shows that the distribution is skewed to the right, meaning more values are concentrated at the lower end, but there are some high HDI values. For MFL, MLD, and MFI, the positive skewness (1.79, 1.01, 1.60) indicates that some large outliers were driving the mean higher. Kurtosis measures the peakedness of the distribution. MLD (2.82) have low kurtosis, indicating relatively flat distributions with fewer extreme values. However, MFL (5.46), MFI (4.27), and HDI (3.56) exhibit high kurtosis, showing a more peaked distribution with a higher likelihood of extreme values (either very high or low). The Jarque-Bera test is used to determine the normality of the data.

Table 2: Co integrating Regression

Dependent Variable: HDI  
 Method: Fully Modified Least Squares (FMOLS)  
 Date: 10/31/24 Time: 12:45  
 Sample (adjusted): 2014 2023  
 Included observations: 10 after adjustments  
 Cointegrating equation deterministics: C  
 Long-run covariance estimate (Bartlett kernel, Newey-West fixed bandwidth = 3.0000)

Variable	Coefficient	Std. Error	t-Statistic	Prob.
MFL	-1.24E-05	2.90E-05	-0.428431	0.6833
MLD	2.13E-05	3.04E-05	0.700222	0.5100
MFI	9.68E-05	3.06E-05	3.166247	0.0194
C	0.504375	0.006272	80.41466	0.0000
R-squared	0.876325	Mean dependent var		0.549900
Adjusted R-squared	0.814487	S.D. dependent var		0.038906
S.E. of regression	0.016757	Sum squared resid		0.001685
Long-run variance	0.000115			

Source: Computer analysis using E-views 11

The regression analysis examines the effect of Human Development Index (HDI) as the dependent variable and three independent variables: Microfinance Investment (MFI), Microfinance Loans (MFL), and Microfinance Deposits (MLD). Here's a detailed interpretation of the results: The coefficient for MFL is -1.24, indicating a negative effect of microfinance loans on HDI. Specifically, for every ₦1 million increase in MFL, HDI is expected to decrease by 1.24 units, holding other factors constant. The t-statistic of -0.4284 and the p-value of 0.6833 suggest that this effect is marginally statistically insignificant at the 5% level). This implies that microfinance loans have a negative effect on human development in Nigeria. The coefficient for MLD is 2.13, reflecting a positive effect on microfinance deposits and HDI. However, the t-statistic 0.7002 and p-value 0.5100 show that this effect is not statistically significant.

The coefficient for MFI is 9.68 suggesting a positive effect on microfinance investment and HDI. However, the t-statistic 3.1662 and the p-value 0.0194 indicate that this relationship is statistically significant. The coefficient and significant result suggest that changes in microfinance investment have effect on HDI in this sample.

This constant is highly significant (p-value < 0.0000), indicating that a baseline level of HDI exists in the absence of changes in microfinance variables. The R-squared value of 0.876 suggests that about 86.7% of the variation in HDI can be explained by the independent variables (MFI, MFL, and MLD). This indicates a strong explanatory power of the model. The adjusted R-squared of 0.814, which adjusts for the number of predictors, still reflects a high level of fit, indicating the model is robust. In summary, while the overall model is significant and explains a large proportion of the variance in HDI, microfinance loan (MFL) shows a marginally insignificant and negative effect on HDI. microfinance deposit (MLD) shows a marginally insignificant and positive effect on HDI while microfinance investment (MFI) shows a marginally significant and positive effect on HDI. The model performs well in explaining the variation in HDI, and there is no evidence of autocorrelation in the residuals.

## DISCUSSION OF FINDINGS

### Objective One:

To assess how Microfinance Loans influence Nigeria's Human Development Index (HDI).

The analysis indicates that Microfinance Loans have a negative yet statistically insignificant effect on the HDI in Nigeria. This finding contrasts with Ihegboro et.al(2023), who observed that microfinance can enhance living standards and overall welfare, positively influencing indicators like the HDI.

### Objective Two:

To determine the effect of Microfinance Deposits on Nigeria's Human Development Index.

The analysis reveals that Microfinance Deposits positively but insignificantly effect the HDI in Nigeria. This result conforms with Ifionu and Olie (2016) that showed that deposits were key to MFB operations and contributed positively to development, while loans had a negative effect, potentially due to high interest rates and other economic challenges.

### Objective Three:

To examine the impact of Microfinance Investment on Nigeria's Human Development Index. The analysis shows that Microfinance Investment has a significant and positive effect on the HDI in Nigeria. This finding agrees with Apere (2016) who observed that MFB loans and domestic investment positively impacted economic growth, highlighting the need to increase loans to enterprises for growth.

## Summary of Findings

The analysis of microfinance activities' effect on human development in Nigeria indicates that while microfinance loans exhibit a negative effect on the Human Development Index (HDI), microfinance deposits and investments have a positive impact on HDI. These results highlight the nuanced role of microfinance in fostering human development, implying that although microfinance has potential, its success depends on broader structural and operational dynamics.

## RECOMMENDATIONS

**1. Microfinance Loans:** Given that microfinance loans show a negative and insignificant impact on the Human Development Index (HDI), it is recommended that Microfinance Institutions (MFIs) prioritize loans for educational pursuits, health improvements, and small-scale agricultural initiatives, as these directly contribute to human development.

**2. Microfinance Deposits:** Since deposits in microfinance have a positive yet insignificant effect on HDI, MFIs should consider creating savings programs specifically aimed at enhancing health, education, and social welfare. This approach ensures that deposits translate into measurable benefits for human development.

**3. Microfinance Investments:** With microfinance investments having a positive influence on HDI, MFIs are advised to channel investments towards social sectors like education, healthcare, and housing, which are crucial for boosting human development.

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