CHAPTER TWO

LITERATURE REVIEW

2.1 Conceptual Review

Microfinance is the provision of a wide range of financial services such as savings, loans, payment services, money transfers, and insurance to poor and low-income persons, households and their microenterprises (CBN & NDIC, 2011). The term also encompasses the provision of financial and non-financial services as well as the management of small amounts of money through a range of products and a system of intermediary functions that are targeted at low income clients (Anane, 2012). According to Ojo (2009) cited in Babarinde, et al. (2019), microfinance is an economic development approach that involves providing financial and non-financial services through institutions to low-income clients, such as micro, small and medium-scale enterprises where the market fails to provide appropriate services. Abdulmajeed, et al. (2019) define microfinance banking as the business of carrying out microfinance services without collateral security.

MFBs are important in that they provide financial services to the active poor, for their entrepreneurial activities; ensures savings mobilization, create employment opportunities, enhance participation of the poor in the socio-economic development and resource allocation, promotes of saving culture, extends credit to customers. Furthermore, microfinance enables poor people to expand their businesses, increase their revenues (Ezeudu, 2010; CBN & NDIC, 2011; Ibrahim, 2013). The guidelines for MFBs provides for three categories of MFBs, which are unit, state, and national MFBs, which are to serve a local government area, state and the nation at large respectively. Each of them are to actualize the aim of microfinance banking, most importantly, to achieve sustainable economy growth via poverty alleviation through provision of financial services to the economically active poor.

Economic growth often measured as gross domestic product, or gross national product, either in nominal or real terms, simply refers to a persistent increase in the productive capacity of country which lead to increase in goods and services. Theoretically, microfinance banks are to involve in savings mobilization, employment creation, investments and provide non-financial services targeted at the economically active poor, thereby stimulating economic growth of the country. The extent to which this postulate has empirical reality has been examined by researchers. Thus, this study reviews some empirical evidence in extant literature on the nexus between microfinance banks and economic growth which for instance, based on desk research approach, Okwoli, et al. (2013) examined MFBs and rural development in Nigeria.

Prior to the advent of the modern Microfinance Banks, there have been attempts to establish such banks to take care of microcredit and its like. This has been both formal and informal.

2.1.1 Microfinance Policy in Nigeria

In December 2005, the Central Bank of Nigeria (CBN) introduced a Microfinance Policy Framework to enhance the access of microentrepreneurs and low income households to financial services required to expand and modernize their operations in order to contribute to rapid economic growth. The rationale was that no economic development can be achieved without improving access of this segment of the economic strata to factors of production, especially financial services.

The purpose of licensing MFBs within the regulatory framework for financial intermediation in Nigeria is to increase access to financial services for underserved segments of the population. The importance of promoting and regulating MFBs came into focus in 2004/2005 at the time of the tenfold increase in minimum capital for DMBs (from NGN 2.5 billion to NGN 25 billion), introduced as of end-December 2005.

The CBN by the provisions of section 33 (1) (b) of the CBN ACT NO.7 of the 2007 and in pursuance of the provisions of sections 56-60 (a) of the Banks and other Financial Institution Act (BOFIA) No. 25 of 1991 (as amended) in conjunction with the MFBs operating template and revised regulatory and Supervisory Guidelines for Microfinance Banks (MFBs), presents a revised National Microfinance Policy Framework (April, 2011) for Nigerians that would enhance the provision of diversified microfinance services on a sustainable basis for the economically active poor and the low income households. The 2011 microfinance policy framework is a revised version of the 2005 policy framework.

Generally, the microfinance policy provides the window of opportunities for the low income earners, market women, tailors, artisans, welders, etc. to expand existing business, open new businesses and consolidate on existing businesses with access to affordable credit products. The policy also promotes the development of appropriate (safe, less costly and easily accessible) savings products that would be attractive to rural clients and improve the savings level in the economy.

There are over eight hundred (800) Microfinance Banks across the country owned by individuals, Cooperative societies, Community Development Associations, private corporate entities, NGO-MFIs, foreign investors and among others. One major justification for the introduction of the microfinance policy by the CBN was existence of the huge size of the un-served market by the existing financial institutions. The purpose of licensing MFBs within the regulatory framework for financial intermediation in Nigeria is to increase access to financial services for underserved segments of the population. The importance of promoting and regulating MFBs came into focus in 2004/2005 at the time of the tenfold increase in minimum capital for DMBs (from NGN 2.5 billion to NGN 25 billion), introduced as of end-December 2005. However, a study conducted by Enhancing Financial Innovation and Access (EFInA) in August, 2010 revealed that 39.2 million people representing 46.3 percent of the adults in

Nigeria were excluded from financial services. Out of the 53.7 percent that had access, 36.3 percent derived their financial services from the formal financial institutions; while17.4 percent exclusively patronized the informal sector.

2.1.2 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. Economic development therefore covers almost all areas of economics, though with modifications to reflect the particular situations of developing countries. Based on a review of the literature, we define economic development as the development of capacities that expand economic actors' capabilities. These actors may be individuals, firms, or industries.

Economic development is a broader concept than economic growth. Development reflects social and economic progress and requires economic growth. Growth is a vital and necessary condition for development, but it is not a sufficient condition as it cannot guarantee development. One of the indicators of economic development is Human Development Index (HDI). The extent to which a country has developed may be assessed by considering a range of narrow and broad indicators, including per capita income, life expectancy, education, and the extent of poverty. Ikechukwu (2012) opined that problems and prospects defined Microfinance as the availability of finance and financial services to the rural dwellers or those that does not have sufficient funds to trade. By implication, microfinance is in another form of poverty alleviation. Based on the work of (Robinson, 2001) income is protected, increased, and diversified when customers use microfinance banks to enable them to acquire or increase their assets. On the other hand, (Seibel, 2007) opines that microfinance banks provide services that includes banking and non-banking, formal and non-formal to institutions and individuals alike. These services are done at a small scale to mostly low-income populace.

In 2020 according to The conversation Journal (2021) using world bank thresh hold of $3.20 a day, Nigeria's poverty rate is 71%. It is also on record that 56% of Nigerians' income is spent on food alone and this contributes to the poverty index of the country. This is seen as the highest in the world when compared to that of Australia, Canada, UK and US that spends 9.8%, 9.1%, 8.2%, 6.4% respectively. Nigeria's Gross National Income per capita moved from 2173 US dollars in 2019 to 1946 US dollars in 2020 making it a 10.45% slide in per capita income. The rate of poverty in Nigeria is so astronomical that many finance experts are researching on the way out. Establishment of microfinance banks brings financial services close to the people particularly those in the rural areas. According to Ogbonna & Ejem, 2020opined that financial deepening is the increase in financial services to the people. When financial services are close to the people it improves their economic well being as they will have access to funds for their businesses. Based on the importance of microfinance banks the researcher embarked on this study in order to ascertain if microfinance bank impacts on the development of an economy or not.

2.2 Theoretical Review

2.2.1 The Neo-Classical and Endogenous Growth Theory

The neoclassical perspective is based on a basic principle in economics which suggests that economic growth requires capital investment in the form of long-term commitment. The neoclassical growth theories assume that capital investment like Foreign Direct Investment (FDI) can channel required funds to the productive sectors of a capital deficient economy which, in turn, would help to increase the economic growth rate by increasing the marginal productivity of capital.

2.2.2 The Solow Development Model

The key variable in Solow growth model is labour and productivity (output per worker). Solow opines a continuous production function linking output to the inputs of capital and labour which are sustainable. This theory determines the values of the variables, equilibrium conditions, that is, conditions that tell us when the economy is in a position of balance and when the variables we are focusing on are ―stable‖, that is, when the variables are changing in simple and predictable ways.

2.2.3 Musgrave Conception of Public Expenditure Growth

This theory was propounded by Musgrave as he found changes in the income elasticity of demand for public services in three ranges of per capita income. He observes that at the high levels of per capita income, typical of developed economies, the rate of public sector growth tends to fall as the more basic wants are being satisfied (Chude & Chude, 2013).

2.2.4 Harrod-Domar Theory of Progress

The Harrod-Domar models are based on economic growth on the experiences of advanced economists. They are primarily addressed to an advanced capitalist economy and attempt to analyze the requirements of steady growth in such an economy. Harrod-Domar assigns a key role to investment in the process of economic growth. But they lay emphasis on the dual character of investment. Firstly, it creates income and secondly, it augments the productive capacity of the economy by increasing its capital stock.

2.2.5 The Keynesian Theory

Keynes regards public expenditures as an exogenous factor which can be utilized as a policy instrument to promote economic growth. From the Keynesian thought, public expenditure can contribute positively to economic growth. Hence, an increase in the government consumption is likely to lead to an increase in employment, profitability and investment through multiplier effects on aggregate demand.

2.3 Empirical Review

Yunus (1999) explained that microfinance entails the means of access to finance by the poor people that allow them to utilize their capacities in favour of lasting development. Ehigiamusoe (2011) also asserted that the use of microfinance does not involve only disbursement and collection of loan repayment and savings, it also refers to a set of flexible organization structures and processes through which provision of essential financial services are offered to low-income earners and small business entrepreneurs on a continuous basis. Microfinance is a general term that explains financial services designed for the low-income earners or to those who do not have access to banking services. The concept encompasses not only the extension of credit to the poor, but also the provision of other financial services (Dasgupta, 2006; Nagayya & Rao, 2009). According to Dasgupta (2006), these financial services mainly comprise deposits, loans, payment services, money transfers, and insurance to poor and low-income households and their microenterprises.

Microfinance has proven to be the most effective and powerful tool for poverty reduction through its provision of capital, social esteem, knowledge, information, empowerment, social capital and market access. Like many other developmental tools, however, it has insufficiently infiltrated the poorer level of society. The poorest from the vast majority of those without access to primary health care and basic education; similarly, they are the majority of those without access to microfinance (Morduch & Haley, 2002). Arabi and Meisami (2013) further argued that microfinance can only empower the poor where the low-income earners are appropriately recognized, and the micro loans are utilized to create job. In that regard, the appropriate recognition of various economic strata of the citizens is crucial to the economic growth of a country. Loan facilities, savings, accessibility to resources of payment and risk safety techniques are evident needs of the populace at large (Saeed, 2014). Since financial services dynamically subscribe to the human and economic growth of a nation, it should result to social safety net and safeguard people from economic distress, thus, the need to provide access to affordable financial services (Krishnakumar & Vijayakumar, 2013). El-Namrouty and Al-thalathini (2013) showed that microfinance is one of the interventions that should be utilized to reduce poverty. For these programs to succeed there must be an evidence of management skills and adequate understanding of financial base for the consumers of the microfinance program.

The concept of accessing microloans at acceptable terms to alleviate the economically active poor has been widely accepted since the introduction of microfinance banking in Bangladesh in the mid 1970's (Chew et al, 2016). The seeming popularity of this model among developing countries is predicated on poverty reduction prospect it offers. The concept of microfinance encompasses banking for the poor and banking with the poor. Thus, these microfinance schemes open a vista of finance for the poor and unbanked who were denied access to finance from the conventional banks as a result of absence of collateral (Nagayya and Rao, 2009). Microfinance targets the poorest segment of clients. They are self-employed and household-based entrepreneurs.

The conception of banking services that is tailored to the poor is not new; Savings and credit groups have existed for decades in many part of the world (Singh & Bhar, 2016). Traditional savings and credit institutions for the active poor have existed for centuries, offering customers who do not have access to the conventional banks financial services through the way of cooperatives and development finance institutions (Acha, 2012). Historically, the Irish Loan Fund was one of the early micro credit institutions offering loans to the active poor with no security back-up; this was established in the 17th century by Jonathan Swift, by 1840, it had spread all over Ireland (Chew, Tan, & Hamid, 2016). The main aim of the Irish Loan Fund was to make small loans at short periods with interest. By the 18th century, different types of bigger and traditional savings and credit institutions had emerged in Europe, coordinated mainly among the active poor; these were the People's Banks, Credit Unions, and Savings and Credit Co-operatives (Omorede, 2014).

The traditional savings and credit institutions for the active poor came into existence centuries ago (Soltane, 2012), providing customers who lack access to the conventional bank’s financial services through the way of cooperatives and development finance institutions (Soltane, 2012). The goal of these micro credit institutions for rural finance intervention was generally illustrated in terms of the agricultural sector innovations with objectives to grow business of the rural sector through deploying idle savings, and growing investment through credit, and cutting repressive outdated connections, which are compelled by debts (Aghion, Armendáriz, & Morduch, 2010).

The microfinance scheme was established to offer financial services to economically active poor people that are excluded from accessing financial services from the traditional banks, create jobs, create development of rural area and poverty reduction (Chew et al., 2016). In furtherance to boost economic development, the government of Nigeria initiated the financial inclusion policy in October 2012 by the CBN, to allow an individual, household, or group to have access to suitable financial services or products (Singh & Bhar, 2016). The government policies even directed on mobilizing five percent (5%) of the conventional banks’ profits before tax to small and medium scale businesses so as to boost the microfinance scheme (Anku-Tsede, 2014). Research has shown that the significance of microfinance is that it allows the poor to have access to financial services that the conventional financial system could not provide to enhance and expand their economic activities, promote morale of the poor and assist in boosting economic development on a consistent level (Anku-Tsede, 2014; Chew et al., 2016; Hassan, 2014).

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.

The study indicates that MFBs have positive impact on rural transformation and development in Nigeria. In another study on the place of microfinance in the Nigeria economy, Eigbiremolen and Anaduaka (2014) applied Ordinary Least Square (OLS) and Granger causality techniques and established that microfinance loans and advances have significant positive impact on the Nigeria economy with a unidirectional causality running from economic growth to microfinance operations. Furthermore, Ayodele and Arogundade (2014) investigated the impact of microfinance on economic growth in Nigeria using OLS. The results of the study, show among others, that except for deposit liability which has negative impact, asset base and loan and advances have positive impact on economic growth in Nigeria. However, according to the study, microfinance banks' deposits impacted negatively on economic growth in Nigeria. In another investigation on the relationship between financial inclusion and economic growth in Nigeria with a particular reference to the microfinance option, carried out by Otiwu, et al. (2018). From the OLS regression, the authors reiterate that MFBs' loans and advances significantly contribute to economic growth unlike microfinance deposits which exert negative effect on economic growth of the country. Furthermore, based on ARDL model, Ezeanyeji, et al. (2020) examined the nexus between microfinancing, poverty alleviation andNigeria's economic growth. The study concludes that MFBs' loan and advances do not significantly affect economic growth 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.

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.

Akpan and Nneji (2015) explored the contribution of microfinance banks to the development of small and medium scale enterprises in Nigeria, and the result showed that MFBs contributes considerably to increased enterprising environment by creating conducive business environment and enhance accessibility to finance for small businesses. Variables like loan size, loan duration (financial variables) and networking meetings (non-financial variables) were found to have a positive impact on SMEs. The study thus confirmed the positive contributions of MFBs towards promoting SMEs performance and growth. The study concluded that MFBs has potentials for enhancing the performance of small businesses through participation in micro financing and offering of non-financial services.

Apere (2016) studied the impact of microfinance banks on economic growth in Nigeria over the period of 1992-2013 using error correction model. The results of the study showed that MFB loans and domestic investment has a positive significant effect on the growth of Nigeria's economy build on the enormity and the level of significance of the coefficient and p-value besides, a relationship exist, in the long-run, between MFB loans, investment and economic growth in Nigeria. The findings imply that MFBs has to increase loans extended to business enterprises in order to generate commensurate economic growth.

Furthermore, Tafamel (2019) examined the effect of microfinance institutions on reduction of poverty as well as entrepreneurial activities in Nigeria. The study employed a survey research instrument through the administration of questionnaires to two hundred (200) micro and small-scale business enterprises in Ikpoba Okha Local Government Area of Edo State, Nigeria. The results showed that microfinance institution and poverty alleviation were positively and significantly related while entrepreneurial activity and poverty reduction were positively and insignificantly related. The study recommended that microfinance institutions should be given a conductive environment to operate in order to assist in developing micro and small business enterprises, thereby help mitigate the effect of poverty ravaging the Nigerian society. Moreover, studies like Khalaf (2019), Ugochukwu and Onochie (2017) and Ikpefan et al (2016) also underpinned the relevance of microfinance in poverty reduction and economic development. From the foregoing, this study is timely and essential to examine whether the microfinance institutions are really addressing these issues, which are some of the reasons for their establishment.

Olakojo and Olanipekun (2011) empirically examined the impact of microfinance bank 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 loans and advances from the banking sector. However, a sectorial analysis using OLS reveals that while loans and advances from microfinance banks positively affect output of manufacturing, building and construction, mining and quarrying sector, the same could not be established for the agricultural sector. They concluded that microfinance banking is very critical to the well-being of the economy as it does not only provide financial assistant to small and medium scale enterprises but also to the real sector of the economy, thereby fast tracking economic growth in Nigeria. Maksudova (2010) empirically investigated the role of microfinance to financial sector development and economic growth in Czech Republic. He employed Panel data approach in addition to Granger causality test for 103 countries for the period 1995-2008 in order to determine the causality between microfinance banks and economic growth. From the review of these prior studies, it is being observed that most of the studies found a positive relationship between microfinance and economic growth. While some had significant impacts, others had insignificant impact.

The most striking contribution of microfinance is through enlarging the access to finance of households. Recent findings of Beck, (2007) and Honohan (2004) demonstrate that financial assets are highly concentrated and therefore asset holdings of the lower-income population are mostly ignored in deriving national resources and aggregate wealth. However, these authors found that the development of the financial sector per se is not enough to reduce poverty and income inequality; what actually matters is the depth of the financial system. The depth of the financial system shapes the structure of the economy in indirect ways and leads to economic growth. The authors suggest that the degree of poor households' access to various financial services that microfinance promotes could help alleviate poverty and reduce inequality. Therefore policy reforms in developing countries should focus on improving household finance by creating better access of the poor to basic services such as deposits, money transfers, insurance, credit and savings - in large what microfinance does.

According to Ademola and Arogundade (2014), credit delivery is one of the most important roles of microfinance banks as the loan extended are used to expand existing businesses and in some cases, to start new ones. Ketu (2008) observed that microfinance banks have disbursed more than 800 million micro credits to over 13000 farmers across the country to empower their production practices. He found that loans and advances have positive impact on economic growth and development and that microfinance loans are statistically significant in explaining changes in economic growth and development at 0.15 level of significance.

Ademola and Arogundede (2014) examined the impact of microfinance to economy growth and development in Nigeria laying emphases on the primary role of microfinance institutions which is poverty reduction and small scale enterprise financing. Using secondary data, the OLS multiple regression revealed that microfinance activities have a significant impact on economic growth and development in Nigeria. If this is true, it therefore means that more investments by microfinance institutions will mean more reduction in poverty, more employment generation and more contribution to economic development.

Microfinance bank deposits are products of customers' savings which are a source of loans to microfinance customers. Reddy and Malik (2011) asserted that savings mobilized from local depositors will ultimately be the largest source of capital for microfinance. The public is encouraged to save so as to create deposits. If microfinance is successful by the measure of any of its aim in Nigeria, including raising income, promoting entrepreneurship, advancing loans, engaging in domestic fund transfer and encouraging savings, then over time, the impact assessment especially in the area of effects on savings mobilization can be gauged.

It can be inferred from the review of empirical studies that while most studies tend to affirm the positive impact of microfinance on economic growth, some studies still concluded otherwise. The use of OLS is common among the methods employed in the past studies reviewed. Measures of microfinance employed by different researchers also give different results. For instance, Okwoli, et al. (2013), and Sultan and Masih (2016) found a positive relationship between microfinance and economic growth. However, Ezeanyeji, et al. (2020) concluded that microfinance and economic growth are inversely related. With these conflicting results, it seems the debate is not yet conclusive on the nexus between microfinance banks and economic growth. This current study is handy in contributing to the perceived debate on microfinance-growth nexus most especially in a developing country like Nigeria.

2.3.2 Challenges Faced by Microfinance Banks

There are numerous challenges hindering the performance of the MFBs, in Nigeria, the challenges the MFBs are faced with are; the uneven spread of MFIs, majority of the banks are located in specific section of the country because investors discern that, that environment would yield them more income; and the erstwhile community banks that transformed to MFBs were still operating like the old regime, with so much inefficiency (NDIC, 2016). In addition, knowledge dearth and lack of skills in micro financing business, with limited support for human and institutional capacity building which grossly affected the performance of the MFBs; and inadequate fund for intermediation as a result of the inability to mobilize savings, business capital, and failure to institute Microfinance Development Fund (NDIC, 2016). These challenges slow the attainment of microfinance objectives which are aimed to expand the financial frontier and stimulate the exploitation and development of economic opportunities in the formal sector through the provision of traditional and even non-traditional banking services.

2.4 Gaps in the Literature

This study seeks to investigate the impact of microfinance banks on economic development, using Nigeria as a case study. A review of existing literature reveals inconsistencies in findings—some studies report positive effects, while others indicate negative outcomes. Notably, only one of the reviewed studies employed a causal analysis of the data. Most research focuses on general populations such as rural dwellers or low-income earners, with limited attention given to specialized microfinance institutions like the Nigeria Police Microfinance Bank (NPMB), which serves a specific demographic, namely police personnel and their families.

While much of the literature highlights microfinance's role in poverty alleviation, few studies examine concrete and quantifiable outcomes like improvements in HDI, income growth, employment generation, or long-term business sustainability. Although microfinance is often linked to female empowerment, there is little insight into gender-specific results within NPMB’s largely male clientele. Additionally, research tends to generalize the geographic and operational reach of microfinance banks, with minimal analysis of regional differences in access and economic outcomes, particularly between urban and rural beneficiaries. The resilience of microfinance during financial crises is acknowledged, but specific assessments of how institutions like NPMB have coped with challenges such as the COVID-19 pandemic or economic recessions remain underexplored.

Moreover, most studies emphasize short- and medium-term impacts—like income increases or repayment rates—while overlooking long-term effects such as intergenerational poverty reduction, enterprise growth, and systemic economic change. There is also limited discussion on how microfinance banks like NPMB collaborate with broader financial entities, such as commercial banks or fintechs, to promote inclusive development. Furthermore, existing research seldom addresses how such specialized institutions tackle structural unemployment within their target population or their internal challenges and growth patterns. Additionally, many studies fail to apply the unit root test, potentially resulting in misleading long-run estimates. In light of these gaps, this study will analyze the role of microfinance institutions in economic development, focusing specifically on the Nigeria Police Microfinance Bank.