

Relationship between microfinance and nigerias economic growth economics essay



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ABSTRACT

Microfinance has over the years been associated with eradicating poverty, and consequently improving the standard of living of the less privileged members of a society, and rubbing on positively on the nation's economy. This dissertation aims at exploring the impact microfinance has on economic growth, considering a specific case of the Federal Republic of Nigeria. Due to the fact that this area of study has not witnessed so much research in the past, this work seeks to come up with an approach where the different links between microfinance and economic growth can be discovered and studied. Since most societies, especially the developing ones usually experience the presence of two types of financial system, the formal and the informal one under which microfinance falls, this will also be taken into consideration. The first hypothesis to be considered has to do with the micro level and this examines the relationship between microfinance and the financial system. The Second hypothesis has to do with the macro level and examines the relationship between the financial system and economic growth, while the third one links the previous two, by checking the relationship between microfinance and economic development.

Keywords: Microfinance; Economic Growth; Financial System; Nigeria

INTRODUCTION

Microfinance Institutions are financial organisations licensed to provide micro-savings, micro-credit, and micro-insurance in an economy. They operate in the informal sector of the financial system and are the major source of fund-provider for the medium, small and micro-enterprises.

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The basics of microfinance is the fact that the poor cannot access a loan from a bank of any reasonable commercial source, that is why Microfinance Institutions go out to the villages, meet with the poor who are encouraged to form an association, they give them micro-credits and sometimes even give them trainings to help them make the best use of the loan accessed (Mohammed and Hasan, 2008).

The methodology used by most micro-finance institutions to make loan is that they gather people into trust groups and meet weekly. These groups assume joint liability and joint guarantee on loans extended to any member of the trust unit and this invariably helps in reducing incidence of defaults and bad loans. Most Micro-Finance Institutions enjoy a high repayment rate.

It should also be noted that majority of microfinance customers are women who also make up a greater percentage of the world's poor, and also experience a very high rate of unemployment; and sadly in most cases are responsible for providing for and taking care of their families.

Nigeria with a GDP-real growth rate of 5 % (2009 est.), remains a major player in the African economy but her population of about 149, 299, 090(sourced from CIA-The world fact book), which is the largest in Africa, has about half of it living in poverty. However, since the introduction of microfinance in the country, an increase has been noticed both in the growth of the economy and also in the increase in number of microfinance institutions.

The Central Bank of Nigeria is saddled with the responsibility of issuing banking license and supervision of banks in the country, Micro-finance Institutions inclusive.

LITERATURE REVIEW

Microfinance, through its provision of financial services to the poor can influence economic growth by encouraging savings, giving out loans for feasible investments, provision of free advisory services to new clients on how best to invest, and also to those with long standing relationship, on how to increase the marginal productivity of capital (Pagano, 1993).

A lot of studies have been carried out on the relationship between financial development and economic growth. King and Levine(1993) are in support of the view that financial development leads to economic growth and in their visit on Joseph Schumpeter's work pointed out that banking institution through their provision of funds for productive investments are of great importance to economic growth(Schumpeter, 1911 cited in King and Levine, 1993). Greenwood and Jovanovic(1990) suggested that the relationship between financial development and economic growth is mutual, while Khan, (1999) who is of a similar opinion explains further that economic growth create financial development which in turns helps in sustaining the growth.

Qayyum et al.,(2007?) are of the opinion that direct finance has a significant positive relationship with economic growth. The availability of funds to the poor increases production and output, this also leads to an increases in the demand for more financial services (micro-savings and micro-insurance), which positively affects financial development and sets the economy on the

path of growth(Khan, 2008). It can then be said that availability of funds generates enterprise, enterprise generates finance flow, finance flow generates financial development, while financial development generates economic growth. De Gregorio and Guidotti(1995) also argued that financial development leads to improved economic growth, especially when funds are efficiently invested.

However, Kemal, et al.,(2004) do not regard finance(micro-finance inclusive) as an important determinant of economic growth and Lucas(1988) even referred to it as overstressed, while Levine(1997) sees financial institutions as more harmful to a nation's economic growth. This led to a call for redefinition and the use of appropriate measure of estimation of the relationship between financial development and economic growth and development of financial intermediaries by Bencivenga and Smith(1991).

The main objective of Microfinance is to raise income, by encouraging private sector activity through the provision of micro-credit to micro and small scale entrepreneurs ((Aghion and Morduch, 2000)). In a study conducted by Chua et al.,(2000), they noticed that the impact of microfinance services on income and consumption is dependent on the initial endowment of the household and the length of time they have been clients of the institution. It is also affected by how efficient they are in the management of the sourced resource and also the profitability of the sector they invest in. Availability of Social amenities and a cheaper source of factors of production also influence income.

According to Akanji (2002), the poor make effective use of the credit facilities and not only are they willing to pay the high interest rate on loan, they also in no time make enough returns to run a savings account with the MFI. It should also be noted that the conversion of the poor who were formerly economic liabilities into profit making micro-entrepreneurs have a positive impact on the financial system and consequently begins the process of economic growth by bring its full physical and human resources into productive use (Kamath, 2008).

METHODOLOGY

Not many literature are available as regard the relationship between microfinance and economic growth, therefore the study will rely much on theoretical framework in order to understand the link between microfinance and economic growth. Both Primary and Secondary sources of data will be used and Questionnaires will be sent out to have a direct feedback from the beneficiary of the scheme while previous studies and findings as regards the Nigerian economy will also be put into use in order to determine a theoretical association between Microfinance and Economic Growth.

It should be noted that the two main variables in this dissertation is Microfinance and Economic growth. The choice of Nigeria as a case study was borne out of the fact that the country has recently had its microfinance regulations tuned to enable it play its role in serving its targeted market effectively. An increase in the growth of microfinance institutions in the country has also made them better established and competitive, giving the erstwhile neglected micro-entrepreneurs a choice.

The relationship between financial system and economic growth will be first examined and in the second part, microfinance, alongside its associated theories will be explored to determine their impact on Economic Growth. The third part will be about examining the impact of theoretical macro-level effect on the case study, which is Nigeria. Its effect on the case study will help in reshaping the theoretical framework which will be the basis for conclusion.

To determine the impact of Microfinance on economic growth, micro credit disbursement from 2000 to 2009 will be analyzed using both non-parametric and parametric test methods.

The parametric test involves regressing the dependent variable (GDP from 2000-2009) against the explanatory variable (micro-credit disbursements) to ascertain if it's significant and provide explanatory power for economic growth. While the Chi-square method of non-parametric test will be used to examine the questionnaire to determine if there is any association between Microfinance and economic growth.

RESEARCH QUESTIONS AND OBJECTIVES

This Objective of this dissertation to answer the following questions:

Is there a relationship between microfinance and Nigeria's economic growth between 2000-2009?

Does investment of micro-credit into commerce contribute more to economic growth than other sectors?

Does microfinance have an effect on the financial system?

Does an increase in the number of Microfinance Institutions result to an increase in economic growth?

POTENTIAL PROBLEM

The potential problems envisaged in this research work is the availability of data from microfinance institutions in Nigeria as a large number of them do not have access to the internet and so do not post their information online. This brings about another problem, which is the distance between my place of study and the location of the case study. The relative scarcity of research on this area of study also creates a problem of limited materials. However, I have devised solutions for each of the problem. Most of my materials will be sourced from the Microfinance Unit of the Other-Financial -Institutions department of the Central Bank of Nigeria, as they have unhindered access to records of every Microfinance Institution operating in Nigeria. Most of my materials will be sent online while I will make use of a cheap and reliable courier service for my questionnaires. Also, the available materials online will be coupled with those sourced from the Central Bank of Nigeria Library and Data collected on the MFIs.

RESOURCES REQUIRED

The main resources needed are data on Nigeria's GDP, list of MFIs presently operating, records of loan disbursement by MFIs, records of total amount set aside for Small and Medium Scale Enterprise by the nation's commercial banks. All of these will be sourced from the Central Bank of Nigeria, while Past Studies and other literature will be freely assessed through the school

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library. The Questionnaires will be sent through mail and returned through courier. Estimated cost at conclusion is £250, which includes cost of printing and binding, as well as courier cost.

WORKPLAN

ITEM

PARTICULARS

NOTES

TIME FRAME

1.

Dissertation Proposal

Submission

May 5, 2010

2.

Literature review

Sourcing of materials and review of literature

July 4- 16, 2010

3.

Submission of preliminary literature review to my supervisor, and making suggested corrections

June 17- 20, 2010

4.

Methodology

Reading on Methodology and structuring of theoretical framework

June 20- 24, 2010

5.

Submission of proposed methodology to supervisor, and making suggested amendments.

July 25-June 28, 2010

6.

Questionnaire

Devise Questionnaire

June 29-30, 2010

7.

Submission of questionnaire to supervisor, and making suggested amendments

July 1-5 2010

8.

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Questionnaire distribution

July 6, 2010

9.

Collection of all other needed data and further review of past literature

July 7-20 2010

10

Collection of questionnaires and analysis of findings

July 21- 25, 2010

11.

Data Analysis

July 26- 30, 2010

12.

Interpretation of Findings.

August 1-5, 2010

13.

Formulation of Conclusion

August 6-10, 2010

14.

Abstract, and appendix and referenced materials arrangement

August 11- 15

15.

Updating and Review

Review with Supervisor

August 16-20, 2010

16.

Self review and amendment

August 21-25, 2010

17.

Final review with supervisor and proof-reading

August 26-28, 2010

18.

Printing and Binding

Printing and Binding

August 29, 2010

19.

Submission

Submission at the PG office

September 2, 2010.

EXPECTED OUTPUT

The output, which is the conclusion of this dissertation, is expected to help the Government in its activities aimed at the nation's economic development. It will also guide them in effective channeling of resources aimed at poverty alleviation. MFI administrators will also benefit from this work as it will help them in making decisions on how to enlarge their area of coverage and to also record higher returns through provision of other services. Donor Agencies and International institutions will also discover opportunities for helping in the economic growth and empowering the poor.

Lastly, this study is expected to pilot other studies in this area and form a basis on which other people discover more efficient and effective ways of making microfinance have a lasting positive impact on economic growth.