

Moderating effect of financial literacy in the relationship between microfinance banks and small business survival

Yunusa Mohammed Kaigama*, Noraini Abu Talib and Haprizah Ashari

Faculty of Management, Universiti Teknologi Malaysia, Johor Bahru, Malaysia
yukaigama@yahoo.com

Abstract

Objectives: To examine the moderating influence of financial literacy on the relationship between microfinance banks services and survival of small business in Nigeria.

Methods/Statistical Analysis: As a theoretical review, the paper adopts financial literacy theory and contingency theory to develop a conceptual framework that explains the moderating influence of financial literacy on the relationship between microfinance banks and small business survival within the context of Nigerian small business sector.

Findings: Adequate, affordable and sustainable financial and non-financial services provided by microfinance banks are presumed to ensure survival of small businesses. However, these services can only be useful where the small business owners are exposed to high financial literacy. High level of financial literacy has the potential to influence profitability and reduce the risk of failure in small businesses sector. Conversely, it is presumed that poor financial literacy will reduce profitability and in turn may reduce the survival potential of small business.

Applications/Improvements: Microfinance banks services are needed to enhance the long-term survival of small business in Nigeria. The financial and non-financial services provided by microfinance banks, utilized properly, can effectively reduce the failure risk of small businesses.

Keywords: Microfinance Banks; Small Business Survival; Financial literacy; Nigeria

1. Introduction

The Nigerian economy is significantly based on the operational capacity of small enterprises[1]. The small business sector constitute nearly 75% share in all enterprises in Nigeria, provides employment for over 43.6 million people and contribute over 46.5% to the nation's GDP[2]. Thus, the fortunes of the Nigerian economy rise or fall with the condition of the small business sector. This reality made the Federal Government of Nigeria to promote the establishment of microfinance banks as the most fit vehicle for small business financing in the country. Despite such interventions however, empirical evidences all point to widespread failure of firms in the sector [1]. It has been argued that financial literacy is one of the least understood mechanisms that moderate the important relationship between the role microfinance banks and small business survival. The main objective of this paper therefore is to develop a moderation framework for investigating this important relationship. In doing the literature review based on which our framework was developed, we follow the narrative design successfully used in a total quality management review paper [3]. This approach enables us to freely utilize the available literature best suited to the objective of our study.

2. Definition of small business in Nigeria

There is no common universally acceptable definition of small business available in the reviewed literature. A firm with employees of not fewer than 100 is regarded as small business USA. Whereas in European Union, venture having not less than 50 employees are considered as small business. In Nigeria, small monetary benchmarks are used to define small businesses, and because of the flux that characterizes value in money markets, it was suggested that the net present value of the 5 million benchmark should always be used [4]. Accordingly, we define small business as a firm having at least or at most 5 million and 50 million Naira respectively in assets exclusive of land and building, and employing between 10 and 50 people.

3.Small business and economic development in Nigeria

Research on small business sector in Nigeria is still at its development phase. Conversely, the wellbeing of small business sector is at their distressing phase. However, with all this distressing signal the contributions of small business sector to the national economic development is overwhelming. The small business sector was considered as backbone of economic growth in both developing as well as developed economies. In Nigeria, small business sector played and is still playing the critical role in the economic growth, progression of technological innovation, sourcing to large industries and promoting economic renewal and social development. Like other developing countries, Nigerian economy is also largely based on small business [5]. Though, there is controversy and debate on what constitute small business, but what is not contestable is the contribution of the sector in national development. A glance cursory at the structure of small business in Nigeria shows that 50 percent are involved in commercial retail trade, 10 percent in manufacturing, 30 percent in agriculture and the other 10 percent in other non-manufacturing activities. Almost 10 percent of the total manufacturing output and 70 percent of potential employment are from small business sector. Small business employed local technology through effective utilization of locally available resources, for production of intermediate goods and services that will lead to economic transformation. In fact, small business enterprises are generally considered as the engine of economic development in most emerging economies [5].

In Nigeria, the small business sector plays vital roles of job creations and poverty reductions. Economically, the sector performs exceptionally well in term of sustainable economic development. The significance of small business sector can be put in appropriate viewpoint in comparative to the structure of the Nigerian economy. With all the significance of petroleum and agricultural, small business sector is the fundamental in providing meaningful employment for over 70 percent of the Nigerian population [6,7]. Notwithstanding the fact that Nigeria is a developing economy with attendant infrastructural challenges and high poverty level [7]. Empirical evidence suggested that there are over 19.4 million small medium and micro enterprises (SMMEs) as at 2013, employing over 43.6 million people and contributing over 46 percent to the nation's GDP. The agricultural sector contributes almost 35 percent of the nation's GDP, most of the entrepreneurs in the agricultural sector are cottage category and small and micro-scale self-employed entrepreneur involved in agro-allied processing. For instance, fabricators small and micro-scale enterprises are the major source of equipment source to agro-allied processors, these fabricators are available almost everywhere in the country, and when included to the output of the SMEs in the agricultural sector, the total input of SMEs was about 60 percent of the national GDP [6].

In recent years, considerable government attention has been directed toward small business sector, due to perceived potentials of small business in realizing multiples economic objectives of employment creation and industrialization. Centred on this development that resources have been channel by the authorities to maintain sustainable development in the SMEs sector [7]. Despite, these considerable efforts toward SMEs sector development the expected influence on the national economy remains elusive. Empirical evidence exposes the inherent challenges in the sector which has been linked to different factors such as; lack of support for SMEs, inability of regulatory authorities to initiate and policies that would develop SMEs, ineffective operating environment characterized by dilapidated infrastructure, structural defects engendering a lot of incapability, poor capital especially equity capital and poor information on viable investment opportunities [5].

Despite these obvious challenges, the roles of SMEs sector, in employment creation, economic development, poverty reduction and equitable distribution of national development have been acknowledged. The agricultural non-farm SMEs account for about 25% of total employment and almost 20 % of GDP. While the non-agricultural SMEs has account for about 6.49 million whichs both retail and wholesale trade with employment capacity of almost 8.97 million. Other statistically measurable sectors are: vehicles maintenance (3.2%), transport (2.9%), restaurants and hotels (2.6%), construction (1.8%), manufacturing (18.7%), leather goods and textiles, clothing (3.8%), furniture (3.3%) and metals products (1.1%)⁵. Thus, there is a great interest in small business sector expansion on its scope and size both through start-ups and diversifications of existing enterprises to effectively contribute to industrialization and national economic development [8]. By international standard big corporations are very rare in Nigeria but they contributed disproportionately great portion of the national GDP. Thus because of their limited numbers and lower links with the rest of the economy, their role on economic development has been very small and unrecognizable [9]

4. Problems of SMEs in Nigeria

It was argued that small business sector has fail to accomplish the basic purpose of sustained economic development in Nigeria [10]. However, researchers [5] highlighted the following factors for constraining small business to accomplish the developmental objectives as: lack of consumer purchasing power, increase input costs, lack of working capital, unfavorable credit, intense competition and high taxes. Small business sector in Nigeria are faced with problems in both start-up and daily operations, and in the case of termination. Among the many obstacles to SMEs, are: heavy costs of compliance resulting from their size, business development services, namely services related to entrepreneurship, business training, marketing, technology development and information are undeveloped and not readily available. This is partly due to poor and unclear policy guidance for the development of the sector, further compounded by weak, fragmented and uncoordinated institutions supporting [5].

Evidence from literature reviewed indicates finance as crucial factor in Nigerian small business in both the start-up, and daily operations, which negatively reflect on their survival rate¹¹. However, it is worth mentioning, small firm depend on divers of sources for finance, this include internal and external, formal and informal financing sources. Even though, the relationship between these sources and their impact on investment remain unclear in the literature. In respect to Nigerian small business micro-credit or loan is the primary alternative of external funding [5].

Limited access to external financial resources available to smaller enterprises compared to bigger firm are the consequences for their poor development and market performance [12]. It has been established that bank credit plays a vital role in providing external financing to small and medium enterprises[5]. But in Nigerian context this critical source of financing small and medium enterprise is obviously not effective. This is evident in the ratio of loan to small business to conventional banks total credit, which indicate that a meagre 0.13% of commercial in the ratio of loan to small firms[13]. The more irritating is the fact that this trend has been falling over the years and continue unabated, the researchers attributed this trend to the high interest rate on government security which serve as a disincentive to intensify lending to small enterprises.

It was argued that due to inadequate finance, poor management and administrative requisite skills and other government related policy challenges only 20% of newly established SMEs survive up to the fifth year [10]. It was established that about 80% of Small and medium business are constrained by inadequate access to financial services in Nigeria[14]. The researchers argued that financing is not so critical, the sources of funds but the strict conditions set by conventional banks, and absence of acceptable collateral security from the SMEs operators, and excessive bank charges are considered to affects any meaningful contribution and long-term survival of SMEs. Regulatory authority and policy makers are struggling to overcome the challenges and intimidations of small and medium scale business and take stapes to enhance the potentials of the sector and actions towards improvement of SMEs infrastructure.

In[15] argued that slump and barrier from global market, low economic of scale, absence of adequate access to capital, poor managerial capabilities, poor entrepreneurial competencies, lack modern technology, heavy regulatory burden, inadequate basic infrastructure, strategic planning problems, poor accounting system and multiple taxation are some of the challenges facing small and medium scale enterprises in Nigeria. In[11] argued that these challenges have been further compounded by owner-managers or operators taking loan for expansion or starting a new venture but only to turnaround to other non-profitable activities which resulted to serious difficulties in financing much needed working capital and this is most frequently mentioned as a problem of SMEs. In[16] observed that the funding problem of SMEs is primarily due to the behaviour of banks and imperfection nature of Nigerian capital markets and lack of access to formal business and social networks.

In[11] observed that majority of the small business operators in Nigeria lack adequate knowledge regarding marketing techniques, branding, customer loyalty and lack of good contacts with others local and international enterprises. They further argued that SMEs in Nigeria have social barriers which are main problems to attain the competitive advantage and consequently many SMEs in Nigeria lose out in terms of opportunities. In[11] further observed that absence of trained manpower and operational competencies and skills among owner-manager constitute the primary challenges to the survival of SMEs in Nigeria. The researchers further, added that inefficiency in overall business management and poor record keeping is also a major feature of most SMEs, poor technical capability, and absence of essential pre-required proficiency in finance, production, procurement, maintenance, and marketing and have always resulted to poor funds application which resulted to wrong and costly decision making [17].

In [18] observed that most Nigerian small business owners have poor investment culture of retain earnings, they further emphasized that only few of them have the attitude of a typical entrepreneur of investing today and gain tomorrow. Moreover, some entrepreneurs divert valuable resources from venture to other non-profitable social. Another challenge is of bias against made in Nigeria product most consumers have developed propensity for consumption of imported products as against substitutes made locally this contributed to poor marketing related challenges in the SMEs sector.

In [19] observed that challenges of business location, market shops are controlled by landlords who charge excessive rates, and market shops are owned wealthy peoples who are discriminating real small-scale entrepreneur from shops allocation. On the other hand, high rents charged by shops owners have forced small business owners into the streets and uneasily accessible locations [19]. Other challenge is that of deregulation and removal of protection as well as financial crisis in the global market has been unfavourable to small and enterprises operators. Like the case of South Africa [20], lack standard accounting system and proper self-performance assessments on the part of SMEs results to mismanagement and ultimately failure of many SMEs in Nigeria [21]. Whereas in [18] observed that another major problem is relate to the role of tax agents hired by local authorities, they are commonly crude and devastating in their assessment in relationship with value added tax. In their bid to collect tax revenue they tax almost everything without due considering the net impact on small business performance.

5. Financial literacy as a moderator on the relation-ship between microfinance banks and small business survival

This section explains the influence of financial literacy as a moderator within the microfinance bank dynamics resulting in survival of small business. Entrepreneur financial literacy is also an important tenet of entrepreneurship as it permits entrepreneurs to assume entrepreneurial decisions and actions all of which have financial implications [22]. Financial literacy is a well-established factor that exerts a significant influence on a verity of activities including negotiating, monitoring, insurance and loan and savings account [23] as well as small business survival among others [24].

Financial literacy is considered a decisive factor in determining the knowledge of entrepreneurs in accessing and obtain available financial services or products [25]. Due to lower level of financial literacy fund sourcing is often a difficult process. Small business owners need financial literacy to be able to effectively evaluate available financial options and then accept the appropriate alternative [25]. Even though, the nature and the influence financial literacy on small business survival is still unclear but it is obvious that survival risk is likely to vary according to the level of entrepreneur financial literacy [25,26]. The uniqueness of financial literacy influences in almost all facet of small business is derived from the fact that poor financial literacy affects the entrepreneur's capacity of seeking financial services, even where then they are available and higher level of financial literacy enhance ability of entrepreneurs to access financial product which in turn enhance small business profitability that may potentially reduce the failure risk of small business [24].

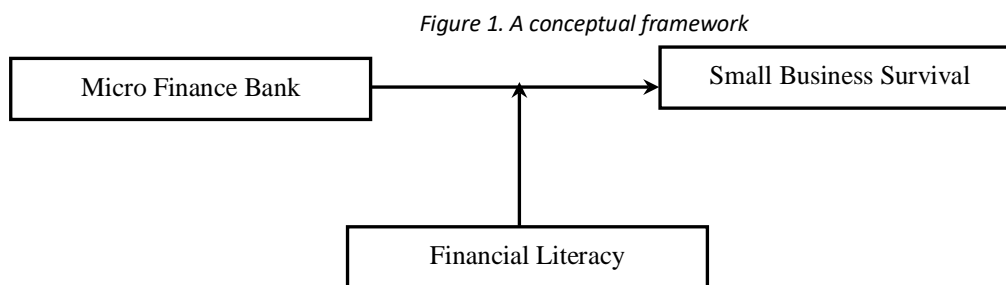
Indeed, there is substantial evidence in small business survival literature which shows that poor financial literacy discourages entrepreneurs from seeking financial services and high financial literacy enhance consumption of financial services which improve profitability that significantly influence survival rate of small business. Access to finance is a key influencing factor for venture start-up, development and survival of small business [27].

Finance not only expedites small business start-ups but also enhance market entry, survival of businesses and risk reduction, it also stimulates innovation and entrepreneurial endeavor and high-return investment ventures [27]. Though, in many emerging countries, most of the informal businesses have poor access to financial services and while many factors attribute to this, poor of financial literacy has been acknowledged as one of the factors that effects the ability of small business owners in accessing financial services [28]. Studies have established that financial literacy influences access to financial services and survival of small business.

In a study on the effect of finance on the survival of small business in Sri Lanka [29] established that financial literacy improved the usage of financial products by the enterprises, which in turn improved their survival. In [28] studied utilization of financial services by SMEs in Ghana and established that financially literate entrepreneurs were more expected to access and employ financial product which potentially improved the survival of their small enterprises. In [29] also established that financial literacy influences financial access and that this had a positive impact on the survival of small enterprises in many developing economics.

6. Conceptual model

Figure 1 depicts the hypothesized model that shows the influence of microfinance banks on small business survival and the moderating role of financial literacy. The proposed theoretical constructs of microfinance banks are training, access to microcredit, mandatory micro savings, technical advice [27-29]. That of survival of small business is: ability to convert profit into investment, good managerial skills, educational qualification, ability to make profit and participation in microfinance, mandatory savings, access to micro credit, and training, technical advice, adopted from [27,30]. While construct for financial literacy are: Financial Management, Debt Literacy, Savings Literacy, Investment Literacy, Insurance literacy[31,32]. Thus, it should be noted that the proposed constructs are not complete set of measurement scale for other contexts as all the dimensions of entrepreneurial competencies and small business survival cannot be included in a single study.



7. Conclusion

This paper is a conceptual framework regarding the importance of microfinance banks towards the survival of business in Nigeria by incorporating the concept of transaction cost as a moderator in the relationships. As the existing literature reveals the significance of microfinance bank towards business survival, hence, this paper argues that through transaction cost, this relationship can be more pronounced. It suggests that an empirical study should be conducted in future by using this conceptual framework to observe the influence of transaction cost as a moderator between the microfinance bank and survival of small business.

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