

EVALUATION OF EFFECTIVENESS OF MICROFINANCE INSTITUTIONS AND THE GROWTH OF SMALL AND MEDIUM SCALE ENTERPRISES IN ILORIN METROPOLIS, KWARA STATE, NIGERIA

ABU – KASUM, Hamidat Adebisi

Department of Accounting, University of Ilorin, Nigeria

Email: adebisi2902@gmail.com

ABDULLAHI, Ibrahim Bello (Ph.D.)

Department of Finance, University of Ilorin, Nigeria

KASUM, Abubakar Sadiq (Ph.D)

Department of Accounting, University of Ilorin, Nigeria

Abstract

This study evaluates the effectiveness of micro finance institutions in the growth of small and medium enterprises in Ilorin metropolis of Kwara State. The study employed stratified sampling technique to select the respondents based on business type. The sampling frame (of) for this study is eighteen SMEs and ten Microfinance Institutions. Structured Open ended questions were used to obtain primary data. Ordered probit regression analysis was used to analyse responses on core issues as specified in the model. Results revealed a positive relationship between microfinance banks effectiveness, loan assessment and loan monitoring on the development of small and medium scale businesses, while there is a negative relationship between loan repayment and collateral security on the growth of small and medium businesses. The study recommends that micro finance institutions should set up a department which shall be charged with the sole responsibilities of monitoring the use of loan borrowed from the institutions to reduce diversification of funds. Issue of collateral should be abolished in line with CBN guideline, rather social security should be emphasised. The study concludes that if the above recommendations are implemented, Micro Finance Institutions will be effective in the development of SMEs in particular and the economy in general.

Keywords: Micro Finance, Small and Medium Scale Enterprises, Growth, Financial institution

1. INTRODUCTION

The contributions of Micro Finance Institutions in the economic growth and development of a nation cannot be over emphasised. Savings and credit groups have been operating for the past centuries, such as: “Susus” of Ghana; “Chit Funds” in India; “Landas” in Mexico; “Arisan” Indonesia, “Ajo” in Nigeria; “Cheelu” in Sri Lanka; “Tontines” in West Africa; and “Pasanaku” in Bolivia, as well as numerous savings clubs found all over the world (Yahaya, Osemene & Abdulraheem, 2010). Past studies revealed that in the 1800s, credit union was developed by Friedrich Wilhelm Raiffeisen with the main aim of assisting the rural population to break out of their dependence on money lenders and to improve their welfare.

However, the development of Small and Medium Scale Enterprises (SMEs) with the aid of financing have stem debate and rising interest among various practitioners owing to the immense contribution of the subsector to the economy growth. A micro finance bank is an institution regulated by law and devoted to extending small loans, referred to as microloans to individuals, businesses, and

organisations. It also offers both financial and non-financial services including savings, micro insurance and business advisory services. Micro Finance is about providing financial services to the poor who are traditionally not served by the conventional financial institutions. The financial sector plays a very vital role in the development of any country or nation. Micro Finance is the form of financial institutions that has its primary aim to alleviate the poverty of the fund seekers who are generally remained unserved or were offered improper financial service (CBN 2005).

Small and medium scale enterprises have been regarded as the engine for employment generation and a grassroots index that set the pace towards growth and development in Nigerian economy, yet it has not performed creditably well. Financing has been the major setbacks of the sub-sector, other mitigating factors include: non- accessibility of funds; illiteracy and ignorance; shortage of skilled manpower; bureaucracy; lack of entrepreneurial skills and costly information.

In Nigeria, government has enacted various policies and programmes aimed at empowering Small and Medium Enterprises. Micro Finance Institutions is one out of many programmes established. The objective of the study therefore is to evaluate the effectiveness of Micro Finance Institutions on the growth of small and

medium enterprises in Ilorin metropolis of Kwara State.

Many studies conducted on Microfinance Institutions have been on its effects on poverty alleviation in both developed and developing nations. Most studies conducted were mainly on impact analysis of Microfinance Institutions, and on poverty alleviation (Akanji, 2001; Magnus, 2005; Folake, 2005; Okerenta, Orebiyi & Adesope, 2007). Similarly, the Central Bank of Nigeria (CBN, 2000) focused attention on the modalities for the operation of Micro Finance Institutions in Nigeria. There is little research effort on the evaluation of the effectiveness of micro finance institutions in the growth of small and medium enterprises in Nigeria. This serves as the major gap which this study tends to contribute to the existing literature. This study could be vital for Nigerian government policy makers for re-appraisal of the institutional policies, programmes and framework, the study investigates whether loans were easily accessible by small and medium entrepreneurs in Ilorin metropolis of Kwara State, Nigeria which makes the outcome of this study important to entrepreneurs with respect to fund raising.

2. LITERATURE REVIEW

2.1 Conceptual Framework

According to Ehigiamusoe (2008), Micro Finance is the supply of loans,

savings and other financial services to the poor. Rajasechar (2004) defined Micro Finance as the strategy for providing to the poor in rural and urban areas; especially women with savings and credit facilities to set up or expand business, invest in self-employment activities and increase household security.

According to Appah, John & Soreh (2012), Micro Finance is coined as the financial services rendered to the deprived group of people and small entrepreneurs to help them in developing self-employment opportunities and various income generating activities. Therefore, for this study, Microfinance is about providing financial services to the poor who are traditionally not served by the Conventional Financial Institutions (CFIs). Olaitan (2001) highlighted three features that distinguish Micro Finance from other formal financial products. They are: the smallness of loans advanced and/or savings collected; the absence of asset-based collateral; simplicity of operations. Okoye (2005) enumerated the benefits of microfinance as: reduction of the vulnerability of the poor; increase in the household income and consumption; reduction in income poverty and growth of businesses; employment generation for the rural populace.

Micro Finance is important because of the following reasons as outlined by

CBN's regulatory policy for Micro Finance Institutions (2005). They include:

(i). Majority of Nigerian population live in the rural areas and are generally characterised by low income, poor standard of living, and they generally engage in agricultural activities, artisanship and other forms of small businesses that need funding, technical and professional assistance.

(ii). The formal financial service providers are unable to reach these people and areas for reasons such as: High operational and administrative cost; Inability to reach the widely spread population in the rural areas; The assumption that the target market lacks the capacity to pay back loans, hence making the business vulnerable and risky; Non-profitability of the rural based clientele business; Illiteracy of the rural people to understand the basics of the banking business.

(iii). The role of Microfinance in poverty reduction, income and employment generation.

From the appraisal of existing microfinance-oriented institutions by CBN (2005), the following facts have become evident: Weak Institutional Capacity; Weak Capital Base; The Existence of a Huge Un-Served Market; Economic Empowerment of the Poor, Employment Generation and Poverty Reduction; The Need for Increased Savings

Opportunity; The Interest of Local and International Communities in Micro Financing; and Utilization of SMEEIS Fund. SMEs have been described variously by different institution all over the world based on the environment, the situation and the scope to which the description apply. Some institutions in Nigeria also describe SME based on the Nigeria's situation. One of such is by Nigeria's National Council on Industry. According to the Council, a small and medium scale enterprise (SME) is defined in terms of employment as one between 10 and 300 employees. Small and Medium Industries Equity Investment Scheme (SMIEIS) defines small and medium enterprises (SMEs) as enterprises with a total capital employed of not less than N1.5 million, but not exceeding N200 million, including working capital, but excluding cost of land and/or with a staff strength of not less than 10 and not more than 300 (Olowe, Moradeyo & Babalola, 2013).

According to Ranjani (2012), SMEs and entrepreneurship are now recognised worldwide as key source of economic growth and development. Kolawole (2013) contends that small and medium scale enterprises play a very important role in developing economies. Chiyah & Forchu (2010) argue that the promotion of micro enterprises in developing countries is justified in their abilities to faster

economic growth, alleviate poverty and generate employment. On the average, SMEs represent over 90% of the enterprises and account for 50% to 60% of employment in most Africa countries (Ahiawodzi & Adade, 2012 cited in Kasum & Oke, 2014).

According to Olowe, *et al.*, (2013), some other benefits of SME include: Contributions to the economy in terms of output of goods and services and creation of jobs at a relatively low capital cost; it is a vehicle for the reduction of income disparities thus, developing a pool of skilled or semi-skilled workers as a basis for the future industrial expansion; and improve forward and backward linkages between economically, socially and geographically diverse sectors of the economy. SME provides opportunities for developing and adapting appropriate technological approaches and also offer an excellent breeding ground for entrepreneurial and managerial talent.

2.2 Theoretical Framework

Effectiveness theory is considered very relevant to this work. The theory was propounded by Simanowitz in (2004). Effectiveness means the capability of or success in achieving a given goal. Effectiveness is the extent to which an activity fulfils its intended purpose or function (Harvey, 2004). According to Fraser

(1994), it is a measure of the match between stated goals and their achievement.

In short, analysing the effectiveness of an intervention helps one to identify the right decision to make (i.e., the best intervention to achieve the desired outcomes). Specifically, effectiveness analysis should answer the following questions: Has the desired outcome been achieved? This question compares actual outcomes of an intervention with its objectives; what is the significance of the achievement? This question refers to the relative distance between stated and actual outcomes; what factors helped the achievement of desired outcomes? This question aims to identify the factors that contributed to the achievement of the desired outcomes such as household characteristics, village characteristics, and the operational environment; what are the key impacts that the process has created? This question looks for direct and important effects, which may not have been planned in the beginning that the intervention created; and was the intervention worthwhile given the achievement of desired outcomes, additional impacts created and level of inputs spent?

The answers to these questions are based on the achievement of desired outcomes and other effects created by the intermediation, given the time and resources spent for the intermediation.

Theory of effectiveness is usually used in management to evaluate the effectiveness of a policy since its enactment, to ascertain whether the policy is effective and efficient or not. Effective theory is relevant to this study owing to the fact that it helps to ascertain the effectiveness of Micro Finance in the growth of small and medium scale enterprises in Ilorin metropolis of Kwara State. For analysis, some questions are accustomed in the theory which ensures its evaluation with respect to its effectiveness.

2.3 Review of Empirical Studies

Osoimehin & Jegede (2011) investigated Microfinance Institutions' outreach in South-Western Nigeria. The study employed secondary panel data collected from 80 microfinance institutions in Lagos and Ondo States over a period of six years from 2005 to 2010 and Generalized Least Squares Method to examine the determinants and trend of outreach of Microfinance Institutions. It revealed that Microfinance outreach is positively and significantly determined by average loan size, debt-equity ratio, loan repayment rates and salaries. Microfinance Institutions were encouraged to increase their outreach by providing relatively small loans which ultimately would reach more clients and therefore achieve a greater outreach. Olowe, et al (2013) examined the impact of Microfinance on SMEs' growth in Nigeria.

The population of the study consists of the entire SMEs in Oyo State, and it was restricted to Ibadan metropolis. Purposive sampling technique was used to select the participating SMEs. Pearson correlation coefficient and multiple regression analysis were used to analyse the data. It was discovered that financial services obtained from Micro Finance Banks have positive significant impact on SMEs growth in Nigeria. The authors recommended that MFBs should lighten the condition for borrowing and increase the duration of their customers' loan and also spread the repayment over a long period of time.

Shamsudeen (2014) examined the impact of micro credit on Small and Medium Enterprises of service operation in Sokoto metropolis. Simple random sampling technique was employed in selecting the 26 SMEs that constituted the sample size of the research and descriptive survey research design was adopted for the study. Structured questionnaires and interview were used to elicit the acquisition of relevant data which was used for analysis. Descriptive statistics which involves simple percentage graphical charts and illustrations was tactically applied in data presentations and analysis. The study discovered that there is significant relationship between microcredit and small and medium enterprises and there is also a strong

relationship between microcredit and performance of small and medium enterprises.

Finally, Maertens (2003) used standard regressions to estimate the impact of Micro Finance on asset accumulation and income growth of client households. The author also descriptively argued that Micro Finance created other impacts such as reduction of vulnerability to poverty. It seems that the notion of impacts and effectiveness were not clarified in previous studies. Thus, this study tends to adopt effective theory as a basis for the current study. The theory reviewed above was used as a basis for the development of a model in evaluating the effectiveness of Micro Finance Institutions in the growth of SMEs in Ilorin Metropolis, Kwara State, Nigeria. To the knowledge of the authors, it appears no specific study introduces a link of effective theory in the evaluation of Micro Finance Institutions in the growth of SME in Ilorin metropolis of Kwara State. This therefore serves as the research gap this current study intends to fill.

3. METHODOLOGY

3.1 Research Design

This section presents the details of methods adopted in this study. Primary source of data was used for the study. The primary data were sourced through the use of structured

questionnaire. The study population comprises of all the micro finance institutions and registered small and medium scale enterprises in Ilorin metropolis. The sample for the study comprises eighteen (18) small and medium scale enterprises and ten (10) Micro Finance Institutions in Ilorin metropolis. The study used stratified sampling technique in dividing various forms of business into five sectors such as manufacturing, retail services, wholesale, poultry and farming. Three (3) were randomly selected from each stratum, while ten (10) were randomly selected from Micro-Finance Institutions in Ilorin metropolis. The sample size for the study is totaling twenty-eight (28).

The data were collected through structured questionnaire to solicit for relevant data. The questionnaires were personally distributed to the selected respondents and were collected two days after distribution. 36 copies of questionnaire were distributed to small and medium scale businesses, entrepreneurial and the accountants; while, 50 copies of questionnaire were distributed to ten (10) Micro-Finance Banks' managers and credit officers, totaling 86 questionnaire distributed. This study covers Ilorin metropolis of Kwara State, owing to the fact that Ilorin metropolis is the major commercial centre in Kwara State.

3.2 Method of Data Analysis

3.2.1 Model Development

The model used for this study was adapted from the work of Olowe, Moradeyo & Babalola (2013) which was given as: $SBG = \beta_0 + \beta_1 LDM + \beta_2 IRR + \beta_3 LDR + \beta_4 LRM + \beta_5 COS$

Where:

SBG = Small Business Growth

LDM = Loan Disbursement

IRR = Interest Rate

LDR = Loan Duration

LRM = Loan Repayment

COS = Collateral Security.

The model used for the study is re-modified as:

$$\text{Prob}(SME_{SD} \leq 5 | X) = \beta_0 + \beta_1 ME + \beta_2 LA + \beta_3 LM + \beta_4 LR + \beta_5 CS + \mu$$

Where:

X is the independent variables

SME_{SD} = Small and Medium Scale Development

ME = Micro Effectiveness

LA = Loan Accessment

LM = Loan Monitoring

LR = Loan Repayment

CS = Collateral Security

μ = error term

This study used descriptive statistics such as simple percentage in analysing the bio data of the respondent and regression analysis (ordered probit) in analysing responses from the questionnaire.

4. INTERPRETATION AND DISCUSSION OF RESULTS

This section consists of data presentation, analysis and interpretation, simple percentage and regression analysis was used in analysing responses from various entrepreneurs and Micro Finance Institutions in Ilorin metropolis, using ordered Probit regression analysis owing to the fact the dependent variable is categorical and ordered.

The Cronbach alpha reliability test

Average inter-items covariance	Number of items in the scale	Scale reliability coefficient
.2018616	6	0.8970

Source: Author's Computation (2015)

The alpha coefficient for the six items is 0.8970, suggesting that the items have relatively high internal consistency and

reliability coefficient of 0.70 or higher is considered acceptable.

Table 4.1 Summary of Regression Statistics

DevSMEs	Coefficient	P>/z/	Prob>chi2	0.000
Micro Effectiveness	0.5528***	0.000	Pseudo R ²	0.1573
Loan Accessment	0.3768***	0.000	/cut1	-1.2420
Loan Monitoring	0.3421**	0.05	/cut2	0.33327
Lending Rate	-0.1759***	0.004		
Collateral Security	-0.3083*	0.1		

Source: Author's Computation (2015)

Note: *** indicates significance at 1%, 5% and 10%

** indicates significant at 5% and 10%

* indicates significant at 10%

The coefficient of micro finance effectiveness is significant at 1%, 5% and 10% in explaining the variation in the growth of small and medium scale in Ilorin metropolis of Kwara State. The result shows that there is a positive relationship between micro finance institutions effectiveness and growth of small and medium scale enterprises, giving a value of 0.5528 and is more likely to report a higher category of development of small business as it can extend to medium scale and even large scale entrepreneurship using the threshold i.e (cut analysis) since the value of the coefficient is greater than /cut 2.

The coefficient of loan accessment from micro finance institutions is significant at 5% and 10% in explaining the variation in the growth of small and medium scale in Ilorin metropolis. The result shows that there is a

positive relationship between loan accessment and growth of small businesses, giving a value of 0.3768, signaling that an increase in loan accessment from micro finance institutions will necessarily decrease the probability of being in the lowest category of growth of SMEs, but increases the probability of moving to higher category of growth of small business as it can even extend to large scale entrepreneurship.

Furthermore, the coefficient of loan monitoring by micro finance institutions is significant at 5% and 10% in explaining the variation in the growth of small and medium scale. The result shows that there is a positive relationship between loan monitoring and growth of small businesses, giving a value of 0.02900, signaling that an increase in loan monitoring by micro

finance institutions will necessarily decrease the probability of being in the lowest category of development of SMEs, but increase the probability of moving to higher category of growth of small business as it can extend its operation to medium scale and even large scale entrepreneurship.

The coefficient of loan repayment is significant at 1%, 5% and 10% in explaining the variation in the growth of small and medium scale. The result shows that there is a negative relationship between loan repayment and growth of small businesses, giving a value of -0.1759, signaling that an increase in loan repayment will necessarily increase the probability of being in the lowest category of growth of SMEs, which ultimately decreases the probability of moving to higher category of growth of small business as it cannot extend its operation to medium scale and large scale.

The coefficient of collateral security is also significant at 1%, 5% and 10% in explaining the variation in the growth of small and medium scale, the result shows that there is a negative relationship between loan accessment and growth of small businesses, giving a value of -0.3083, signaling that an increase in collateral security will necessarily increase the probability of being in the lowest category of growth of SMEs, but decrease the probability of moving to higher category of

growth of small business as it cannot extend to medium scale and even large scale entrepreneurship. The Prob>chi2 shows a value of 0.000, indicating that the model is statistically significant at 1%, 5% and 10%.

Discussion of Findings

The finding in this study is in line with most of the studies on this subject matter. Previous studies like Osotimehin and Jegede (2011) investigated Microfinance Institutions' outreach in South-western Nigeria. It was revealed that Microfinance outreach is positively and significantly determined by average loan size, debt-equity ratio, loan repayment rates and salaries. Microfinance Institutions was encouraged to increase their outreach by providing relatively small loans which ultimately would reach more clients and therefore achieve a greater outreach. Olowe, et al (2013) examined the impact of Microfinance on SMEs growth in Ibadan metropolis, Oyo State, Nigeria. The study discovered that financial services obtained from Micro Finance Banks have positive significant impact on SMEs growth in Nigeria. Also, Shamsudeen (2014) examined the impact of micro credit on Small and Medium Enterprises of service operation in Sokoto metropolis and the study discovered that there is significant relationship between microcredit and small and medium enterprises.

5. SUMMARY, CONCLUSION AND RECOMMENDATIONS

The study discovered that:

(i) Micro Finance Institutions are effective in the growth of small and medium scale enterprises in Ilorin metropolis of Kwara State, signaling that the alternate hypothesis should be accepted;

(ii) Small and medium scale businesses in Ilorin metropolis of Kwara state were able to access loans from various micro finance banks in the area; and

(iii) Also, it was discovered that micro finance banks do not monitor the use of money given out to small a medium scale enterprise.

Based on the findings of this study, it could be concluded that micro finance institutions in Nigeria have the capability to contribute significantly to the growth and development of SMEs if there is adequate financing of operations, with effective service awareness, loan assessment and loan monitoring are ensured by relevant stakeholders. It is not new to say that SMEs are the engine of growth and economic development, accounting for over 60% in developed economies

Based on the findings, the study recommends the following:

(i) The Nigerian policy maker(s) i.e CBN should further reduce the interest rate charged by MFI taking into consideration infrastructural facilities that could enhance

utilisation of assets to effectiveness of growth of SMEs in Nigeria.

(ii) Micro-credit institutions should provide advisory service to management of small and medium scale enterprises and possibly consultancy services at no cost attached on utilisation of loan granted by them.

(iii) Micro finance institutions should set up a department which shall be charged with the sole responsibilities of monitoring the use of loan borrowed from the institutions to reduce diversification of funds

(iv) Issue of collateral and other impediments to access loans by SMEs should be abolished in line with CBN guideline; rather, social security should be emphasised.

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APPENDIX

Summary of Responses to Operational Questions

Questions (State questions in opinion response)	Low Growth	Medium Growth	High Growth			Total
Growth of SMEs in Ilorin metropolis of Kwara State	18	43	25			76
	Strongly agree	Agree	undecided	Strongly disagree	disagree	
Micro finance institutions are effective in the growth of small businesses in Ilorin West Local Government Area	29	9	-	24	14	76
Loans were easily accessible by small and medium scale businesses in Micro Finance institutions	20	5	5	9	37	76
Micro finance institutions monitors the use of loans given out to small and medium scale business in Ilorin West Local Government Area	11	24	2	22	17	76
Loan repayment schedule were favourable and convenient for Small and medium scale enterprise in Ilorin West Local Government Area	31	6	1	10	28	76
Collateral security hinders small businesses in accessing loans from micro finance institutions in Ilorin West Local Government Area	43	17	4	8	4	76
High interest rate charged on credit causes set back in loan assessment by small businesses in Offa L.G.A	28	39	3	6	10	76

Source: Author's Survey, (2015)