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SMALL AND MEDIUM ENTERPRISES FINANCING AND POVERTY REDUCTION IN NIGERIA

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Abstract

This study examined how small and medium enterprises (SMEs) financing affects poverty reduction in Nigeria. This followed the understanding that SMEs play a critical role in the process of economic development. The datasets obtained from the CBN Statistical Bulletin and World Bank were analysed using the error correction model (ECM) Technique. The parsimonious ECM result showed that bank credit to SMEs significantly reduced poverty during the study period. This finding highlights the critical role played by SME financing in promoting economic development in Nigeria. The results further showed that private sector credit affected poverty headcount negatively indicating that the availability of credit to the private sector has not contributed to poverty reduction in Nigeria. On the contrary, the result also showed that interest rate contributed positively to poverty in Nigeria. This finding could be attributed to the continuous increase in interest rates which limits investments in critical sectors of the economy that have the potential for poverty reduction. Owing to the findings, this study concludes that SME financing provides a sustainable road map for poverty reduction in Nigeria. Hence, it is recommended that the Central Bank of Nigeria and deposit money banks should prioritize SME financing to create more opportunities for sustainable poverty reduction strategies.

Keywords: *Economic development, poverty reduction, private sector credits, Nigeria, SME financing,*
JEL Classification Codes: *G21, H51, H52 I132, I138*

1. Introduction

Poverty remains a critical global challenge, disproportionately affecting developing countries such as Nigeria. Despite her vast economic potential and natural resources, Nigeria continues to grapple with deepening poverty, characterized by low income, unemployment, inadequate access to basic amenities, and widespread inequality. According to the National Bureau of Statistics (NBS, 2022), approximately 133 million Nigerians, representing 63% of the population, are multi-dimensionally poor. This troubling trend has persisted over the decades, further exacerbated by rapid population growth, structural economic inefficiencies, and external shocks such as the COVID-19 pandemic and global inflationary pressures (World Bank, 2023). Nigeria's ranking on the Human Development Index (HDI) remains low, with high poverty incidence observed in both rural and urban areas. The poverty trend in Nigeria demonstrates not only stagnation but a worsening crisis, particularly in the northern region. The World Poverty Clock (2023) reported that Nigeria is home to the largest number of people living in extreme poverty globally. Efforts to address this issue have included government-led social protection programs, international interventions, and policy reforms, yet significant progress remains elusive. Structural economic constraints, such as a weak private sector and insufficient access to finance for micro, small, and medium enterprises (MSMEs), have hindered these efforts. This underscores the need for innovative, inclusive, and sustainable poverty reduction strategies.

Small and medium-sized enterprises (SMEs) are highly recognised as essential drivers of economic expansion, especially in developing economies like Nigeria. According to Ayagari, Demirguc-Kunt, and Maksimovic (2011) SMEs are critical for promoting economic development and are also vital in creating jobs and reducing poverty. In Nigeria, where SMEs make up 96% of all enterprises, 84% of employment, and contribute over 48% of the country's GDP, their influence is especially noticeable (NBS, 2020). This large contribution highlights the crucial part SMEs play in the Nigerian economy. It is also highlighted in extant literature that SMEs are essential for economic resilience and diversification. Despite their significant economic contributions, SMEs in Nigeria face a myriad of challenges. Access to financing remains a critical challenge for many of these enterprises. Financial resources availability to SMEs can significantly influence their ability to expand, innovate, and compete in the business environment.

One of the promising approaches to addressing poverty is through the promotion of small and medium enterprises (SMEs). According to Akinyemi and Adejumo, (2023) SMEs are widely recognized as engines of economic growth, employment generation, and poverty alleviation. SMEs account for over 80% of businesses in Nigeria and contribute significantly to gross domestic product (GDP). Their capacity to create jobs, foster innovation, and empower communities makes them vital to the socioeconomic transformation of Nigeria. However, despite their potential, SMEs in Nigeria face numerous challenges, with access to finance emerging as the most critical barrier to their growth and sustainability (Adegbite et al., 2022).

The role of SMEs in poverty reduction lies in their ability to provide income-generating opportunities and foster economic inclusion. Empirical evidence suggests a direct correlation between SME development and poverty reduction. For instance, Ibidapo-Obe et al. (2023) found that SMEs contribute to improved living standards and reduced inequality in countries where they are adequately supported. In Nigeria, however, the financing gap remains substantial. Data from the International Finance Corporation, (2022) reveals that Nigerian SMEs face a financing gap of $158 billion, representing one of the highest in sub-Saharan Africa. Limited access to credit, high-interest rates, and stringent collateral requirements are key barriers that hinder SMEs from scaling their operations and, by extension, from playing a transformative role in poverty alleviation.

The worsening poverty trends in Nigeria suggest that existing interventions are either insufficient or poorly targeted. While several studies have examined poverty reduction strategies in Nigeria, gaps remain in understanding how targeted SME financing can serve as a sustainable solution. Most prior studies have focused on macroeconomic interventions, often neglecting the microeconomic dimensions of poverty alleviation through SMEs. Furthermore, while the relationship between SME financing and economic growth is well-documented, the specific nexus between SME financing and poverty reduction in Nigeria remains under explored. This study seeks to fill this gap by critically examining the role of SME financing in addressing Nigeria's poverty crisis. Despite the growing importance of SME financing, access to credit and other financial resources has remained a major challenge to SMEs in Nigeria. It is worrisome to note that the limited availability of credit facilities, often due to stringent lending criteria and a lack of collateral, restricts the ability of SMEs to access necessary funds. This financial exclusion not only limits their operational capacity but also restricts their ability to innovate, expand into new markets, and improve their competitiveness. The knowledge gap in terms of the scope of the previous studies prevents stakeholders from crafting strategies that precisely address the financial barriers impeding SME growth and their potential for poverty alleviation. Thus, this study must provide a better understanding of the relationship between SME financing and poverty alleviation which can lead to more targeted and effective economic policies.

Following the Introduction, Section 2 of the study reviewed related literature with emphasis on the theoretical and empirical literature while Section 3 embodies the methodology. Sections 4 and 5 focused on the results and discussion, and conclusion, respectively.

2. Literature Review

2.1 Theoretical Literature

The Schumpeterian growth theory, developed by Joseph Schumpeter in 1934, emphasizes the role of entrepreneurial activity and innovation in driving economic development. The theory highlights the importance of innovative entrepreneurs who disrupt existing markets and create new products, processes, and technologies, which he famously termed creative destruction. Schumpeter (1934) argued that access to finance is critical for entrepreneurs to implement innovative ideas and bring transformative products to market. He posited that without adequate financial support, many innovative ideas would never move beyond the conceptual stage. This aspect of Schumpeter's theory is particularly relevant to SMEs which often face more significant financial constraints than larger firms. Schumpeter's theory is supported by empirical research that shows how entrepreneurial financing fosters innovation and economic growth. For example, studies have indicated that areas with more advanced venture capital markets saw a faster expansion rate in the innovative sectors (Samila & Sorenson, 2011). The association highlights the pivotal function of customized financial assistance in cultivating an atmosphere favourable to innovation and economic vitality.

Furthermore, the endogenous growth theory developed by Romer (1990) and Lucas (1988), provides a comprehensive framework for understanding economic growth from within an economy, focusing on human capital, innovation, and knowledge as primary growth drivers. This theory marks a significant shift from traditional growth models on the emphasis of economic growth been driven by internal economic factors, particularly through investments in human capital and technology. Lucas (1988) highlights the significance of human capital, putting forth the argument that workforce expertise and knowledge are essential for economic growth. He contends that spending on education and training increases collective intellectual capital, which propels economic growth in addition to improving individual productivity. Romer (1990) extends this by emphasizing the development of new technologies and the acquisition of knowledge. He contends that knowledge, as opposed to physical capital, produces growing returns and hence maintains economic progress. Romer suggests that policies that support R&D can lead to technical breakthroughs that accelerate economic growth. For small and medium enterprises (SMEs), particularly in emerging markets, these theories underscore the critical role of access to finance. Financial resources enable SMEs to invest in new technologies and undertake significant workforce training, thereby enhancing their productivity and competitiveness. These investments are not just beneficial for individual firms but also catalyse broader economic growth by elevating the technological and skill base of the entire market.

This study is Anchored on endogenous growth theory, which provide a robust framework for understanding how access to finance enables SMEs to drive innovation, create jobs, and reduce poverty. By analysing recent poverty trends and SME financing challenges, the study offers actionable understanding of how financial institutions, policymakers, and development agencies can better support SMEs to maximize their poverty-reducing potential.

2.2 Empirical Literature Review

Bamidele, (2023) investigated the relationship between SME financing and poverty reduction in urban centres of Nigeria. Data were collected from 300 SMEs operating in Lagos, Abuja, and Port Harcourt. Using panel data analysis over a 15-year period (2007–2022), the study found that SMEs with better access to finance reported higher employment generation and income levels, resulting in a 19% reduction in poverty rates in urban areas. The study concluded that targeted financial policies tailored to urban SMEs can address poverty effectively. It recommended partnerships between private financial institutions and government agencies to design SME-specific funding programs. On the other hand, Bello and Can (2022) investigated how the Bank of Industry's MSMEs lending affected the poverty reduction in North-Central Nigeria. One hundred and thirty people were given questionnaires using a descriptive survey technique. The independent t-test and one-way ANOVA were used to evaluate the hypotheses at the 0.05 level of significance. It was shown that the region's efforts to reduce poverty are significantly impacted by the Bank of Industry's MSME financing. For this reason, it is recommended that the federal, state, and local governments use caution while allocating additional capital finance through the Bank of Industry to boost the MSME sector and reduce poverty, particularly in north-central Nigeria. Through MSMEs, more individuals in the area should be allowed to decrease poverty and create jobs, regardless of their level of education. In addition, banks should be encouraged to support the expansion of MSMEs by reducing loan interest.

Nwachukwu and Amadi, (2022) assessed the effectiveness of government policies on SME financing in reducing poverty across Nigeria. Data were drawn from 220 SMEs and various policy documents. Using a qualitative approach supplemented by thematic analysis, the study revealed gaps in the implementation of SME financing policies, leading to suboptimal poverty alleviation outcomes. Despite these gaps, SMEs supported through government grants and soft loans reported a 25% improvement in household welfare. The authors concluded that while SME financing policies are critical, their impact is limited by poor implementation. Recommendations included better policy enforcement, increased funding, and regular policy reviews to address emerging challenges. Ademola and Yusuf, (2022) evaluated the impact of SME financing on poverty alleviation in the northern region of Nigeria. Data were collected from 200 SMEs in Kano, Kaduna, and Bauchi states. Descriptive statistics and multiple regression analysis showed that increased financial support for SMEs led to a 28% increase in income levels and job creation in the region. The study concluded that targeted financial interventions can significantly mitigate poverty in economically disadvantaged areas. It recommended establishing specialized SME funding schemes in northern Nigeria to address regional disparities. The study by Adegbite and Agboola, (2021) on the impact of small and medium enterprises (SMEs) financing on poverty reduction across five geopolitical zones in Nigeria was analysed using primary data. The result revealed a significant positive relationship between increased SME financing and reductions in poverty levels, with financing accounting for a 27% decrease in the poverty index within communities where SMEs thrived. The authors concluded that improving access to finance for SMEs enhances job creation, economic stability, and income redistribution, thereby reducing poverty. They recommended that the government intensify microfinance programs and provide SMEs with affordable credit facilities.

Usman and Aliyu, (2021) explored the relationship between SME development and poverty reduction using secondary data from 350 SMEs from 2001 to 2021. Using fixed-effects regression model, the result revealed that increased SME activity contributed to a 31% decline in poverty headcount ratios over two decades. The authors concluded that fostering SME development through financial and technical support is critical for poverty reduction. They recommended improving access to credit for SMEs and strengthening regulatory frameworks.

Eze and Nwankwo (2020) explored the role of SME financing in alleviating rural poverty in southeastern Nigeria. A mixed-methods approach was adopted, with data collected from 120 SMEs and 50 rural households. The researchers used structural equation modelling (SEM) for data analysis. Findings indicated that SME financing contributed significantly to poverty reduction, with a 32% increase in household incomes and employment opportunities within rural areas. The study concluded that SMEs are vital to rural economic development and emphasized the need for government interventions in facilitating soft loans and grants for SMEs in rural regions.

Olawale and Okeke, (2019) examined the impact of microfinance institutions on SME financing and poverty alleviation in southwestern Nigeria. The study used primary data from 150 SMEs and secondary data from Central Bank of Nigeria (CBN) reports. Logit regression analysis revealed that access to credit from microfinance institutions significantly increased SMEs' capacity to expand, leading to a 23% improvement in household welfare. The study concluded that microfinance is a key driver of poverty reduction in Nigeria. Recommendations include enhancing microfinance institutions' capacity to offer low-interest loans and technical training to SME operators. Sokoto and Abdullahi (2013) investigated how empowering SMEs can reduce poverty in northwest Nigeria. A survey of 400 SMEs in the states of Zamfara and Sokoto was used to gather primary data. Additionally, secondary data was gathered from publications of the National Bureau of Statistics (NBS) and the Nigerian Stock Exchange (NSE) to examine the performance of listed companies. Comparisons between the two sets of businesses were made within and between sectors concerning employment creation and the use of domestic technology. T-test analysis was used for the data that was collected. The major findings indicate that large businesses make a greater contribution to employment creation than SMEs. This goes against the presumption that SMEs create jobs and employ more domestic technology than huge multinationals. Thus, this study recommends a pragmatic approach by government to reduce poverty through the strengthening of SMEs.

3. Methodology

The study adopted the ex-post facto research design in interpreting the data relevant to the study. The ex-post facto design is used because the independent and dependent variables used for analysis involve data that already exists. The data were sourced specifically from the Central Bank of Nigeria Statistical Bulletin and the World Bank.

3.1 Model Specification

The model for this study is structured after the work of Bello and Can, (2022) with some modifications following the use of poverty headcount and other indicators of SME financing as follows:

$$POVT = f(LRATE, SMEF, CPR) \qquad (3.1)$$

Where: POVT = poverty headcount, LRATE = lending rate, SMEF = credit to SME and CPR = ratio of the private sector credit to GDP

The error correction model (ECM) is specified as follows:

$$\Delta POVT_t = \boldsymbol{\beta_0} + \sum_{i=1}^{k} \alpha_1 \Delta POVT_{t-1} + \sum_{i=1}^{k} \alpha_2 \Delta LRATE_{t-1} + \sum_{i=1}^{k} \alpha_3 \Delta SMEF_{t-1} + \sum_{i=1}^{k} \alpha_4 \Delta CPR_{t-1} + \pi Ect_{t-1} \quad \text{Ut} \qquad (3.2)$$

Where:.β_0 = Constant parameter, α1 – α4 = short-run coefficients. and μ = error term, Δ = first difference notation, π = error correction coefficient, Ect = error correction term, k = notation for optimal lag order.

3.4 Data Analysis Techniques

The least squares method was applied to estimate the ECM. Following the general-to-specific approach to model estimation, the parsimonious ECM was estimated to capture the dynamic effects of the regressors on poverty headcount. The estimation of the parsimonious ECM was enabled following the evidence of non-stationary cointegrated variables. The augmented Dickey-Fuller test was also applied to test for unit root in each series. This follows the recognition of the fact that time series tend to be nonstationary. In addition to the unit root test, this study subjected the variables to a cointegration test using the Johansen method. The choice of the Johansen method was justified because the variables are all integrated into order one, I(1). This study further applied descriptive statistics to analyse the distribution of each of the variables over the period under consideration.

4.0 Results and Discussions

4.1 Unit Root Test

The summary of the ADF unit root test result for each of the variables is presented in Table 4.1.

Table 4.1: ADF Unit Root Test

Variable	ADF Stat. at levels	5% significance level	5% significance level	5% significance level	Order of Integration
POVR	-2.380251	-2.971853	-9.673288	-2.967767	1(1)
LRATE	-2.157837	-2.963972	-8.416808	-2.967767	1(1)
SMEF	-1.978029	-2.963972	-6.633244	-2.967767	1(1)
CPR	-0.93219	-2.963972	-4.165287	-2.967767	1(1)

Sources: E-views 12 Output (2024)

The result in Table 4.1 shows that all the variables are nonstationary, given that their ADF statistic at levels are less than the corresponding critical value at a 5% significance level. Thus, the null hypothesis of the unit root cannot be rejected. Thus, the variables were subjected to the first difference test and they were found to be stationary at first difference. This finding indicates that the variables are integrated of order one, I(1). The evidence of the first difference necessitates the conduct of the cointegration test using the Johansen method.

4.2 Cointegration Test

Following the evidence of nonstationary and cointegrated series, the Johansen multivariate approach to cointegration was utilised in this study. The results are presented in Table 4.2.

Table 4.2: Johansen cointegration test results

Series: POVR SMEF CPR LRATE				
Hypothesized		Trace	0.05	
No. of CE(s)	Eigenvalue	Statistic	Critical Value	Prob.**
None *	0.765904	83.01394	47.85613	0.0000
At most 1 *	0.658288	40.90527	29.79707	0.0018
At most 2	0.283511	9.765473	15.49471	0.2992
At most 3	0.003342	0.097078	3.841466	0.7554
Hypothesized		Max-Eigen	0.05	
No. of CE(s)	Eigenvalue	Statistic	Critical Value	Prob.**
None *	0.765904	42.10867	27.58434	0.0004
At most 1 *	0.658288	31.13980	21.13162	0.0014
At most 2	0.283511	9.668395	14.26460	0.2346
At most 3	0.003342	0.097078	3.841466	0.7554

Note: * denotes rejection of the hypothesis at the 0.05 level

Sources: E-views 12 Output (2024)

As observed from Table 4.2, two cointegrating equations exist in the model from the trace test results. There is also evidence of two cointegrating equations from the maximum eigenvalue test results. These findings prompted the rejection of the null hypothesis of no cointegration among the variables. This indicates that poverty headcount has a long-term relationship with the regressors including credit to SMEs, lending rate and credit to the private sector. The evidence of cointegration among the variables is consistent with the findings of Abisuga-Oyekunle, Patra and Muchie (2020), Ogundele, Jacob and Awodiran (2022) and Manzoor *et al.* (2019) who reported that poverty rate has a long-term relationship with SMEs financing.

4.3 Model Estimation

The general-to-specific approach was followed to estimate the ECM using the least squares method. The parsimonious ECM results are presented in Table 4.3.

Table 4.3: Summary of parsimonious ECM results

Dependent Variable: D(POVR)				
Method: Least Squares				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	1.350053	0.675754	1.997845	0.0603
D(POVR(-1)	0.455091	0.186700	2.437544	0.0248
D(SMEF)	-0.081180	0.032982	-2.461332	0.0236
D(CPR)	-0.489610	0.283407	-1.727585	0.1003
D(CPR(-1))	-0.471542	0.296163	-1.592170	0.1278
D(LRATE)	1.959744	0.451096	4.344409	0.0003
D(LRATE(-1))	-0.361058	0.226464	-1.594329	0.1274
ECT(-1)	-0.599484	0.184551	-3.248330	0.0042
R-squared	0.838293	Mean dependent var		0.250000
Adjusted R-squared	0.770206	S.D. dependent var		6.876144
S.E. of regression	3.296209	Akaike info criterion		5.478515
Sum squared resid	206.4349	Schwarz criterion		5.906723
Log likelihood	-67.69921	Hannan-Quinn criter.		5.609423
F-statistic	12.31204	Durbin-Watson stat		2.089722
Prob(F-statistic)	0.000005			

Sources: E-views 12 Output (2024)

The results showed that the first lag of the poverty rate has a positive effect on the current level of poverty. This suggests that poverty in the current period can be predicted based on the previous level of poverty. Evidence of a negative effect of credit to SMEs on poverty headcount was established from the results. This finding is significant at the 5% level, indicating that SME financing is critical for poverty reduction in Nigeria. This finding supports the previous results by Green, Kirkpatrick and Murinde (2006) and Abisuga-Oyekunle, Patra and Muchie (2020) which showed the availability of funds to SMEs provides a pathway for poverty reduction in Nigeria. It implies that SME financing is an important channel through which financial deepening mitigates the incidence of poverty in Nigeria. Similarly, the results showed that the credit to the private sector affected poverty headcount negatively. This implies that an increase in the ratio of the private sector to the GDP provides an opportunity for poverty reduction. This finding corroborates the results of Ali and Sajid (2020) who reported that financial deepening and inclusion are imperative for reducing the incidence of poverty. Thus, it followed from the results that Nigeria can leverage its financial depth through increased fund availability to SMEs to foster poverty reduction in the country.

The results also showed that the current value of the lending rate has a positive and significant effect on poverty headcount while the first lag of the lending rate negatively affected poverty headcount. The significant positive effect of lending on poverty headcount indicates that an increase in interest rate increased the relative rate of poverty in Nigeria. This finding conforms to the theoretical expectation and previous finding by Ogundele, Jacob, and Awodiran (2022) which highlighted that high interest increases the incidence of poverty. The error correction coefficient (-0.5994) shows that reversion to long-run equilibrium is achieved at the speed of 59.94%. This finding shows that it would take a relatively short period for the convergence to be completed. It further authenticates the evidence of long-run relationships among the variables. With an adjusted R-squared of 0.7702, the regressors jointly explained about 77.02% of the total variations in poverty headcount. This finding is impressive as it highlights the goodness of fit of the estimated model.

Table 4.4: Post-estimation test results

Test Type	Null Hypothesis	Test Statistic	Prob. value	Decision
Breusch-Godfrey Serial Correlation LM Test	H_0: Serial independence	1.2878	0.5252	Accept H_0
White heteroskedasticity test	H_0: Homoscedasticity	5.512	0.7017	Accept H_0
Normality test	H_0: Normal distribution of residuals	0.359	0.8362	Accept H_0

Source: E-views 12 output (2024)

Results of the post-estimation test shows the absence of serial correlation. This is because the probability value (0.5252) of the Chi-square statistic of the Breusch-Godfrey Serial Correlation LM Test is greater than the significance level of 5% (0.05). The White heteroscedasticity test also provided significant evidence to reject the null hypothesis of no heteroscedasticity based on the fact the probability value (0.7017) of the test statistic is greater than the significance level of 5% (0.05). Again, the results showed evidence of normal distribution of the residuals in the estimated model is associated with a high probability value (0.8362) which is greater than 0.05. These findings provide the basis for the reliability of the estimated ARDL model.

5. Conclusions and Recommendations

This study provides some insights into the development implications of SME financing with the Nigerian case focusing on poverty reduction. This followed the growing recognition of the role of SMEs in developing countries including Nigeria. The findings show that bank credit to SMEs significantly reduced poverty during the study period. This finding highlights the critical role played by SME financial in promoting economic development in Nigeria. The results also showed that credit to the private sector affected poverty headcount negatively. This finding indicates that the availability of credit to the private sector is essential in mitigating the incidence of poverty among the Nigerian population. On the contrary, the results showed that interest rates contributed positively to poverty incidence. This finding could be attributed to the continuous increase in interest rates which limits investments in critical sectors of the economy that has the potential for poverty reduction. Given the findings, this study concludes that SME financial provides a sustainable road map for poverty reduction in Nigeria.

Based on the findings, the following recommendations were made.

i. Policymakers should develop targeted financial policies that facilitate affordable credit access for SMEs. This could include expanding microfinance institutions, offering government-backed credit guarantees, and reducing collateral requirements to ensure broader access for small and medium businesses.
ii. It is crucial for the Central Bank of Nigeria (CBN) and other financial regulatory bodies to maintain lending rates at levels conducive to SME growth. Subsidized loan programs or interest rate caps for SMEs can alleviate borrowing costs, encouraging investments that reduce poverty.
iii. The financial sector should prioritize extending credit to productive sectors, including SMEs. This requires financial literacy programs to help SMEs access available funds to focus more on developmental sectors that can generate employment and income growth.

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