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Impact of Credit Accessibility of Small Businesses Profitability

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Abstract:

This study examined the impact of credit accessibility on profitability of small businesses. The impact of Legal formation, Age of firm, Industry and Reputation are assessed on the profitability of small businesses. This was with the view of examining the effect of credit accessibility on profitability among small businesses in Osun East Senatorial District (Ife/Ijesa). To achieve this, the study relied on primary data which was collected through structured questionnaire administered to 600 small businesses owners in Osun East Senatorial District (Ife/Ijesa) but only 580 were retrieved. The data was analyzed in accordance with the research objectives and hypotheses. In the course of the study it was found that majority of small businesses find it difficult to seek for credit facility from formal financial institutions only to resort to informal source of finance that attract high cost of interest and unsuitable lending policies that rob the profit of these just coming up businesses. The study concludes that Government of Nigeria are advised to look into financial distress of small businesses and enact policies that will ensure that this targeted business have access to short and medium terms credit and soft lending policies to encourage them to fulfill their objective of economic growth and industrialization through the Central Bank of Nigeria.

Keywords: Credit, credit accessibility, small business, profitability

1. Introduction

Small businesses are globally recognized as the oil required lubricating the engine of socio-economic transformation of any nation. The Small and Medium Enterprises Development Agency of Nigeria (SMEDAN) was established in 2003, to improve the promotion and development of a structured and efficient Micro, Small, and Medium Enterprises (MSMEs) sector that enhance sustainable economic development in Nigeria. Accessing credit financing has been identified as one of the numerous and essential tools for small to succeed in their drive to build productive capacity, compete and contribute to poverty alleviation in developing nations and without finance, this group of businesses may not have capacity to grow to compete in the global market and absorb new technology (Steijvers, 2008, Alexander & Hall, 2003) Collateral, interest rate, extra-bank charges, inability to evaluate financial proposals and lack of financial management skill also impends growth of small businesses (Stiglitz & Weiss 1981). Small businesses must overcome the financing hurdle in order to start up and stay in business and these, can be overcome with access to external capital (Otieno et al, 2011). Informal source of credit with high interest rates constitutes very substantial contribution to business startups in developing countries. Commercial banks and micro finance institutions, cooperative societies are the most significant source of external financing to small businesses, credit lending institutions consider the quality of management among other factors in deciding whether to grant lending or not. Entrepreneurs that have bright business ideas may end up not utilizing them as a result of capital and other shy away from approaching lending institutions for credit facility for fear of consequence that may arise as a result of business failure which may not guaranteed payment of such facility.

Small businesses can access credit from financing institutions or from other sources. Most small businesses in Nigeria die within their first five years of establishment, a small percentage go into extinction between the sixth and tenth year, while only about five to ten percent survive, thrive and grow to maturity (Adesunkanmi 2014). Lending policies have been identified as one of the limiting factors that somehow determines access to financial credit facilities. Where credit duration, terms of payment, required security and other packages do not fit the needs of the target group, the borrow will need not apply for credit even where it exists and when they are not denied access. Financing is an important element of a profitable venture irrespective of its size or sector where it operates. Financing makes sure that firms are liquid enough to meet their working capital and take advantage of new investment opportunities. In Nigeria, effort has been made by the government in the past to address the small businesses funding issues. A number of schemes have been put in place to address these issues. For instance, the CBN had approved the investment of the sum of ₦500 billion stocks issued by Bank of Industry (BOI), part of which is for the refinancing /restructuring of banks' existing loan portfolio to small businesses.

Also, federal government has put in place a number of interventionist policies, designs to make it easy for small businesses in Nigeria to obtain business finance in the form of grants and small interest loans. These includes the You Win Programme, the SMEDAN loan project and the YES Programme of the Nigerian Bank of Industries and also Small and Medium Enterprise Equity Investment Scheme (SMEEIS), which was initiated by the Bankers Committee of Nigeria made

compulsory for all banks to set aside 10% of their Profit After Tax (PAT) for equity investment and promotion of SMEs with a view to alleviating the burden of interest payment. However, the scheme was largely unsuccessful as a result of the low participation of banks (Garikai 2011)

However, credit financing increases capital base of a business (Adesunkanmi 2017). Small businesses can access financing either by traditional approach, that is, borrowing from friends, personal savings or formalized approach by borrowing from lending institutions (Adesunkanmi 2016). Access to credit financing attracts those who are restrained by lack of capital thus the process of economic development set in (Goldsmith, 1969). This tends to increase the capacity of enterprise to take advantage of investment opportunities in the firm's operating environment.

In order to reduce financial risk and moral hazard associated with lending, the financial institution use collateral or guarantors as one of measures and assurance to the bank or cooperative societies in case of default and also ensures borrowers commitment to servicing of their loans. Statistically, small businesses are reported to have high failure rates making it difficult for lenders assess accurately the viability of their enterprises, the ability of the entrepreneur and the likelihood of repayment. In addition to this, the associated risks involved in lending to small businesses make it unattractive to the banks to deal with this group (World Bank, 1994).

2. Research Problem

The impact of credit accessibility on profitability is not clear and has been crucial discussion among finance scholars from different schools of thought. From economic perspectives, some argued that accessing credit facilities improves profitability while some are of the opinion that credit financing ought to be welfare enhancing and not always output-driven or improve small businesses profitability.

Contrary to economic view of credit financing (Karlan & Morduch, 2009) the cost of financing off set the benefits from taken such financial decision. The government of Nigeria has switch to actions through different schemes such as reduction in cost of registering SMEs (FGN, 2018), the CBN had approved the investment of the sum of ₦500 billion stocks issued by Bank of Industry (BOI), part of which is for the refinancing /restructuring of banks' existing loan portfolio to SMEs, You Win Programme, the SMEDAN loan project and the YES Programme of the Nigerian Bank of Industries and also Small and Medium Enterprise Equity Investment Scheme (SMEEIS) among other scheme.

Most SMEs in Nigeria die within their first five years of establishment, a small percentage go into extinction between the sixth and tenth year, while only about five to ten percent survive, thrive and grow to maturity. The purpose of this study is therefore centered on examining the impact of credit financing on profitability of small businesses in Osun East senatorial district. It is targeted to bridge the gap that occurs on accessing credit financing and its effects on the profitability of small businesses.

3. Review of Literature

Adverse selection has been found to be a key hindrance to small businesses access to credit accessibility. Adverse selection occurs because lenders assess borrowers' capability to repay their loans since lenders expected returns depend on the probability of repayment. In an attempt to identify borrowers with high probability of repayment, lenders are likely to use interest rates that an individual is willing to pay as a screening device. Stiglitz and Weiss (1981) concluded from their study that interest rates charged by a credit lending institution are seen as having a dual role of sorting potential borrowers and affecting the actions of borrowers. Both effects are seen as a result of the imperfect information inherent in credit markets. Stiglitz and Weiss (1981) further propounded that high credit interest rates induce firms to undertake projects with higher payoffs. Since credit lending institutions are not able to control all actions of borrowers, they formulate borrowing policies to induce borrowers to take actions in the institutions' interest and to attract low risk borrowers.

Researchers have postulated that credit information sharing institutions have a positive effect on SME credit access. Jappelli and Marco (2002) in their study on Information sharing, lending and defaults, found that strong credit information sharing institutions are positively related to the size of the credit market and that credit information sharing between lenders is associated with increased and cheaper credit in transition countries in Eastern Europe. Further, they found that bank lending is higher and credit risk is lower in countries where lenders share information, regardless of the private or public nature of the information sharing mechanism. They also concluded that public intervention is more likely where private arrangements have not arisen spontaneously and creditor rights are poorly protected. This implies that establishment of credit referencing bureaus and sharing of credit information is likely to promote small businesses credit accessibility by addressing the adverse selection problem. Miller (2005) demonstrated how such financial institutions that shared credit information increased the quantity of small business loans in the United States and more importantly, served to expand credit to riskier and marginal borrowers. Miller (2005) posited that incomplete borrower information generates a possibility of loan default that eventually leads to credit rationing. Credit rationing refers to a situation where lenders limit the supply of additional credit to borrowers, even if the latter are willing to pay higher interest rates. The role of risk in allocation of credit therefore becomes important in credit markets. Lenders will want to minimize their risk exposure by advancing credit to borrowers who exhibit a low risk of default.

Garikai (2011) studying the growth of small and medium sized in developing nations identified constraints that hinder new business start-ups in Kenya. The study identifies the constraints to include limited access to credit finance, limited market opportunities, and lack of business enabling environment, market information and managerial skills. Other factors also identified as affecting enterprise growth are poor management skills, financial constraints, poor marketing

skills and limited laws to regulate SMEs. The study recommended that measures to enhance credit financing for SMEs to be put in place to ensure accelerated SMEs start-ups and growth.

Nkuah and Gaeten (2013) undertook a study on challenges and determinants in accessing bank credit by small businesses in Ghana. Their findings were that as part of the entrepreneurs' characteristics, male entrepreneurs were most favoured by financial institutions than their female counterparts in credit accessibility. However, general credit accessibility among both genders was very low. The study also revealed that entrepreneurs within the age category of 31 years to 40 years as well as 41 years to 50 years were considered worthier of credit than the other age groups.

Further, small businesses with view number of employees were considered for credit more than SMEs with more than seven employees. Most small businesses could not readily measure their monthly average returns from the business yet, financial institutions found them worthy of credit. The study further found that there was no significant relationship between the location of a business and access to credit. The study also showed that lack of collateral, inadequacy of managerial competence and lack of a clear repayment plan were some of the reasons for which most entrepreneurs could not access credits for their businesses. Nkuah and Gaeten (2013) concluded that some characteristics or attributes of a firm significantly enhanced their credit accessibility. Mwangi et al. (2013) carried out an evaluation of Financing and Development of small businesses in Mombasa, Kenya using descriptive research design. The study deduced that the performance of most SMEs was curtailed by poor economic conditions, high operating prices, high inflation rate and frequent increases in prices of basic commodities. SMEs cited loyal and reliable customer base as a reason for their survival. Age of an enterprise was found to dictate the level of borrowing from financial institutions.

Small businesses cited lack of information on finance to expand the businesses, taxation, unfriendly laws, lack of insurance, increased fuel prices and political instability as some of the reasons that inhibited their growth. Among those who were using credit facilities, 74 percent found the facility. The findings further revealed that two thirds of all respondents were willing to take extra credit in order to expand. Based on the findings, bank loans as sources of start-up capital contributed to only 6 percent of respondents as compared to 70 percent contributed by own savings.

4. Research Methodology

4.1. Research Design

This study adopted descriptive research design and the result of research is used to describe the features of the population being study as a whole.

4.2. Population

The targeted population of this study are the small/ micro businesses in Osun East senatorial district (Ife/Ijesa). The district has ten local government areas, four (4) in Ife and six (6) in Ijesa. Five local governments are covered for this study with two (2) and three (3) local government in Ife and Ijesa respectively. The local government are chosen because of large number of commercial centers and their high population been another considered factor.

4.3. Sample

A sample of 600 small businesses in total were sampled using the sector weights as determined by dividing Small business in each industry by the total Small business in Osun East. By applying simple random sampling, samples are taken across five local governments in the region, one hundred and twenty (120) Small business were taken in each chosen local government. The 120 are further stratified into three sectors which are the manufacturing, services and trading so that all the characteristics in these sectors are represented. The five local governments are chosen because of their high population and large concentration of commercial centers.

4.4. Data Collection

The researcher administered questionnaires to elicit needed information. Closed ended questions have the advantage of collecting quantitative data while open ended questions allow the respondents freedom and chance to provide in-depth response. A questionnaire is desirable because of low cost and adequacy of time for respondents to give responses. It is free of interviewer's biases and a large number of respondents were reached. The questionnaires have three sections. Section A sought to obtain background information of the small/micro business and section B drew data on their credit accessed. Total credit finance is the total sum of total accounts payable, current loans payable and long-term loans. Section C sought information on profitability.

4.5. Data Validity and Reliability

This study used the most common internal consistency measure known as Cronbach's alpha (α). The recommended value of 0.7 was used as a cut-off of reliabilities (Ngugi, 2013). To prevent bias and inaccuracy on profitability, the data was extracted from 30 small/micro business within Ife Central Local Government.

4.6. Data Analysis

Data collected was checked for completeness after which it was coded to enable the responses to be grouped into various categories for easy analysis. Statistical Package for Social Sciences (SPSS) software was used to apply multiple regression analysis in the analysis of primary data to establish a causal effect relating independent variable to the dependent variable. The data was presented in tables, charts and graphs.

4.7. Data Analytical Model

Multiple regression analysis was used to determine whether the independent variable (credit financing) impacts the dependent variable (Profitability). Small business profitability as measured by return on Assets (ROA) was regressed against the independent variables. The model and the moderating variables used were borrowed from the studies by Nkuah and Gaeten (2013) and Ngugi (2013). The moderating variables used were found in literature to be the main factors affecting Small business profitability other than credit financing.

$$Y = \beta_0 + \beta_1X_1 + \beta_2X_2 + \beta_3X_3 + \beta_4X_4 + \varepsilon$$

Ys = Small businesses profitability as measured by ROA computed from data obtained from small /micro business

β_0 = Constant (coefficient of intercept)

X1 = Small businesses annual credit access as a percentage of total assets

X2 = Small businesses industry, coded for analysis where 1 will be Manufacturing industry, 2 Trade and 3 Service industry

X3 = Age of the Small business in years

X4 = Legal Composition of small business, coded for analysis where 1 will be sole proprietorship,

1partnership and 3 limited company $\beta_0, \beta_1, \beta, \beta_3, \beta_4$ is the regression coefficient of four variables ε = Error term which will be assumed to be zero for this study

4.8. Test of Significant

Inferential statistics are techniques that allow us to test hypotheses and make estimations using sample data. Such techniques include analysis of variance (ANOVA) which the researcher used to test the significance of the overall model at 95% level of significance. According to Mugenda (2008), ANOVA is used because it makes use of the F -test which plays an important role in the analysis of variance. Coefficient of correlation (R) and coefficient of determination were also applied in making conclusions.

5. Presentation, Analysis and Interpretation of Data

5.1. Socio Demographic Characteristics

Table 1 shows the respondents' socio-demographic characteristics which consisted of 580 Small businesses, years in operation, position in the firm, legal formation, number of employees and education status of the respondents. The business sector distribution showed that 31.1% of the response firms are into Manufacturing, 44.8% and 24.1% were into Trading and Services respectively. The year in operation distribution showed that 20.7% of the respondents have been in operation for 2-4 years, 63.8% of the respondents have been in operation for 5-8 years, 15.5% of the respondents have been in operation for more than 10 years, This showed that most of the respondents' firms have been in operation for more than 5 years. They have the experience to give the necessary information needed.

The Position in the firm distribution showed that 89.7% of the respondents were Owners, while 10.3% were Partners. This showed that most of the respondents are aware of credit accessibility of the firm. 89.7% of the respondents' firms were Sole proprietorship, while 10.3% were into partnership. The table further shows that majority of the businesses employed between 1-2 staffs with 77.6% and 22.4% have 3-4 staffs. In addition, majority 55.2% had secondary education, while tertiary and pry was 34.5% and 10.3% respectively. This shows the larger percentage of the respondents have formal education.

Parameters	Classification	Frequency	Percentage
Business sector	Manufacturing	18	31.1
	Trade	26	44.8
	Services	14	24.1
	Total	58	100.0
Years in business operation	2-4yrs	12	20.7
	5-8yrs	37	63.8
	>10yrs	9	15.5
	Total	58	100.0
Position in the firm	Owner	52	89.7
	Partner	6	10.3
	Total	58	100.0
Legal formation	sole proprietor	52	89.7
	Partnership	6	10.3
	Total	58	100.0
Number of employees	<1-2	45	77.6
	3-4	13	22.4
	Total	58	100.0
Educational status	Primary	6	10.3
	Secondary	32	55.2
	Tertiary	20	34.5
	Total	58	100.0

Table 1: Socio Demographic Characteristics

Source: Field Survey, 2019

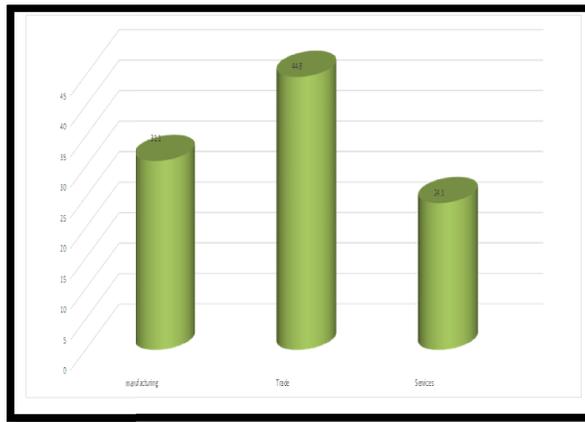


Figure 1: Respondents by Business Sector
Source: Field Survey, 2019

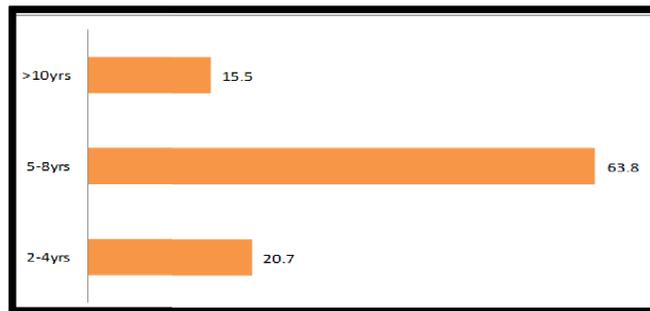


Figure 2: Respondents by Years in Business Operation
Source: Field Survey, 2019

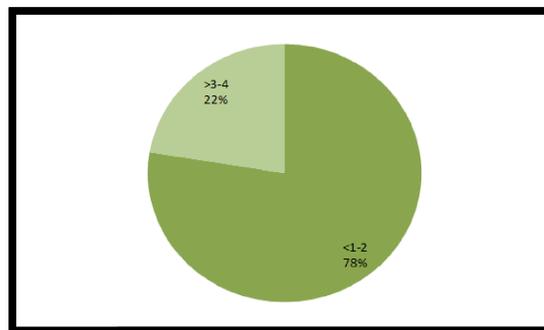


Figure 3: Respondents by Number of Employees
Source: Field Survey, 2019

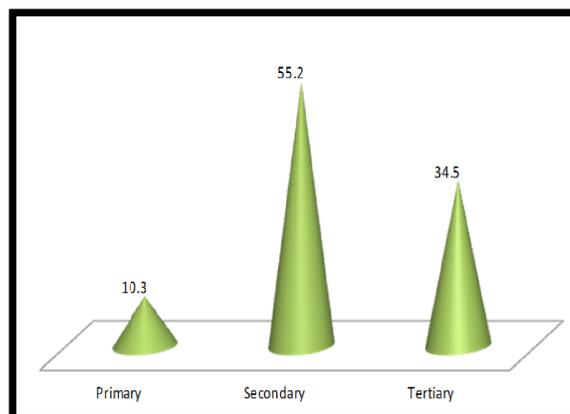


Figure 4: Distribution of Respondents by Educational Status
Source: Field Survey, 2019

6. Distribution of Respondents by Factors Affecting Profitability of Small Businesses

Table 2 shows the distribution of respondent on factors affecting profitability of small businesses. In analyzing the distribution of respondents on the impact of firm's legality on the profitability of small businesses, it was confirmed that 89.7% of the respondents Strongly agreed that Firm's legality has impact on the profitability of small businesses and a total of 10.3% of the respondents Agreed that firm's legality have impact on the profitability of small businesses, 0% of these respondents Disagreed that firm's legality affects the profitability of small businesses. It means 100% of the respondents agreed that firm's legality affects profitability of small businesses. This is confirmed with a mean value of 3.9 and by standard deviation of 0.31.

In analyzing the distribution of respondents on the impact of firm's Age on the profitability of small businesses, it was confirmed that 77.6% of the respondents strongly agreed that the Age of businesses affects its profitability, 22.4 % of the respondents agreed that Age of the firms affect it profitability. This means that a total of the 100% of the respondents indicated that Age of the firm has impact on profitability of small businesses with a mean value of 3.22 and standard deviation of 0.42,

In analyzing the distribution of respondents on the impact of firm's industry on the profitability of small businesses, it was confirmed that 44.8 % of the respondents Strongly Agreed that firm's industry affects profitability of the businesses, 32.7% of respondents Agreed that firm's industry affects its profitability and a total of 22.4% of respondents Disagreed that firm's industry affects their profitability. It means that 77.5% of the respondents indicated that firm's industry has impact on the small business profitability with a mean value of 2.8 and confirmed by standard deviation of 0.58.

In assessing the impact of the firm's reputation on the profitability of the small businesses only 10.3% of the respondents disagreed that firm's reputation has impact on the profitability of the firm with a mean value of 3.1 and confirmed by standard deviation of 0.37. It could be confirmed that majority (91.8%) of respondents agreed that firm's Legality, Age, Industry and Reputation affect the profitability of small businesses.

Parameters	Strongly Agree	Agreed	Disagree	Strongly Disagree	Mean	Standard Deviation
Firm's legality(incorporation) affects its profitability	52(89.7)	6(10.3)	0 (0.0)	0 (0.0)	3.90	0.31
Firm's Age affects its profitability	45(77.6)	13(22.4)	0(0.0)	0(0.0)	3.22	0.42
Firm's industry affects profitability	26(44.8)	19(32.7)	13(22.4)	0(0.0)	2.80	0.58
Reputation of the firm's affect profitability	46(79.4)	6(10.3)	6(10.3)	0(0.0)	3.10	0.37

Table 2: Distribution of Respondents by Factors Affecting Profitability of Small Businesses
Field Survey, 2019

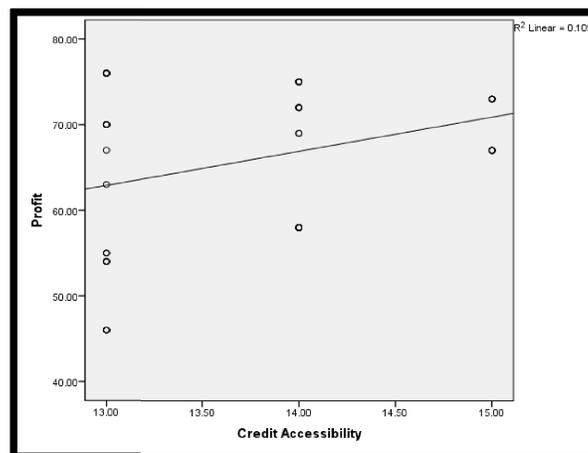


Figure 5: Regression of Profitability on Credit Accessibility
Field Survey, 2019

7. Hypothesis of the Research

- H_0 : credit accessibility does affects small business profitability
- H_1 : credit accessibility does not affect small business profitability

TABLE 3 shows the regression model analysis of credit Accessibility on Profit. From the table it can be inferred that the effect of credit accessibility on profit is significant with p-value of 0.011 and it contributed 10.9% to the effect of credit accessibility on Profit. Therefore, a null hypothesis H_0 should be accepted.

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate		
1	.330 ^a	.109	.093	8.91365		
ANOVA ^a						
	Model	Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	542.624	1	542.624	6.829	.011 ^b
	Residual	4449.376	56	79.453		
	Total	4992.000	57			
A Dependent Variable: Profit						
Coefficients ^a						
	Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	11.036	21.065		.524	.602
	Credit Accessibility	3.990	1.527	.330	2.613	.011

Table 3: Model Summary

8. Summary, Conclusion and Recommendation

8.1. Summary

This study examined the impact of credit accessibility on profitability of small businesses. In the course of carrying out this study, the impact of legal formation, age of firm, industry and credit reputation on the profitability of small businesses was taken into consideration. This was with the view of examining the effect of credit accessibility on small businesses profitability in Osun State. To achieve this, the study relied on primary data which was collected through the structured questionnaire administered to 600 employees of different small businesses in Osun State but only 580 were retrieved. The data was analyzed in accordance with the study objective and hypotheses.

The study assessed the reliability and validity of the measurement scales in accordance with accepted practices. For the reliability test, Cronbach's alpha was used and the results showed that the constructs for credit accessibility and profitability showed a high reliability of the measurement scales of the instruments.

Analysis on credit accessibility and profitability was carried out. The results showed that Age, Legal formation, Seize and Credit reputation of businesses have impact on credit accessibility of small businesses in Osun State

Using multiple linear regression analysis, the results showed credit accessibility has a significant effect on profitability. The overall model showed that credit accessibility does have significant impact on profitability of the small businesses.

8.2. Conclusion

The study concluded that credit accessibility does have significant impact on profitability of small businesses. Access to credit financing has been difficult for small businesses in Osun State.

8.3. Recommendation

Small businesses play an important role in any growing economy by contributing to economic growth and industrialization; therefore, it is very important that necessary measures should be put in place to support their development. Based on the findings of the study, the following recommendations are made:

- Financial institutions should consider establishing less stringent collateral requirements to make it easier for small businesses to access credit needed to support their operations.
- Small businesses should be watchful of their debt level and ensure that it did not rise to a stage where its cost will exceed the profit of the firm
- Government should create different incentives to enhance and support the growth and development of the targeted businesses.

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Appendix

Questionnaire

The purpose of this questionnaire is to collect data for purely academic uses. The study seeks the impact of credit accessibility on profitability of small business in Osun State. All information will be treated as confidential. Please do not put any form of identification on this questionnaire.

Section A: Background Information

1. What is your business sector?
Manufacturing Trade Services
2. How long has your business been in operation?
Less than 2 yrs 2-4 yrs 5-8 yrs 8-10 yrs More than 10 yrs
3. What position are you holding currently?
Owner Partner Line Manager Director
Other (specify).....
4. What is your business legal formation?

- Sole proprietorship [] Partnership [] Limited company []
5. Current number of employees
 Below 1 -2 [] 3-4 [] 5-6 [] 7 and above []
6. What is your education status? Primary [] Secondary [] Tertiary []

Profitability and Credit Accessibility

Parameters	Strongly Agreed	Agreed	Disagreed	Strongly Disagreed
Firm's legality(incorporation) have impact on profitability				
Firm's Age affect impact on profitability				
Firm's industry affects its profitability				
Firm's reputation has impact on profit				

Table 4: Please Tick Appropriate Options in the Information Provided Below

Thanks for your time.

Results of Reliability Test

Case Processing Summary			
Cases	Valid	58	100.0
	Excluded ^a	0	.0
	Total	58	100.0
a. Listwise deletion based on all variables in the procedure.			
Reliability Statistics			
Cronbach's Alpha		N of Items	
.957		7	

Table 5: Scale: Credit Financing

Reliability Statistics	
Cronbach's Alpha	N of Items
.857	5

Table 6: Scale: Access to Finance

Reliability Statistics	
Cronbach's Alpha	N of Items
.950	5

Table 7: Scale: Profitability