NON-INTEREST BANKING AND THE GROWTH OF MICRO, SMALL AND MEDIUM ENTERPRISES IN NIGERIA

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ABSTRACT

The current study investigates the influence of non-interest banking on the growth of micro and small enterprises (MSMEs) in Nigeria. Micro, small and medium business access to finance is critical to the promotion of sustainable economic growth and poverty reduction in many economies. The study adopted primary data. The research methods applied were questionnaire survey and observation to gather information from micro, small and medium entrepreneurs and non-interest bank managers. The methods were further supplemented with a semi-structured interview with MSME entrepreneurs and bank managers. The obtained data were analyzed by statistical methods. In association with the conducted researches it can be generally stated that the respondents agree with the statement that non-interest banking influence the growth of MSMEs in Nigeria. The study concluded that profit sharing should not only be seen as overriding motive in formulating credit strategy but based on enterprise development service with potential sustainable growth and survival.

Keywords: Nom-Interest Banking, Micro, Small and Medium Enterprises, Equity Participation, Profit Sharing and Growth

INTRODUCTION

Non-interest banking has recently sprouted as a unique service for small entrepreneurs and a solution to the start-up capital challenge of small enterprises worldwide. Carl (2015) opine that the need for micro, small and medium business growth in Nigeria is beyond question, but access to finance is one of the factors standing in the way of their growth. Non-interest financing, is important to individual especially small entrepreneurs. This is because it offers loans and financial assistance without collecting interest on these loans, thereby, facilitating entrepreneurship and improving business performance and growth. Ashamu (2014) added that access to finance is considered the most important factor hampering the performance of micro, small and medium enterprises (MSMEs) in Nigeria, faced with the incapability to secure bank loans from the conventional banking system. Etuk & Etuk (2014) posit that micro, small and medium enterprises have been forced to operate struggling for survival and eventually folding up. Bank credit is the most common source of external finance for micro, small and medium entrepreneurs who are often heavily reliant on debt to finance their start up, cash flow and investment needs.

According to Anifowose (2015) the micro, small and medium business sector has been stagnated and remains relatively small. The sector is far from meeting its targeted goal due to a number of constraints such as lack of access to credit which hinders growth in the performance of micro, small and medium enterprises, inability to access funds at favorable interest rates which could help improve their performance and deregulation of the Nigeria financial system since 1986 which resulted to high interest rates demanded by commercial banks creating liquidity crisis and increasing credit rationing in favour of only larger companies. Overtime they have credit risk which has resulted in the failure of micro and small enterprises in Nigeria. Aremu & Adeyemi (2011) agree that in the after math of the 2008-2009 global financial crises, bank credit constraints (fluctuation of interest rates) experienced by micro, small and medium enterprises in many countries including Nigeria. The constraints have further highlighted the vulnerability of the micro, small and medium business sector to changing conditions in bank lending.

According to Evbuomwan et al (2012) most micro, small and medium enterprises in Nigeria hardly use debt in financing their projects due to high interest rates charged by commercial banks this in the long run has reduced the performance and growth of MSMEs rendering them less competitive and eventually collapse. Lack of government support is another major constraint militating against the performance and growth of MSMEs in Nigeria. Nwesa & Oseni (2013) explain that several schemes have been set-up to assist in the financing of micro, small and medium enterprises but they haven't proved to be very useful. A good example is the small and medium industries equity investment scheme (SMIELS). The scheme requires all banks in Nigeria to set aside 10 percent of their profit before tax (PBT) for equity investment in micro, small and medium industries. Safiriyu & Njogo (2012) reveal most banks would prefer to pay the fee for not adhering to the scheme than to give out finances to MSMEs due to the risk involved as a result of micro, small and medium businesses not able to secure acceptable collateral and not being able to pay back loans. Also, micro finance banks were licensed to provide loans to small businesses. Ana (2008) supported that despite this, however, finance is still considered as one of the major constraints to micro, small and medium enterprises' development in Nigeria.

Nevertheless Non-interest banks, like conventional banks, are in the banking business to make profits not losses. Therefore, returns on investments influence their investment decisions. Their capitals also flow into those sectors which offer the highest profit-sharing ratios to investors, other things being equal. Due to their specialization in equity and short-term trade financing non-interest banks tend to have lower levels of solvency risk than their conventional counterparts. This is because their solvency is tied to the solvency of all the trading institutions they have business affiliations with. This implies that non-interest banks are also highly dependent on the stability of the economy. Being heavily dependent on trading activities, non-interest banks are bound to be easily affected by trade fluctuations and cycles. Hence, in an unstable economy, their solvency risk is likely to be comparatively high. The aim of the study is to establish the association between implemented non-interest banks' credit policies and the growth of micro, small and medium enterprises in Nigeria.

LITERATURE REVIEW

Theoretical Review

The Finance-growth theory and Pecking order model can be employed to justify the course in advancing the non-interest banking to achieve the growth of micro, small and medium enterprises. These theories are relevant to the financing of MSMEs. The finance-growth theory advocates that financial development creates a productive environment for growth through 'supply leading' or 'demand-following' effect. The theory also perceives the lack of access to finance as a critical factor responsible for persistent income inequality as well as slower growth. Therefore, access to safe, easy and affordable source of finance is recognized as a pre-condition for accelerating growth and reducing income disparities and poverty which creates equal opportunities, enables economically and socially excluded people to integrate better into the economy and actively contribute to development and protect themselves against economic shocks (Serrao, Sequeira & Hans, 2012). Pecking order theory on the other hand was developed by Myers (1984). The theory proposes that firms prefer to use internal sources of capital first and will resort to external sources only if internal sources are inadequate. Most small businesses start with internal financing before looking for external sources. Older firms have more opportunities to accumulate retained earnings and thus more funds are available to finance operational growth.

Holmes & Kent (1991) opine that small businesses experience constraints in respect of access to appropriate external sources of capital. Small businesses differ in their capital structure and thus rely on private capital markets, while larger firms are financed through public market. MSMEs reliance on private markets limits the types of financing that they can receive; most small businesses rely on commercial banks and finance companies to provide capital (Berger and Udell, 1998). In most cases, the cost of capital for small businesses is usually higher than it is for larger firms. The size of the loan and lack of information on the quality of operation of the small firms force lenders to protect their investment by demanding higher rates of return, which come in the form of high interest rate and high cost of capital for the small firm. In an attempt to avoid higher cost of capital, smaller firms are then forced to use more short-term debt, which carries lower costs but raises the firm's risk exposure (Chittenden et al., 1996). Hall et al (2000) supported that firm's size is positively related to long-term debt and negatively related to short-term debt.

Concept of Non-Interest Banking

Banking system is among the most imperative aspects of any developed and thriving economy and financial system. A functioning banking system helps to create a more successful and efficient society. Banks facilitate in the transfer of resources from those with excess to those who require extra resources to run their businesses (Ariyo, 2008). It is a known fact that banks like any other firms are in business to make money and banks major source of income or profit is the difference in interest rates at which they pay to their depositors and the rate at which they lend to companies and entrepreneurs. According to Mohammed, Bashir & Bashir (2014) under non-interest banking or Islamic banking jurisprudence, depositors' returns are managed not by a predetermined fixed interest rate, but by the size of the bank's return on its investments. Non-interest banks financing is a conversion of lending into asset based finance known as non-interest banks' modes of financing. The modes of financing can be narrowed down into three: debt-based financing, profit and loss sharing financing and leased-based financing. Ihua (2009) explain that when disbursing loans, the non-interest bank functions as an investment bank, whereby both the investor and the bank not only share the benefits of high returns on investments, but also share the losses. If return on investment is high, the bank will take a percentage of the investor's profits. This is impossible for conventional banks, which just receive the interest that they themselves fix at the time the loan was granted not minding whether the loan receivers made profit or loss. Al-Jarhi (2004) supported that Islamic banks, like conventional banks, offer the same set of banking services provided by conventional banks, although the operational modes differ in some areas however both are in the banking business to make profits not losses. Therefore, returns on investments influence their investment decisions. Their capitals also flow into those sectors which offer the highest profit-sharing ratios to investors, other things being equal. The difference is that Non-interest banks neither charge nor pay interest on deposits and loans.

Micro, small and medium Enterprise Growth Financing in Nigeria

Micro, small and medium businesses are very crucial to the development of any economy. In developed countries, small business account for over 60 per cent of industrial employment. Despite the contribution of small businesses to national development, small businesses are faced with series of challenges most importantly finance (Bello & Mohammed, 2015). Finance is vital for the sustainability and growth of micro, small and medium enterprises because it is the livelihood on which MSMEs thrive. Afolabi & Oni agree that accessibility to funds and cost of raising funds have remained the issues limiting the capitalization requirements and therefore, leading to premature death of the micro, small and medium enterprises. Bank lending is the most common source of external finance for MSMEs. However, conventional bank financing poses challenges to micro, small and medium businesses. Inegbenobor (2006) argue that MSMEs play vital roles in economic growth and development and have proven to be an important factor in job creation, mobilization of savings, diversification and transformation of local entrepreneurship.

According to Adoyi & Agbo (2009) micro, small and medium enterprises require considerable amount of funds at different stages of their existence to grow and expand adequately. These funds are sometimes obtained from personal savings, friends and families, financial institutions and other informal sources. These sources may involve some costs such as opportunity cost of investing in other ventures, open or overt cost such as interest rate. When funds are inadequate

MSMEs may find it difficult to survive and perform their role in an economy. Dada (2014) state that financial institutions, especially commercial banks, are unwilling to lend to MSMEs because they are considered as risky ventures due to their sole proprietorship nature, lack of proper accounting records, and possibility of diversion of loans to other uses. Government initiatives and policies for MSMEs are often time not well implemented and are mismanaged so that most micro, small and medium enterprises don't benefit therein.

Fajnzylber, Maloney & Rojas (2006) explain that with the significant development of financial liberalization and globalization MSMEs are faced with the question of how to finance their projects. Debt financing is the most advisable mode of financing, In Nigeria it is one of the most difficult way of financing a project as interest rate on loans and advances of conventional banks could be as high as 25 percent which is not favorable to small business, debt financing appears to be ill-suited for renewal, innovative, fast-growing companies with a higher risk-return. The financing constraints can be especially severe in the case of startups or small businesses that rely on intangibles in their business model, as these are highly firm specific and difficult to use as collateral in traditional debt relations (Obasan & Adedira, 2010). According to Duru & Lawal (2012) the development of an alternative method of debt financing relevant for the start-up, high-growth, high-performance development and innovation of small businesses in Nigeria brings the issue of non-interest banking (financing) as an option for helping in the financing of projects of MSMEs. Ayozie & Latinwo (2010) added that due to the non-interest collection policy of non-interest banking (financing) small businesses could achieve their goal of high business performance by experiencing positive growth and profitability increase.

Empirical Review

Theoretical discussion on the effects of non-interest banking on the growth of micro, small and medium enterprises has brought forth empirical expositions aimed at establishing an economic link and causal variables affecting both non-interest banking and the growth of micro and small enterprises. Many studies have investigated the effect of particular (functional) categories of non-interest banking for example Dada (2014) investigated the effect of commercial banks' credit on SMEs development in Nigeria and employing ordinary least squares (OLS) technique to estimate the multiple regression models. The finding reveals that commercial banks' credit to SMEs and the savings and time deposits of commercial banks exert a positive and significant influence on SMEs development proxy by wholesale and retail trade output as a component of GDP, while exchange rate and interest rate exhibit adversative effect on SMEs development.

Akingunola (2011) assessed the specific financing options available to SMEs in Nigeria and their contribution to economic growth performance. The Spearman's Rho correlation was employed to determine the relationship between SMEs financing and investment level. At 10 percent level of significance, the Rho value of 0.643 indicated a significant and positive relationship between SMEs financing and economic growth in Nigeria.

Safiriyu and Njogo (2012), examined the impact of small and medium scale enterprises on employment generation in Lagos State, Nigeria and employed primary data instruments, questionnaire and interview. The results of simple percentages and chi-Square (X2) tests conducted show that small and medium scale enterprises and sustainable development of Nigerian economy are positively related, just as promotion of SMEs and improvements in employment generation are positively related and significant. Availability of finance has been widely viewed as a constraint to the growth of SMEs.

Azende (2011), conducted an empirical evaluation of the performance of small and medium scale Enterprises, Equity Investment Scheme (SMEEIS) in Nigeria used Benue and Nassarawa states as sample studies. Using total credit to SMEs as a percentage of Banks' total credit for the period 1993 to 2008, the T-test conducted to determine the extent of relationship between bank loans before and after the introduction of SMEEIS indicated no significant difference between loans disbursed by banks to SMEs. This result, according to him, was due to the fact that the conditions for accessing SMEEIS funds were beyond the reach of the targeted SMEs.

Afolabi (2013) investigated the growth effect of SME financing in Nigeria, the study employed ordinary least squares (OLS) method to estimate multiple regression model. The resulst reveal that SMEs output proxy by wholesale and retail trade output as a component of GDP. Commercial banks' credit to SMEs and exchange rate of naira vis-à-vis U.S dollar exert positive influence on economic development proxy real GDP while lending rate is found to exert negative influence on economic growth. In term of partial significance and using

t-statistic as a test of evaluation, SMEs output and commercial banks' credit to SMEs were found to be significant factors enhancing economic growth in Nigeria at 5% critical level. Therefore, the study proffered that the central authority should provide an enabling environment for SME development.
Despite the numerous positive effect of bank credit on performance of small and medium enterprises, the fact remains that there is still scarcity of empirical investigation on non-interest banking and the growth of micro and small enterprises.

Drawing from the outcome of previous studies, the following hypotheses are presented for examination:

HO_1: Profit and loss sharing financing has no significant influence on the growth of micro, small and medium enterprises

HO_2: Debt-based financing has no significant influence on the growth of micro, small and medium enterprises

HO_3: Lease-based financing has no significant influence on the growth of micro, small and medium enterprises

METHODOLOGY

Survey method was adopted to collect data for analysis. The target population of this study was the licensed non-interest banks in Nigeria. The study made use of primary data. The primary data was obtained through a structured questionnaire and observation. The target respondents were bank managers and micro, small and medium entrepreneurs of selected Eti-Osa local government in Lagos State. These methods were further supplemented with a semi-structured interview with micro, small and medium entrepreneurs and bank managers of the selected non-interest banks. The bank managers responded to the section on the non-interest banking while the entrepreneurs responded to the section on the growth of micro, small and medium enterprises. Ninety five (95) out of one hundred and twenty (120) copies of the questionnaire were properly completed, returned and analyzed using regression analysis. Regression analysis was used to establish the nature and magnitude of the influence of non-interest banking on the growth of micro, small and medium enterprises. Descriptive statistics such as frequencies and percentages were computed for organizational data and multiple choice questions in order to describe the main characteristics of the variables of interest in the study. Mean scores were computed for a modified five point Likert type of questions. SPSS software was used for analysis. Data was presented in form of tables.

DATA ANALYSIS AND RESULTS

This study sought to establish the influence of non-interest banking on the growth of micro, small and medium enterprises. The tests were carried out using regression analysis at 5% significance level (a=0.005). To test the hypotheses, it was necessary to compute composite scores for variables that had several measures. In this regard, composite scores were calculated to represent the responses to the various attributes that defined non-interest banking. Similarly, composite scores were calculated to represent the responses to the various attributes that defined the growth of micro, small and medium enterprises which were used as input to the evaluation.

This hypothesis was tested by regressing non-interest banking on the growth of micro, small and medium enterprises guided by the equation:

$Y = b_o + b_1X$

Where: X = Non-interet banking (operationalized as profit and loss sharing financing, debt-based financing, and lease-based financing), and

Y = Growth of micro, small and medium enterprises.

The outline and the results from the evaluation were as presented below:

HO_1: Profit and loss sharing financing has no significant influence on the growth of micro, small and medium enterprises.

The regression results of the influence of profit and loss sharing financing on the growth of MSMEs was tested and the results were as presented in table 1.

Table 1: Profit and loss sharing financing and the growth of MSMEs

Variables	Coefficient	Std. Error	T-Stat	Prob.
Constant	2.261	0.588	3.843	0.000
Profit and loss sharing financing	0.232	0.113	2.060	0,009
R-Square	0.643			
Adjusted R^2	0.606			
S.E. Statistics	0.906			
F-Statistics	3.585			
Prob. F(Stat)	0.000			
DF	99			

Source: SPSS Output 2020

The results presented in table 1 show that the influence of profit and loss sharing financing on the growth of micro, small and medium enterprises was positive and significant ($R2=0.643$, $F=3.585$, $p< 0.05$). From the table, 64.3% of the variation in the growth of MSMEs was explained by variation in profit and loss sharing financing. It also suggested that profit and loss sharing financing accounted for 64.3% of the growth of MSMEs, (R square= 0. 643, $p<0.05$), ß was also statistically significant (ß 0.232, $t=3.843$, $p<0.05$). The probability value of the first hypothesis tested showed 0.000 which was less than 0.05 (p<0. 05).The p-value is statistically significant and therefore the null hypothesis that says there is no significant influence of profit and loss sharing financing on the growth of MSMEs is rejected. Overall regression results presented in table 1 indicate that profit and loss sharing financing has a positive significant influence on the growth of MSMEs. The hypothesis that says there is a significant influence of profit and loss sharing financing on the growth of MSMEs is therefore confirmed.

Ho2: Debt-based financing has no significant influence on the growth of micro, small and medium enterprises

The regression results of the influence of debt-based financing on the growth of MSMEs was tested and the results were as presented in table 2.

Table 2: Debt-based financing on the growth of MSMEs

Variables	Coefficient	Std.Error	T.Stat	Prob.
Constant	1.327	0.434	3.059	0.000
Debt-base financing	0.142	0.90	3.266	0,002
R-Square	0.540			
Adjusted R^2	0.423			
S.E. of Statistics	0,693			
F-Statistics	18.972			
Prob. F(Stat)	0.002			
DF	98			

Source: SPSS Output 2020

The results presented in table 2 show that the influence of debt-based financing on the growth of micro, small and medium enterprises was positive and significant ($R2=0.540$, $F=18.872$, $p< 0.05$). From the table, 54% of the variation in the growth of MSMEs was explained by variation in zero interest rate (R square=0.540, $p< 0.05$). b =0. 142. T=3.059, $p< 0.05$). Overall regression results presented in table 3 indicate that debt-based financing has significant effect on the growth of MSMEs. The hypothesis that debt-based financing has no significant influence on the growth of micro, small and medium enterprises is rejected and alternative hypothesis that debt –based financing influences the growth of MSMEs is confirmed

HO_3: Lease-based financing has no significant influence on the growth of micro, small and medium enterprises

The regression results of the influence of lease-based financing on the growth of MSMEs was tested and the results were as presented in table 3.

Table 3: Lease-based financing on the growth of MSMEs

Variables	Coefficient	Std.Error	T- Stat	Prob.
Constant	1.502	0.626	2.400	0.001
Lease-based financing	0.069	0.121	0.567	
R- Square	0.399			
Adjusted R^2	0.355			
S. E. OF Statistics	0.981			
F- Statistics	4.434			
Prob. F(Stat)	0.018			
DF	98			

Source: SPSS Output 2020

The results presented in table 3 indicate that the influence of leased-based financing on the growth of micro, small and medium enterprises was positive and significant (R2=0.399, F=4.434, $p<0.05$). From the table, 39.9% of the variation in the growth of MSMEs was explained by variation in lease-based financing. It also suggested that leased-based financing accounted for 39.9% of the growth of MSMEs, (R square=0. 399, $p<0.05$). Overall regression results presented in table 3 indicate that leased-based financing has a positive significant influence on the growth of MSMEs. The hypothesis that says there is significant influence of leased-based financing on the growth of MSMEs is therefore confirmed.

CONCLUSION AND RECOMMENDATIONS

The results of the study reveal that non-interest banking significantly influence the growth of micro, small and medium enterprises in Nigeria. The implication of this to a firm is that access to fund at different stages of firm existence is an essential condition for growth and contribution to economic development of a country. Non-interest bank mode of financing proves to be more suitable for small businesses due to the comparability of its principles to the achievement of maximum output from invested projects.

As the most difficult factor to every entrepreneur is the sourcing of capital. MSME owners should seek to increase their entrepreneurial skills by participating in trainings and workshops designed to train them in entrepreneurship, preparation of feasibility report and record keeping as this will enable them access loanable fund from financial institutions Small business owners should also admit other partners or merge with similar enterprises in order to ensure continuity in the business and to reduce decline of loan requests due to their sole proprietorship nature. Participatory financing is a unique feature of non-interest banking, and could be responsible for financing to socially and economically relevant development projects. The system should encourage risk-sharing, promote entrepreneurship, discourage speculative behaviour, and emphasize the sanctity of contractors. Non-interest banks should ensure that more funds are allocated to MSME sector of the economy. Government policy meant to regulate financial institutions in lending to MSMEs should be implemented and monitored. Policies such as interest rate regulation should be encouraged. Policy that might limit MSMEs growth and development such as taxes and tariffs should be relaxed to ensure that MSMEs expand and perform their role in the economy. Imported finished products that can serve as substitute for MSME products should be discouraged so as to encourage purchase of local goods and thereby strengthen micro, small and medium enterprises in the country.

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