

# **The Impact of Finance on Nigeria's Rural Entrepreneurial Development**

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## **ABSTRACT**

*The rural area is disadvantaged in terms of access to infrastructure and amenities and lack of productive resources. This makes entrepreneurial activities and productivity in the area to be low. This study is aimed at investigating the effect of finance on rural entrepreneurial development. Using time series data from 1981 to 2013, the study employs OLS method to assess the effect of finance on rural enterprises in Nigeria. Findings show that lending rate, loans and advances as well as banks' performance had positive and significant relationship with rural entrepreneurship. The study recommends the need to improve on economic climate in Nigeria; the importance of increasing the quality and quantity of loans and advances to the rural area and the need to put in place policies that will engender banks' performance.*

**Keywords:** *Entrepreneurship, Finance, Nigeria, Rural*

## **INTRODUCTION**

The Nigerian economy is predominately a rural setting. According to World Bank (2014), 2010 and 2013 57% and 54% of the population respectively live in the rural area. The existence of a subsistence rural economy and a modern urban economy reflects the dualistic nature of the Nigerian economy. This is a feature of many developing countries where there exists an economy that is predominantly traditional in outlook and engages in subsistence agriculture existing side by side with an economy that uses modern technology and engages commercial production. A greater percentage of the rural dwellers in Nigeria are engaged in subsistence agriculture using crude and traditional implements. This accounts for the low productivity in the sector and the high incidence of poverty in the rural areas than in the urban areas of Nigeria. According to NBS (2005), the national poverty incidence in 1980 was 28.1% while that for the urban and rural areas were 16.2% and 28.1% respectively. Over the years the incidence

of poverty has been on the increase as evidenced by data from NBS (2005). In 1985, the national poverty incidence increased to 46.3% while that for urban and rural areas were 37.8% and 51.4% respectively. In 2004, the national poverty incidence according to NBS (2005) had increased to 54.4% while it was 43.1% for the urban area and 63.8% for the rural area. These years clearly show that the rural areas of Nigeria had poverty incidence higher than the national level. The extents of poverty in rural areas are manifested in several ways. Such manifestations include poor access to safe drinking water, poor sanitary facility, inadequacy and poor access to infrastructural facilities, dependency on forests for livelihoods and domestic energy sources etc. (NEED, 2004).

In recognition that the growth, development and empowerment of these masses of the rural populace is moral as well as a human right, Nigeria government over the years have embarked on and implemented several strategies and policies to develop the rural areas. The concept of rural development in particular and development in general have evolved over the years necessitating different methods and approaches of achieving rural development. More recently, developmental efforts are geared towards integrating the poor into taking their fates in their own hands as the top-down approach has not yielded the desired benefits. The bottom-up approach requires that the rural dwellers are empowered to contribute to economic growth so as to be among the potential beneficiaries of economic growth.

One of such approaches to rural development is through expansion of banking and financial services in the rural areas. Theoretical and empirical evidence have shown a robust link between economic growth and the depth of financial intermediary given that equitable economic growth is necessary for sustained poverty reduction (Schumpeter, 1934; Goldsmith, 1969; King and Levine 1993a, 1993b; Stiglitz, 1998; Kirkpatrick, 2000). Financial intermediation is poorly developed in developing countries like Nigeria in terms of size and depth. Financial inclusion in Nigeria is very low and is worst at the rural areas. According to Stone (2010) in a study conducted on behalf of EFINA, 53% of adults in Nigeria are financially excluded while 40% of urban adults and 57% of rural adults are financially excluded.

There is also an indirect link between financial sector development and a general improvement in the average standard of living to the extent that financial sector development supports economic growth (Kirkpatrick, 2000). In the light of this, advancing credit and other financial services to poor people is seen as a way of improving and diversifying their income-earning capacity. This work is geared towards assessing the impact of finance on rural entrepreneurial development. To achieve the above objective, the study formulates the question: What is the impact of finance in enhancing rural entrepreneurship in Nigeria?

### **Concept of Rural Entrepreneurship**

Historically, according to EU (2004), rural regions tended to be areas that were geographically distant from population centres and densely industrialized zones: they were thus peripheral to the main thrust of economic activity. The main occupation of

these people, according to Todaro and Smith (2007), is subsistence agriculture and their basic concern is survival. In their quest for survival, their behaviour may seem untoward as their actions and inactions may appear incomprehensible to many observers. The rural area is characterized by high incidence of poverty, stagnated and depressed economy. The basic infrastructural facilities are not readily available and where they are, often are inadequate. The seat of government is almost always far from the people making them alienated from government policies. To elucidate the characteristics of rural areas, Nemes (2005) notes that there are disadvantages facing these rural dwellers when compared to the growing global market competition. These disadvantages are of two types: the first is the access-type disadvantage which is as a result of underdevelopment and/or uneven development of different infrastructures which limits access to communication, products, policy, finance, information etc. to and from the rural areas to the urban areas or seats of government. This limited access discourages investors from investing in the rural areas.

The second type is called resource-type disadvantage which is as a result of lack of resources or factors of production especially financial and human resources. The limited availability of resources or its total lack is as a result of economic and political dependency on urban centers which has persisted for a long time, unfavourable economic structure and/or geographical location and their limited access to goods, information and central resources. These disadvantages hinder the rural areas from producing quality goods and services that are saleable and can compete on the global market.

Thus, the rural areas are areas where the vicious circle of poverty is most pervasive and endemic because of low productivity, low income, low savings, low investment and low capital accumulation. In these areas, there is dearth of infrastructural facilities and where they are available are in poor conditions and inadequate. These areas are usually densely populated and majority of the population are illiterate. There is also high incidence of unemployment, underemployment and disguised unemployment.

But it is not always stories of woes for the rural areas. There are also opportunities and potentials existing in these areas. The rural areas have lots of untapped and under tapped resources such as the surplus labour, water resources, forestry, land etc. Opportunities and potentials also exist in the processing of agricultural produce and the development of simple tools and technology used in the agricultural and processing sectors. Recently, there has been paradigm shift in the desire of urban dwellers to shift to the country-side to enjoy certain amenities that are in abundance supply in the rural areas such as clean air, less noise and the reduction of the many pressures of life that exists in the urban areas. There has also been increased development in rural tourism which is a huge source of earning and wealth generation.

Smallbone, North and Kalantaridis (1999); Vaessen and Keeble (1995) have found proof of other potentials of the rural economy. They found that some small firms are better able to adapt in rural localities to overcome external environmental constraints. On the other hand, Dabson (2001) finds that the rural economy provides the

opportunities to products that promote traditions of quality and craftsmanship, connecting to nature and a sense of place and culture. With these challenges and opportunities facing the rural Nigeria in particular and the whole of Nigeria in general, the role that entrepreneurship could play in the development of the Nigerian economy is more than ever recognized. The meaning of entrepreneurship has evolved over the years but is generally conceptualized as the transformation process of innovative ideas into a new product, service, business or new business organizations, creating value as well as starting a new profit making enterprise (Bird, 1989). This transformative process is very important and critical economic development and growth. Entrepreneurship involves devotion of the necessary time and effort and the assumption of the attendant financial, psychological, and social risks, so as to receive some level of satisfaction (reward) be it pecuniary or non-pecuniary (Hisrich and Peters, 2002).

Churchill (1992) sees entrepreneurship as the process of seizing and exploiting an opportunity without regard to constraints and challenges such resources (human, financial, capital etc.) or location (rural, urban, developing country, developed country etc.) to create value in a new or existing organization (Churchill, 1992). Taking these concepts of entrepreneurship into consideration, an entrepreneur could be defined as a risk taker with very high skills and abilities that spearheads change and organizes production. An entrepreneur is usually self-employed through the establishment of micro, small and medium scale enterprises and it provides an avenue of self-satisfaction and actualization, wealth creation and providing employment for others.

It has been observed that the level of entrepreneurship differ within, between and among countries. Several factors have been identified as crucial in development of entrepreneurship and explain the differences observed. These determinants could be viewed from the demand or from the supply approaches; dynamic or static approaches or from exogenous or endogenous approaches. Blanchflower (2000) and Wennekers (2006) explain that this difference is related to variations in economic and non-economic factors. Economic factors include the level of economic development, level of per capita income etc. Non economic factors include demographics, culture and institutional features etc. No matter the type of categorization used, the direct impact of finance on entrepreneurship has been acknowledged both as a necessary institution and environment while the indirect impact could be seen from the impact of finance on the level of economic development and then, the impact of economic development on level of entrepreneurship. Theoretical and empirical evidence have shown a robust link between economic growth and the depth of financial intermediary (Schumpeter, 1934; Goldsmith, 1969; King and Levine 1993a, 1993b; Stiglitz, 1998; Kirkpatrick, 2000; Beck, Demirguc-Kunt and Levine, 2004).

According to Jhingan (2007), for entrepreneurship to thrive requires the creation of a climate for entrepreneurship. Creating an entrepreneurial climate requires the establishment of social institutions and the maturation and development of personalities whose dominant orientation is the direction of productivity, working and creative integration. The social institutions include political acts and policies guarantee protection

of property rights and maintain of law and order; establishment of financial institutions; monetary and fiscal policies that encourage entrepreneurship; establishment of research and training institutions and clear cut policies that encourage and reward entrepreneurship. A virile financial institution is sine qua non to promotion of entrepreneurship in particular and national development in general. It is the necessary intermediary between the deficit sector of the economy and the surplus sector of the economy. Financial intermediary supports the accumulation and development of entrepreneurship by mobilizing savings from firms and households which are necessary for investments; and ensuring that these savings are directed to their most productive uses. The financial institutions also support entrepreneurial development by spreading risk and providing liquidity to enable firms expand capacity and operate effectively.

The financial system also serves as a channel through which government implements its monetary policy. Other services that the financial system performs in the economy are advisory, insurance, transfer, leasing etc. For the rural economy, the importance of the financial system is even more burdensome. This is owing to the characteristics peculiar to the rural economy. Among the characteristics of the rural economy is that it is usually inhabited by the poor and the main occupation is usually subsistence agriculture. Infrastructural facilities are at worst not existence and at best inadequate and dilapidated. They are often vulnerable and face high risks in their everyday lives. These characteristics shape their needs and uses of financial services.

Rural households need credit for investing in agriculture and other agro-allied industries and to smoothen out seasonal fluctuations in earnings. Majority of rural households depend on credit for other consumption needs such as education, food, life-cycle expenditures etc. since cash flows and savings in rural areas are small. Rural households need access to financial institutions that can provide them with credit at lower rates and at reasonable terms than the traditional money lender and thereby help them avoid vicious debt-traps. Olawepo and Ariyo (2011) conducted a study aimed at finding the impact of community banking in rural transformation of Kogi State, Nigeria. The study reports that the banks fared well in areas of special loan scheme, rural customer size, direct rural investment and rural income generation. The major weakness of this study, however, is that it suffers from attribution bias and selection bias and had no control group.

Ojo (2009) uses primary data obtained through questionnaire to examine the impact of microfinance on entrepreneurial productivity and development in Nigeria. Using the method of simple regression analysis, he concludes that microfinance improves entrepreneurial productivity and activities. The conclusion of the study following the analysis of the result is invalid. Moreover, the author did not mention the coefficients of the variable, which will enable us to know the sign and magnitude of the variable. His usage of simple regression is also faulty. Somoye (2013) examines empirically the impact of finance on entrepreneurs in Nigeria, having concluded that the level of finance is weak. The author used the ratio of total loans approved for entrepreneurs and MSMEs from formal sources to credits to the private sector to represent

entrepreneurship growth while finance was represented by ratio of total money outside the banking system to money supply. He regressed the variable for entrepreneurship growth against finance and other variables. Using time series from 1980-2009 and cointegration method of estimation, he finds that finance had positive and significant impact on entrepreneurship in the long and short run. The weakness of the study is that it did not show the VECM table to enable the reader understand his point of argument. In 2013, Wang (2013) conducted a study aimed at accessing the impact of microfinance in the development of SMEs using survey data collected through questionnaires from SMEs in Taizhou, Zhejiang. OLS method of estimation was used to examine the determinants of SME development in terms of revenue growth and net profit growth.

The results of the regression show that the use of microfinance brings in statistically higher income to SMEs than those that did not while microfinance has negative impact on revenue growth. Due to this latter result, Tobit regression of dependent variables (weight of microfinance 2000(%)) and participation in microfinance in 2011) on independent variables (including revenue growth from 2010 to 2011; level of productivity in 2010 and retained earnings (%) in 2010) was performed to determine the probability of participation in microfinance. Result from this indicates that greater demand for microfinance may be due to lower level of productivity and retained earnings.

## METHOD

The impact of finance on rural entrepreneurial development was examined using both statistical and econometric tools. The statistical approach used correlation matrix to find the direction of relationship between indicators of finance and rural entrepreneurial development while the econometric approach used the Ordinary Least Square method. Thus the model for the study is specified as:

$$ENT = \alpha_0 + MAX\alpha_1 + LAA\alpha_2 + BI\alpha_3 + e$$

Where:  $\alpha_0$  is the constant;

$\alpha_{1-3}$  are the coefficients to be estimated and

$e$  is the serially uncorrelated error term.

The study period was between 1981 and 2013 based on availability of data. Data used were sourced from CBN statistical bulletin available online at CBN website. Since the rural economy is typically agrarian, thus rural entrepreneurship (ENT) was captured by percentage contribution of agriculture to GDP and financial services are captured by three variables: volume of commercial banks' loans and advances to the agricultural sector (LAA); maximum lending rate which is the cost of borrowing and captured the business climate in Nigeria (MAX) and bank investment which is one measure of banking performance (BI). It was expected that LAA and BI would have positive impact on ENT while MAX would have negative impact on ENT. Estimation of variables was conducted using E-View 6.0.

## RESULTS AND DISCUSSION

The correlation matrix shows that all the independent variables had positive correlation with ENT, with LAA and BI having very high correlation while MAX had low correlation with ENT. Unit root test was done prior to estimation to examine the characteristics of the time series. The importance of this is to determine the stationarity or otherwise of the series and the order of integration. If the variables are not stationary, the estimated model will yield misleading results and any inference drawn from it will be invalid. The unit root test was performed using Augmented Dickey-Fuller test and the results obtained are summarized on table 2. The table shows that none of the variables were stationary at level form but they became stationary at first difference. Thus they were integrated at order 1. The results show that a percentage increase in loans and advances to the agricultural sector significantly increases rural entrepreneurship by 48% which is in conformity with a priori expectation. Also as expected a percentage increase in banks' performance (BI) significantly increases rural entrepreneurial development by 15%.

Contrary to expectation, a percentage increase in maximum lending rate significantly increases rural entrepreneurship by 167%. The present study was aimed at investigating the impact of finance on rural entrepreneurship. Findings of the study implied that finance is a very critical resource needed for rural entrepreneurial development. This was evidenced by a high Adjusted R<sup>2</sup> of about 94%. The result shows that bank loans and advances (LAA) and banks' performance significantly improve rural entrepreneurship through their positive impact on the agricultural sector. The positive and significant sign of cost of borrowing and the general economic climate in Nigeria implies that improvement in the general economic climate and management of the Nigerian economy will go a long way to encourage rural entrepreneurship.

**Table 1:** Correlation Matrix

	ENT	MAX	LAA	BI
ENT	1.000			
MAX	0.3001	1.000		
LAA	0.9042	0.2059	1.000	
BI	0.9022	0.1567	0.7458	1.000

*Source:* authors' computation

**Table 2:** Augmented Dickey-Fuller Unit Root Test

Variable	Level	First Difference	Order of Integration
ENT	0.577	-4.814	I(1)
MAX	-2.979	-7.156	I(1)
LAA	0.346	-7.106	I(1)
BI	-2.166	-7.925	I(1)

Critical Value: 1% -4.273; 5% -3.558; 10% 3.212

Critical Value: 1% -4.285; 5% -3.563; 10% -3.215

*Source:* Authors' Computation

### OLS Result

Dependent Variable: ENT

Method: Least Squares

Date: 09/20/14 Time: 21:47

Sample: 1981 2013

Included observations: 33

Variable	Coefficient	Std. Error	t-Statistic	Prob.
LAA	0.478165	0.061766	7.741511	0.0000
MAX	1.669720	0.617733	2.702981	0.0114
BI	0.149889	0.018637	8.042590	0.0000
C	79.60269	13.24449	6.010248	0.0000
R-squared	0.947740	Mean dependent var	181.2485	
Adjusted R-squared	0.942334	S.D. dependent var	83.94024	
S.E. of regression	20.15723	Akaike info criterion	8.958216	
Sum squared resid	11783.11	Schwarz criterion	9.139611	
Log likelihood	-143.8106	Hannan-Quinn criter.	9.019250	
F-statistic	175.3059	Durbin-Watson stat	1.556699	
Prob (F-statistic)	0.000000			

**Source:** Authors' Computation

## CONCLUSION AND RECOMMENDATIONS

The research which was aimed at finding the impact of finance on rural entrepreneurship was conducted using OLS method. Findings show that lending rate had positive and significant relationship with rural entrepreneurship. This implies that further improvement in business climate has the potential of improving rural entrepreneurship. On the other hand, banks' performance and quantity of loans and advances had positive and significant relationship with rural entrepreneurship. This implies that consistent improvement in the performance of banks and increase quantity of loans and advances to the agricultural sector over time can enhance entrepreneurship. It was on the basis of these that the following are recommended:

- i. Banks should improve the quantity and quality of loans advanced to the agricultural sector in particular and rural sector in general
- ii. Favourable loan terms such as longer maturity period is important for the loans to have effect. This is because some enterprises take longer gestation period to mature.
- iii. The general business and investment environment should be improved to enhance entrepreneurship by provision of amenities such as roads, water, electricity, health care among others.
- iv. Policy formulation and implementation in the financial sector must be consistent in order to derive maximum benefits from it.
- v. It is necessary to increase the level of financial inclusion of rural areas in Nigeria's financial budget in order to enhance their expansion and development.
- vi. It is ideal to create products and services tailored at meeting the needs and demands of rural dwellers.
- vii. Policies that engender improvement in banks' performance should be pursued and encouraged.



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