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## **Formal Land Titling vs. Small and Medium Enterprises' (SMEs') Access to Credit: The South-Western Nigerian Experience**

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### Abstract

SMEs play vital roles in national economic development. However, lack of formal land title often times deprived them the right to use assets as collateral. The wealth entrenched in assets is thus not properly being deployed. Hence, this study expounded the impact of formal titling on access to credit from the viewpoints of entrepreneurs in the South-Western Nigeria. To achieve this, questionnaires were distributed to 200 randomly selected SMEs across the study area. Data gathered were analyzed using descriptive and inferential statistical analysis. Findings showed that the ratio of commercial banks' loans to SMEs compared to private sector is at lower ebb. There were significant differences in some of the factors influencing SMEs in case study areas. In addition, the study revealed collateral, firm staff strength, firm's age and annual financial statement as having significant effect and positive relationship on SMEs access to credit. The outcome of the study will assist stakeholders in SMEs, relevant government institutions and government to understand the significance of land titling in the provision of loan to SMEs. It would also contribute to relevant policy aimed at encouraging land titling among SMEs in order to further bridge SME financing gap due to collateral.

**Key Words:** Credit Access, Land, Formal Title, SMEs, South-Western Nigerian

### Introduction

Globally, there is no clear cut definition of SMEs and as such, there is no single, uniformly established meaning of small and medium sized enterprises. However, the World Bank (2005) described SME as an enterprise with fewer than 250 employees. The World Bank definitions of SMEs as espoused by International Finance Corporation (IFC) (2009), categorizes firms with between 11 and 50 employees and fixed assets of \$50,000 to \$250,000 as small and firms with between 51 and 200 employees and fixed assets of \$250,000 and \$500,000 as medium-sized. The Central Bank of Nigeria also described it as firms with asset base equal or less than N5 million, and a staff strength equal or less than 100 employees. Regardless of the variability in its definitions, its significance has been universally acknowledged. This include absorption of up to 80 percent of employees, enhancement of per capita income, increase in value addition to raw materials supply, improvement of export earnings and stepping up capacity utilization in key industries (National Micro, Small and Medium Enterprises Collaborative Survey, 2010). In addition, developing countries with greater share of SME employment have higher economic growth than their counterparts (Onugu, 2005).

Moreover, SME is also structured across key sectors, including agriculture, mining and quarrying, building and construction, manufacturing, solid minerals, amongst others, and so has strong linkages with the entire array of economic activities in the country. Therefore, the role of SME in the national and economic development of a country cannot be underrated. Then, to harness the potentials of the SMEs, government,

agencies and other relevant stakeholders needs to proactively develop sustainable intervention policies toward repositioning, creating efficient and viable SME sector in Nigeria. This is more imperative now than before, as the nation suffers severe economic downturn with its associated high rate unemployment. As part of the measure to cushion the excruciating effect of the economic recession, various economic proponents have at different times suggested that the country look inward to her SMEs.

However, in spite of the significant importance and contribution of SMEs to economic growth, there are extensive number of challenges and constraints confronting the sector across the globe, particularly in Nigeria. These include; lack of adequate collateral, difficult loan processes, high interest rates and other charges associated with normal bank lending. Others are limited access to mortgages, non-availability of comprehensive information on SMEs, banks' unwillingness to lend to SMEs, production technology, poor infrastructures (roads, electricity, energy, communication, manufacturing environment), difficult tax payment reports, fluctuating value of the Naira and lack of information from financial organizations. Of the various constraints facing Nigerian SMEs, access to finance as related to land title, is of particular interest to this study.

With the focus of this study in mind, access to finance has been described as the lifeblood of any enterprise, making it to grow, generate more output and employment (Beck, Demirgüç-Kunt & Maksimovic, 2008). Empirical findings by Phouphet (2010) confirmed that SMEs with financial constraints perform poorly compared with SMEs that do not have such constraints. Nevertheless, accessing fund through the formal source is often a very serious problem to SMEs. For instance, World Bank Development Report (2004) revealed that small firms had only 30 percent of their capitals from external sources, while large firms obtain 48 percent of their capital from external finance sources. The implication of this is that bulk of SMEs finance is through the informal sources which might not be adequate enough for effective administration and expansion.

Furthermore, Fafchamps (1996) avowed that stringent collateral requirements of formal financial organizations often rule out a large segment of SMEs. Though, lack of collateral hinders access to credit, when SMEs have assets that can be used as collateral, they are often constrained by several other factors which include bureaucratic problems by titling agency, poorly defined property, land use rights, weak land and property markets. Torero & Field (2005) noted that titling has a significant impact on access to formal credit and a positive, although smaller effect on informal credit. In view of this, this study considered that most of SMEs borrowers will be turned down if they do not have collateral to offer the lender as a guarantee for their loan and therefore be excluded from the credit market.

The principal objective of the study is to investigate land titling as a determining factor influencing small and medium enterprises' access to formal finance as a typical case of a developing country. Since the potential of SMEs in developing countries is constrained by their ability to access finance, this study will contribute to relevant policy aimed at encouraging land titling among SMEs in order to further bridge SME financing gap due to collateral by the government and its relevant agencies.

### **Materials and Methods**

The study was carried out in south-western Nigeria which comprises of Ekiti, Lagos, Ogun, Ondo, Osun and Oyo states. The area lies between longitude 2°31' and 6°00' East and Latitude 6°21' and 8° 37'N with a population of 33,173,581 (NPC, 2006) and a total land mass of 77,818 square kilometer (NPC, 1991). It's bordered in the North by Kwara and Kogi states, in the south by the Gulf of Guinea, in the West by the Republic of Benin and in the East by Edo and Delta states.

The study focus is however on SMEs in Lagos and Ondo states, southwest Nigeria. Lagos state is considered suitable because of the relatively high concentration of about eighty percent of the SMEs (Onugu, 2005) coupled with the fact that it is one of the major commercial nerve centre in Nigeria, while Ondo state was chosen so as to have a comparable of what may likely be obtainable in the other Nigerian, south-western states.

A quantitative survey was used in the study with the use of questionnaires in data collection. The survey targeted SMEs (manufacturing, wholesale and retail trade, hotel and restaurants, mining and quarrying, building and construction real estate, renting and business activity, health and social works, organized road transport, storage and communication, educational services, agriculture (corporate farms) with other community, social and personal service activities employing either below or a maximum number of 100 employees. A total number of 200 close-ended structured questionnaires were directed at 100 SMEs in each of the study area. The state capitals (though with slight exemption in Lagos) were purposely selected to represent a diverse cross-section of what is obtainable in each of the states, while the firms surveyed within each state were selected at random. The questionnaire was aimed at gathering data on SME characteristics, whether the firm had recently obtained a loan, sources of finance (bank or informal source), size of the firm, age of the firm, firm ownership and title amongst others. Descriptive tools like graphs, tables, frequency, percentages and pie chart were used. Inferentially, Mann-Whitney U test was used as well as the logistic regression analysis to examine the impact of collateral on access to loan by the SMEs.

The regression model is given as:

$$APVL(Y) = b_0 + b_1 SSGHT + b_2 FMAGE + b_3 NANFI + b_4 AFSTM + b_5 AMSAV + b_6 VALMA + b_7 PFWCF + b_8 PFWFB + b_9 ONWTH + b_{10} COLTR + \epsilon \dots\dots\dots (1)$$

Where: Y=approval of loan measured as dummy (1=approved, 0=not approved)

$b_0$  = regression intercept

$b_{1-10}$  = regression slope

SSGHT is Staff strength/Size (if small  $>5 <19 = 0$ , if medium  $>20 <99 = 1$  and Large  $>100 = 3$ )

FMAGE is Firms age/ Year of experience (years).

NANFI is Net annual firm income (Dollar).

AFSTM is Annual financial statement as dummy (1=available, 0=not available)

AMSAV is Amount of Savings (Dollar)

VALMA is value of purchase machinery, vehicles, equipment in last financial year (Dollar)

PFWCF is Proportion of firm's working capital financed from internal fund/retained earnings (percentage)

PFWFB is Proportion of firm's working capital financed from bank (percentage)

ONWTH is firm's owner net worth including private and business asset (actual amount in Dollars)

COLTR is Collateral measured as dummy (Dummy variable takes value 1 if a firm is required to provide collateral as a condition for financial approval, or 0 otherwise).

$\epsilon$  is the error term

**Results and Discussion**

Apart from the secondary data obtained from the Central Bank of Nigeria's website, the respondents in this study were either the CEOs or senior officers from each of the SMEs considered in the case study areas.

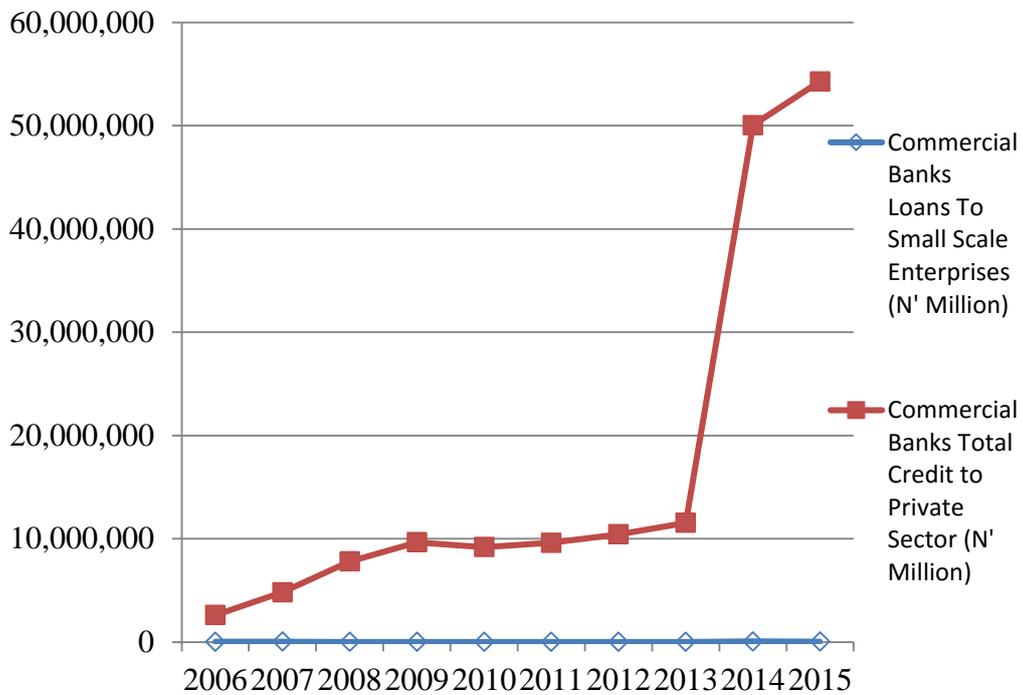


Fig 1: Commercial Banks' Loans to SMEs

Source: Central Bank of Nigeria (2016)

Fig 1 compared the quantum of loan access by SMEs through Commercial Bank with the quantum of loan granted the Private Sector. The chart confirmed an upward and progressive movement in the loan access by the Private Sector through Commercial Banks over the years while access to loan by SMEs remained static and at lower ebb. This shows that with the growing number of SMES in the nation, the financing available might not be sufficient to meet the needs of the SME sector. Though, there is no information with regard to the demand side from the SMEs.

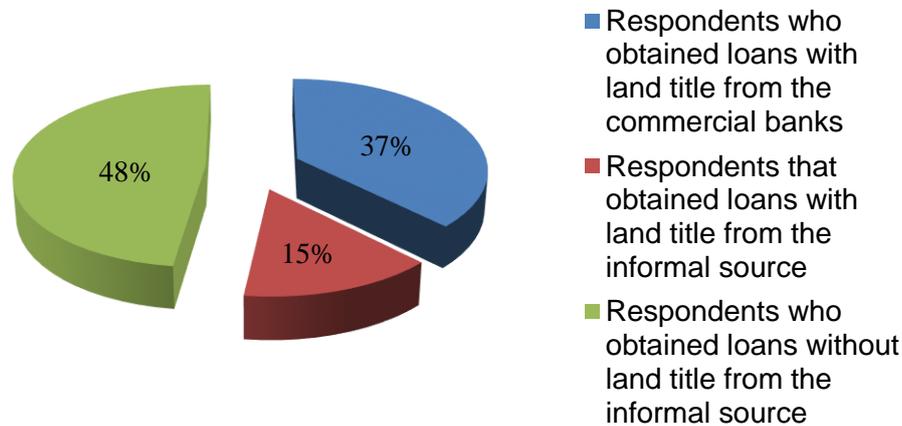


Fig 2: The extent of access to credit

Fig 2 measured the level of access to credit obtained by land or real property collateralized mortgages. Of the 200 respondents only 37% obtained loans from the commercial banks with collateral, 15% obtained loan from the informal source with their formal title, while 48% of the respondents access loan from the informal source without title documents. It is thus apparent that ownership of official document of property title increases chances of obtaining bank loans as mortgagees feel secured providing credits to mortgagors whose collaterals have certificates. This outcome corroborates the observation of the Enhancing Financial Innovation & Access (EFInA) and FinMark Trust (2010) that customer's lack of property documentation is the basic reason responsible for about 60% of the mortgage banks in Nigeria for refusing mortgage applications.

Table 1: Mann-Whitney- Factor Influencing SMEs in South-Western Nigeria

Variable	Mann-Whitney U	Wilcoxon W	Z	Asymp. Sig. (2-tailed)
Lack of adequate collateral	3230.000	8280.000	-4.563	.000
Difficult loan processes	4400.000	9450.000	-1.558	.119
High interest rates and other charges associated with normal bank lending	4475.000	9525.000	-1.398	.162
Limited access to mortgages	3750.000	8800.000	-3.175	.001
Lack of work space	4400.000	9450.000	-1.558	.119

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Banks' unwillingness to lend to SMEs	4562.500	9612.500	1.193	.233
Production technology	3175.000	8225.000	-4.629	.000
Difficult tax payment reports	4475.000	9525.000	-1.377	.169
Defective business plans	3750.000	8800.000	-3.172	.002
Fluctuating value of the Naira	4075.000	9125.000	-2.428	.015
Lack of information from financial organizations	4050.000	9100.000	-2.417	.016
Poor infrastructures	4500.000	9550.000	-1.313	.189
Multiple taxation	4237.500	9287.500	-1.973	.049
Inconsistent government policy	4475.000	9525.000	-1.351	.177
Lack of government support	3543.000	8593.000	-3.812	.000

The statistical result from Table 1 shows that there is a significant difference between lack of adequate collateral  $p=0.000$ , limited access to mortgages  $p=.001$ , production technology  $p=0.000$ , flawed business plans  $p=0.002$ , fluctuating value of the Naira  $p=0.015$ , lack of information from financial organizations  $p=0.016$ , multiple taxation  $p=0.049$  and lack of government support  $p=0.000$  responses in both Lagos and Ondo states SMEs' study sample, since the agreed critical p-value of this study is .05(significance level). On the other hand, there is no significance difference between difficult loan processes  $p=0.119$ , high interest rates and other charges associated with normal bank lending responses  $p=0.162$ , lack of work space  $p=0.119$ , Banks' unwillingness to lend to SMEs  $p=0.233$ , difficult tax payment reports  $p=0.169$ , poor infrastructures  $p=0.189$  and inconsistent government policy  $p=0.177$  in both local and multinational companies' study sample. The significance difference found in some of the variables in the case study areas, particularly lack of adequate collateral might not be far from the high level of land titling in Lagos as compared to Ondo state. The identified problems irrespective of their peculiarity or dissimilarity in the study areas, however remains critical factors influencing SMEs.

Table 2: Result of Logistic Regression Analysis

Variables	Coefficients	S.E	Sig
Constant	-5.408	2.659	.069
SSGHT	.002	.001	.028
FMAGE	.600	.907	.037
NANFI	-.748	.769	.701
AFSTM	.735	.874	.043
AMSAV	-.605	.590	.485
VALMA	1.679	.678	.497
PFWCF	-.040	.039	.253
PFWFB	.081	.061	.269
ONWTH	-.007	.035	.639
COLTR	1.700	.461	.003

Diagnostic test for the model

-2 log likelihood 679.785

Chi-squared 27.179

Significance level .000

Cox & Snell R Square=0.409, Nagelkerke R Square =0.578

The logistic regression result reveals staff strength/size of firm, firm's age/ year of experience, annual financial statement and lack of collateral as the only variables that have significant effect on the SMEs access to loan at 5% and a positive relationship with the dependent variable in the study area. The result also revealed that a unit increase in the right to use collateral will mean a 0.03 unit increases in possibility of access to loan by the SMEs. Also, the effect of all independent variables on the dependent variable tested at 5% level of probability was significant with the Cox & Snell R Square at 0.409 and the Nagelkerke R Square at 0.578 respectively. The result of the study is in line with Fafchamps (1996) who found lack of collateral as the chief main reason amongst other factors why SMEs applications for finance from banks were unsuccessful.

### Conclusion

In recognition of the gap created by banks in assisting the financial needs of SMEs, this study empirically examined the influence of formal land titling on SMEs' access to credit. Data for the study is generated from a structured questionnaire conducted in two southwestern states in Nigeria. Despite its extensive contributions to economic development of Nigeria, SMEs growth is yet, usually fraught with limited access to

credit especially by banks. Banks and other financial institutions unwillingness to provide credit to SMEs are typically due to lack of land documents or improper titling. This study showed that formal land titling (pave way for assets to be used as collateral) had positive impact on SMEs access to finance in the study area. In view of this, it became imperative to encourage land titling among SMEs by creating enabling environment whereby SMEs can title their landed property with ease, so as to close the financing breach faced by them. Governments' role in supporting the SMEs sector must be deepened, especially now that the Nigeria economic conditions and financial system impede SMEs from sourcing adequate financial assistance from formal financial institutions. The need to create awareness to entrepreneurs about financing options at their disposal is also paramount. The empirical results obtained from this study are obviously appropriate with real situation in Nigeria and of considerable policy relevance.

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