

# IMPACT OF CREDIT FACILITY ASSESSMENT ON PERFORMANCE OF SMALL AND MEDIUM SCALE ENTERPRISES IN SOUTH-WEST NIGERIA

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## Abstract

This research aims at evaluating the impact of credit facility assessment on the performance of small and medium scale enterprises in South-West Nigeria. It targets microfinance credit assessment, cooperative credit assessment, trade credit and development bank assessment, as they are part of the financing options available for small and medium scale enterprises in South-West Nigeria. A descriptive and explanatory research design will be employed. About 387 registered small and medium scale enterprises will be randomly selected from Osun, Oyo and Ogun State. This study intends filling the gap by simultaneously examining these four alternatives financing options and identifying which is the most suitable for small and medium scale enterprises in the South-West, Nigeria.

**Keywords:** Credit facility assessment, Microfinance credit assessment, Trade credit, Small and Medium Enterprises, Financial performance.

## 1. INTRODUCTION

Access to finance remains one of the most critical determinants of the survival and growth of small and medium scale enterprises. Globally, Small and Medium Scale Enterprises (SMEs) are recognized as the engine of economic transformation, employment generation, and poverty reduction. In Nigeria, small and medium scale enterprises contribute over 48% to the national Gross Domestic Product, account for about 96% of businesses, and employ approximately 84% of the workforce (SMEDAN & NBS, 2022). SMEs are known to make use of credit facilities which serve as financial instruments that allow businesses to obtain funds to meet working capital requirements, expand operations, or invest in productive assets (Adeleke, et al., 2023). Their ability to perform financially is, however, often constrained by limited access to credit and the complex assessment criteria adopted by traditional banks. This has made some Small and Medium Scale Enterprises not to function again while some are stagnant due to inability to access credit facility.

The concept of credit facility is a financial assistant provided by a microfinance institution, cooperative society and other lending body to an individual or business to access funds for investment or expansion of their business with the obligation to repay later usually with interest. Credit facility refers to financial arrangement in which a lender provides funds, goods, or services to a borrower with the expectation of repayment within agreed terms. It may be in the form of loans, overdrafts, leasing, trade credit, or cooperative contributions (Ogunleye, 2023). Credit facilities are vital in Nigeria for fostering economic growth, business expansion, job creation, poverty alleviation and supporting small and medium sized enterprises. Credit facility is important for small and medium scale enterprises as it assists them to acquire fund needed to improve their operations, production and achieve sustainable growth.

Credit facility assessment is the process used by lenders to determine creditworthiness of borrowers. Credit facility assessment refers to the evaluation process used by lenders to determine the eligibility, credibility,

and repayment capacity of small and medium scale enterprises before granting access to financial support (Bello, et al., 2023). Credit facility assessment involves evaluating small and medium scale enterprises' financial health, repayment capacity, collateral, and management strength before loans are granted (Oladeji, et al., 2020). Credit remains a critical resource for small and medium scale enterprises to improve their productivity and remain competitive. It helps lenders to ascertain how to obtain the fund, whether the business can repay the loan and whether they have the capacity to grow and sustain its operations with the borrowed funds. Credit facility assessment evaluates a borrower's ability to repay debt by analyzing their financial history, income, assets and liabilities to determine the associated risks for the lender. The goal is to protect the lender from losses by ensuring loans are granted only to creditworthy individuals or businesses with a probability of fulfilling their obligations. This process helps lenders to make informed decisions and maintain financial stability by minimizing credit risk and protects the lenders from default risks.

Financial performance, on the other hand, reflects the ability of firms in achieving profitability, liquidity, and sustainability in their operations. Empirical evidence suggests that access to appropriate credit facilities can improve small and medium scale enterprises' sales growth, profitability, and market expansion (Adebayo, 2023; Eze & Olowookere, 2021). Owolabi, et al. (2024) stated that financial performance of Small and Medium Scale Enterprises, measured through indicators such as profitability, return on investment, sales growth, and liquidity, is directly influenced by the nature, accessibility, and management of credit facilities. However, the extent to which credit facility could be assessed across microfinance institutions, cooperative societies, trade creditors, and development banks is presumed to affect Small and Medium Scale Enterprises' financial performance. This study therefore investigates the impact of credit facility assessment on financial performance of SMEs in South-West Nigeria with a focus on microfinance credit, cooperative credit, trade credit and development bank credit to determine the most suitable financing option that supports Small and Medium Scale Enterprises growth and sustainability in the region.

## **1.2 Statement of the Problem**

Despite the role Small and Scale Medium Scale Enterprises play in Nigeria's economy, access to credit remains a major barrier to their growth and sustainability. Deposit money banks dominate the financial system but impose stringent assessment criteria which the Small and Medium scale Enterprises struggle to meet. Banks often require collateral far beyond the capacity of small business owners and demand financial statements that most Small and Medium Scale Enterprises cannot provide due to informal operations (Olutayo, et al., 2023). These restrictive conditions have pushed many Small and Medium Scale Enterprises toward alternative financing sources such as microfinance credit, cooperative societies, trade credit and development bank credit etc. While these options appear more accessible, they are not without limitations. Microfinance loans often come with high interest rates, cooperative loans are limited by member contributions, trade credit depends heavily on supplier trust and repayment discipline (Bamidele, et al., 2021). Development banks, established to support Small and Medium Scale Enterprises, often demand comprehensive documentation and rigorous assessments that discourage small businesses (Uchenna, et al., 2023). Development Bank credit, particularly from institutions such as the Bank of Industry and Development Bank of Nigeria, provides medium to long-term loans with government backing and lower interest rates aimed at promoting industrial development (Oke, et al., 2022).

The central issue is therefore, the need to evaluate how the credit facility assessment under different financing options will affect the financial performance of Small and Medium Scale Enterprises in South-West Nigeria; and also, which is most suitable and appropriate for sustainable small and medium enterprises growth in the South-West region, Nigeria.

## **1.3 Aim of the Study**

The main objective of this study is to examine the impact of credit facility assessment on financial performance of small and medium scale enterprises in South-West Nigeria. The specific objectives are stated below:

- i. examine the effect of microfinance credit assessment on the financial performance of small and medium scale enterprises
- ii. assess the influence of cooperative credit assessment on the financial performance of small and medium scale enterprises
- iii. determine how trade credit assessment affects the financial performance of Small and medium Scale Enterprises in South-West Nigeria.
- iv. evaluate the impact of development bank credit assessment on the financial performance of small and medium scale enterprises.
- v. identify and recommend the most suitable credit facility option among microfinance, cooperative, trade, and development bank credits for enhancing small and medium enterprises financial performance.

## **2.0 LITERATURE REVIEW**

### **2.1 Conceptual Review**

#### **2.1.1 Credit facility**

A credit facility is any arrangement between a lender and a borrower that allows access to funds with the agreement of repayment, usually with interest. It may take the form of loans, overdrafts, leasing, or trade credit. In Nigeria, credit facilities are vital to economic development because they support businesses in financing operations, investment, and expansion (Olawale, et al., 2021).

A credit facility is a formal financial arrangement between a borrower and a lending institution that grants the borrower access to funds up to a predetermined limit, either as a one-time loan or through multiple withdrawals, subject to agreed repayment conditions. It is designed to provide flexible financing options that support working capital needs, business expansion, or other financial obligations. Okpara, et al. (2021) noted that credit facilities function as structured financial agreements that enhance liquidity by giving businesses timely access to capital. Olawale, et al. (2020) describe them as financial tools that enable enterprises especially Small and Medium Scale Enterprises to secure the resources necessary for growth and continuity. Furthermore, Eze, et al. (2022) highlight that without access to adequate credit facilities, many businesses face significant constraints in meeting operational and investment demands.

#### **2.1.2 Credit Facility Assessment**

Credit facility assessment refers to the process by which financial institutions or lending organizations evaluate the creditworthiness of borrowers. It involves examining repayment ability, credit history, collateral, cash flow, and business performance. While deposit money banks adopt rigorous assessments often disqualifying Small and Medium Scale Enterprises alternative financing sources like microfinance, cooperatives, and trade creditors adopt more flexible procedures (Eze, et al., 2022). Credit facility assessment refers to the process by which a financial institution (bank, microfinance bank, fintech lender, etc.) evaluates Small and Medium Scale Enterprises loan or credit request before approval (amount, terms, collateral, repayment schedule, etc.). The goal is to determine the creditworthiness and repayment capacity of the Small and Medium Enterprises, ensure risk is accepted and priced appropriately, and that the facility aligns with institutional and regulatory standards. In the context of Nigerian Small and Medium Scale Enterprises, this assessment is vital because many small businesses face difficulty accessing credit, often due to inadequate financial records, collateral, or perceived risk by lenders. For example, one study found that the degree of accessibility to credit facilities for Nigerian Small and Medium Scale Enterprises is significantly influenced by government policies, tax incentives and collateral requirements Jacob (2025). Credit facility assessment serves three main functions: Risk mitigation for the lender (ensuring the SME

will repay), Credit allocation (determining amount, rate, tenor), Supporting Small and Medium Enterprises growth and financial inclusion (when the assessment framework is fair and appropriate).

### **2.1.3 Impact of Credit Facility Assessment on Small and Medium Scale Enterprises' Access to Finance in South-West Nigeria**

Credit facility assessment procedures refer to the methods, criteria, and processes financial institutions employ to evaluate the eligibility of Small and Medium Enterprises for loans. While these procedures are intended to minimize default risk and safeguard lenders' resources, they significantly affect Small and Medium Scale Enterprises' ability to secure financing in South-West Nigeria.

**Collateral-Based Assessments Limit Access:** Many banks and microfinance institutions in South-West Nigeria demand tangible collateral such as land titles, fixed assets, or movable assets registered under the National Collateral Registry. Since most Small Medium Scale Enterprises operate informally and lack titled assets, strict collateral requirements exclude them from credit markets studies. (Adepoju, et al., 2025) confirm that collateral rigidity is the leading cause of loan rejection among Small and Medium Scale Enterprises in the region.

**Emphasis on Financial Records and Documentation:** Financial institutions often require audited financial statements, tax clearance certificates, and evidence of registration before granting loans. Small and Medium Scale Enterprises in South-West Nigeria, particularly in informal retail and agriculture, typically lack structured accounting records, which hinders their eligibility. According to Ayodele, et al. (2024), Small and Medium Scale Enterprises with proper bookkeeping and formalized records have a higher likelihood of obtaining bank credit.

**Character and Creditworthiness Evaluations:** Lenders assess Small and Medium Enterprise owners' reputation, repayment history, and credit bureau records before loan approval. While this promotes financial discipline, it disadvantages entrepreneurs without prior credit history. Evidence from Osun State shows that many new Small and Medium Scale Enterprises are denied funding due to thin or non-existent credit histories (Olawale, et al., 2022).

**Cash Flow and Repayment Capacity Tests:** Credit assessment procedures focus heavily on cash flow projections and repayment capacity. Small and Medium Scale Enterprises with irregular income cycles (common in seasonal businesses such as agriculture and textiles) often fail to meet these standards despite being profitable in the long run (Ogunleye, et al., 2023). This creates a mismatch between institutional lending frameworks and Small and Medium Scale Enterprises' operational realities.

**Macroeconomic and Sectoral Risk Considerations:** Financial institutions also consider industry risks, inflation, policy changes, and market volatility in their assessment. Small and medium Scale Enterprises in high-risk sectors such as agriculture and trade in South-West Nigeria face stricter credit scrutiny, which reduces their access to credit facilities (Nwankwo, et al., 2021).

**Impact on Access to Finance:** The above procedures have both positive and negative effects: Positive Effects: Encourages Small and Medium Scale Enterprises to formalize operations by keeping records, paying taxes, and registering businesses. Reduces loan defaults, ensuring credit sustainability. Builds financial discipline among Small and Medium Enterprise owners. Negative Effects Excludes many Small and Medium Scale Enterprises from accessing formal finance due to rigid criteria. Forces businesses to depend on informal financing (friends, family, cooperatives, trade credit). Limits the growth potential of Small and Medium Scale Enterprises that cannot meet stringent assessment requirements.

### **2.1.4 Various sources of financing available for Small and Medium Scale Entreprises in Nigeria**

Financing is one of the most critical factors determining the success, survival, and growth of Small and Medium Enterprises in Nigeria. The ability of Small and Medium Scale Enterprises to access sufficient and

affordable funding directly influences their investment capacity, production level, and financial performance (Adeleye, et al., 2023). The sources of Small and Medium Enterprise financing in Nigeria can broadly be categorized into formal and informal sources.

### **2.1.5 Formal Sources of Small and Medium Scale Enterprises Financing**

Formal sources financing Small and Medium Scale Enterprises refers to credit obtained from regulated financial institutions that operate under the supervision of the Central Bank of Nigeria and other regulatory bodies. Formal financing also refers to as external financing for Small and Medium Scale Enterprises, which is known as fund obtained from outside the firm. This type of financing involves various options, including debt and equity. Debt financing involves obtaining loans from financial institutions or other lenders, while equity financing involves acquiring capital from investors in exchange for ownership shares in the business, external financing or formal financing, whether through debt or equity, is crucial for Small and Medium Scale Enterprises' growth, expansion, and survival. Debt financing is particularly attractive to Small and Medium Scale Enterprises as it allows for faster access to funds and provides stability for growth. On the other hand, equity financing offers long-term funding options and may involve business angels, venture capitalists, or crowd funding platforms. By securing formal sources of financing, Small and Medium Scale Enterprises can overcome financial constraints and pursue their growth objectives (Nguyen, et al., 2022). Formal financing includes:

**Deposit Money Banks:** These remain the most recognized formal source of Small and Medium Scale Enterprises financing. They provide loans, overdrafts, and credit lines to businesses after thorough credit assessments. However, due to stringent collateral requirements, high-interest rates and documentation requirements, only a small proportion of Small and Medium Scale Enterprises can access such loans (Obi, et al., 2024). Most banks require tangible collateral such as landed property and fixed assets, which many small firms lack. Despite initiatives like the Central Bank of Nigeria's Credit Risk Guarantee Scheme and Small and Medium Scale Enterprises focused intervention funds, access remains limited due to perceived risks associated with SME lending (Ogunleye, et al., 2023).

**Microfinance Banks:** Microfinance institutions were established to provide financial services to micro and small-scale entrepreneurs who are excluded from traditional banking systems. Microfinance loans are usually smaller, have flexible repayment terms, and require less collateral. Studies by Adeniran, et al. (2022) found that microfinance loans significantly improved Small and Medium Scale Enterprises' working capital and short-term liquidity positions in Oyo and Ogun States. However, high interest rates and short repayment periods still pose challenges.

**Development Finance Institutions:** Development finance institutions such as the Bank of Industry, Development Bank of Nigeria, and NEXIM Bank provide medium- to long-term financing to Small and Medium Scale Enterprises in strategic sectors. These banks often collaborate with microfinance institutions and deposit money banks to channel funds at lower interest rates. According to Akinbode, et al. (2022), Development Finance Institutions have contributed to over 15% of SME credit disbursement in South-West Nigeria through targeted industrial and agricultural support programs.

**Government Intervention Funds:** The Federal Government, in collaboration with the Central Bank of Nigeria, has launched various intervention schemes such as: Agri-Business/Small and Medium Enterprises Investment Scheme, Small and Medium Scale Enterprises Credit Guarantee Scheme, Anchor Borrowers' Programme, Youth Investment Fund. These initiatives aim to ease credit access and improve business productivity. However, bureaucratic procedures and limited awareness have reduced their effectiveness (Adegboye, et al., 2021).

### **2.1.6 Informal Sources of Small and Medium Scale Enterprises Financing**

Informal sources are unregulated financial mechanisms often used by entrepreneurs who lack access to formal institutions. They are flexible, socially driven, and adapted to local realities. It also refers to as internal sources of financing which is a vital source of financing Small and Medium Scale Enterprises. It includes loans obtained from relatives, money lenders, rotating-saving credit associations and non-profit organization Previous research has consistently demonstrated that access to internal finance can have a positive impact on business performance. Maran (2022) as well as Owen, et al. (2023) found that internal financing has the potential to facilitate Small and Medium Enterprises growth and can play a role similar to that of angel investors in supporting the establishment and growth of fast-growing start-ups in developing countries. The literature also suggests that internal finance can help bridge the finance gap faced by Small and Medium Scale Enterprises and significantly influence their performance (Aderemi, et al. 2023). Particularly during initial stages of Small and Medium Enterprises development, owner managers often rely on personal savings and support from family members or friends. Start-up Small and Medium Scale Enterprises face significant challenges in obtaining external finance from banks and financial institutions, making internal finance of critical importance (Esho, et al., 2022; Singh, et al., 2022). Typically, Small and Medium Scale Enterprises exhaust internal sources of finance before turning to external sources, aligning with the pecking order theory that suggests a preference for internal financing before seeking external debt and equity (Rao, et al., 2023). Therefore, internal sources of financing include:

**Cooperative Societies:** Cooperative societies are popular financing sources among Small and Medium Scale Enterprises in South-West, Nigeria. Members contribute periodically to a common fund from which they can borrow at low interest rates. Cooperative loans are usually collateral-free and based on trust and mutual responsibility. They provide loans through pooled savings, allowing members to access credit at lower interest rates compared to banks (Adebayo, et al., 2023). They are vital for traders, artisans, and agro-processors who lack formal collateral. Adeleye, et al. (2023) observed that cooperative credit enhances Small and Medium Scale Enterprises' financial stability and reduces dependence on expensive bank loans, particularly in rural and semi-urban communities.

**Trade Credit:** Trade credit involves suppliers allowing Small and Medium Scale Enterprises to buy goods or raw materials on credit and pay at a later date. It is one of the most accessible financing options because it does not require collateral or formal documentation. According to Okpara, et al. (2021), trade credit enhances cash flow and allows Small and Medium Scale Enterprises to maintain inventory levels without immediate cash outlay. However, default in payment can damage business relationships and reduce future credit access. This practice helps in managing liquidity challenges, especially in wholesale and retail businesses (Okoro, et al., 2022).

**Personal Savings and Family Support:** A potential business owner who is in a paid job and who has intention to quit in the future; must have a business plan with a strong financial model by saving towards it. One of the benefits of this method of start-up funding is that the business does not carry any financial liability. Many Small and Medium Scale Enterprises in Nigeria rely heavily on personal or family savings as start-up capital. While this source is easily available, it is often inadequate for expansion or technological investment (Olaoye, et al., 2022). Nevertheless, it remains the most common financing source among micro-entrepreneurs.

**Informal Moneylenders and Rotating Savings Groups (Esusu/Ajo):** Informal moneylenders and local thrift collectors provide quick but high-interest loans. They are common among micro-enterprises that require immediate funds for inventory or daily operations. Although convenient, the high repayment rate and lack of legal protection are major risks (Akinola et al. 2023).

**Government grant:** Governments offer financial assistance in the form of grants and tax credits to support start-up or expanding businesses at federal and state level.

**Government initiative:** In Nigeria, the government has implemented various initiatives to support Small and Medium Scale Enterprises with capital. Notably, the Federal Government of Nigeria rolled out billions

of loan program to assist Small and Medium Enterprises, with the Central Bank of Nigeria disbursing the fund at a single-digit interest rate. This initiative is a part of the government's efforts to boost Small and Medium Scale Enterprises in Nigeria.

### **2.1.7 Emerging and Alternative Financing Sources**

**FinTech and Digital Lending Platforms:** The rise of financial technology (FinTech) has transformed Small and Medium Enterprises financing in Nigeria. Platforms such as Carbon, Fair Money, and Moniepoint offer quick, collateral-free digital loans using AI-based credit scoring systems. Research by Oyetunde, et al. (2024) found that Small and Medium Scale Enterprises utilizing FinTech credit solutions recorded higher short-term financial performance and improved credit inclusion in South-West Nigeria.

**Venture capitalists:** Venture capitalists serve as financial intermediaries, raising funds from investors to invest in high-risk, information ally opaque firms, typically young or start-up firms. They play a crucial role in determining the timing and type of investment, as well as in monitoring, screening, and contracting. Actively participate in the strategic planning and decision-making processes of the invested firms. The venture capital market encompasses various organizations, including public corporations, small business investment corporations, and private limited partnerships.

**Microfinance Credit:** Microfinance can be defined as the provision of thrift, credit and other financial services and products in very small amounts to the poor to enable them to raise their income levels and improve their standard of living (Chukwu, et al., 2024). Microfinance is the act of providing a whole range of financial services such as deposits, loans, payment services, money transfers, and insurance to poor and low-income households and, their microenterprises. Microfinance is the practice of rendering short-term loans to business owners who do not have access to capital to start a small business or other income generating activities (Oyedokun, 2022). Microfinance banks' credit facilities were intended to reduce poverty levels and encourage economically active Micro, Small and Medium Scale Enterprises that are financially constrained through granting of micro credit for business purposes. Notwithstanding the acclaimed success of microfinance as an integral contributor to output growth in an economy, loan facilities or services from micro finance institutions have not adequately met the financial need of the poor that desperately need microfinance facilities to enhance their business emergence and survival.

**Trade Credit:** Credit is the loan extended by one trader to another when the goods and services are bought on credit. Trade credit facilitates the purchase of supplies without immediate payment. Trade credit is commonly used by business organizations as a source of short-term financing (Lee, Wang & Ho, 2020). Trade credit refers to supplier-financed arrangements where Small and Medium Scale Enterprises acquire goods or services on credit, to be paid for at a later date. Assessment criteria are often based on prior business relationships, transaction history, and payment behavior (Olowookere, 2022). Trade credit is the loan extended by one trader to another when the goods and services are bought on credit. Trade credit facilitates the purchase of supplies without immediate payment. Trade credit is commonly used by Small and Medium Enterprises as a source of short-term financing. It is granted to those customers who have a reasonable amount of financial standing and goodwill (Kuveya, 2020). Trade credit enhances working capital but exposes Small and Medium Scale Enterprises to potential supplier pressure in cases of delayed repayment

### **2.1.8 Development Bank Loan Assessment**

Development banks, such as the Bank of Industry and Development Bank of Nigeria, are mandated to provide long-term, low-interest loans to Small and Medium Scale Enterprises. Their credit assessment involves evaluating business plans, audited accounts, collateral value, and repayment capacity (Uchenna, et al., 2023). However, cumbersome documentation and strict criteria hinder accessibility for most Small and Medium Scale Enterprises. A development bank is a specialized financial institution established to

provide medium- to long-term financing for projects that contribute to national or regional development. Unlike deposit money banks, development banks prioritize economic, social, and environmental impact over short-term profit. Therefore, their loan assessment process goes beyond financial viability it also evaluates how the project aligns with policy goals such as industrialization, infrastructure development, job creation, or climate resilience. According to Marbuah, et al. (2022), Development Finance Institutions play a vital role in filling investment gaps that private finance often ignores, particularly in infrastructure, green energy, and Small and Medium Scale Enterprises. Loan assessment in a development bank context refers to the systematic evaluation of a proposed project or borrower to determine its: financial soundness, technical feasibility, economic and social benefits, and alignment with the bank's development mandate. This process ensures that the loan supports projects that are both bankable and developmentally impactful. Asah, et al. (2021) explain, formal financial institutions including Development Finance Institution use structured evaluation criteria to ensure responsible credit allocation, reduce default risks, and enhance financial inclusion.

### **Importance of Development Bank Loan Assessment**

Ensures sound lending decisions that protect both the borrower and the bank. Promotes accountability and transparency in the use of development finance. Supports national and regional development priorities such as industrialization and green growth. Reduces non-performing loans through better risk identification and management. Measures developmental impact, ensuring that projects deliver social and environmental benefits beyond financial return.

#### **2.1.9 Financial performance**

Financial performance reflects the ability of Small and Medium Scale Enterprises to generate profit, sustain liquidity, and achieve growth. Common measures include profitability ratios, sales turnover, return on assets, and cash flow stability (Adebayo, 2023). Profitability ratios, such as the Net Profit Margin or Gross Profit Margin, measure Small and Medium Scale Enterprises' ability to generate earnings relative to its revenue, assets, and equity. These ratios provide a window into the financial health of the business and the effectiveness of management in controlling costs. A high ratio indicates success at converting sales into profit, which is essential for long-term survival and sustainability. For Small and Medium Scale Enterprises, which may have limited access to capital, strong profitability is vital for generating internal funds for growth and managing risk. Sales turnover refers to the total amount of money a business receives from selling its goods or services during a specific period. Consistent and increasing sales turnover is a primary indicator of market success and growth. It reflects the effectiveness of the Small and Medium Scale Enterprise's sales strategies, market demand for its products, and overall business activity. While high turnover isn't the same as high profit (costs must be deducted), it is a necessary foundation for profitability and generating the cash flow needed for short-term obligations and future investments. Cash flow stability refers to the predictability and consistency of Small and Medium Scale Enterprise's cash inflows and outflows over time. Stable cash flow is critical for Small and Medium Scale Enterprise's day-to-day operations and liquidity. It ensures the Small and Medium Enterprises can meet their short-term liabilities without financial distress or the need for emergency borrowing. It allows for better planning, managing working capital efficiently, and navigating economic instability. Return on Assets is a profitability ratio that measures how efficiently a company uses its assets to generate a profit. It is calculated as net income divided by total assets. Return on Assets indicates how well management is using the company's total resources (both debt and equity financed) to produce earnings. Financial performance is directly influenced by the enterprise's access to affordable credit, sound financial management, and the effectiveness of business operations (Okafor, et al., 2022). In South-West Nigeria, where entrepreneurial activity is vibrant, access to sustainable credit facilities remains a crucial determinant of Small and Medium Enterprises financial success.

#### **2.1.10 Factors that hinder the performance of Small and Medium Scale Enterprises in South-West, Nigeria**

**Limited access to finance:** Small and Medium Scale Enterprises often need help accessing affordable credit and financing options, hindering their capacity to invest in technology, expand operations, and meet international trade standards. One of the most persistent challenges is difficulty in accessing credit facilities from banks and other financial institutions. High collateral requirements, strict credit assessment procedures, and high-interest rates often exclude Small and Medium Scale Enterprises from affordable financing. According to Ojo, et al. (2021), over 65% of Small and Medium Scale Enterprises in Osun, Ogun, and Oyo rely on personal savings and informal loans because of limited access to bank credit

**Poor Infrastructure:** Inadequate electricity supply, poor road networks, and insufficient transport systems increase the cost of doing business. Small and Medium Scale Enterprises in manufacturing, agribusiness, and services struggle with frequent power outages, forcing them to rely on generators, which raises operating costs (Ademola, et al., 2022).

**Market Access Constraints:** Small and Medium Enterprises face challenges in penetrating local and international markets due to poor branding, weak marketing strategies, and lack of e-commerce adoption. Competition from imported goods and larger firms reduces their market share (Olayinka, et al., 2022).

**Technological Barriers:** While Lagos hosts Nigeria's fintech and tech hubs, most Small and Medium Scale Enterprises in other South-West states lag behind in adopting digital technologies for operations, marketing, and record-keeping. Limited digital adoption restricts their ability to integrate into modern value chains (Ajayi, et al., 2024).

**High Cost of Production:** Inflation, fluctuating exchange rates, and rising fuel prices increase the cost of raw materials and business operations. Small and Medium Scale Enterprises in agro-processing and manufacturing are particularly vulnerable to these cost pressures (Okoro, et al., 2023).

## **2.2 Theoretical Review**

### **2.2.1 Credit Rationing -Based Theory**

This study is anchored on credit Rationing-Based Theory, Pecking order theory, Financial Intermediation theory, Resources-Based theory and Social Capital theory. Credit Rationing Theory was propounded by Stiglitz and Weiss (1981) and explains why financial institutions, especially banks, may limit the amount of credit they give to borrowers, even when borrowers are willing to pay high interest rates. According to the theory, banks do not always increase interest rates to balance the demand and supply of credit. Instead, they often ration credit that is, they provide loans selectively or reduce the size of loans to certain groups of borrowers. This happens because higher interest rates can attract riskier borrowers and discourage low-risk borrowers, which increases the likelihood of loan default. Therefore, instead of raising interest rates, banks prefer to restrict access to loans by carefully screening applicants and demanding collateral or credit history proof. Stiglitz and Weiss (1981) argue that lenders face information asymmetry, meaning that lenders do not have complete information about borrowers' creditworthiness. Due to this imperfect information, lenders cannot perfectly distinguish between high-risk and low-risk borrowers. As a result, they use strict credit assessment criteria such as collateral, past repayment history, business performance, and financial statements to decide who gets credit and how much. For SMEs, this means limited access to bank credit despite their financing needs. Recent studies confirm that credit rationing still affects Small and Medium Scale Enterprises in Nigeria (Okafor, et al., 2021). The theory helps to explain why many Small and Medium Scale Enterprises in South-West Nigeria struggle to gain access to credit from deposit money banks. Due to stringent assessment criteria, many Small and Medium Scale Enterprises are considered too risky or unqualified, even if they are creditworthy in practical terms and this situation forces Small and Medium Scale Enterprises to seek alternative credit sources such as microfinance credit, cooperative credit, trade credit, and development bank credit, which are often more flexible and better suited to the realities of small businesses. The theory provides a framework for understanding how and why access to credit is constrained for Small and Medium Scale Enterprises not because of the lack of funds in the economy, but

because of credit rationing practices that exclude many smaller enterprises from formal lending channels. Ogunleye, et al. (2021) found that deposit money banks credit rationing practices significantly reduced loan accessibility for Small and Medium Scale Enterprises in South-West Nigeria. Similarly, Adebayo, et al. (2022) confirmed that credit rationing resulting from asymmetric information constrained the growth potential of many Small and Medium Scale Enterprises. This research will be anchored on Credit rationing Theory because it explains the mismatch between Small and Medium Scale Enterprises' credit needs and financial institutions' lending criteria, and also aligns where Small and Medium Scale Enterprises face credit rationing from formal banks and therefore turn to microfinance, cooperative, trade credit, and development bank credit.

### **2.2.2 Pecking Order Theory**

The Pecking Order Theory was developed by Myers and Majluf (1984), explains how firms prioritize their sources of financing based on the principle of minimizing information costs and financing risks. According to Myers and Majluf (1984), firms prefer internal financing (such as retained earnings) first because it involves no external obligations. When internal funds are insufficient, they turn to debt financing, and finally to equity financing as a last resort. The theory implies that firms are more comfortable using financing options that require minimal disclosure and negotiation. The theory helps explain why Small and Medium Scale Enterprises in South-West Nigeria often prefer alternative credit sources like microfinance and cooperative loans over deposit money bank loans. Since deposit money banks have stringent credit assessment procedures and collateral requirements, Small and Medium Scale Enterprises adopt a “pecking order” approach—using informal or semi-formal credit sources that are easier to access and less bureaucratic. The theory identifies which credit facility among the four alternatives best enhances Small and Medium Scale Enterprises' financial performance. Ogunjobi et al. (2022) stated that Nigerian Small and Medium Scale Enterprises prioritize internal and microfinance sources before considering deposit money bank loans. Likewise, Akinola et al. (2023) said that cooperative and trade credit are popular among Small and Medium Scale Enterprises due to their flexibility and relationship-based lending practices.

### **2.2.3 Financial Intermediation Theory**

The Financial Intermediation Theory was propounded by Joseph in (1911) and further expanded in 1960 by Gurley and Shaw, the theory emphasizes the role of financial institutions as intermediaries that bridge the gap between savers (depositors) and borrowers (investors or businesses). According to Schumpeter (1911), financial intermediaries such as banks and microfinance institutions play a crucial role in economic development by channeling savings into productive investments. Later, Gurley and Shaw (1960) expanded this view, asserting that intermediaries help reduce transaction costs and information asymmetry between lenders and borrowers. The theory argues that financial intermediaries exist because they can perform credit evaluation, risk management, and monitoring functions more efficiently than individual investors. By assessing the creditworthiness of borrowers through structured credit facility assessments, intermediaries allocate resources more effectively and support business growth. The theory provides the broader economic justification for examining credit facility assessment as it highlights the intermediary role of banks, microfinance institutions, cooperatives, and development banks in promoting SME growth.

### **2.2.4 Resource-Based Theory**

The Resource-Based Theory, developed by Barney (1991), explains that a firm's ability to achieve sustainable competitive advantage and improved performance depends on how it acquires, manages, and utilizes its valuable resources. These resources include both tangible assets (such as finance, equipment, and technology) and intangible assets (such as skills, innovation, relationships, and knowledge). According to Resource-Based Theory, for a resource to create a sustainable competitive advantage, it must have four key characteristics, often summarized as Valuable, Rare, Inimitable and Non-substitutable. Valuable means resource must enable the firm to exploit opportunities or threats. Rare means resource must be unique or not easily available to competitors, Inimitable means the resource must be difficult for others to copy or

acquire and non-substitutable means There must be no strategic equivalent for that resource. Small and medium enterprises, financial resources such as credit facilities play a vital role in ensuring that businesses can acquire other productive resources (like modern equipment, skilled labor, and market access) that enhance performance and competitiveness. The Theory links access to credit facilities (microfinance, cooperative, trade, and development bank credit) to the financial performance of SMEs. Credit availability serves as a strategic resource that enables Small and Medium Scale Enterprises to invest in innovation, technology, inventory, and skilled labor all of which are essential for achieving superior performance. Adeniran et al 2021 found that financial resources significantly improve innovation capacity and profitability of Small and Medium Scale Enterprises in Oyo and Ogun States. Olawale et al. (2022) reported that Small and Medium Scale Enterprises that accessed microfinance and cooperative loans performed better financially due to efficient resource utilization.

### **2.2.5 Social Capital Theory**

Pierre Bourdieu can be traced as the originator of Social Capital Theory as early as 1986. The Theory emphasizes the value of networks, trust, relationships, and social norms in facilitating cooperation and access to resources among individuals or organizations. According to Bourdieu (1986), social capital refers to the aggregate of actual or potential resources linked to a durable network of institutionalized relationships. Coleman (1988) extended the concept to show how social structures facilitate certain actions of individuals within the structure, while Putnam (1993) argued that communities with strong networks of trust and civic engagement perform better economically and socially. Social capital exists in three forms: Bonding social capital means close relationships within a group, such as members of a cooperative or trade association, bridging social capital means connections between different groups or networks, such as relationships between Small and Medium Scale Enterprises and financial institutions and linking social capital means vertical connections between individuals and formal institutions, such as access to policymakers or development banks. Social capital acts as an informal credit guarantee by building trust and reputation, which can influence access to finance, reduce transaction costs, and improve loan repayment behaviors. Adebisi, et al. (2020) found that trust-based networks among cooperative members in Lagos and Osun States significantly increased access to cooperative loans. Ololade, et al. (2021) observed that SMEs that maintained strong trade relationships had better credit repayment records and improved profitability. Nwachukwu et al. (2024) concluded that social relationships and trust remain powerful determinants of Small and Medium Enterprises survival and growth in South-West Nigeria.

### **2.3 Empirical Review**

Fabrice (2024) examine the impact of microfinance loans on the financial performance of small and medium Enterprises in central district of Kampala Uganda. The purpose of the study is to assess how the credit repayment terms and conditions impact the performance of Small and Medium Scale Enterprises in the central district of Kampala. A descriptive research design was used and copies of questionnaires was distributed to Ninety-eight (98) respondent. The data were presented in tables and hypotheses were tested with Croncha's Alpha statistics. The research found that credit repayment term is one of the most crucial factors that affect Small and Medium Scale Enterprises in managing cash flow to perform on their financial obligations. However, the study shows that interest rate is relevant in the determination of the financial performance of Small and Medium Scale Enterprises The study recommends that Small and Medium Scale Enterprises take the to improve their creditworthiness if they are to have improved financial performance. The study advice that microfinance institution should ensure that approval criteria are comprehensive enough to assess the financial health and creditworthiness.

Alonge (2025), examined Relationship between Cooperative Societies and Small Medium Scale Enterprises in Ondo State. The study employed secondary data, collected from journals, textbooks and government reports. The study found that many challenges impact the performance of Small and Medium Scale Enterprises such as insecurity, inadequate infrastructure, inadequate funding, poor management structure, low level of technology. It was also discovered that cooperative societies contribute to Small and Medium Scale Enterprises through provision of funding, advisory services, tools and equipment, extension services.

This study concludes that cooperative societies and Small and Medium Scale Enterprises are partners in progress and such government should provide an enabling environment, adequate infrastructural facilities, progressive policies and adequate monitoring of their activities to ensure conformity to global standard.

Chukwu et al. (2024), examine the place of cooperative societies in Nigerian microfinance sector ANOVA was the tool used to test for hypotheses. The study indicate that cooperatives societies have a big place in the microfinance sector in Nigerian significant and positive influence on micro credit delivery in Nigeria.

Adam, et al. (2024), examined analysis of the impact of credit facilities on performance of small and medium scale business in Tangaza local government. A descriptive correlational design was applied for survey. A structured questionnaire was employed to 96 Small and Medium Scale Enterprises, the data were presented in table and hypotheses were tested with Pearson test-retest method. The study claimed that trade credit has on significant impact on the performance of small and medium scale business in Tangaza local government. The study advice that bank should provide more loans at a reasonable rate to Small and Medium Scale Enterprises to enable them explain their business and also increase the amount Small and Medium Scale Enterprises can assess in case of overdrafts.

The study conducted by Enoch et al. (2025), examined credit facility and performance of Small and Medium Scale Enterprises evidence from Adamawa, Nigeria. The purpose of the study is to examine the relationship between short term loan, intermediate term loan and long term and the performance of Small and Medium Scale Enterprises. The study employed primary data and adopted survey and cross-sectional research design. Survey and cross sectional allow the study to obtain data from respondent at a single point in time the sample of the study comprised 384 respondent multiple linear regression model was used to determine the effect of explanatory variable and analysis was done through SPSS version 23. The result show that short term, long term plays significant role on performance of SMEs in Adamawa.

Ajibola et al. (2024), investigated the effect the impact of development bank financing on growth of Small and Medium Scale Enterprises Small and Medium Scale Enterprises in Nigeria. 398 questionnaires were administered to registered Small and Medium Enterprises, binary logistic regression analysis was used to analysis the impact of development bank credit financing on Small and Medium Scale Enterprises profits .the finding highlight that the impact of development bank credit financing and a Micro, Small and Medium Enterprises profitability revealed that sales of the Micro Small and Medium Scale Enterprises and support and services training for Small and Medium Scale Enterprises impacted positively on the profitability of the Small and Medium Enterprises. The finding recommended that tax reduction should be given to the beneficiaries of this credit financing until full repayment of their loans was discovered that the average amount of tax paid by Small and Medium Scale Enterprises.

Gunawardena, et al. (2023), carried out research on "Effect of Development Finance Lending on Financial Performance of Small and Medium Enterprises in Sri Lanka. The purpose of this study is to identify the relationship between development finance lending on the financial performance of Small and Medium Scale Enterprises and determine what components of development finance credit have the most impact on the growth of Small and Medium Scale Enterprises. The study was adopted with a target sample of 120 registered Small and Medium Scale Enterprises within the ABC Bank PLC, Sri Lanka. Secondary data was collected for the study using internal documents from the Small and Medium Enterprises section in ABC Bank PLC and annual reports. Data was analyzed using descriptive statistics, correction and multiple regression approach. Findings revealed that development finance credit positively influences the financial performance of SMEs through the amount of credit provided, the initial credit amount, the collateral requirement, and the loan period granted by the bank, which affects the financial performance negatively based on the analysis. The study also found that all Small and Medium Scale Enterprises borrow credit to increase their financial performance. The study concludes that return improved with each consecutive loan, showing that microfinance facilities enhance the financial performance of Small and Medium Scale Enterprises in Sri Lanka with the evidence from ABC Bank PLC.

Kaltume et al. (2024), The study will investigate whether micro credit, micro savings and micro insurance have significant effect of overall performance of the said Small and Medium Scale Enterprises in the state. Descriptive survey design will be employed and the researcher intend to use simple random sampling technique in the proposed study. Borno state was chosen to carry out the research 346 respondents were

proposed and the data when obtained will be analyzed using multiple regression analysis technique. However, validity and reliability test will be conducted upon collection of the data during pilot study before the full research is conducted. A well developed and structured questionnaire is designed using Five -Likert scale from strongly disagreed to strongly agreed.

Genga et al. (2023), examine A Critical review of Small and Medium Scale Enterprises Access to credit and their performance/ growth in Nigeria. The finding conclusion showed that the performance and growth of small and medium-sizes enterprises in Nigeria are Influence by their access to credit.

### 3. METHODOLOGY

#### 3.1 Research Design

The study will adopt a descriptive research design. A descriptive research design is good or appropriate for collecting data from a large population to describe existing conditions and relationship between variables. It enables the researcher to gather data from Small and Medium Scale Enterprises and managers in their natural setting through structured questionnaires and interviews. According to Afolabi et al. (2021), descriptive surveys are suitable for Scio-economic research where opinions attitudes and experiences of respondents are essential to understand a phenomenon. Therefore, this design provides the flexibility required to measure the impact of different credit facility assessment including Microfinance credit, cooperative credit, trade credit, and development bank credit, on Small and Medium Scale Enterprises performance in Osun Oyo and Ogun State.

#### 3.2 Area of the Study

This study focuses on alternative financing options that help Small and Medium Scale Enterprises in Osun, Oyo and Ogun State Western Nigeria to access loan in order to expand their business. The alternative financing options used in this study are: Microfinance credit, cooperative credit, trade credit, and development bank credit.

#### 3.3 Population of the Study

The population of the study comprises of registered small and medium scale enterprises licensed by Corporate Affairs Commission. These Small and Medium Scale Enterprises are operating in Osun Oyo Ogun State of South-West Nigeria, and their population are as follows:

**Table 1: Numbers of Registered Small and Medium Scale Enterprises in South-West Nigeria**

State	Small and Medium Scale Enterprises
Osun	3007
Oyo	6131
Ogun	2465
TOTAL	11603

Sources: SMEDAN/NBS Survey Report (2021)

#### 3.4 Sample Technique and Sampling Size

In order to ensure statistical validity, the sample size of 387 was determined using Yaro Yamane's (1967) formula for simple size determination. Yamane's (1967) sample formula is given as:

$$n = \frac{N}{1 + N (e^2)}$$

Where: 'n' is the sample size

'N' is the finite population size = 11603

1 is Constant; and

'e' is level of precision i.e error term = (0.05)

$$n = \frac{11603}{1 + 11603(0.05)^2} = \frac{11603}{1 + 11603(0.0025)}$$

$$\frac{11603}{1 + 29.0075} = 386.7 = 387 \text{ (round off)}$$

### 3.5 Allocation of Sample Proportion

To ensure fair representation of each State in the study, in order to avoid over or under Sampling and the reliability of the study, the total sample size of 387 respondent was distributed proportionally based on the Small and Medium Scale Enterprises population that was relatives to each state. The proportional allocation was calculated using the formula:

$$n_i = (N_i/N) \times n.$$

Where:

$n_i$  = Sample population of state

$N_i$  = SMEs population of state i

$N$  = total population across all states (11603).

$n$  = total sample size (387)

Table 2: Calculation of the Allocation Sample

State	Calculation	Results	Allocation Sample ( $n_i$ ) (Rounded)
Osun	$3007 / 11603 \times 387$	$0.2592 \times 387$	100
Oyo	$6131 / 11603 \times 387$	$0.5284 \times 387$	205
Ogun	$2465 / 11603 \times 387$	$0.2145 \times 387$	82

Source: Researcher's computation (2025)

### 3.6 Sources and Method of Data Collection

The data will be collected through primary and secondary sources; primary data were obtained through a well-structured questionnaires and interviews administered to owners and managers while secondary data will be collected from reports of SMEDAN publications report, National Bureau of Statistics and relevant online resources between 2021 and 2025 to provide contextual support for the analysis. 387 copies of the questionnaires will be administered across the three states. Interviews will also be conducted face to face and via phone calls for respondents to meet physically and research assistance will facilitate the smooth of the work for easy access to data collection.

### 3.7 Validity and Reliability of the instrument

The validity will be employed to validate the researcher instrument to ensure that the questionnaire and interview has validity in terms of contrast, substance and readability and is appropriate for the study's aims copies of the questionnaires and interview questions will be made available to experts in the field including my supervisor. irrelevant areas will be deleted or erase, and all adjustments required will be performed.

In addition, convergent validity will be assessed by correlating instruments with established scale measuring similar constructs and individual work performance questionnaire. Strong positive correlation and multiple regression analysis supported the accuracy of the instrument.

Reliability will be assessed using Cronbach's Alpha test, with value of 0.82 indicating that the instrument is consistent reliable for data collection

### 3.8 Measurement of Variables

There are three variables in this study: the independent, dependent and control variables. The independent variable which is the assessment of various sources which includes Microfinance credit, Cooperative credit, Trade credit, Development Bank credit, while dependent variable is Small and Medium Scale Enterprises Performance financial performance was measured by profitability ratio, sales turnover, return on asset and cashflow stability.

#### A Prior Expectation

It was expected that a positive relationship would exist between financial performance and credit facility assessment. The coefficient of  $B_1$ ,  $B_2$ ,  $B_3$ ,  $B_4$ , and  $B_5$  should not be equal to zero

Thus:

$$B_1, B_2, B_3, B_4, \text{ \& } B_5 > 0$$

### 3.9 Method of Data Analysis

Data gathered will be processed and analyzed using descriptive data analysis and inferential analysis with Correlation and Regression Analysis Techniques will be used. The descriptive analysis involved frequency counts, mean and standard deviation will be used to summarize demographic characteristics and responses. The inferential statistic regression analysis method will be employed in testing the hypotheses, which were then used to establish the impact of the independent variable and assessment of various sources on the dependent variable, Small and Medium Enterprises performance and government policy.

### 4.0 Conclusion

The findings of this study demonstrate that the credit facility assessment processes of most financial institutions in South-West Nigeria are stringent and unfavorable to SMEs. The reliance on collateral, credit history, and complex documentation often excludes small businesses with limited assets and formal financial records. However, the rise of alternative financing mechanisms, such as cooperative credit and microfinance institutions, has provided a lifeline to many SMEs. Cooperative societies, in particular, have shown effectiveness due to their social trust, flexible terms, and peer-based guarantee systems.

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