

Impact of Microfinance Services on Entrepreneurship Development: Empirical evidence from Pokhara Valley

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<https://doi.org/10.3126/kanyaj.v4i1.57023>

Abstract

Microfinance plays a critical role in consumer entrepreneurship development. This study measures the impact of microfinance services on entrepreneurship development in the Pokhara valley using a sample of 320 individuals. Confirmatory factor analysis (CFA) and structural equation modeling (SEM) are employed to assess the relationship between microfinance services and entrepreneurship development. The CFA results indicate a strong fit, aligning with the hypothesized model. Path analysis reveals significant positive associations between lending services, training and education services, and consultancy services provided by microfinance firms and entrepreneurship development. Conversely, saving services show a negative and insignificant association. These findings underscore the positive impact of certain microfinance services on entrepreneurship development, suggesting the need for policymakers and microfinance company management to prioritize the enhancement of lending, training, and consultancy services while reevaluating the effectiveness of saving services in promoting entrepreneurial endeavors.

Keywords: Consultancy services, entrepreneurship development, lending services, saving services, training and education services.

Background

Microfinance serves as a vital financial service aimed at providing support to individuals and small enterprises who are omitted from the traditional banking system (Bansal & Singh, 2020). This inclusive approach seeks to address the financial needs of marginalized populations, allowing them to overcome the barriers they face in accessing loans, savings accounts, and insurance products (Dhungana & Ranabhat, 2022). By doing so, microfinance endeavors to foster economic growth, reduce poverty, and promote financial stability among those living in low-income neighborhoods (Adhikari & Shrestha, 2013).

The significance of microfinance in supporting entrepreneurship and driving economic development cannot be overstated (Ferdousi, 2015). Empirical evidence from various studies has regularly emphasized the positive impact of microfinance programs on the income and productivity of small business owners (Gyimah & Boachie, 2018). Moreover,

these initiatives have proven helpful in improving the availability of vital resources and market access for entrepreneurs operating in resource-constrained environments (Kanayo et al., 2013). By bridging the financial gap and providing tailored services, microfinance plays a crucial role in empowering individuals to establish and expand their enterprises, contributing to overall economic growth and stability in low-income communities (Omnowo et al., 2016).

Despite its potential, microfinance faces certain challenges that limit its effectiveness in get rid of poverty (Olu, 2009). In Nepal, for instance, formal banking services struggle to reach rural populations, leading to inadequate access to financial resources (Dhungana & Ranabhat, 2022). Strict collateral requirements and complex procedures further worsen the difficulties faced by these marginalized communities in obtaining credit (Samson et al., 2013). As such, it becomes vital to carefully examine and understand the role of microfinance, particularly microcredit, in promoting entrepreneurship and economic development in Nepal (Ranabhat & Dhungana, 2021).

The purpose of this research is to investigate and assess the influence of microfinance services on entrepreneurial development in the Pokhara valley. This research tries to understand the present condition of microfinance in the region and its potential for decreasing poverty and encouraging economic growth by evaluating the various microfinance services offered and their consequences. The research highlights issue suches, "What microfinance services are available in the Pokhara valley?" How do these services affect the growth of entrepreneurship development? This study adds to our understanding of how microfinance might be utilized to help resource poor rural households in Nepal overcome poverty and achieve economic growth by answering these concerns.

The results of this study would not only add to the current literature on microfinance and entrepreneurship, but also give significant insights for Pokhara valley policymakers, practitioners, and microfinance organizations. Analyzing the structure of microfinance services and their influence on entrepreneurial development would allow stakeholders to modify their approaches, interventions, and policies to optimize microfinance's positive effects on poverty reduction and economic growth in the region.

Review of Literature

Microfinance institutions offer a range of services to support entrepreneurship development. Saving services involve the provision of accessible and secure savings accounts, allowing individuals to accumulate funds for future investment, including entrepreneurial activities (Dupas & Robinson, 2013). Lending services provide small loans to individuals, particularly those with limited access to traditional banking

systems, enabling them to obtain capital for starting or expanding businesses (Waller & Woodworth, 2001). Training and education services aim to enhance the entrepreneurial capacity of clients by providing knowledge and skills in areas such as business planning, financial management, and marketing strategies (Njoroge & Gathungu, 2013). Consultancy services offer expert advice and mentorship to entrepreneurs, assisting them in business strategy development, market analysis, and operational improvements (Omnowo et al., 2016). Entrepreneurship development encompasses the fostering of entrepreneurial activities through resources, support, and enabling environments, aiming for economic growth, job creation, innovation, and poverty reduction (Tende, 2014).

Saving Services and its Impact on Entrepreneurship Development

Previous research has examined the role of saving services in entrepreneurship development and its impact on the success of entrepreneurs. Studies such as Samson et al. (2013) have highlighted the positive relationship between savings mobilization and entrepreneurial outcomes. These findings suggest that individuals with access to formal savings services are better equipped to accumulate capital and invest in their entrepreneurial ventures. Moreover, savings can serve as a safeguard during challenging times, allowing entrepreneurs to sustain their businesses. Based on this literature, the researcher hypothesizes the following hypothesis:

H1: Saving services provided by microfinance firms have a positive impact on entrepreneurship development.

Lending Services and its Impact on Entrepreneurship Development

The provision of lending services by microfinance institutions has been recognized as a critical factor in supporting entrepreneurship development. Karlan and Valdivia (2011) have documented the positive effects of microcredit on business growth and expansion. Access to credit allows entrepreneurs to invest in their ventures, purchase necessary equipment, and expand their operations. Additionally, the availability of loans can provide entrepreneurs with financial stability and flexibility. Building upon this literature, the researcher hypothesizes the following hypothesis:

H2: Lending services offered by microfinance firms have a positive impact on entrepreneurship development.

Training & Education Services and its Impact on Entrepreneurship Development

The importance of training and education services in fostering entrepreneurship development has been emphasized by scholars. Studies such as Chowdhury and Che Mohd Salleh (2017) have highlighted the positive impact of training programmes on

entrepreneurial skills and knowledge acquisition. Access to training and education can enhance the capacity of entrepreneurs to make informed decisions, develop effective business strategies, and adapt to market changes. Based on this literature, the researcher hypothesizes the following hypothesis:

H3: Training and education services provided by microfinance firms have a positive impact on entrepreneurship development.

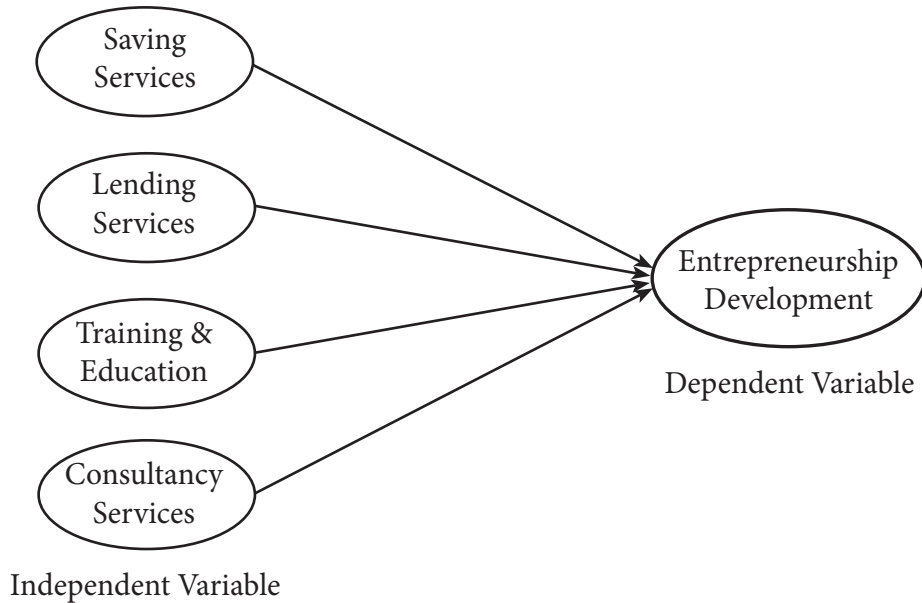
Consultancy Services and its Impact on Entrepreneurship Development

The provision of consultancy services by microfinance firms has gained attention as a valuable resource for entrepreneurs. Consultancy services offer guidance, mentorship, and expert advice to entrepreneurs, enabling them to overcome challenges and make informed business decisions. Previous research, such as the study by Omnowo et al. (2016), has highlighted the positive impact of consultancy services on entrepreneurial success. It is argued that access to consultancy services enhances the entrepreneurial capabilities of individuals and contributes to the growth and sustainability of their ventures. Building on this literature, the researcher hypothesizes the following hypothesis:

H4: Consultancy services offered by microfinance firms have a positive impact on entrepreneurship development.

Theoretical Framework

The theoretical framework proposed in this study is based upon empirical research conducted by Omnowo et al. (2016) and focuses on the relationship between various independent variables, namely saving services, lending services, training and education services, and consultancy services provided by microfinance companies within the Pokhara valley. The dependent variable of interest in this framework is entrepreneurship development. By examining the impact of these different services on the development of entrepreneurship, this theoretical framework aims to provide insights into the specific factors that contribute to entrepreneurial growth in the context of microfinance. The framework suggests that the provision of saving, lending, training, and consultancy services by microfinance companies can positively influence the development of entrepreneurship within the Pokhara valley.



Source: Omnowo et al. (2016)

Research Methodology

The research design for this study is descriptive and causal comparative. It aims to describe the impact of various microfinance services on entrepreneurship development and establish causal relationships between the independent variables (saving services, lending services, training & education services, and consultancy services of microfinance) and the dependent variable (entrepreneurship development). The population of the study consists of all the local people seeking microfinance services from different microfinance institutions within Pokhara Valley. Due to the absence of a sampling frame, non-probability sampling was used for this study. Specifically, convenience sampling was employed to select respondents conveniently available for data collection. The sample size for this study is determined based on the level of significance and error margin. With a level of significance set at 5% and an error margin of 4%, the calculated sample size is 267 (Rahman, 2023). However, to account for potential non-responses, a sample of 320 respondents was selected. A structured questionnaire was used as the primary data collection instrument. The questionnaire was divided into three parts: demographic information, microfinance services, and entrepreneurship development. The questionnaire was designed to gather relevant data related to the research objectives. To ensure the reliability of the questionnaire, Cronbach's alpha and composite reliability (CR) was calculated. These measures will assess the internal consistency of the questionnaire items. For validity, average variance extracted (AVE) and Fornell-Larcker criterion was used to evaluate the convergent and discriminant validity of the research

instrument (Birne, 2016). The collected data was processed and analyzed using statistical software packages such as SPSS version 26 for descriptive statistics. Confirmatory Factor Analysis (CFA) was performed to assess the measurement model's validity. Structural Equation Modeling (SEM) was employed to examine the relationships between the independent and dependent variables and to test the research hypotheses (Hair, 2011). To ensure ethical standards, the respondents were provided with all necessary information regarding the nature of the study. They were assured that their responses will be treated with confidentiality. Respondents' names were not asked to maintain anonymity and ensure data confidentiality.

Results and Findings

The result and findings for the study is presented as demographic characteristics, characteristics of enterprise relativity & validity, CFA and data analysis.

Demographic Characteristics of Respondents

The demographic characteristics of respondents seeking various microfinance services from various microfinance firms in Pokhara is presented as gender, age, education and marital status. The summary of demographic characteristics of respondents has been presented in Table 1.

Table 1

Demographic Profile of Respondents

Profile	Group	Frequency	Percentage
Gender	Male	120	37.5
	Female	200	62.5
Age	Less than 25 yrs	2	0.6
	Between 25-30 yrs	56	17.5
	Between 30-35 yrs	80	25.0
	Between 35-40 yrs	96	30.0
	Above 40 years	86	26.9
Education	SLC	102	31.9
	Intermediate	52	16.3
	Bachelor	6	1.9
	Masters	4	1.3
	Others.....	156	48.8

	Single	4	1.3
Marital Status	Married	296	92.5
	Others	20	6.3

Source: Field Survey, 2022

Table 1 shows the demographic characteristics of the respondents. The gender distribution of the respondents shows that 37.5 percent are male while the remaining 62.5 percent are female. The age of the participants shows that most of them i.e. 81.9 percent are above 30, the remaining 18.1 percent is divided between those who are below 30 years. The distributions of the participants based on marital status are roughly equal with married 92.5 percent and 7.5 percent falls to unmarried and others. The respondents are highly uneducated with overwhelming majority, 80.7 percent with no or with SEE level qualification.

Characters of Enterprise of respondents.

The various characteristics of enterprise of respondents is presented with reference to time engaged, nature, time involved in current firms, intital source of capital purpose of borrowings, number of employee and is presented in table 2.

Table 2

Characteristics of Enterprise of respondents

Profile	Group	Frequency	Percentage
Time Engaged with microfinance	1 year	48	15.0
	2 years	96	30.0
	3 years	142	44.4
	4 years	34	10.6
Nature of enterprise	Wholesaler	22	6.9
	Retailer (Shop)	128	40.0
	Services (Hotel, Motel)	94	29.4
	Agriculture	76	23.8
Time involved in current enterprise	Less than 1 years	2	0.6
	2 – 5 years	156	48.8
	5 -10 years	94	29.4
	More than 10 years	68	21.3
Initial source of Capital	Savings	126	39.4
	Loan from MFIs	54	16.9
	Sale of tangible/ intangible assets	70	21.9
	Others ...	70	21.9

Purpose of Borrowings	Establish new enterprises	10	3.1
	Stability of existing enterprises	94	29.4
	Expansion of existing enterprises	180	56.3
	Others	36	11.3
Number of employee in your enterprise	No	273	85.3
	3	25	7.8
	4	16	5.0
	5	4	1.3
	7	2	0.6

Source: Field Survey, 2022

Table 2 shows some of the characteristics of enterprise of the respondents they are involved in. Most of the people i.e. 44.4 percent have at least 3 years of engagement with microfinance. The nature of enterprise of the respondents was found to be highest in Retailer (40 percent), followed by Services (29.4 percent), then Agriculture (23.8 percent). Wholesaler was the least engaged nature of enterprise with only 6.9 percent. About 48.8 percent of the respondents were involved with current enterprise with duration of 2-5 years, followed by 29.4 percent with 5-10 years of involvement and finally 21.3 percent with more than 10 years of involvement. Initial source of capital for the respondent were from savings consisting of 39.4 percent, followed by sale of assets consisting of 21.9 percent. People used to get initial source of capital from loan from MFIs consisting of only 16.9 percent. The people used to borrow fund from the MFIs to expand their existing enterprise consisting of 56.7 percent, followed by stability of existing enterprise consisting of 29.4 percent. Majority of enterprise about 85.3 percent had no employee in their firm followed by 3 employees consisting of 7.8 percent.

Reliability and Validity

Construct Reliability: The construct is considered reliable if the CR is > 0.70 and Alpha > 0.70 . The outcomes of the test (Table 3) shows that all the Cronbach's Alpha values are above the threshold criteria of > 0.70 where the lowest is 0.753 for lending services and the highest is 0.845 for saving services. Further, the Composite Reliability of the model is shown to be above the critical values > 0.70 where the lowest is 0.787 for lending services and the highest is 0.882 for saving services. Thus the construct reliability is clearly established.

Table 3

Construct Reliability of scale

Variables	Cronbach's Alpha	Composite Reliability (CR)
Saving services	0.845	0.882
Lending services	0.753	0.787
Training & Education	0.762	0.818
Consultancy services	0.774	0.823

Source: Field Survey, 2022

Construct validity

The construct validity has been calculated for its two subtypes, discriminant and convergent validity, as shown in Tables 4 and 5. According to the recommended criteria $CR > 0.70$ and $AVE > 0.50$, the construct reliability table shows that the model has $CR > 0.70$ and $AVE > 0.50$. Where minimum value for Training & Education is 0.687 and the maximum is of 0.759 for lending services, thus achieving the convergent validity.

Table 4*Convergent and Discriminant Validity*

Variables	Average Variance Extracted	Maximum Shared Variance
Saving services	0.719	0.575
Lending services	0.759	0.642
Training & Education	0.687	0.646
Consultancy services	0.736	0.619

Source: Field Survey, 2022

Table 5*Square Root of AVE and Construct Correlation Analysis*

Variables	Saving services	Lending services	Training & Education	Consultancy services
Saving services	0.848			
Lending services	0.506	0.871		
Training & Education	0.624	0.590	0.829	
Consultancy services	0.762	0.571	0.631	0.858

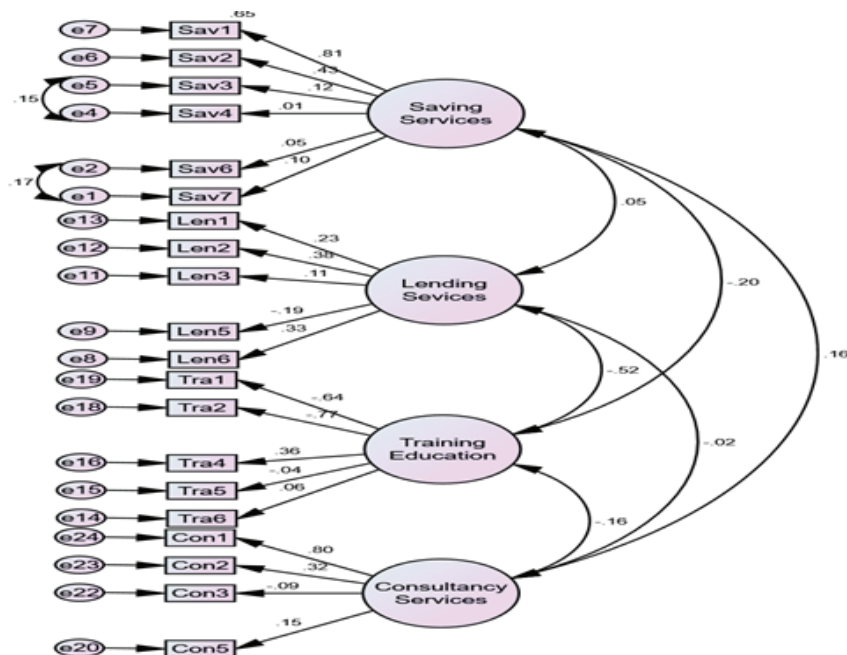
Source: Field Survey, 2022

Further, the recommended criteria of $MSV < AVE$ and Square Root of AVE greater than Inter-construct correlation have been achieved and accordingly the discriminant validity has also been established.

Confirmatory Factor Analysis (CFA)

The first step in data analysis using the structural equation modeling technique is to conduct confirmatory factor analysis to validate the constructs of the model (Hair et al, 2010). A confirmatory factor analysis was conducted on the data collected from respondents through Structural Equation Modeling in AMOS (Version 22), using Maximum Likelihood (ML) estimation (Byrne, 2010). The CFA shows an acceptable model fit based on absolute fit indices (GFI, AGFI, χ^2 , and RMSEA). The goodness of fit indices (GFI and AGFI) values are 0.951 and 0.937 respectively which are cut-off value of 0.9 indicating excellent fit of hypothesized model with sampled data. However, GFI and AGFI values are affected by sample size and can be larger for models that are poorly specified and as such their use as fit indices is rather limited. Hence, the model fit is examined employing additional fit indices. The normal chi-square (χ^2) - (χ^2 to degrees of freedom, $\chi^2=165.413$, d.f. = 162) is 1.021, which is below the acceptable cut-off value of 3.0. However, chi-square value increases with sample size and number of observed variables, introducing bias in the model. Hence, alternative model fit indices have been examined. Root mean square error of approximation (RMSEA) is 0.008, which is lower than 0.08, indicating excellent fit. The values of incremental fit indices CFI (comparative fit index) and TLI (Tucker Lewis Index) are 0.985 and 0.983 respectively. The values of more than 0.90 are indicator of excellent model fit.

Figure 1
Measurement Model of the types of Microfinance Services



Structural Model or Path Analysis

In moving from the measurement model to the structural model, the emphasis of the study now shifts from the relationships between latent constructs and the observed variables to the nature and magnitude of the relationships between the constructs as depicted in figure below. The structural model is specified based on the existing theories of economics. It is hypothesized that saving services, lending services, training & education and consultancy services of Microfinance firms are propositioned to entrepreneurship development within Pokhara. The results of the SEM path analysis are shown in table. By using structural or path analysis, the study evaluates the hypothesized causal relationship proposed in the theoretical model. The latent constructs entrepreneurship development is endogenous as the variable is being explained in the model by exogenous variables. The latent constructs saving services, lending services, training & education and consultancy services are exogenous constructs as they are not explained by other variables in the model. The structural model examines the hypotheses H1, H2, H3 and H4 given in the previous section.

Table 6
SEM Path Analysis

Structural Path	Estimate	SRW
Entrepreneurship development ← Saving services	-0.144 (0.516)	-0.252
Entrepreneurship development ← Lending services	0.021** (0.41)	0.031
Entrepreneurship development ← Training and Education	0.136*** (0.631)	0.144
Entrepreneurship development ← Consultancy services	0.203** (0.861)	0.196

Squared Multiple Correlation

Entrepreneurship development ($\gamma^2 = 0.593$)

Model Fit Measures

Chi-square = 289.361 (df=261, prob. = 0.110)

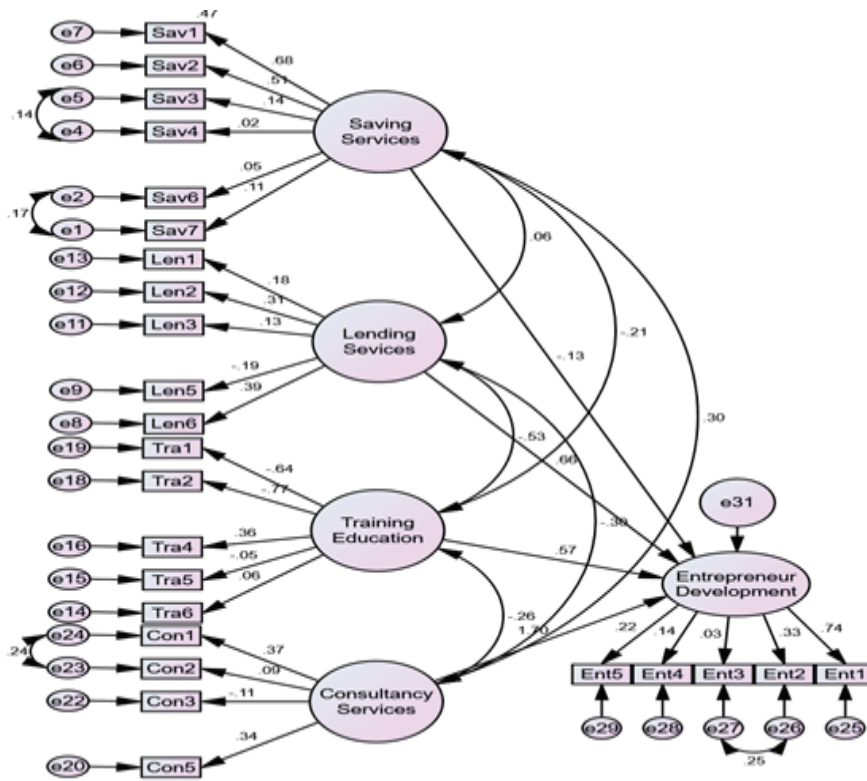
CMIN/DF= 1.109, PGFI= 0.751, CFI=0.927, RMSEA=0.018, GFI=0.936 ,AGFI=0.920, TLI=0.917 (Standard error of estimate).

SRW = Standardized regression weights*** p<0.001, **p<0.01

Source: Field Survey, 2022 and authors' calculation.

Figure 2

SEM Path Analysis indicating relationships between Microfinance Services and Entrepreneurship Development



The path analysis results show the overall fit measures as discussed in the preceding section which provides judgment for how the structural or path model fits the data. Analysis of path model outputs reveal chi-square value [$\chi^2 (261) = 289.361, p=0.110$], GFI=0.936, AGFI=0.920, CFI=0.927, TLI=0.917, RMSEA=0.018] yielded to some extent a reasonable fit to data. The χ^2 is insignificant ($p=0.110$), indicative of a good fit. However, the normal chi-square (χ^2 / df) is 1.109 which is lower than cutoff value of 3 implying satisfactory model fit. Additionally, the RMSEA value of 0.018 is less than acceptable limit of 0.08. Similarly, the values of the incremental fit indices CFI and TLI are generally cited near to cut-off value of 0.90 hence, the results indicate a very good fit of the model. Therefore, the model is determined to have excellent fit to proceed with further analysis.

The path analysis results allow for testing the hypothesized relationship of the constructs as outlined in Figure 2. In H1, saving service has negative insignificant

impact on entrepreneurship development which indicates that customer does not consider and give priority on saving services provided by microfinance companies to have an impact on entrepreneurship development. In H2, it was hypothesized that lending services has significant positive impact on entrepreneurship development which indicated that people considers lending services provided by microfinance to be critical and important in determining entrepreneurship development. As stated by H3, training and education has significant positive impact on entrepreneurship development which is in hypothesized direction and it is statistically significant. Thus, it is accepted that people consider training and education services provided by microfinance to be critical and important in determining entrepreneurship development. Similarly, H4 predicted that consultancy services have significant positive impact on entrepreneurship development which is supported by the model. This indicates that the people consider consultancy services provided by microfinance to be critical and important in determining entrepreneurship development. Among the relationship between the latent constructs, the relationship between consultancy services and entrepreneurship development is the highest and significant. The values of squared multiple correlations reveal that around 59.3 percent of variation in entrepreneurship development is explained by saving services, lending services, training & education and consultancy services.

Discussion

The findings of this study provide valuable insights into the demographic characteristics of microfinance recipients and the relationship between microfinance services and entrepreneurship development. The high percentage of female respondents supports with existing research that highlights the positive impact of microfinance on empowering women entrepreneurs (Chowdhury & Che Mohd Salleh, 2017). The majority of participants above the age of 30 suggests that microfinance services are reaching individuals in the later stages of their entrepreneurial venture, possibly indicating the need for targeted support for younger entrepreneurs. The low levels of education among the respondents highlight the potential of microfinance to provide opportunities for individuals with limited formal education, consistent with studies emphasizing the inclusive nature of microfinance interventions (Akingunola et al., 2013).

Regarding enterprise features, the status of retail and service-based businesses reflects the trends observed in previous research on microenterprises (Sussan & Obamuyi, 2018). The findings also highlight the critical role of microfinance in supporting the growth and expansion of prevailing enterprises, which aligns with studies stressing the positive impact of microfinance on entrepreneurship development (Karlan & Valdivia, 2011). The reliance on personal savings as a source of capital suggests the

limited access to formal financial institutions, further emphasizing the importance of microfinance as an alternative source of funding for entrepreneurs in underserved communities (Swapna, 2017).

The reliability and validity analysis of the measurement model in this study demonstrated acceptable levels, consistent with previous research on microfinance and entrepreneurship (Omnowo et al., 2016). The positive and significant impact of lending services, training and education, and consultancy services on entrepreneurship development reaffirms the notion that microfinance interventions go beyond mere financial support by providing valuable non-financial services that contribute to entrepreneurial success (Omnowo et al., 2016). The lack of a significant impact for saving services contradicts some studies that have highlighted the role of savings mobilization in enhancing entrepreneurial outcomes (Samson et al., 2013). Further exploration is needed to understand this discrepancy and assess the specific mechanisms through which saving services influence entrepreneurship development.

Conclusion

This study provides empirical evidence on the impact of microfinance services on entrepreneurship development in the Pokhara Valley. The findings demonstrate that lending services, training and education services, and consultancy services offered by microfinance firms have a significant positive influence on entrepreneurship development. However, saving services do not show a significant impact, highlighting the need for further investigation into their effectiveness. The study also reveals important insights into the demographic characteristics of microfinance recipients, with a high percentage of female respondents and individuals above the age of 30, emphasizing the empowering role of microfinance for women and the potential for targeted support for younger entrepreneurs with limited education. The results of this study align with existing research, emphasizing the inclusive nature of microfinance interventions and their positive impact on empowering women entrepreneurs and supporting the growth and expansion of existing businesses. Based on these findings, policymakers and microfinance company management should prioritize the enhancement of lending, training, and consultancy services to further support entrepreneurship development. Additionally, further investigation is needed to understand the discrepancy regarding the effectiveness of saving services and to explore the specific mechanisms through which these services can contribute to entrepreneurship development.

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Annex 1

Operationalization of Study Variables

A) Types of Microfinance services

Saving Services

Sav1: It helped to improve on marginal propensity of the people to save.

Sav2: It helped to improve on growth and expansion of microenterprise due to wealth accumulation.

Sav3: It helped to improve on saving programs.

Sav4: It helped in managing liquidity at their households.

Sav5: It helped in managing frequent cash inflows.

Sav6: It helped in cushion people against familiar risks such as illness, theft, job losses etc.

Sav7: It helped to bring down interest chargeable on loans.

Lending Services

Len1: It helped in growth and expansion of microenterprise.

Len2: It helped cushion microenterprise from stiff competition from established firms.

Len3: It helped microenterprise to avoid microenterprise failure.

Len4: It helped microenterprise to increase their profitability.

Len5: It helped to improve their microenterprise through innovation.

Len6: It helped to increase in household venturing into microenterprise.

Training and Education

Tra1: It enhanced efficient management in microenterprise.

Tra2: It helped to improve people attitude towards micro enterprising.

Tra3: It helped to improve on performance undertaking tasks.

Tra4: It had made possible for use of new technology in microenterprise.

Tra5: It helped microenterprise to drive down the cost of operations

Tra6: It helped impart widespread knowledge to people on how to manage loans.

Consultancy Services

Con1: It helped to led rapid expansion of microenterprise.

Con2: It provided fashionable management knowledge and techniques to microenterprise.

Con3: It helped appropriate remedies on emerging problems in microenterprise.

Con4: It helped in new organizational forms and strategies for microenterprise.

Con5: It helped in evolution of microenterprise thinking.

B) Entrepreneurship Development

Ent1: Its services aided in the generation of job opportunities.

Ent2: Its services aided in the growth of low-income families.

Ent3: Its services aided in the formation of economic diversity.

Ent4: Its services aided in the poverty alleviation.

Ent5: Its services aided in the elimination of gaps between rural populations.

Ent6: Its services have aided low-income people.