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Deposit Money Banks' Lending Rate and Small Scale Firms Performance in Nigeria

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ABSTRACT

The research work investigated the impact of Deposit Money Banks' Lending Rate on Small and Medium Firms Output in Nigeria spanning for the period 2002-2014. The objectives of the study were to ascertain the impact of bank lending rate, inflation rate and exchange rate on small and medium scale firms output in Nigeria. Ex-post Facto research design was adopted while Ordinary Least Square estimation techniques was used. It was discovered that bank lending rate has negative significant impact on Small and Medium Scale firms Output; Exchange rate has significant positive impact on Small and Medium Scale Industry Output while inflation rate has positive and insignificant impact on Small and Medium scale industry output in Nigeria. The study recommended that appropriate policies be put in place to drive down bank lending rate to stimulate economic growth and enhance small and medium scale industry output in Nigeria and to further support the SMIs output, there is need for government to pursue policies to drive down the lending rate to the barest minimum so as to stimulate economic growth in Nigeria.

Keywords: Deposit money bank, Lending rate, Inflation rate, Exchange rate, Nigeria.

INTRODUCTION

There are various problems facing the establishment of small and medium scale industry like financing, high rate of inflation that led to vast depreciation of naira exchange rate, thus making it difficult for most SMIs to obtain required inputs for expansion, lack of raw materials, lack of adequate planning and feasibility studies [1].

The most common and problematic issues is funding. Small and medium industry find it difficult to obtain fund from established institution like commercial banks. The cost of borrowing from the banking sector especially for the small and medium scale industry in Nigeria has been high [2]. The issue involved is the question of capital adequacy, when a company is under capitalized it cannot realize its' full potentials. Many small and medium scale enterprise in Nigeria, experience this problem. They cannot expand their scale of production to optimum level. The challenge remains how to establish the link between high lending rate and SMIs performance in Nigeria [3, 4].

In Nigeria today, Small and Medium Scale Industry (SMIs) have been considered very essential for economic growth and development since they are seen as being more innovative; have higher labour absorptive capacity; greater utilization of local raw materials; employment generation; encouragement of rural development of entrepreneurship mobilization of local savings; provision of opportunity for training managers and semi skilled workers [5, 6]. The commercial banks and other financial institutions play a vital role in making sure that the nation's economic growth is sustained and well organized through efficient provision of bank credit at affordable lending rates [7, 8].

A commercial bank is a financial institution that is authorized by law to accept deposits from businesses and individuals and to extend credit to borrowers. Bank of Industry (BOI) defines small scale industry as "an industry with capital not exceeding

N750,000 including working capital but excluding cost of land [9, 10, 11]. The Nigerian concepts of Small And Medium Scale Industries (SMIs) are some what divergent but the Central Bank of Nigeria (CBN) agrees with the Small And Medium Industries and Equity Investment Scheme (SMIEIS) in their definition of small and medium scale industries as any industry with a maximum asset base of less than 14200 million excluding iSnd and working capital and with the number of staff employed not less than ten (10) and not more than 300 [13, 14, 15]. Commercial banks in Nigeria has played a vital role in developing small and medium scale industry, but have not fully solved the problem of the small and medium scale enterprises in Nigeria despite all the effort made.

The (SMIs) have encountered some series of problem, and they are in absolute terms, not strong and virile as to bridge the major gap in Nigeria's quest for rapid industrialization. Since then, government policies have been rooted in the neoclassical theory of perfect competitive markets whose assumptions do not reflect constraints on SMIs in developing countries such as Nigeria. The major reason for low performance of the SMIs is the poor access to Credit [16]. Essien (2001) [7], states that adequate credit delivery to Small and Medium Scale Industries is what is expected in order to enable the country's industrial sector meet their main challenges of poverty alleviation and globalization. A number of financial institutions have invested in small and medium scale industries development in Nigeria, Some of these institution's that the Nigerian government set up to boast entrepreneurship development includes the Bank of Industry (BOI). Nigerian Agricultural and Rural Development Bank (NARDB) (now known as the Bank of Agriculture (BOA) and Peoples Bank of Nigeria (PBN) now known as Micro Finance Bank (MFB).

The broad objective of this study is to ascertain the impact of commercial bank lending on small scale industries in Nigeria. In view of the above, the study has the following specific objectives are to; examine the impact of bank lending rate on small and medium scale

industries output in Nigeria, ascertain the impact of exchange rate on Small and Medium Scale Industries output in Nigeria and determine the impact of inflation rate on the Small and Medium Scale Industries output in Nigeria.

Empirical Literature and Conceptual Framework

Adafu and Audu (2010) [1] used ordinary least square method to assess the rontribution and efficiency of financial institution in enhancing economic growth Nigeria, one of the variables of the study was commercial bank credit to igriculture (SMIs). The study used annual data and found that commercial banks credits to agriculture impact positively on GDP. The study therefore, concludes that financial institutions play a significant role in enhancing economic activities and hence recommend that monetary authorities should ensure appropriate determination of interest rate that will break the doubles-edge effect of interest rate on savers and local investors.

A study of the trend of commercial bank credit to Small and Medium Scale Industries in Nigeria suggests that an increase in commercial banks credit allocation to SMIs, would increase SMIs contribution to GDP [8]. Therefore, the reasons for the low contribution of the SMIs to the total GDP includes lack of credit facilities, shortage of skills among the entrepreneurs, weak infrastructural facilities, inability of small and medium industrialists to transform ideas into reality.

Mobolaji (2010) [11] contends that one of the major objectives of any government is the acceleration of economic growth and development. Each country tries to achieve this by various ways channels. He conducted an empirical study that analyzes the impact of Small and Medium Scale Industries on economic development in Nigeria for the period 1980-2008. The paper employs a time series econometric approach to assess this impact, the study finds that though SMIs is a catalyst for development, its' impact on the development path in the country is still negligible. This performance

many due to several reasons such as poor funding facilities, low level of education and weak government support amongst others.

The paper suggest more positive government support and more enlightenment, for sector to actually play its, expected role of facilitating economic development and for a smooth transition to innovation-driven economy.

A study conducted by [5], reveals the gap between deposit money bank deposits (DMBD) and commercial bank lending to Small Medium Scale Industry (SMIs) from the year 2000 upward. There is a wide margin between the two variables and while deposit money bank deposits becomes very high, commercial bank lending to Small Medium Scale Industry (SMIs) declined from 2004 to 2010. The gap between commercial bank deposits and its lending to major investors (customers).

[6, 9], noted that research efforts in the areas of financial sector reforms and its impact on Small Medium Scale Industry (SMIs) are minimal. The few ones sighted include reforms and growth of SMIs in Nigeria's Anjo (2011) on the impact of banking sector reforms on growth and development of Entrepreneurs; Lawal and Ijaiga (2010) on Small Medium Scale Industry (SMIs) Access to Commercial Bank Credit and their Contribution to GDP in Nigeria. Lastly Aruwa (2009) Assessment of Small and Medium Industries Equity Investment Scheme (SMIEIs) implementation guidance. The studies are unanimous in their conclusions that the negative impact of banking sector reforms on Small Medium Scale Industry (SMIs) have out weight the positive impacts. The reasons for this includes instability in the exchange rate of the naira, high interest rate etc.

According to Mawoli (2010) [12] high foreign exchange rate, galloping inflation and unstable monetary and fiscal policies hamper, Small and Medium Scale Industries development. Majority of SMIs in Nigeria rely on foreign imported technology and even agricultural raw materials from advanced countries to carry out production. Thus it could be argued that when the Nigerian currency losses value or is devalued the exchange rate between naira and any foreign currency, say U.S dollars (all things being equal) increases.

Historical Background of SMIs in Nigeria

Small and Medium Scale Industries has long history like every other part of the world. Historically, "Small and medium Industries has its origin in the eastern and mediterian", Small and Medium Scale Industries, all over the world is a divergent arrays of business concerns involve in economic activities spanning from micro and rural industries to contemporary industrial organization that uses sophisticated technologies. As a result of their relevance and contribution i.e Small and Medium Scale Industries to national economies, policy planners, academic and national government have shown interest in issues pertaining to Small and Medium Scale Industries (SMIs) all over the world.

It was a means of survival for the people since ages, it has managed to save many poor homes that have the innovation to start a unique business but with different problems with establishment or survival. In Nigeria, there is no generally acceptable definition of SMIs but it varies over time from organization to organization. The National Council of Industry (NCI) in 2001 include the capital investment of SMIs at between N150million to N200 million, excluding land but including working capital and work force base between 11 and 300 inclusive. But on the other hand, National Association of Small and Medium Scale Enterprise (NASME) also define a Small and Medium Scale Industries as a business with less than fifty employees within the industry, and with an annual turnover of N100 million. NASME came up with Mother definition, which states that Small and Medium Scale Industries is a business with less than 100 employees and an annual turnover of N500 million.

The Central Bank of Nigeria (CBN) defines SMIs as an Industry with maximum asset base of N200 million, without land and working capital, also the member of

employees not less than 10 and not more than 300. Due to the flexible nature, SMIs are quite able to withstand economic diverse situations. In Nigeria SMIs are more likely able to survive in smaller urban and rural areas where they can effectively contribute to the distribution of economic activity in any region and that has helped the reduction in the migration to the larger cities like Lagos and Kano.

Small and Medium Scale Industries in Nigeria can be categorized into urban and rural Industries, but in a more formal way they can be called organized and unorganized Industries. The organized Industries have paid employees with a registered office while the unorganized Industries are mainly made up of artisans who work in open spaces, operating in temporary wooden workshop or structures, the unorganized Industries rely mostly on apprentices or family members and mostly low rate or no salary paid workers. Rural Industries are made up of family groups, women that engaged in food production from local farm crops and individual artisans. The major activity involved in this sector include; soap and detergents, fabrics, textile and leather, local blacksmith, clothing and tailoring, timber and winning, food processing, agro processing, beverages bakeries, chemical based product and mechanics. (www.cenbank.org accessedonline 20-05-09).

According to history, Small and Medium Scale Industries in Nigeria have exists since the country independence in 1960, probably before independence but since independence Nigeria has had series of seminars, studies and workshops, each of which appraised the excellence, importance and need to facilitated establishment and sustainability of Small and Medium Scale Industries. All the National four year development plans from 1963 to 1985 have laid strong emphasis on strategies of government led industrialization mount on import as ititution. In addition, the Structural Adjustment Program (SAP) initiation in i, the state did not appreciate the Structural Adjustment Program (SAP) active involvement in industrialization by a process of commercialization and privatization. Special attention was then shifted from Large Scale Industry to a Small and Medium Scale Industries, which as a prominent potential for developing domestic linkages for effective growth, sustainable industrial development. Bigger and greater learning were then placed on the Organized Private Sector (OPS) to head previous industrialization programmes.

The sector further actively encouraged, by more incentive; these were directed at solving or at least alienating the huge problems that were encouraged by the industrialists in the country and therefore enabling them greater leeway towards increasing their contribution to the national economy.

[10], in a study contends that there is lack of appropriation and adequate managerial and entrepreneurial skills with the attendant lack of strategic plan, business plan, succession plan, adequate organizational system and managers of small and medium industries (SMIs) in Nigeria.

The study heavily relied on the Supply Leading Theory which postulates that the existence of financial institutions like commercial banks and the supply of their financial assets, liabilities and related financial services in advance of demand for them would provide efficient allocation of resources from surplus units to deficit units, thereby leading the other economic sectors in their growth process [11]. This theory performs two functions. First, it transfers resources from traditional sectors to modern sectors and secondly, it promotes and stimulates an entrepreneurial response (SMIs) in the modern sectors.

METHODOLOGY

Research Design and Model Specification

This study used the ex post Facto Research Design. This is because the study attempts to explore cause nature that affects relationships, where causes already exist and cannot be manipulated. The choice of model for this research is the Ordinary Least Squares because it provides satisfactory results for estimates of structural parameters. This research design is based on the classical linear regression model, otherwise referred to as ordinary least square (OLS) technique. The choice of this method is not only as a result of its optimal properties of linearity, unbiasedness and minimum variance, but also of its computational simplicity. However, due to conventional reasons, we used E-view statistical package in the analysis for a reliable result.

The source of data used for this work is completely secondary source of data. The data generated for this work are quarterly and annually panel data from the period of 2002-2014. we generated time series data and commercial bank lending rate on small and medium scale industry output from the Central Bank of Nigeria Statistical Bulletin, and other, published research works of the period under review. However the research adopted multiple regression analysis in order to test the three objectives as stated above is stated below thusly;

This model estimate that:

$$Y_t = a_0 + a_1 X_t + U_t \dots (1)$$

Equation (1) above is the growth equation where;

- Y_t = index of small and medium scale industries (SMIs)
- a_0 = the intercept term
- a_1 = the regression co-efficient of the parameter estimates
- X_t = a set of baseline explanatory variables that have been shown to be robust determinants of bank lending rate.
- U_t = error term

The above model was modified and estimated as follows:

$$SMI = f(IRS, EXR, INF) \dots (2)$$

$$SMI_t = a_0 + a_1 IRS_t + a_2 EXR_t + a_3 INF_t + U_t \dots (3)$$

Where SMI = Small and Medium Scale Industry Output

IRS = Interest rate spread

EXR = Exchange rate

INF = Inflation rate

t = time series (annual)

a_0 = represents the constant or the intercept on Y axis

$a_1 = a_3$ Regression co-efficient of the parameter estimate

u = error or disturbance term

Description of Research Variables

The variables used in this research study are time series in nature and are categorized into dependent and independent variable. The dependent variable represents the index of Small and Medium Scale Industry (SMIs). Central Bank of Nigeria (CBN) agrees with the Small and Medium Industries and Equity Investment Scheme (SMIEIS) in their definition of small and medium scale industries as any industry with a maximum asset base of less than N200 million excluding land and working capital and with the number of staff employed not less than ten (10) and not more than 300 [12, 13, 14, 17].

Whereas, the independent variable includes interest rate spread (IRS). In banking, the interest rate spread is the difference between interest earned on loans, securities, and other interest-earning assets and the interest paid on deposit and other interest bearing liabilities.

Inflation rate (INF): Is the rate at which the general level of pieces for goods and services is raised and, consequently, the purchasing power of currency is falling.

Exchange rate (ER): Is a price for which the currency of a country can be exchanged for another country's currency. Are the baseline explanatory variables that have been shown to be robust determinants of high lending rate in Nigeria.

Estimation Procedures

The study performed unit root test to ascertain the statistics of the data Descriptive test were carried out to examine the characteristics of the data in terms of the mean, median and standard deviation. Correlation test was performed to ascertain the nature of the relationship between the dependent and independent variables. Co-integration test was done to ascertain whether there is long-term impact of bank lending rate on Small and Medium Scale Industries Output (SMIs). The size and probability value of the t-statistics formed the bases for testing the statistical significance of the results to be obtained.

Data presentation and results

Descriptive Test

Table 1: Descriptive Statistics Test Result

	SMI	IRS	FXR	INF
Mean	8965.980	9.797333	135.2985	9.306667
Median	8071.070	9.490000	132.1470	9.000000
Maximum	16132.28	15.57000	158.5526	12.00000
Minimum	3044.910	6.300000	102.1052	7.000000
Std. Dev.	4935.599	2.633117	18.10087	1.266867
Skewness	0.314264	0.554593	-0.147924	0.274090
Kurtosis	1.536350	2.509602	1.865599	3.166163
Jarque-Bera	1.585824	0.919241	0.858994	0.205070
Probability	0.452525	0.631523	0.650836	0.902546
Sum	134489.7	146.9600	2029.477	139.6000
Sum Sq. Dev.	3.41E+08	97.06629	4586.983	22.46933
Observations	15	15	15	15

Sources: Researchers' compilation from E-view (version 7.0)

Descriptive statistics shows the effect of commercial bank on small and medium industry output within the period of the study was found to be consistent increase over the period of the study as seen by the standard deviations. From table 1 above, there was a positive skewness of all the variables employed indicating that the degree of departure from symmetry of a distribution was positive, also kurtosis value of which is the normal value revealed that the degrees of peakedness of all the variable employed within the period under review were normally distributed as it trends goes around the mean with 15 years observation period of 2002 to 2014.

The use of time series data for estimating the parameters of economic relationship among variables is predicted upon some assumptions one of which is that such a data series is stationary. In this context, testing for stationarity or otherwise of the employed data sets becomes of essence in this analysis. The Augmented Dickey-Fuller (ADF) was employed to test for the existence of unit roots in the data using trend and intercept. The test results are presented in below:

Table 2: ADF Unit Root Result Test

Series	ADF @ Level	ADF @ 1 Difference	5% Critical value	Order of co-integration	Remark
SMI	-2.704664	-4.678109	-3.828975	1(1)	Stationary
IRS	-3.358561	-3.274314	-3.008157	1(1)	Stationary
EXR	-2.418460	-5.653156	-3.828975	1(1)	Stationary
INF	-4.445014	-4.795896	-3.828975	1(1)	Stationary

Sources: Researchers' compilation from E-view (version 7.0)

Table 2 above shows the summary of unit root test results. The result shows that none of the variables; SMI, IRS, EXR and INF were stationary at levels using Augmented Dickey Fuller test. This is because their critical values were greater than ADF test statistics in absolute value at 5 percent level of significance. However, all the variables considered became stationary after first difference since their ADF test statistics were greater than their critical values in absolute value. The results show that the series are integrated of the same order; I (1) with the application of both ADF test. Therefore, the variables are fit to be used for the analytical purpose for which they were gathered.

Co-integration Test

Johansen co-integration test determines whether there exist long-term relationship occurs in variables or not. The test envisage that there can be just one relationship between variables in long term. In most cases, if two variables that are I(1) are linearly combined the combination will also be I(1). More generally, if variables with differing orders of integration are combined, then the combination will have an order of integration equal to the largest. The model with lag 1 was chosen with the linear deterministic test assumption and the result is presented below:

**Table 3: Co-integration Result Test
Unrestricted - Rank Test (Trace)**

Hypothesized No. of CE(s)	Eigen value	Trace Statistic	0.05 Critical Value	Prob. **
None *	0.994061	82.99493	47.85613	0.0000
At most 1 *	0.573383	16.35479	29.79707	0.6871
At most 2 *	0.279828	5.280486	15.49471	0.7783
At most 3 *	0.074967	1.014043	3.841466	0.3142

Trace test indicates 4 co-integration eqn(s) at the 0.05 level

Sources: Researchers' compilation from E-view (version 7.0)

Under the Johansen Co-integration test, Co-integration is said to exist if the values of computed Eigen values are significantly different from zero or if the trace statistics is greater than the critical value at 5 percent level of significance. The results of the co-integration in table 3 above indicated three co-integrated equation. This is because trace statistics is greater than the critical value at 5 percent level of significance in only of the hypothesized equations. Similarly, the computed Eigen value is significantly differently different from zero in one of the hypothesized equations.

Hence, one of the hypothesized equations satisfies this condition and therefore the null hypothesis of no co-integration among the variables is rejected in at least one equation. There is therefore a long run relationship between the variables used for the analysis in Nigeria within the period under study 2002-2014

Presentation of Regression Result

Available data on small and medium industry output(SMI), Lending rate (IRS), Exchange Rate (EXR) and inflation rate (INF) were collected and used for the purpose of this analysis.

Table 4: regression test Result (OLS)

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	6.652335	1.147062	5.799454	0.0001
IRS	-0.082720	0.037935	-2.180561	0.0518
EXR	0.019998	0.005475	3.652337	0.0038
INF	0.042407	0.069783	0.067705	0.5557
R-squared	0.802009			
Adjusted R-squared	0.748012			
F-statistic	14.85270			
Prob (F-statistic)	0.000349			
Durbin-Watson stat	1.175232			

Sources: Researchers' compilation from E-view (version 7.0)

From table 4 above, the value of the intercept which is 6.65233 shows that small and medium scale industry output in Nigeria will experience a 6.652335 unit increase when all other variable are held constant. The coefficient of Bank lending rate (IRS) is -0.082720. This shows that lending rate is negatively related in (IRS) is followed by a decrease in Small and medium industry output in Nigeria. The coefficient of Exchange rate (EXR) is 0.019998. This shows that exchange rate is positively related to small and medium industry output in Nigeria. This means that a unit increase in (EXR) is followed by a increase in Small and Medium industry output in Nigeria. Furthermore, the value of Inflation rate shows a positive relationship with Small and medium industry output in Nigeria with a value of 0.042407. This implies a unit increase in inflation rate in Nigeria exert 0.042407 unit impact on small and medium industry output in Nigeria.

Decision Rule:

If $t\text{-calculated} > t\text{-tabulated}$, we reject the null hypothesis (H_0) and accept the alternative hypothesis (H_A), and if otherwise, we accept the null hypothesis (H_0) and reject the alternative hypothesis (H_A).

T - Test: The t-statistics is used to test for individual significance of the estimated parameters (A_1 , A_2 , and A_3). From the table above, we can deduce that all the variable employed are statistically significant given that their T-value is greater than T-tabulated value. Apart from inflation rate which has its p value greater than 0.05 level of significance in this case, we therefore accept H_1 and reject the null hypothesis for the individual variables in the model employed indicating significant in at least two variables employed.

F-Test: The F-statistics is used to test for simultaneous significance of all the estimated parameters. If the f-calculated is greater than the f-tabulated ($f\text{-cal} > f\text{-tab}$) reject the null hypothesis (H_0) that the overall estimate is not significant and conclude that the overall estimate is statistically significant. From the result, f-calculated (14.85270) is greater than the f-tabulated (2.95), that is, $f\text{-cal} > f\text{-tab}$. Hence we reject the null hypothesis (H_0) that the overall estimate has a good fit which implies that our independent variables are simultaneously significant.

Goodness of Fit Test (R^2): The (R^2) shows the amount of the variation in the dependent variables (GDP) that are explainable by the explanatory variable. The (R^2) which measures the overall goodness of fit of the entire regression shows the value of 0.802009 = (80% approx). This indicates that the independent variables accounts for about 80% of the variation in the dependent variable.

Durbin Watson Statistics (DW): The computed DW is 1.17, at 5% level of significance with three explanatory variables and 15 observations, the tabulated DW for dI and dU are 1.26 and 1.65 respectively. The value of DE is less than the lower limit. Therefore, we conclude the there is evidence of positive first order serial correlation.

From the foregoing, the OLS result (Table 4) indicates that Bank Lending rate has a negative relationship with private sector investment. The t-value (-2.180561) and P-value (0.0518) shows that the impact is negative and significant. Therefore, we reject the null hypothesis and conclude that Bank Lending rate has significant impact on small and medium scale industry output in Nigeria.

Secondly, The OLS result (Table 4) indicates that Exchange rate has a Positive relationship with private sector investment. The t-value (3.652337) and P-value (0.0038) shows that the impact is positive and significant. Therefore, we reject the null hypothesis and conclude that Exchange rate has significant positive impact on small and medium scale industry output in Nigeria within the years under review.

Lastly, the OLS result (Table 4) indicates that Inflation rate has a Positive relationship with private sector investment. The t-value (0.0607705) and P-value (0.5557) shows that the impact is positive and significant. Therefore, we reject the null hypothesis and conclude that Inflation rate has significant impact on small and medium scale industry output in Nigeria within the year under review.

CONCLUSION

From the foregoing, it is obvious that deposit money banks play a great role in the financing and encouragement of Small and Medium Scale Industry (SMIs) that constitute the foundation for the sustained growth and development of any economy. Hence, it is notable that the urgent regulatory system/mechanism by the central Bank of Nigeria is needed to ensure that deposit money banks are effective in administering their required role especially in the area of interest rate charges and credit allocation towards these Small and Medium Scale Industry (SMIs). In the era of industrialization, rigidly in giving out loans to the Small and Medium Scale Industry (SMIs) particularly cannot encourage investment in the key areas that will give way or contribute to economic growth in the country.

If all these are done, success may be achieved in attenuating the problems arising from poor control of the national economy and the dark economic clouds that bedevil the banking sector of Nigeria and as well, discourage some Small and Medium Scale Industry (SMIs) that have made themselves perpetual beggars to various international monetary organizations for instance, every financial institution ought to be interested in facilitating economic development and not for profit maximization.

Hence, any system that does not have this view in mind is bound to crumble. For business to function effectively finances required; and this should be made available through the instrumentalism of the banks. When finances are made available, industries like Small and Medium Scale Industry (SMIs) manufactured goods which helps to offer individuals the best standard of living.

Finally, the deposit money banks should not only be interested in its gains, but should also be occupied with the various needs of SMIs in order to protect her nation against risk.

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