



## Deposit Money Banks Loans to Small Medium Enterprises and the Nigerian Economy: An Empirical Analysis

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### Abstract

*The study empirically investigated the effects of deposit money banks loans to small medium enterprises on the Nigerian economy for the period 1989-2019. Data were collected from secondary sources through the CBN statistical bulletin 2019 and analyzed using Vector Autoregression (VAR), OLS regression, Wald test. In the model, GDP was used as the proxy for the economy which is the dependent variable while loan to small medium enterprises, loan to private sector, loan to small medium enterprises as a percentage of loan to private sector are the independent variables. The empirical results showed that short-run relationship exist between the economic variables and the Nigerian economy. The VAR test revealed that loan to private sector has positive relationship with GDP and can significantly explain GDP. Loan to small medium enterprises has positive relationship with GDP but not significant while loan to small medium enterprises as a percentage of total credit to private sector have negative relationship with GDP and it is not significant enough to explain GDP. The link between bank loans to small medium enterprises and the economy is positive and can be improved upon through sound policies and developments of small medium enterprises. In particular, deposit money banks should make more funds available for the development of small medium enterprises in Nigeria and not only to large Corporations. Regulatory authorities should introduce strict measures against any bank that failed or refused to follow the guidelines for the financing of small medium enterprises.*

**Keywords:** Deposit money banks, small medium enterprises, Nigerian economy, loan to private sector, Gross Domestic product

JEL Classification: G21, N80, E20, O17

### Introduction

Generating growth and development of the economy by reduction of poverty and employment generation can be achieved through small and medium enterprises (SMEs). Small and medium enterprises (SMEs) are channels for reducing the poverty level affecting our country's economy. Therefore, the need for growth of SMEs cannot be over emphasized. Oyelaran-Oyeyinka (2007) explained that approximately 96% of Nigerian businesses are SMEs compared to 53% in the US and 65% in Europe, they contribute approximately 1% of GDP compared to 40% in Asian countries and 50% in the US or Europe. Okere, Njoku and Nwosu (2020) explained that SMEs play crucial role as a channel of economic growth, economic development and reduction of unemployment hence there is need for government to develop small and medium enterprises. The question now is what is the influence of SMEs to the economy of Nigeria? Small and medium scale enterprises get their funds from various sources like personal savings, family and friends, loans and deposit money banks and some institutions of the government like National Directorate of Employment, National Economic Reconstruction Fund and other SMEs schemes; regardless of all these sources of funds, growth of SMEs is still inhibited by financial challenges. Nwoye (2008) identified the problems of SMEs as financial constraints, inadequate manpower, dearth of infrastructural facilities, lack of data, imperfect knowledge of market and general slump in the economy with its attendant social and political consequences.



However, today's world, financial institutions worldwide play a key role in economic growth and development. The ability to play this role effectively depends on the degree of financial system functionality. The deposit money banks of nearly every economy have the potential to pull financial resources together to meet the credit needs of SMEs. Hence there is still a huge gap between deposit money banks' supply abilities and the challenging needs of SMEs. Also, SMEs do not use formal means of financing as much as the large enterprises do. World bank (2001) indicated that small-scale business firms obtain only 19 percent of their financing needs as against 44 percent by large scale enterprises from external sources in developing countries. The challenges of assessing bank credit often discourage SMEs from approaching deposit money banks for loans.

Abereijo and Fayomi (2005) posits that the payback period of deposit money banks loans to SMEs is too short to encourage any significant expansion or investment. In addition, deposit money banks in many developing countries choose to lend to the government rather than private sector borrowers because the risk involved is smaller and returns higher. The size of an enterprise is dependent on the yardstick used to measure it. This raises the question of how should the size of an enterprise be measured? According to SMEDAN (2007), the yardstick for differentiating large, medium and small among enterprises are turnover, assets, investment and paid-up capital. Ayegusi (2004) explained that an enterprise with fifty (50) persons or workers and capital not exceeding one hundred and fifty thousand naira (N150,000) is small. Julius (2004) also explained that enterprise with total assets and capital not exceeding two hundred and fifty thousand naira (250,000) and thirty (30) full-time workers is small. These two definitions did not clearly differentiate SMEs, they only categorized business as small if workers are between 30-50 and investment capital between N150,000-N250,000.

Since 1975 when the government changed its industrialization policy to give focus and pre-eminence to SMEs away from import substitution and big corporations, there have been series of incentives financial institutional and otherwise by successive government to promote SMEs. Despite the potential importance of SMEs in any economy, high mortality rate among established SMEs is a matter of major concern in developing economies. International Finance Corporation (IFC) reported in 2002 that in Nigeria, out of 10 new businesses, only 2 survive up to 5 years. The report was supported by SMEDAN (2007) that in Nigeria, only 15 % of new enterprises last 5 years. This indicates there is a challenge. Hence, it is due to this challenge that this study aims to empirically investigate deposit money banks loans to small medium enterprises and the Nigerian economy.

### **Literature Review**

Theoretical framework undertaken in this study includes the work of Schumpeter (1911) and Hicks (1969). Schumpeter (1911) examines financial sector and the economy and concludes that the financial sector leads economic growth by providing financial support to enterprises with good prospects. This is principled on the view that a well functional financial system would encourage business creation innovation by selecting and financing businesses that are successful. Other studies include endogenous growth models which are: Greenwood and Jovanovic (1990) and Abiola, Adegboye and Omankhanlen (2015). Abiola, Adegboye and Omankhanlen (2015) emphasized that for sustained economic growth, financial sector has a vital role to play in the economy. It was argued that a developed financial sector improves productive capacity both human and physical capital which in turn impacts positively on the economy. Greenwood and Jovanovic (1990) argued financial sector are positively correlated to productivity growth of economy and posits the vital role of financial sector intermediation in an endogenous growth model.

Successive government overtime, had created various schemes and programmes to support SMEs. According to CBN (2014) these includes, the Nigerian Industrial Development Bank (1962), Small Scale Industries Credit Scheme (1971), the Nigerian Bank for Commerce and Industry (1973) and the Bank of Industry (2001). Others include; 200 billion naira restructuring/refinancing scheme, 200-billion-naira commercial agricultural credit scheme (2009). Besides government and the CBN, other institutions like the world bank and Nigerian



bankers' committee have come up with SME support schemes such as the US\$41 million World bank SME loan scheme in 1984 and US\$270 million SME loan scheme in 1990.

In many economies, the incentive to stimulate business creation which create employment opportunities and triggers economic prosperity has been provided by SMEs. Takats (2004) posits that SMEs contribute more to employment generation as they employ 50% and more of total workforce in the United States and two-third in the European Union. The growth of SMES is very critical for economic development in Nigeria. This is particularly so in a developing economy like Nigeria which needs to activate and grow SMEs to promote inclusive development. Given the right incentives and adequate funding some SMEs eventually transform to big enterprises. Then, a new challenge may emerge because according to Takats (2004), the traditional portfolio theory supports the notion, that large banks can finance a wider range of firms, including for instance large enterprises. As a result, the traditional portfolio theory predicts size to be the most important factor in small business lending, large banks finance small firms less. This implies that banking consolidation adversely affects small business lending.

Uzonwanne (2015) investigated deposit money banks and financing of Small Medium Enterprises in Nigeria and found evidence that deposit money banks in Nigeria have been lacking in their function of providing resources to meet the borrowing needs of SMEs. In a study conducted by Aribaba, Ahmodu, Oladele, Yusuff and Olaleye (2019) assessing the role of deposit money banks loan facilities in financing small and medium scale enterprises in Nigeria, found that deposit money banks have a positive relationship with loan facilities variables while there is negative relationship between fund deposit and returns on equity variable which affect SMEs in the economy. Ayuba and Zubairu (2015) investigated the impact of banking sector credit on the growth of small and medium enterprises in Nigeria between 1985 and 2010 using descriptive statistics, correlation analysis and error correction and the findings revealed that there is significant and positive relationship between banking sector credit and small and medium enterprises in Nigeria. Oke and Aluko, (2015) examined the impact of deposit money banks in financing small and medium scale enterprises (SMEs) in Nigeria between 2002 and 2012. Employing panel regression, the results revealed that deposit money banks loans is significant and positively related to SMEs' financing in Nigeria.

The perception is that, big banks usually lend more to big firms in relation to SMEs, as the share of loans to SMEs is a small percentage of their total loan pool. It might be expected that as small banks are acquired and merged into big banks, the focus might be big borrowers or even shift the composition of their assets from their previous activities because most big banks see SMEs loans as less profitable given their assets size. There is also the perception that after consolidation, banks lend more to SMEs. Bank consolidation is a dynamic process, therefore, participants in the process are expected to adopt appropriate strategies consistent with market developments and this would adjust lending behaviours of deposit money banks to both big and small borrowers. This would manifest in efficiency gains which would favour lending to SMEs. From the literature, banking reforms and consolidation effect on credit flows to SMEs has been mixed. While studies by Strahan and Weston (1996) on the USA and German economies showed that bank consolidation enhanced the flow of credit to SMEs, Banaccorsi di Patti and Gobbi (2001) and Craig and Hardee (2004) found the opposite result for Italy and the USA.

### **Data and Methods**

Data for this study was sourced from the CBN statistical bulletin 2020 and the data spanned from 1989 to 2019. The 1989 base year makes it a 30-year period. The indicator for Nigerian economy used in this study is the real gross domestic product which is specified to depend on loan to small medium enterprises, loan to private sector and loan to SME as a percentage of total credit to private sector. Data collected were analyzed using statistical techniques; and diagnostic tests which includes Augmented Dicker Fuller (ADF) unit root test, Jarque-Bera normality test, Breusch-Godfrey Serial Correlation test, Wald test, vector auto regression (VAR), ordinary least square regression.

### 3.1 Model specification

Having adapted the model stated by Johnny and Ayawei (2018)  $GCFM=F$  (CBLSME, BLR, IFR); by replacing bank lending rate and inflation rate with loan to small medium enterprises as a percentage of total credit to private sector and loan to private sector as a proxy of deposit money banks loans to small medium enterprises, the relationship between it and the Nigerian economy can be specified as:

The functional relationship is presented as:

$GDP = f(LSME, LPS, PLSME)$

The model is expressed in econometric equation as:

$$GDP = \alpha_0 + \alpha_1 LSME + \dots \dots \dots (1)$$

Where:

GDP = real gross domestic product

LSME = loan to small medium enterprises

LPS = loan to private sector

PLSME = loan to SME as a percentage of total credit to private sector

$\alpha_0$  = intercept of the model

$\alpha_1 - \alpha_3$  = coefficient of the independent variables or parameters

$\mu_t$  = stochastic error term incorporating other factors that are not considered in the model

To bring the data of both the dependent and independent variables to a level of equal comparability, their logarithm is calculated and gotten. The logarithm form of the model becomes:

$$\log GDP = \alpha_0 + \alpha_1 \log LSME + \dots \dots \dots (2)$$

The coefficients in the model are expressed in their elasticity since the variables are in natural logarithm form hence, they measure direct response of economic growth to variable changes.

### Data Analysis and Discussion of findings

The Augmented Dickey Fuller (ADF) unit root test showed in tables 1, 2 and 3 are the tests of stationarity for variables used in the model analysis. A non-stationary time series is not possible to generalize to other time periods apart from the present hence this makes forecasting based on such time series to be unrealistic. Table 1 shows all variables (GDP, LSME, LPS, PLSME) having ADF value less than the critical ADF value at 5% and 10% respectively and having probabilities above 5% is not stationary at levels. Table 2 shows the result of the unit root test at first difference, GDP with an ADF value of -5.038908 exceeds the critical ADF value of -2.967767 and -2.622989 at 5% and 10% respectively and a probability of 0.0003 which is less than 5% is stationary at first difference i.e. I(1). PLSME with an ADF value of -5.210527 exceeds the critical ADF value of -2.967767 and -2.622989 at 5% and 10% respectively and a probability of 0.0002 which is less than 5% is stationary at first difference i.e. I(1). Table 3 shows the result of the unit root test at second difference, LSME with an ADF value of -13.82756 exceeds the critical ADF value of -2.971853 and -2.625121 at 5% and 10% respectively and a probability of 0.000 which is less than 5% is stationary at second difference I(2). LPS with an ADF value of -5.269949 exceeds the critical ADF value of -2.971853 and -2.625121 at 5% and 10% respectively and a probability of 0.0002 which is less than 5% is stationary at second difference I(2). The result of the Augmented Dickey Fuller unit root test, initiated the use of the vector autoregression (VAR) test. The vector autoregression test revealed that there is short run relationship between the variables and the R-squared figure of 0.873 explains that all independent variables jointly explain 87% of the dependent variable GDP which is the Nigerian economy.

The Durbin-Watson result of 1.82 which is close to 2 as shown in table 8, indicate that there is no serial correlation. The R-squared figure of 0.873983 is not greater than the Durbin-Watson figure of 1.824490 hence there is no spurious regression. A robust model must be linear and

should be normally distributed hence the Jarque-Bera normality test was carried out and the result is shown in table 4. The normality test carried out on the data revealed that the F-Statistics probability figure of 0.498184 is greater than 5% hence the model is normally distributed hence we accept  $H_0$ . Breusch-Godfrey Serial Correlation Langrange Multiplier (LM) Test was carried out to test for the serial or autocorrelation of residuals as shown in table 5. The serial correlation test carried out on the data revealed that F-Statistics probability figure of 0.1348 is greater than 5% hence the model's data has no serial correlation hence we accept the null hypothesis.

The Heteroskedasticity Test carried out revealed in table 6 that the F-Statistics probability figure of 0.1020 is greater than 5% hence the model's data has no heteroskedasticity hence we accept the null hypothesis. It can therefore be concluded that the model is good.

**Table 1: Augmented Dickey Fuller Unit Root Test at Level**

variable	ADF test at level	critical value at 5%	critical value at 10%	Probability	Remark	order of integration
Gdp	-1.981525	-2.963972	-2.621007	0.2929	Non-stationery	Nil
Lsme	-1.185308	-2.963972	-2.621007	0.6675	Non-stationery	Nil
Lps	-0.95845	-2.967767	-2.622989	0.7543	Non-stationery	Nil
Plsme	0.370694	-2.963972	-2.621007	0.9782	Non-stationery	Nil

*Source: Authors' Computation (2021)*

**Table 2: Augmented Dickey Fuller Unit Root Test at First Difference**

variable	ADF test at 1st diff.	critical value at 5%	critical value at 10%	probability	remark	order of integration
Gdp	-5.038908	-2.967767	-2.622989	0.0003	Stationery	i (1)
Lsme	-2.802302	-2.971853	-2.625121	0.0708	Non-stationery	nil
Lps	-2.657232	-2.967767	-2.622989	0.0937	Non-stationery	nil
Plsme	-5.210527	-2.967767	-2.622989	0.0002	Stationery	i (1)

*Source: Authors' computation (2021)*

**Table 3: Augmented Dickey Fuller Unit Root Test at second Difference**

Variable	ADF test at 2nd diff.	critical value at 5%	critical value at 10%	probability	remark	order of integration
Lsme	-13.82756	-2.971853	-2.625121	0.000	Stationery	i (2)
Lps	-5.269949	-2.971853	-2.625121	0.0002	Stationery	i (2)

*Source: Authors' computation (2021)*

**Table 4: Jarque-Bera normality test result**

JarqueBera Statistics	1.3935	Probability Value	0.498184
Skewness	0.4197		
Kurtosis	2.3303		

*Source: Authors' Computation (2021)*

**Table 5: Breusch-Godfrey Serial Correlation LM Test**

F-Statistics	2.2450361	Prob. F(2,18)	0.1348
Obs* R-Squared	5.789759	Prob. Chi-Square (2)	0.0553

*Source: Authors' Computation (2021)*

**Table 6: Breusch-Pagan-Godfrey Heteroskedasticity Test Result**

F-statistic	3.432679	Prob. F(8,20)	0.1020
Obs*R-squared	16.77955	Prob. Chi-Square (8)	0.0325
Scaled explained SS	5.308667	Prob. Chi-Square (8)	0.7241

**Source:** Authors' Computation using E-Views 9 (2021).

The Wald test shown in table 7, 8 and 9 revealed the combinations of independent variables that can jointly explain or influence the dependent variable.

Null Hypothesis:  $C(3)=C(4)=0$

The Probability of Chi-Square is not significant at 0.3046 hence we accept the Null hypothesis that  $C(3)=C(4)=0$  which means that LSME(-1) + LSME(-2) jointly cannot explain or influence dependent variable GDP.

Null Hypothesis:  $C(5)=C(6)=0$

The Probability of Chi-Square is significant at 0.0251 hence we reject the Null hypothesis that  $C(5)=C(6)=0$  which means that LPS(-1) + LPS(-2) jointly can explain or influence dependent variable GDP.

Null Hypothesis:  $C(7)=C(8)=0$

The Probability of Chi-Square is not significant at 0.1121 hence we accept the Null hypothesis that  $C(7)=C(8)=0$  which means that PLSME(-1) + PLSME(-2) jointly cannot explain or influence dependent variable GDP.

**Table 7: WALD TEST for C3(-1) and C4(-2)**

F-Statistics	1.188879	Probability	0.3252
Chi-square	2.377757	Prob. Chi-Square(2)	0.3046

**Source:** Authors' Computation (2021)

**Table 8: WALD TEST for C5(-1) and C6(-2)**

F-Statistics	3.684930	Probability	0.0434
Chi-square	7.369860	Prob. Chi-Square (2)	0.0251

**Source:** Authors' Computation (2021)

**Table 9: WALD TEST for C7(-1) and C8(-2)**

F-Statistics	2.188795	Probability	0.1382
Chi-square	4.377590	Prob. Chi-Square (2)	0.1121

**Source:** Authors' Computation (2021)

### **Discussion of findings**

The result of the ordinary least square regression result in table 9 revealed that LSME (-1) has a positive relationship with GDP but it is not significant to explain the dependent variable GDP. A 1% change in LSME (-1) leads to a 0.13% increase in GDP. LSME(-2) has a negative relationship with GDP and it is not significant to explain the dependent variable GDP. A 1% change in LSME (-2) leads to a 0.1% decrease in GDP. LPS (-1) has a positive relationship with GDP and it is significant to explain the dependent variable GDP with a probability figure of 0.0272. A 1% change in LPS (-1) leads to a 0.89% increase in GDP. LPS (-2) has a negative relationship with GDP and not significant to explain GDP with a probability figure of 0.0708. A 1% change in LPS (-2) leads to a 0.58% decrease in GDP. PLSME (-1) has a negative relationship with GDP and not significant to explain GDP. A 1% change in LSME (-1) leads to a 0.12% decrease in GDP. PLSME(-2) has a positive relationship with GDP and it is significant to

explain dependent variable GDP. A 1% change in LSME leads to a 0.26% increase in GDP.

Loan to private sector have positive relationship with GDP and can significantly explain the dependent variable GDP. Loan to small medium enterprises have positive relationship with GDP but not significant while loan to small medium enterprises as a percentage of total credit to private sector have negative relationship with GDP and not significant enough to explain dependent variable. A 1% increase in loan to private sector will cause 0.89% increase in GDP. This result conforms with theoretical expectation because the more the loan to the private sector will cause investment and ultimately increase GDP. A 1% increase in loan to small medium enterprises will cause 0.13% increase in GDP which conforms with theoretical expectation because the more the loan to small medium enterprises will trigger expansion and employment especially in the rural areas which will increase GDP. Takats (2004) in his study posits that SMEs contribute more to employment generation as they employ more than half of the total workforce in the United States and two-third in the European Union. This is similar to the conclusions of Ayuba and Zubairu (2015), Oke and Aluko, (2015) who finds evidence that banking sector credit has significant impact on the growth of small and medium enterprises in Nigeria.

A 1% increase in loan to small medium enterprises as a percentage of total credit to private sector leads to a 0.12% decrease in GDP. This is not in line with theoretical expectation because as SMEs expand generally, their percentage increase in relation to the private sector loan is meant to increase GDP. This is likely to occur if loans to private sector is not monitored to ensure certain agreed percentage goes strictly to SMEs and not large corporations. This is similar to the conclusion of Uzonwanne (2015) who finds evidence that deposit money banks in Nigeria have been lacking in their function of providing resources to meet the borrowing needs of SMEs.

**Table 9: Ordinary Least Square Regression**

	Coefficient	Std. Error	t-Statistic	Prob.
C(1)	0.790882	0.177837	4.447243	0.0002
C(2)	-0.10258	0.180923	-0.566979	0.577
C(3) LSME(-1)	0.1368	0.104922	1.303824	0.2071
C(4) LSME(-2)	-0.166429	0.110306	-1.508786	0.147
C(5) LPS(-1)	0.896079	0.376137	2.382318	0.0272
C(6) LPS(-2)	-0.58766	0.307953	-1.908281	0.0708
C(7) PLSME(-1)	-0.124944	0.08406	-1.48637	0.1528
C(8) PLSME(-2)	0.259338	0.125454	2.067188	0.0519
C(9)	-1.402894	1.693745	-0.828279	0.4173
R-squared	0.873983			
Durbin-Watson stat	1.82449			

**Source: Authors' Computation (2021)**

### Conclusion and Recommendations

This research study empirically investigated the effects of deposit money banks loans to small medium enterprises on the Nigerian economy for the period 1989-2019. The result revealed that loan to private sector have positive relationship with GDP and can significantly explain dependent variable GDP. Loan to small medium enterprises have positive relationship with GDP but not significant while loan to small medium enterprises as a percentage of total credit to private sector have negative relationship with GDP and it is not significant enough to explain dependent variable GDP. The Jarque-Bera normality test result revealed that the model is normally distributed. Breusch-Godfrey Serial Correlation LM Test shows that the model has no



serial correlation. The Heteroskedasticity Test carried out revealed that the F-Statistics probability figure of 0.1020 is greater than 5% hence the model's data has no heteroskedasticity. The Wald test revealed that C (5) is not equal to C (6) is not equal to 0 which means that only LPS (-1) + LPS (-2) jointly can explain or influence dependent variable GDP and the economy.

This study recommends that deposit money banks should make more funds available for the development of SMEs in Nigeria and not only to large Corporations. The Central Bank of Nigeria should introduce strict measures against any bank that failed or refused to follow the guidelines for the financing of SMEs. There should be checks and balance in place and strictly monitored.

The rigorous conditions for loans demanded by deposit money banks should be reviewed down. The relevant institutions should be persuaded to change their policies in such a way that it will now favors the small-scale businesses more.

Government should do everything possible to encourage the development of SMEs. It can do this by providing financial assistance, favorable legislation, skill acquisition institutions and the enabling environment for SMEs to thrive.







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