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Influence of Monetary Policies on the Growth of the Small and Medium Scale Enterprises

ATARERE, Lovy O.I.
Department of Business Education
School of Vocational Education
Delta State College of Physical Education, Mosogar, Nigeria
G.S.M NO: 08033249177
Email: atarerea@gmail.com

ABSTRACT
Over the years, the major goals of monetary policy have been those of attaining price stability and external balance of trade. As such, inflation targeting and exchange rate policy have dominated CBN's monetary policy focus based on the assumption that these are essential tools of achieving macroeconomic stability. In doing this, the CBN uses monetary tools to exercise strict controls over the supply of money in the economy, the rate of interest chargeable to borrowers of credit, amongst which are the small and medium scale enterprises. Hence, the paper examined the influence of monetary policies on the growth of the Small and Medium Scale Enterprises. Literatures were reviewed in areas of, concept of Small and Medium Scale Enterprises, monetary policy and Influence of Monetary Policies on the Growth of SMEs. The paper is hinged on the finance-led growth theory. The literatures reviewed revealed that monetary policies are very important in the regulation of any economic system. it was however recommended that the Monetary authority (CBN) should implement policies that increase the flow of money and direct it to sectors like SMEs with higher propensity to contribute to national economic productivity and should endeavour to make more use of the cash reserve ratio in regulating the operations of commercial banks; and interest rate policy should be such that banks can efficiently intermediate funds in the economy.
Keywords: Monetary policies, Growth & SMEs

INTRODUCTION
The Central Bank of Nigeria (CBN)'s enabling law (CBN Act 2007) saddles it with the responsibility of the regulation of the country's stock of money in such a way as to promote social welfare. This role is anchored on the use of monetary policy with the primary goal of maintaining stable prices or low and stable inflation. This is necessary as fluctuations in the exchange rate have been shown to have significant impacts on the macroeconomic fundamentals such as interest rates, prices, wages, unemployment, and the level of output (Fasanya et al, 2013). Duru and Kehinde (2012) assert that financial systems play a fundamental role in the growth and development of nations through the intermediation between surplus and deficit units of the economy. Imoughele and Ismaila (2014) quoting research by United Nations Conference on Trade and Development (UNCTAD) (2001) identify finance as one of the most important factors that make for growth and survival of SMEs, be they in developed or developing climes. The goal of stabilizing the inflation and exchange rates in Nigeria is to give the local industries an opportunity to grow into formidable force that can translate into economic growth. This can only come about if they have access to finance that would enable them expand their business by embarking on productive investments such as acquiring the latest machines and technologies and boosting their competitiveness.
Acknowledging the role monetary policy can play in achieving these lofty goals, the monetary authorities in Nigeria have initiated several policies such as the reduction of the borrowing rate to reduce inflation and ensuring a stable exchange rate (Okigbo, 2008). Economic laws state that fluctuations in the exchange rate, if left unchecked, may ultimately result in a macroeconomic disequilibrium that could lead to real exchange rate devaluation. Price stability and financial stability are regarded (Bernanke and Gertler (1999) as mutually complementary and consistent objectives of monetary policy and to this end, Adekunle (2002) argues that the kind of monetary policies put in place by the CBN are very important for the health of the economy, especially as regards the small

and medium scale enterprises. Folawewo and Osinubi (2006) describes monetary policy as a combination of measures designed to regulate the value, supply and cost of money in an economy in consonance with the expected level of economic activity. However in the formulation of the monetary policies much attention does not seem to be given to their effect on the small and medium scale enterprises in the country, especially in their ability to raise the needed finance for their businesses, the stability and predictability of prices and hence their competitiveness in today's global marketplace. This is despite the agreement amongst writers that the small and medium scale enterprises is the engine of growth of most economies, be they developed or developing (Udechukwu, 2013). According to Duru and Kehinde (2012) empirical results abound to the effect that this sector is a veritable vehicle for self-sustaining industrial advancement of indigenous technology. In Nigeria, research efforts in the area of monetary policy and their impact on SMEs are minimal. The question which thus arises is: has the use of monetary policies in Nigeria attained the desired goal? Has control of the quantity of money in circulation made it easier for SMEs to acquire the needed capital for their developmental activities? Has this control affected the interest rates demanded of SMEs for monies needed to carry on their business? Are there any empirical evidence to show that the use of monetary policies have impacted the growth of the SMEs and hence the economy? The main thrust of this study, examined the influence of monetary policies on the growth of the small and medium scale enterprises.

Statement of the Problem

The major concern of the Central Bank of Nigeria (CBN) has been the regulation of the stock of money in circulation in such a way as to promote economic growth and price stability, and through that a favourable balance of payment. Over the years, the major goals of monetary policy have been those of attaining price stability and external balance of trade. As such, according to Ajayi (1999) in Fasanya, Onakoya and Agboluaje (2013), inflation targeting and exchange rate policy have dominated CBN's monetary policy focus based on the assumption that these are essential tools of achieving macroeconomic stability. In doing this, the CBN uses monetary tools to exercise strict controls over the supply of money in the economy, the rate of interest chargeable to borrowers of credit, amongst which are the small and medium scale business and the rate of exchange of the naira for businesses needing to import raw materials and finished products from other countries. The issue that is of interest to many Nigerians relate to the small and medium scale enterprises. Since this category of business has been acknowledged as relevant engine room for development and deepening of any economy, it is important to ascertain if the monetary policies pursued by the country have encouraged the growth of this all-important sector.

Conceptual Review

The conceptual review is discussed in subheadings as thus:

Small and Medium Scale Enterprises (SMEs)

Small and Medium Scale Enterprises (SMEs) has no generally established definition and this is acknowledged by the Central Bank of Nigeria (CBN)'s communiqué No 69 (2010) of the special monetary policy committee which acknowledged the existence of several ways of defining SMEs. Imoughele & Ismaila (2014) noted that definition and criteria for classification of an enterprise as small, medium or large varies from one country to another, depending on whether it is developed or developing country. What constitutes an SME is a matter each country decides individually as there is no universally accepted definition of what they are, as shown by the Central Bank of Nigeria (CBN)'s communiqué No 69 (2010) of the special monetary policy committee which acknowledged the existence of several definitions of SMEs. What is termed a large-scale business in a developing country may be a small business to a developed one.

Small and medium enterprises (SMEs) are a very important part of the Nigerian economy with approximately 96% of Nigerian businesses been SMEs (Gbandi & Amissah ,2014). Academic writers have delineated the small and medium scale enterprises based on very different modalities such as capital out lay, number of employees, sales turnover, fixed capital investment, available plant and machinery, market share and the level of development (Ogechukwu, 2009). The trend in developed nations like the United States of America (USA), Britain and other European countries is to class small and medium scale enterprises in terms of turnover and number of employees – a system adopted to delineate them in Nigeria.

One of such definitions (by Small and Medium Enterprises Credit Guarantee Scheme (SMECGS) states that an enterprise that has an asset base (excluding land) of between N5 million and N500 million and labour force of between 11 and 300 belongs to the SME sub-sector. The Small and Medium Enterprises Equity Investment Scheme (SMEEIS) took a rather more broad view of SMEs, delineating them as businesses with turnover of less than N100million, asset base of N1.5 billion (excluding land and working capital) with no lower or upper limit of staff.

The Central Bank of Nigeria Monetary Policy Circular No. 22 of 1996 defines a small or medium scale business enterprises as any manufacturing or service enterprise whose business turnover does not exceeds N500,000 (including land and working capital) and or the annual turn-over did not exceed N5 million. In the 1990 budget, Federal government of Nigeria (CBN) also defined small/medium scale enterprises, for the purpose of commercial bank loans as those enterprises with annual turnover not exceeding N500,000 and for Merchant Bank loans, those enterprises with capital investments not exceeding N2m excluding cost of land, Asa-Afiana (2003) and between 11 and 100 people. Large Scale industries are those with investment of over N200m, excluding land but including working capital and a work force of over 300 people.

The SMEs represent about 90% of manufacturing/industrial sector in terms of number of enterprises in Nigeria; unfortunately Gbandi & Amissah (2014) that this is not reflected in their contribution (1%) to the gross domestic product (GDP). They further assert that this disproportionate figure owes a lot to the inability of the SMEs to get fair avenues of financing their businesses; just as makers of policies on monetary matters do not often consider the effects of such policies on their growth and survival. One of the consequences of this, according to Steel and Webster (1992) is the that SMEs are subject to high transaction cost and risks associated with small loans, lack of collateral which prevents them from been players in the main financial field because they do not have access to public capital markets; they naturally depend on banks for funding. Duru & Kehinde (2012) assert that dependence on banks make them more vulnerable for the simple reason that shocks in the banking system can have significant impact on the supply of credit to SMEs. The manufacturing sector is acknowledged to have huge potentials for employment generation and wealth creation in any economy, yet in Nigeria, the sector has stagnated and remains relatively small in terms of its contribution to gross domestic product (GDP) or to gainful employment because SMEs which form the majority of companies in Nigeria are not able to competitively operate in this sector because of money policy fundamentals including interest and exchange rates. Berger and Udell (2001) notes the existence of shocks in the economic environment in which both banks and SMEs operate because of monetary policies been tilted to finance government's fiscal financial deficit. These shocks they claim can significantly undermine the ability of SMEs to generate fund or to remain liquid and hence curtail their growth potentials. Shocks, according to them, come in variety of forms such as technological innovation, regulatory regime shift in competitive conditions and changes in the macroeconomic environment.

Monetary Policy

The Central Bank of Nigeria (2011) defines monetary policy as the specific actions taken by it to regulate the value, supply and cost of money in the economy with as view to achieving predetermined macroeconomic goals. Thus, to achieve predetermined economic goals, the CBN embarks on monetary controls. In doing this, it classifies money into Narrow Money (M1) and Broad Money (M2). M1 is made up of currency in circulation with the non-bank public; and demand deposits (current accounts in the banks). This category of money represents money used for daily transactions and short-term monetary needs. The M2 (broad money) consists of narrow money and savings as well as time deposits (that is, call money). It also includes foreign currency-denominated deposits.This categorization measures the total volume of money in supply in the economy. It is via the broad money that liquidity and inflation issues are tackled by the CBN.

The need to regulate money supply arises from the observed direct relationship that exists between it and economic activities. This means that when the supply of money rises above required levels or falls below required levels, economic activities are negatively affected owing to inflation or illiquidity as the case may be; and this in turn can hamper economic growth of industries. In it attempt to control the money supply to achieve desired levels, the CBN uses several strategies such as the growth of money aggregates, price levels and inflation. To aid it in achieving its target, it uses such instruments as direct control of credits (such as amounts of interest loans to give, rates to allow as interests on loans, definition of preferred loans liquidity ratios); as well as indirect control of credits (which includes open market operation, reserve requirements and the use of discount windows). However, there is no clear evidence that these strategies have engendered the expansion and development of the small and medium scale business sector or if it has been taken into consideration. Ndekwu (2013) asserts that despite government's continued arguments that its intervention in money control is to stimulate growth of the economy, observations have revealed that this growth may not have been the end result thus far as changes in banks' interest rates have a direct relationship with changes in CBN rates which drives the needed funds from the entities (such as SMEs) that need it for creating growth. Ndekwu (2013) further asserts that because of the precarious relationship between monetary policy rate (MPR) and production activity in Nigeria's real economy, the effect of CBN's monetary policy has been at best uncertain and called for a re-evaluation of such policies to ensure their soundness and effectiveness in producing the desired results in Nigeria.Growth is associated with an increase in size and importance over time. Unfortunately, according to Mustar (2002), historical evidence abound to show that compared with other emerging markets, Nigeria has shown lack of commitment to building a strong SME sector via its economic policies. The Asian countries, for example have long recognized the potential of the SME to impact all aspects of their economic development and have shown consistent commitment to its development by ensuring access to growth-enabling facilities such as finance and financial incentives, basic and technological infrastructure, adequate legal and regulatory framework, and a commitment to building domestic expertise and knowledge; and as a result, have been able to generate impressive statistics of SMEs contributions to GDP. Even developed countries realize that their growth is traceable largely to the activities of SMEs. Onugu (2005) gave statistics of SME contribution to GDP to buttress this point: 53% United States of America and 65% in Europe compared with the approximately 1% they contribute in Nigeria. In Nigeria many of the natural facilities that should enable growth are present: large, energetic and innovative population and SMEs distributed in clusters all over the country with significant untapped growth potentials in the area of export and employment; distributed along sectors within regions and creating potential operational and cost synergies.

Theoretical Framework

The theoretical base found adequate for this work is the finance-led growth theory, (Imoughele & Ismaila, 2014) and it has the support of such renounced economists as Schumpeter. This theory holds that financial institutions serve as a useful tool for increasing the productive capacity of the economy as they are able to efficiently allocate savings in the economy thereby creating a pool of finance for entrepreneurs to access for their productive endeavours and improvement of technical abilities. The earliest work on finance-led economic growth is traceable to the works of Bagehot (1873), Schumpeter (1912) and Hicks (1969) with further enhancements to the hypothesis being provided by a host of others including Galbis (1997); Fry (1988) and King and Levine (1993b), (Odeniran & Udeaja (2010). This school of thought (also known as supply-led theory of finance-growth), holds that there are four distinguishable, but not mutually exclusive, effects of financial activity and development on overall economic performance. The first is the provision of an inexpensive and reliable means of payment. The second is the volume and allocation effect, in which financial activities increase resources that could be channeled into investment while improving the allocation process of such resources. The third is a risk management effect by which the financial system helps to diversify liquidity risks, thereby making the financing of riskier but more productive investments and innovations possible. The fourth is an informational effect; according to which an ex antes information about possible investment and capital is made available to firms and households who otherwise would not have been able to afford same, thus reducing the effects of asymmetric information (Levine, 2004) in Thiel (2001). Trew (2006) reports that that in total (viewed from an aggregate production function point), each of these financial effects may contribute to the transformation of a given amount of savings and investment inputs into a larger amount of output through either a capital accumulation channel (as argued by Hicks, 1969) or a technological change channel (as argued by Schumpeter, 1912).

Influence of Monetary Policies on the Growth of SMEs

In an attempt to link money supply to economic growth recent contributors in the new economic growth literature have considered the role of financial structure which presupposes that the level of money stock drives economic growth. Money supply can be defined as the sum of all the money holdings of all the members of the society. This could be either M1, M2, M3, or MM; in Nigeria this definition is restricted to M1 or M2 while it the United Kingdom (UK) it is M1, M2, M3 and even up to M4 in United States of America (USA).

The M1 is a narrow measure of money supply; it focuses on the role of money as a medium of exchange and defines money as currencies in circulation outside the banks plus demand deposits held in banks. The Central Bank of Nigeria defines M1 as currencies outside banks plus positively held demand deposits. M2 is a broad measure of money supply. It includes savings and time deposits in commercial banks which can be easily converted into cash at short notice and used to carry out financial transactions. M_3 is made up of M1 and M2 plus deposits held in other financial institutions including finance houses, merchant banks and similar institutions. M4 comprises of M1, M2, M3 plus investment in government security in government bonds and securities such as treasury bills and certificates, call money e.t.c. M3 and M4 are only effectively used by financial systems that have been reasonably developed and have broad portfolio. Another type of money is the base money identified as M_0. It comprises of all currencies in circulation and all reserves of banks including the central bank. It is high powered money that government uses in creating other types of money.

In controlling money stock, the monetary authorities use two broad sets of monetary tools – direct and indirect instruments. Under a system of direct monetary control, the Central Bank uses some criteria to determine monetary, credit and interest rate targets that would achieve the goals of economic policy. In a regime of indirect monetary control, the monetary base (specifically bank reserves) is managed while the market is left to determine interest rates.

For monetary policies to be effective the financial sector of the economy, which in Nigeria is predominantly the commercial banks and a few financial houses, need to be broadly spread in other to impact the economy and must offer services that impact the economic activities of all sectors of the economy. It is only recently with the recapitalization in the banking sector which resulted in mergers, acquisitions increased bank branches and innovations of new products and technology coupled with growth in the capital markets that the Nigerian financial system has shown some level of development and move towards financial intermediation and financial deepening which the economy requires for sustained growth.

Empirical researches have focused on addressing two issues. First, to ascertain if money could forecast growth in future output as there is some empirical evidence (Jeog, 2000) that growth and inequality are strongly associated with money supply and the depth of the financial institutions in any economy. Ogunmuyiwa & Ekone (2001) submit that the effect of financial depth (money in circulation) on economic growth can manifest in three channels: (a) improved efficiency of financial intermediation (b) improved efficiency of capital stock and (c) increased national savings rate. In Nigeria however, the influence of money supply on economic growth cannot be discussed definitely although several studies have confirmed the significance of money supply and economic growth. Between 1971 and 1975, the growth rate of the economy measured by the real GDP ranged from 21.3% in 1971 to 3.0% in 1975. By 1981, the real GDP grew by 26.8% and remained negative till 1984. A simple variance analysis shows that between 1971 and 1986, the mean spread of the GDP was 108.7. However, between 1986 and 1994, the real GDP had a variance of 9.1. The variability of the GDP was much higher before deregulation, while it becomes lower during and after the deregulation of the economy. Both M1 and M2 had little correlation with growth of real GDP before deregulation in 1986. M2 was observed to have a variance of 362.6 and a correlation coefficient of 0.21. The period 1986-1994 had a lower correlation of 0.16 between broad money (M2) and growth of real GDP. The mean spread of M2 was 289.2 as against 108.7 for the real GDP. The correlation between M1 and GDP between 1970 and 1986 stood at 0.22 and for 1986-1994, it was 0.33. In essence, the above descriptive analysis does not suggest any strong relationship between monetary aggregates and economic growth in Nigeria. Could this be that the monetary policies have not been effective? Could this also have led to SMEs not been adequately factored into the equation for growth and development when monetary policies are been formulated?

Exchange rate affect the price at which companies are able to get vital supplies from overseas for their productive and innovative activities and the CBN policy target is to ensure a stable exchange rate for more investments to be possible by SMEs. The study will attempt therefore to test the a priori relationship between SME growth and exchange rate. The study would therefore test the effect of monetary policy relating to exchange rate, represented here by EXR on the growth of SMEs.

The choice of exchange rate made by the monetary authorities affects the stabilization of prices and hence the economic growth. Such policies may be contractionary or expansionary in nature. In international trade, the openness of the economy to international prices can result in shocks that can create business cycles. According to them, a fixed exchange rate regime can increase trade and output growth by reducing exchange rate uncertainty and thus the cost of hedging, and also encourage investment by lowering currency premium from interest rates. However, on the other hand it can also reduce trade and output growth by stopping, delaying or slowing down the necessary relative price adjustment process. A fixed exchange rate regime can increase trade and output growth by providing a nominal anchor and credibility for monetary policy; that is, by avoiding competitive depreciation, and enhancing the development of financial markets. On the other hand, however, a fixed exchange rate regime can also delay the necessary relative price adjustments and often lead to speculation. Therefore, many developing and emerging economies using fixed exchange rate regime end in crashes as fixed regimes often lead to stoppage of foreign investment and capital flight as the investors become dissatisfied with the benefits derivable from their investments, (Calvo and Reinhart, 2002). This crash is most devastating for SMEs who find it almost impossible in such cases to get finance needed production; and whose goods are not able to command the needed quality and low prices to compete favourably in the market. Therefore, according to Frankel et al (2001), exchange rate anchor must be very minimally used. What is emphasized by them is the need for a deepening of the market, fiscal discipline, and well established financial institutions such as stock market.

Devaluation on output could be contractionary and this can come about through several channels. Devaluation could induce a shift in income distribution towards savers, which in turn depresses consumption and real absorption. While this could improve the trade balance of the devaluing country, it often leads to a decreased economic activity in addition to an increase in inflation. Edwards (1989) found that devaluation tend to reduce the output in the short term even where other factors remained constant. However, overvaluation of exchange rates constitute setback the economic growth.

SUMMARY AND CONCLUSION

This study was hinged on the influence of monetary policy on the growth of small and medium scale enterprises (SMEs). The indicators of monetary policy from literature reviewed are to the effect that monetary policies (exchange rate and interest rate) affect monetary behaviour in any economy.

Researches also indicate that growth of SMES in any economy has positive correlation with the growth of the entire economy in terms of technological developments, reduction in unemployment figures and deepening of the economic base. The theory on which the study would be based is the Finance-Led theory of money made popular by Levine (1993). This theory argues that the development of the financial sector usually stimulates the development of the economy.

RECOMMENDATIONS

The following recommendations were made in this study:

1. Since monetary policies have been identified as a veritable vehicle for self-sustaining industrial advancement of indigenous industries, Small and Medium Scale Enterprises should be fully aware of monetary policies in Nigeria, so that they can take advantage of them to grow their enterprises.
2. Monetary authority (CBN) should implement policies that increase the flow of money and direct it to sectors like SMEs with higher propensity to contribute to national economic productivity and should endeavour to make more use of the cash reserve ratio in regulating the operations of commercial banks; and interest rate policy should be such that banks can efficiently intermediate funds in the economy.
3. CBN should ensure that it does not over regulate or under regulate as a highly regulated monetary policy environment in which policies on credits, interest rate ceiling and restrictive monetary expansion are the rule would have negative economic implications that would not allow Small and Medium Scale Enterprises access to finance for productive activities and technological innovations.

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