**THE ROLE OF BANKS IN THE NIGERIA ECONOMY**

**Abstract**

An efficient financial system is essential for building a sustained economic growth and an open vibrant economic system. Countries with well developed financial institutions tend to grow faster; especially the size of the banking system and the liquidity of the stock markets tend to have strong positive impact on economic growth. This study examines the role of banks in the Nigeria economy. It seeks to know the impacts of the sector in the Nigerian economy and whether the sector has been able to achieve its main objective of intermediation as a result of the inability of the sector to assist the real sector despite the huge profits declared yearly & also the short term lending of the banks instead of long term investment that can boost the economy. The OLS method of the regression analysis was employed; the financial development was proxies by ratio of liquidity liabilities to GDP (M2GDP), real interest rate (INTR), ratio of credit to private sector to GDP (CPGDP) while the economic growth was measured by the real GDP (RGDP).

**CHAPTER ONE**

**INTRODUCTION**

**Background of the study**

An efficient financial system is essential for building a sustained economic growth and an open vibrant economic system. Countries with well-developed financial institutions tend to grow faster; especially the size of the banking system and the liquidity of the stock markets tend to have strong positive impact on economic growth. This study examines the impact of financial sector development and economic growth in Nigeria. It seeks to know the impacts of the sector in the Nigerian economy and whether the sector has been able to achieve its main objective of intermediation as a result of the inability of the sector to assist the real sector despite the huge profits declared yearly & also the short term lending of the banks instead of long term investment that can boost the economy. Economic growth in a developing economy rest on an efficient financial sector that pools domestic saving and mobilizes foreign capital for productive investments. In the developing countries, industries need more funds to increase their investment so that they can meet globalization constraint. The financial sector of any economy in the world plays a vital role in the development and growth of the economy. The development of this sector determines how it will be able to effectively and efficiently discharge its major role of mobilizing fund from the surplus sector to the deficit sector of the economy. This sector has helped in facilitating the business transactions and economic development (Aderibigbe 2004). A well- developed financial system performs several critical functions to enhance the efficiency of intermediation by reducing information, transaction and monitoring costs. If a financial system is well developed, it will enhance investment by identifying and funding good business opportunities, mobilizes savings, enables the trading, hedging and diversification of risk and facilitates the exchange of goods and services. All these result in a more efficient allocation of resources, rapid accumulation of physical and human capital, and faster technological progress, which in turn results in economic growth. Development in the real sector, as noted by Ajayi (1995), influences the speed of growth of the financial sector directly, while the growth of the finance, money and financial institutions influence the real economy. The economic growth is a gradual and steady change in the long-run which comes about by a general increase in the rate of savings and population (Jhingan 2005). It has also been described as a positive change in the level of production of goods and services by a country over a certain period of time. Economic growth is measured by the increase in the amount of goods and services produced in a country. An economy is said to be growing when it increases its productive capacity which later yield more in production of more goods and services (Jhingan 2003). Economic growth is usually brought about by technological innovation and positive external forces. It is the yardstick for raising the standard of living of the people. It also implies reduction of inequalities of income distribution. Oluyemi (1995) regards the financial sector of any economy as an engine of growth that could greatly assist in the promotion of rapid economic transformation. It can be concluded that no economy can ever develop without an appreciable growth in the financial sector. An efficient financial system is essential for building a sustained economic growth and an open vibrant economic system. Countries with well-developed financial institutions tend to grow faster; especially the size of the banking system and the liquidity of the stock markets tend to have strong positive impact on economic growth (Beck and Levine, 2002 in Nnanna, 2004). It is well known that stock market and other financial market institutions play a major role in the economy through enhancing the efficiency in capital formation and allocation. They enable both corporations and the government to raise long-term and short term capital which enables them to finance new projects and expand other operations, In this regard, it is observed that the performance of the economy is boosted when capital is supplied to productive economic units. Furthermore, as economies continue to develop, additional funds are therefore needed to meet the rapid expansion and the stock market therefore serves as an appropriate avenue for the mobilization and allocation of resources among competing uses which are critical to the growth and efficiency of the economy. In another study by Alile (1997), he argued that the determination of the overall growth of an economy depends on how efficiently the stock market performs its locative functions of capital. Stock markets are a vital component for economic development as they provide listed companies with a platform to raise long-term capital and also provide investors with a forum for investing their surplus funds. As economies develop, more funds are needed to meet the rapid development and the stock markets and banks serve as an important source in the mobilization and allocation of savings among competing uses which are critical to the growth and efficiency of the economy. Stock markets fuel economic growth through diversification, mobilizing and pooling of savings from different investors and availing them to companies for optimal utilization. The causality relationship between financial development with particular emphasis on stock market, banks and economic growth issue has stirred debates in academic circles and the controversy has arisen from the fact that the relationship between the two variables is dynamic in nature.

**1.2 STATEMENT OF PROBLEM**

The Nigerian financial sector, like those of many other less developed countries, was highly regulated leading to financial disintermediation which retarded the growth of the economy. The link between the financial sector and the growth of the economy has been weak. The real sector of the economy, most especially the high priority sectors which are also said to be economic growth drivers are not effectively and efficiently serviced by the financial sector. The banks are declaring billions of profit but yet the real sector continues to weak thereby reducing the productivity level of the economy. Most of the operators in the productive sector are folding up due to the inability to get loan from the financial institutions or the cost of borrowing was too outrageous. The Nigerian banks have concentrated on short term lending as against the long term investment which should have formed the bedrock of a virile economic transformation.

**1.3 RESEARCH QUESTION**

In other to achieve the objective of the study and proffering solution to problem of study, the following research question were formulated:

1. What is the role of the banks on the economic development of Nigeria’s economy?
2. What is the economic importance of the banks to the economy?
3. What is the relationship between economic growth and economic development?
4. What is the role of the stock market on economic development?

**1.4 OBJECTIVE OF THE STUDY**

The broad objective of this study is to empirically investigate the impacts of the Nigerian financial sector on the growth of the economy. The specific objectives are to

(1) Determine the relationship that exists between economic growth and the Nigerian banks

(2) Examine the impact of the financial sector on the Nigerian economic growth.

(3) To evaluate the impact of the banks on the economic development of Nigeria

(4) Proffer recommendation to enhance the performance of the banks

**1.5 RESEARCH HYPOTHESIS**

The hypothesis of this study is;

**H0**: banks development does not have any impact on Nigerian economic growth

**H1**: banks development has impact on the Nigeria’s economy

**H0** banks development does not have any impact on Nigerian economic development

**H1**: banks development has impact on the Nigeria’s economic development.

**1.6 SIGNIFICANCE OF THE STUDY**

It is conceived that at the completion of the study its findings would be beneficial to the management of business entities who are contributors to the subject in consideration. The accounting profession and auditors in their different engagements and assist them to project a good image of accounting profession. Research students who may want to use the study as a source of reference in their academic pursuit. The entire public (Investors and potential investors) who rely on the external auditor for economic decision making.

**1.7 SCOPE OF THE STUDY**

The scope of the study covers role of financial sector in the economic growth of the Nigeria economy. The study seek to evaluate the role of the financial sector in expanding the frontiers of Nigeria economy

**1.8 LIMITATION OF THE STUDY**

This research has some constrain to its scope and coverage which are:

a) **AVAILABILITY OF RESEARCH MATERIAL**: The research material available to the researcher is insufficient, thereby limiting the study

b) **TIME:** The time frame allocated to the study does not enhance wider coverage as the researcher has to combine other academic activities and examinations with the study.

c) **Organizational privacy**: Limited Access to the selected auditing firm makes it difficult to get all the necessary and required information concerning the activities

**1.8 STRUCTURE OF THE STUDY**

This research work is organized in five chapters, for easy understanding, as follows

Chapter one is concern with the introduction, which consist of the (overview, of the study), statement of problem, objectives of the study, research question, significance or the study, research methodology, definition of terms and historical background of the study. Chapter two highlight the theoretical framework on which the study its based, thus the review of related literature. Chapter three deals on the research design and methodology adopted in the study. Chapter four concentrate on the data collection and analysis and presentation of finding. Chapter five gives summary, conclusion, and recommendations made of the study.

**1.9 DEFINATION OF TERMS**

**FINANCE**

 Is a field that deals with the study of [investments](https://en.wikipedia.org/wiki/Investments). It includes the dynamics of [assets](https://en.wikipedia.org/wiki/Asset) and [liabilities](https://en.wikipedia.org/wiki/Liability_(financial_accounting)) over time under conditions of different degrees of uncertainty and risk. Finance can also be defined as the science of money management. Finance aims to price assets based on their risk level and their expected [rate of return](https://en.wikipedia.org/wiki/Rate_of_return). Finance can be broken into three different sub-categories: [public finance](https://en.wikipedia.org/wiki/Public_finance), [corporate finance](https://en.wikipedia.org/wiki/Corporate_finance) and [personal finance](https://en.wikipedia.org/wiki/Personal_finance)

**FINANCIAL SECTOR**

The financial sector is a category of stocks containing firms that provide financial services to commercial and retail customers; this sector includes banks, investment funds, [insurance companies](http://www.investopedia.com/terms/f/financialinstitution.asp) and real estate. Financial services perform best in low interest rate environments. A large portion of this sector generates revenue from [mortgages](http://www.investopedia.com/terms/o/overvalued.asp) and loans, which gain value as interest rates drop.

**FINANCIAL SECTOR DEVELOPMENT**

 In developing countries and [emerging markets](https://en.wikipedia.org/wiki/Emerging_markets) is part of the [private sector development](https://en.wikipedia.org/wiki/Private_sector_development) strategy to stimulate [economic growth](https://en.wikipedia.org/wiki/Economic_growth) and reduce poverty. The [Financial sector](https://en.wikipedia.org/wiki/Financial_sector) is the set of [institutions](https://en.wikipedia.org/wiki/Financial_institution), [instruments](https://en.wikipedia.org/wiki/Financial_instrument), and [markets](https://en.wikipedia.org/wiki/Financial_market). It also includes the legal and [regulatory framework](https://en.wikipedia.org/wiki/Financial_regulation) that permit [transactions](https://en.wikipedia.org/wiki/Financial_transaction) to be made through the extension of [credit](https://en.wikipedia.org/wiki/Credit_(finance)). Fundamentally, financial sector development concerns overcoming “costs” incurred in the [financial system](https://en.wikipedia.org/wiki/Financial_system). This process of reducing costs of acquiring information, enforcing [contracts](https://en.wikipedia.org/wiki/Contract), and executing transactions results in the emergence of financial contracts, [intermediaries](https://en.wikipedia.org/wiki/Financial_intermediary), and markets. Different types and combinations of information, transaction, and enforcement costs in conjunction with different regulatory, legal and tax systems have motivated distinct forms of contracts, intermediaries and markets across countries in different times.

The five key functions of a financial system in a country are:

(i) Information production [ex ante](https://en.wikipedia.org/wiki/Ex-ante) about possible investments and capital allocation;

(ii) Monitoring investments and the exercise of corporate governance after providing financing;

(iii) Facilitation of the trading, diversification, and management of risk;

(iv)Mobilization and pooling of savings; and

(v) Promoting the exchange of goods and services.

Financial sector development takes place when financial instruments, markets, and intermediaries work together to reduce the costs of information, enforcement and transactions. A solid and well-functioning financial sector is a powerful engine behind economic growth. It generates local savings, which in turn lead to productive investments in local business. Furthermore, effective banks can channel international streams of private [remittances](https://en.wikipedia.org/wiki/Remittances). The financial sector therefore provides the rudiments for income-growth and job creation.

**ECONOMIC GROWTH**

Economic Growth is the increase in the inflation-adjusted [market value](https://en.wikipedia.org/wiki/Market_value) of the goods and services produced by an [economy](https://en.wikipedia.org/wiki/Economics) over time. It is conventionally measured as the percent rate of increase in real [gross domestic product](https://en.wikipedia.org/wiki/Gross_domestic_product), or real GDP, usually in per capita terms. Growth is usually calculated in real terms – i.e., [inflation-adjusted](https://en.wikipedia.org/wiki/Real_vs._nominal_in_economics) terms – to eliminate the distorting effect of [inflation](https://en.wikipedia.org/wiki/Inflation) on the price of goods produced. [Measurement of economic growth](https://en.wikipedia.org/wiki/Measures_of_national_income_and_output) uses [national income accounting](https://en.wikipedia.org/wiki/National_accounts). Since economic growth is measured as the annual percent change of gross domestic product (GDP), it has all the advantages and drawbacks of that measure. The "rate of economic growth" refers to the geometric annual rate of growth in GDP between the first and the last year over a period of time. Implicitly, this growth rate is the trend in the average level of GDP over the period, which implicitly ignores the fluctuations in the GDP around this trend.

An increase in economic growth caused by more efficient use of inputs (such as labor productivity, [physical capital](https://en.wikipedia.org/wiki/Physical_capital), energy or materials) is referred to as intensive growth. GDP growth caused only by increases in the amount of inputs available for use (increased population, new territory) is called [extensive growth](https://en.wikipedia.org/wiki/Extensive_growth)

**CHAPTER TWO**

**REVIEW OF RELATED LITERATURE**

**2.1 THEORITICAL FRAME WORK**

The idea that financial development promotes growth was first put forth by Schumpeter as early as 1911 (Schumpeter, 1912). Several other economists have investigated this relationship and hold the view that financial development is a necessary condition for achieving high rate of economic growth [Patrick, 1966] , [Goldsmith, 1969] , [Mckinnon, 1973] and [Shaw, 1973] ).

**2.2DEMAND FOLLOWING AND SUPPLY LEADING HYPOTHESIS:** Patrick (1966), taking the cue from Goldsmith's analysis, further expanded the Gurley and Shaw thesis and stated that, "the causal nature of this relationship between financial development and economic growth has not been fully explored either theoretically or empirically". Moving away from the neo-classical state equilibrium analysis, to a highly developed financial system, consisting of financial intermediaries, leads to a 'demand following' phenomena (Patrick, 1960). Under this, in response to the demand from real economy, there is the creation of modern financial institutions, their financial assets and liabilities, and related financial services. The evolutionary development of the financial system is a continuous result of the pervasive, widespread process of economic development. The financial system is influenced by economic environment, institutional framework and also by individual motivations, attitudes, tastes and preferences. The demand for financial services is a function of growth of real output, commercialization, monetization of agriculture and other traditional subsistence sectors. The faster the growth in real national income, the greater will be the demand for external funds by enterprises. Financial intermediation plays a vital role, as internal funds generated are not sufficient for firms to finance expansion. Thus, finance is passive and permissive to growth process. In contrast, the "Supply Leading" phenomena refers to the creation of financial institutions and the supply of their financial assets, liabilities, and related financial services taking place, prior to their demand especially in the modern growth inducing sectors. 'Supply Leading' approach performs two important functions, these are:

(i) Transfer of resources from 16 traditional (non-growth) sectors to modern sectors, and

(ii) Promotes and stimulates an entrepreneurial response in these sectors. According to Patrick, in actual practice, there is an interaction of 'supply leading' and 'demand following' phenomena. Prior to sustained modern growth 'Supply Leading' could induce real growth through innovative investments by financial means. With real growth, the 'supply leading' gradually becomes passive and the 'demand following financial response becomes predominant. According to Patrick, in the linkage between financial growth and economic development, one of the most important relationships is the stock of financial assets and liabilities to the real capital stock, apart from their optimal composition, rate of growth, their efficient allocation and utilization. Thus, the financial system influences the capital stock in three different ways. First, financial intermediaries through intermediation among various types of asset holders can encourage more efficient allocation of a given amount of tangible wealth. Second, by intermediating between savers and investors, they can bring in allocative efficiency in new investments, i.e., additions to capital stock from lesser to more productive uses. Third, by providing increased incentives to save, invest and work, they can induce an increase in the rate of capital. While recognizing the important role played by financial intermediaries and also the differences in the distribution of saving and investment in both developed and underdeveloped countries, Patrick views that with the perfection of financial markets, near optimum allocation of investment is possible and the financial system accommodates economic growth. On the contrary, if the financial system is underdeveloped or inefficient, the growth is restricted

**2.3 GOLDSMITH THEORY:**

Goldsmith (1969) was one of the foremost to recognize the role of financial intermediaries in the institutionalization of savings. Since the growth process is financed either through domestic funds or foreign funds or both, the sources and uses of funds and their method of financing throw light on the factors determining the demand for funds. In this context, the role of financial intermediaries in mobilizing savings and channeling them to various sectors become crucial. Recognizing this, Goldsmith analyzed the volume of assets of various financial intermediaries, trends in their types and distribution, in relation to long-run economic growth. According to Goldsmith, the development of financial intermediaries and the trend of their share in national asset and wealth particularly are important from the economist's point of view. It indicates the extent and character of financial interrelations, which in turn helps to determine how capital expenditures are financed and how existing assets are shifted among owners. These together are important in directing the flow of savings into investment and also their size, which in turn stimulates economic growth. Goldsmith (1958) illustrates that despite the growth of all financial intermediaries in the first half of the twentieth century, the claims of non-bank financial intermediaries increased relative to the claims of demand deposits of commercial banks thereby diminishing their importance among all financial intermediaries. This implied that with the relative decline in the share of commercial banks, the ability of the central banks to control economic activity weakens and it called for a direct control of the non-bank intermediaries. Goldsmith (1969) found that the nature of financial structure in less developed countries as compared with developed ones is such that a small proportion of primary securities to Gross National Product and aggregate saving is issued by individual economic unit, which is acquired through financial intermediaries. Besides, the central bank accounts for about two-thirds of all claims on financial intermediaries, which are held by the public. This implies that there is greater dependence on self-finance and thereby hardly any direct contact between the primary borrower and the ultimate lender. He demonstrated that as real income and wealth increase both in terms of aggregate and per capita levels, the size and complexity of the financial super structure also grows. Economic growth was associated with expanding size and increasing complexity of financial structure.

**2.4 MCKINNON'S COMPLEMENTARITY HYPOTHESIS**:

Mckinnon (1973) explains the relationship between financial development and growth through a model based on 'outside money" and analyses the impact of real interest rate on saving deposits, investment and growth through the Complementarity hypothesis. The Complementarity is illustrated in the money demand function. (M/P)D = L (Y, I/Y, {d-pe }) Where, M is the money stock (which includes savings and time deposits. demand deposits and currency less M2), P is the comprehensive price index of goods in terms of money, Y is 18 the real Gross National Product, I/Y is the ratio of gross investment to Gross National Product, and (d-Pe ) is the real deposit rate of interest (d being the weighted average of nominal deposit rate of all classes of deposits and Pe is the expected future inflation rate and both are compounded). The complementarily is stated to work both ways, as McKinnon (1973) puts it, "The conditions of money supply have a first order impact on decisions to save and invest", it can also be expressed as an investment function as, (I/Y)=f (r, {d-Pe }) Where, r is the average return to physical capital and the complementarily between money and physical capital arises in the partial derivatives as follows:

ϴ (M/P) / ϴ (I/Y) = > 0; ϴ (I/Y) / ϴ (d-Pe ) = > 0.

The complementarily hypothesis is based on the assumption that all the economic units are circumscribed to self-finance. It is also assumed that investment expenditures are lumpier than consumption expenditures, implying that aggregate demand for money will be greater with larger proportion of investment to total expenditures. According to McKinnon, economic units must accumulate money balances prior to investment in the case of underdeveloped countries. Therefore, there exists a complementarily relationship between real money balances and investment in physical resources. With the constraints of self-financing, domestic savings equals domestic investments. Thus, domestic savings have a positive relationship with demand for real money balances.

**2.5 CONCEPTUAL FRAME WORK**

There have been both theoretical and empirical evidence that suggest that a strong financial sector promotes economic growth. Schumpeter (1934) in Oluyemi (1995) stressed the impact of banks as the key agent in the process of development. The financial sector increases the productivity of investment, reduces transaction costs and affects savings; therefore the financial sector will enhance economic growth. The financial system of any economy plays a determining role by ensuring that savings are invested in an efficient and optimal way. Economic growth has been described as sustained increase in per capita national output or net national product over a long period of time. It also implies that the rate of increase in total output must be greater than the rate of population growth (Dwivedi 2006). Economic growth occurs when a nation’s production possibility frontier (PPF) shifts outward. Economic growth, being the growth in output per capita, is an important objective of government since it is associated with rising average real incomes and living standard. The Robert Solow neo-classical growth model posits that growth depends on capital accumulation – increasing the stock of capital goods to expand productive capacity, and the need for sufficient saving to finance increased allocation of resources towards investment. Bencivenga and Smith (1991) asserted that economic growth will increase if more savings are channeled into the activity with high productivity while reducing the risk associated with liquidity needs. This will show that banks provide the benefits of eliminating unnecessary liquidations. Studies have shown that countries with well developed financial institutions tend to grow faster, particularly the size of the banking system and the liquidity of the stock market tend to have strong positive impact on economic growth. The financial services provided by these institutions are essential drivers for innovation and economic growth. Nnanna (2004) stated that the rate of output growth is determined by the accumulation of capital, the efficiency of resource utilization and the ability to acquire and adopt modern technology. He concluded that the degree of financial system development is crucial for attracting and sustaining capital flows, savings mobilization and utilization. The roles of foreign direct investment in the development of a nation have been considered to be important for countries to attract since the domestic savings falls short of the needed capital for sustained economic growth. The reliance on foreign direct investment flows may be misplaced because of the inability of most African countries to attract, sustain or adopt foreign capital/technologies on long-term basis. According to Calderon and Liu (2003), an enhanced financial system may attract capital and raise national savings, thus, increasing both capital formation and growth, and also allocate savings more efficiently. Patrick (1966) in his work postulates a bidirectional relationship (known as the supply leading hypothesis and the demand following hypothesis) between financial development and economic growth. In the supply leading hypothesis, the creation of financial institutions and the continuous supply of innovative financial products generate additional demand in the real sector, leading to economic growth. The demand following hypothesis emphasis the role of the real sector in promoting the financial development. The growth in the real sector increases the demand for financial services which stipulates a response from the financial sector in the form of increased supply and financial innovation. CarboValverde et al (2003) in their study investigated the issue of causality between financial development and regional economic growth in Spain. They found that increased competition in the banking sector (which leads to higher deposit and lower loan rates) has not caused economic growth in Spain. Their conclusion is that the positive link between financial development and economic growth in cross-country may be due to an unobserved third factor. McKinnon Shaw hypothesis, according to many authors implies that a monetized economy reflects a highly developed capital market; hence a high degree of monetization should be positively related to growth performance. Fama (1980) asserted that financial markets channel funds from agents willing to save to those requiring funds and provide liquidity services. Most literatures stated that Mckinnon (1973) and Shaw (1973) argue that policies that lead to financial repression reduce the incentives to save. The McKinon-Shaw thesis suggests that a low or negative real interest rate discourages savings and hence reduces the availability of loanable funds, constrains investment, and in turn lowers the rate of economic growth. They posited that an increase in the real interest rate may induce the savers to save more which will enable investment to take place. DiazAlejandro (1985) in his study show that financial deepening in Latin America is unlikely to increase savings, therefore, the main contribution of financial deepening to growth should be thought of as increasing the marginal productivity of capital rather than the volume of savings and investment Dornbusch (1990) finds that financial savings are not related to the level of real interest rates, and that the positive effect of real interest rates on growth does not come through its effect on the volume of investment. Khan and Villanueva (1991) suggest that positive real interest rate is a good proxy for the efficiency of capital accumulation. De Gregorio and Guidotti (1995) asserted that credit granted by banks appears to the most appropriate indicator of the degree of financial intermediation that occurs through the banking system. He stated further that it may be a weaker indicator of financial development broadlydefined, to the extent that a significant portion of financial development occurs outside the banking system. He stated that it is a better proxy for financial development in developing countries since most of financial development occurred within the banking system. Greenwood and Jovanovic (1990), in their model, show that financial intermediation promotes growth by ensuring a high rate of returns to the capital invested and that growth realized makes it possible, in its turn, to reduce the costs of the financings thanks to the drop in risk premiums due to the drop in the asymmetry of information. Bencivenga and Smith (1991) also underlined the positive effects that financial intermediaries have on the economy by encouraging the re-allocation of savings from liquid investments to longer-term productive investments. It is a matter of moving from speculative financial investments to investments in production and development projects.

**2.6 OVERVIEW OF THE NIGERIA FINANCIAL SYSTEM**

Overview of the Nigerian Financial System A financial system consists of different institutions, markets, instruments, and operators that interact within an economy to provide financial services such as resource mobilization and allocation, financial intermediation and facilitation of foreign exchange transactions. The Nigerian financial sector can be categorized into two namely;

1. The informal sector which comprises of the local money lenders, the thrifts and savings associations, etc. It is poorly developed, limited in reach, and not integrated into the formal financial system, but plays a major role in the Nigerian financial system.

2. The formal financial system comprises of the capital and money market institutions and these comprise of the banks and non-banks financial institutions. According to the CBN Annual Report and Statement of Account (2008), the Nigerian financial system consists of the Central Bank of Nigeria (CBN), the Nigerian Deposit insurance Corporation (NDIC), the Securities and Exchange Commission (SEC), the National Insurance Commission (NAICOM), the National Pension Commission (NPC), deposit money banks, microfinance banks, finance companies, bureaux-de-change, stock exchange, commodity exchange, primary mortgage institutions, development finance institutions, discount houses and insurance companies and registered insurance brokers. The deposit money banks emerged as a result of the adoption of the universal banking system in 2001 and the removal of the division between the commercial and merchant banks. These banks accept deposits, provide loans and advances to customers, operate the payment and settlement mechanism and also create money while providing loans and advances. There has been special attention of the regulatory bodies (that is CBN and NDIC) on the activities of these banks since they have a great impact on the soundness and stability of the financial system. There has been rapid growth in terms of service delivery and number of institution, which later decline from 89 in 2004 to 25 in 2006 and further reduction due to the consolidation of banks. Community banks are self-sustaining financial institutions owned and managed by communities. They obtain their licenses from the CBN after operating for two years. They were licensed to operate both in the rural and urban areas to complement the activities and programs of People’s Bank of Nigeria (Aderibigbe 2001). Community banks have now been converted to microfinance banks since 31, 2007. Microfinance refers to the provision of financial services to poor or low-income clients, including consumers and the self-employed. It is a system of banking where many poor and near-poor households have permanent access to an appropriate range of high quality financial services, including not just credit but also savings, transfers. Those who promote microfinance generally believe that such access will help poor people out of poverty. Development finance institution or specialized financial institutions are established to contribute to the development of specific sectors of the economy, most especially the manufacturing and agricultural sectors. They include the Bank of Industry (BOI), Nigerian Agricultural, Cooperative and Rural Development Bank (NACRDB), Urban Development Bank of Nigeria Plc, the Federal Mortgage Bank of Nigeria and the Nigerian Export-Import Bank (NEXIM)

**2.7 Financial Sector Development and Economic Growth:**

It will be necessary to focus on what have been the relationship and also the impact of financial sector development on the economic growth of other countries. This section will focus on the evidence of financial sector development in other countries. Bakhouche(2007) tests for a unidirectional link between financial sector development and economic growth in Algeria using the real per capita GDP as the economic growth indicator, and the ratios of M2 to GDP, total domestic credit and government expenditure to GDP. The result shows that there is no evidence of any short term relationship between the financial sector development and the Algerian economic growth and possibility of any long –run relationship. This, he assumed, may be as a result of persistent effects on economic performance of the country’s former central planning system where all economic decisions were as predetermined by government. He finally concluded that Algeria will need more time to realize the full benefits of financial sector reform and liberalization and competition between financial services providers. AlaouiMonstain (2004) in Bakhouche (2007) also tests the relationships between financial sector development and economic growth in Morocco using the real GDP to measure growth, and the ratios of liquid liabilities M3 to GDP, domestic credit issued by the banking sector to GDP and the domestic credit issued to the private sector to GDP are used as the financial development indicators. Causality relationships are identified from economic growth to the liquid liabilities and domestic credit indicators and from credit to the private sector to economic growth. There is evidence of a stable long-run relationship between economic growth and the financial indicators. He asserted that the financial reforms implemented in Morocco in the 1990s do not appear to have resulted in the generation of a level of savings sufficient to boost productive investment, and thus long-term growth. He then concluded that institutional and legal reform may necessary to achieve the objective of this fund mobilization. Richard Sylla (2005) in one of his hypothesis supported that financial sector development spurs economic development as the countries with the most developed financial systems became later the richest countries. He noted that since 1913, the United States of America has the most advanced financial sector and is thus leading in per capita income. Japan had a financial revolution in the late nineteen century and its economic development became at par with the western industrialized countries a century later. The recent upward movements towards the world average of China and India is partly the result of their improved financial systems. Damar et al (2006) studied the link between financial development and economic growth using a province-level data set for 1996-2001 on Turkey. Using both traditional OLS and dynamic panel GMM techniques, it was shown that financial deepening (i.e. an increase in the total deposits to GDP ratio) has a direct and robust impact on the growth rate of real GDP per capita. However, unlike most of the cross-country studies in their literature, the findings suggested that financial development has a negative relationship to economic growth. Their conclusion does fit rather well with the state of the Turkish economy and banking sector during the late 1990s.Unlike the traditional theories of financial intermediation, the Turkish banking sector during this period was not mobilizing and pooling domestic savings in order to invest in productive capital. Instead, the sector was engaged in channeling domestic resources to the government, which used the funds to cover its budget deficit. Ardic and Damar (2006) confirm the very important link between financial development and growth, but also sounds a note of caution that not all types of financial deepening is beneficial for the economy. In the case of Turkey, financial deepening meant that savings left the provinces, depriving the real industry of credit needed for investment projects. As such, it may not be hard to imagine that if the banking sector was functioning efficiently during this period, then financial deepening may have contributed to economic growth in the provinces, as opposed to taking them into a serious crisis. They concluded that it is important to note that financial deepening measured in terms of the ownership of banks may distort incentives leading to an underdevelopment of growth of both the public and the private banks. Therefore, financial sector deepening in terms of the public and private banks could be analyzed separately before making firm conclusions about the negative relationship between financial growth and economic growth.

**2.8 PERFORMANCE OF THE FINANCIAL SECTOR**

The financial sector is the hub of productive activity of an economy as it performs the vital role of intermediation, provider of payment services and the fulcrum of monetary policy implementation. Financial systems have long been identified as a sector that has an important role to play in the development of any economy. The financial sector has been described to be a catalyst of economic growth if it is developed and healthy (Adeoye, 2007). The reforms in the financial sector has enhanced the capacity of the market to provide windows of opportunities where large scale investors can raise funds to finance long-term projects and it has also lead to increase in employment opportunities as a result of increase in number of branches of banks. Through financial intermediation functions of the financial institutions, savers are linked up. The financial sector as a prime mover of economic development, mobilizes savings from surplus to deficit economic units. This has helped in the productivity of any economy. The efficiency and effectiveness of financial intermediation is a subject of the level of the financial systems development. The financial system is dominated by banks which concentrated on short term lending as against the long-term investment. Financial sectors reduce information and transaction costs in the economy. This facilitates more exchange of goods and services thereby allowing greater specification and productivity in the economy. The financial intermediaries can reduce information costs by acquiring and comparing information about many competing investment opportunities on behalf of all their savers, thereby ensuring that capital is efficiently allocated. Financial sectors provide risk management services and reduce risks involved in financial transactions. When financial institutions combine savings, they also ensure that each individual get his money back whenever needed. By investing in projects, they facilitate risk diversification, which increases returns and encourages more savings. The insurance sub-sector has been able to provide a safety net for entrepreneurs desirous of taking insurable risks and also help to reinforce and facilitate investment and mercantilism at both national and international levels (Uche, 2008) The development of the financial sector can also reduce poverty. The provision of bank accounts can enable the poor to accumulate funds in a secure place over time so as to finance a large, anticipated future expenditure. The bank account can also improve access to financial services like remittances or insurance. The mobilization of savings from the poor will also create funds available for tending. The availability of credit will strengthen in new and better tools, equipment, or fertilizers. The availability of credit has assisted in the expansion of small business leading to increase in income and employment generation. This, according to Uche (2008), has made the financial sector to facilitate transactions between local and international business concerns which enhance value creation. The table in (Appendix) shows that the broad money supply, M2, has been increasing since 1992. The factor responsible for the growth in the M2 was the expansion in net domestic credit complemented by the increase in foreign and other asset (net) of the banking system. The growth could also be driven by expansion in both narrow and quasi money Credit to private sector also increase on yearly basis, at times with some decelerated growth most especially when the 2007 with a growth of 90.8 percent is compared with that of 2008 where there is a growth rate of 59.4 percent.

**CHAPTER THREE**

**RESEARCH METHODOLOGY**

* 1. **Research design**

The researcher used descriptive research survey design in building up this project work the choice of this research design was considered appropriate because of its advantages of identifying attributes of a large population from a group of individuals. The design was suitable for the study as the study sought to the role of banks in the Nigeria economy

* 1. **Sources of data collection**

Data were collected from two main sources namely:

(i)Primary source and

(ii)Secondary source

**Primary source:**

These are materials of statistical investigation which were collected by the research for a particular purpose. They can be obtained through a survey, observation questionnaire or as experiment; the researcher has adopted the questionnaire method for this study.

**Secondary source:**

These are data from textbook Journal handset etc. they arise as byproducts of the same other purposes. Example administration, various other unpublished works and write ups were also used.

* 1. **Population of the study**

Population of a study is a group of persons or aggregate items, things the researcher is interested in getting information on the study the role of banks in the Nigeria economy. 200 staff of Nigeria stock exchange, Lagos state was selected randomly by the researcher as the population of the study.

* 1. **Sample and sampling procedure**

Sample is the set people or items which constitute part of a given population sampling. Due to large size of the target population, the researcher used the Taro Yamani formula to arrive at the sample population of the study.

n= N

1+N (e) 2

n= 200

1+200(0.05)2

= 200

1+200(0.0025)

= 200 200

1+0.5 = 1.5 = 133.

**3.5 Instrument for data collection**

The major research instrument used is the questionnaires. This was appropriately moderated. The secretaries were administered with the questionnaires to complete, with or without disclosing their identities. The questionnaire was designed to obtain sufficient and relevant information from the respondents. The primary data contained information extracted from the questionnaires in which the respondents were required to give specific answer to a question by ticking in front of an appropriate answer and administered the same on staff of the two organizations: The questionnaires contained structured questions which were divided into sections A and B.

* 1. **Validation of the research instrument**

The questionnaire used as the research instrument was subjected to face its validation. This research instrument (questionnaire) adopted was adequately checked and validated by the supervisor his contributions and corrections were included into the final draft of the research instrument used.

* 1. **Method of data analysis**

The data collected was not an end in itself but it served as a means to an end. The end being the use of the required data to understand the various situations it is with a view to making valuable recommendations and contributions. To this end, the data collected has to be analysis for any meaningful interpretation to come out with some results. It is for this reason that the following methods were adopted in the research project for the analysis of the data collected. For a comprehensive analysis of data collected, emphasis was laid on the use of absolute numbers frequencies of responses and percentages. Answers to the research questions were provided through the comparison of the percentage of workers response to each statement in the questionnaire related to any specified question being considered.

Frequency in this study refers to the arrangement of responses in order of magnitude or occurrence while percentage refers to the arrangements of the responses in order of their proportion. The simple percentage method is believed to be straight forward easy to interpret and understand method.

The researcher therefore chooses the simple percentage as the method to use.

The formula for percentage is shown as.

% = f/N x 100/1

Where f = frequency of respondents response

N = Total Number of response of the sample

100 = Consistency in the percentage of respondents for each item

Contained in questions.

**CHAPTER FOUR**

**PRESENTATION ANALYSIS INTERPRETATION OF DATA**

**4.1 Introduction**

Efforts will be made at this stage to present, analyze and interpret the data collected during the field survey. This presentation will be based on the responses from the completed questionnaires. The result of this exercise will be summarized in tabular forms for easy references and analysis. It will also show answers to questions relating to the research questions for this research study. The researcher employed simple percentage in the analysis.

**DATA ANALYSIS**

The data collected from the respondents were analyzed in tabular form with simple percentage for easy understanding.

A total of 133(one hundred and thirty three) questionnaires were distributed and 133 questionnaires were returned.

Question 1

Gender distribution of the respondents.

TABLE I

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Gender distribution of the respondents** | | | | | |
| Response | | Frequency | Percent | Valid Percent | Cumulative Percent |
| Valid | Male | 77 | 57.9 | 57.9 | 57.9 |
| Female | 56 | 42.1 | 42.1 | 100.0 |
| Total | 133 | 100.0 | 100.0 |  |

From the above table it shows that 57.9% of the respondents were male while 42.1% of the respondents were female.

Question 2

The positions held by respondents

TABLE II

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **The positions held by respondents** | | | | | |
| Response | | Frequency | Percent | Valid Percent | Cumulative Percent |
| **Valid** | **Accountants** | 37 | 27.8 | 27.8 | 27.8 |
| **Economists** | 50 | 37.6 | 37.6 | 65.4 |
| **Insurers** | 23 | 17.3 | 17.3 | 82.7 |
| **Bankers** | 23 | 17.3 | 17.3 | 100.0 |
| **Total** | 133 | 100.0 | 100.0 |  |

The above tables shown that 37 respondents which represent 27.8% of the respondents are accountants, 50 respondents which represent 37.6 % are economists, 23 respondents which represent 17.3% of the respondents are insurers, while 23 respondents which represent 17.3% of the respondents are bankers.

**TEST OF HYPOTHESES**

Banks development does not have any impact on Nigerian economic growth

Table III

|  |  |  |  |
| --- | --- | --- | --- |
| **Banks development does not have any impact on Nigerian economic growth** | | | |
| Response | Observed N | Expected N | Residual |
| Agreed | 40 | 33.3 | 6.8 |
| strongly agreed | 50 | 33.3 | 16.8 |
| Disagreed | 26 | 33.3 | -7.3 |
| strongly disagreed | 17 | 33.3 | -16.3 |
| Total | 133 |  |  |

|  |  |
| --- | --- |
| **Test Statistics** | |
|  | banks development does not have any impact on Nigerian economic growth |
| Chi-Square | 19.331a |
| Df | 3 |
| Asymp. Sig. | .000 |
| a. 0 cells (0.0%) have expected frequencies less than 5. The minimum expected cell frequency is 33.3. | |

Decision rule:

There researcher therefore reject the null hypothesis that state banksdevelopment does not have any impact on Nigerian economic growth as the calculated value of 19.331 is greater than the critical value of 7.82

Therefore the alternate hypothesis is accepted that there is a significant impact of the financial sector on economic growth.

**TEST OF HYPOTHESIS TWO**

Banks development does not have any impact on Nigerian economic development

Table V

|  |  |  |  |
| --- | --- | --- | --- |
| **Banks development does not have any impact on Nigerian economic development** | | | |
|  | Observed N | Expected N | Residual |
| Yes | 73 | 44.3 | 28.7 |
| No | 33 | 44.3 | -11.3 |
| Undecided | 27 | 44.3 | -17.3 |
| Total | 133 |  |  |

|  |  |
| --- | --- |
| **Test Statistics** | |
|  | Banks development does not have any impact on Nigerian economic development |
| Chi-Square | 28.211a |
| Df | 2 |
| Asymp. Sig. | .000 |
| a. 0 cells (0.0%) have expected frequencies less than 5. The minimum expected cell frequency is 44.3. | |

Decision rule:

There researcher therefore reject the null hypothesis that state that banks development does not have any impact on Nigerian economic development as the calculated value of 28.211 is greater than the critical value of 5.99

Therefore the alternate hypothesis is accepted that there is a significant relationship between banks and economic development.

Question 5

What is the role of the banks on the economic development of Nigeria’s economy?

TABLE III

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **What is the role of the banks on the economic development of Nigeria’s economy** | | | | | |
| Response | | Frequency | Percent | Valid Percent | Cumulative Percent |
| Valid | Issue loan | 91 | 68.4 | 68.4 | 68.4 |
| Accept deposit | 24 | 18.0 | 18.0 | 86.5 |
| Undecided | 18 | 13.5 | 13.5 | 100.0 |
| Total | 133 | 100.0 | 100.0 |  |

From the table above it can be observed that the researcher asked the respondent what is the role of the banks on the economic development of Nigeria’s economy, it was discovered that 91 respondent which represent 68.4% of the respondents said granting of loan, 24 respondent which represents 18% of the respondents said acceptance of deposit, while 18 respondents which represents 13.5% percent were undecided.

The researcher therefore conclude that the banks mob capital from the surplus unit and used it to financed the deficit unit inform of loans and acceptance of deposit.

Question 6

|  |
| --- |
| Is there any economic importance of the banks to the economy? |

Table IV

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Is there any economic importance of the banks to the economy?** | | | | | |
| Response | | Frequency | Percent | Valid Percent | Cumulative Percent |
| Valid | Yes | 82 | 61.7 | 61.7 | 61.7 |
| No | 30 | 22.6 | 22.6 | 84.2 |
| Undecided | 21 | 15.8 | 15.8 | 100.0 |
| Total | 133 | 100.0 | 100.0 |  |

From the table above it can be observed that the researcher asked the respondents is there any economic importance of the banks to the economy, it can be observed that 82 respondents which represents 61.7% said yes, 30 respondents which represents 22.6% said no, while 21 respondents which represents 15.7% were undecided.

The researcher therefore concludes that the banks are of great importance to the economy.

Question 7

Is there any relationship between economic growth and economic development?

Table V

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Is there any relationship between economic growth and economic development?** | | | | | |
| Response | | Frequency | Percent | Valid Percent | Cumulative Percent |
| Valid | Yes | 90 | 67.7 | 67.7 | 67.7 |
| No | 23 | 17.3 | 17.3 | 85.0 |
| Undecided | 20 | 15.0 | 15.0 | 100.0 |
| Total | 133 | 100.0 | 100.0 |  |

From the table above, the researcher asked the respondents is there any relationship between economic growth and economic development, it can be observed that 90 respondents which represents 67.7% said yes, 23 respondents which represents 17.3% of the respondents said no, while 20 respondents which represents 15% were undecided.

The researcher therefore concludes that there are significant relationship between economic growth and economic development

Question 8

What is the role of the stock market on economic development?

Table VI

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **What is the role of the stock market on economic development?** | | | | | |
| Response | | Frequency | Percent | Valid Percent | Cumulative Percent |
| Valid | Promote FDI | 45 | 33.8 | 33.8 | 33.8 |
| Trade on security | 30 | 22.6 | 22.6 | 56.4 |
| Sells govt bonds | 38 | 28.6 | 28.6 | 85.0 |
| Undecided | 20 | 15.0 | 15.0 | 100.0 |
| Total | 133 | 100.0 | 100.0 |  |

From the table above, the researcher asked the respondents What is the role of the stock market on economic development. It is observed that 45 respondents which represent 33.8% of the respondents said it promote foreign direct investment (FDI), 30 respondents representing 22.6% said it breed common interest, 38 respondents representing 28.6% said it trade on securities and 20 respondents representing 15% were undecided.

The researcher therefore concludes that the stock market plays a lot of roles in economic development.

**CHAPTER FIVE**

**SUMMARY CONCLUSION AND RECOMMENDATION**

**5.1 Introduction**

It is important to ascertain that the objective of this study was to investigate the role of banks in the Nigeria economy

In the preceding chapter, the relevant data collected for this study were presented, critically analyzed and appropriate interpretation given. In this chapter, certain recommendations made which in the opinion of the researcher will be of benefits in addressing the role of the banks in the growth of Nigerian economy

**5.2 Summary**

The role of banks is vital for inclusive growth in terms of wealth distribution and making capital safer for investors. The banks can create greater financial inclusion by introducing new products and services tailored to suit investors’ preference for risk and return as well as borrowers’ project needs and risk appetite. Innovation, credit counseling, financial education and proper segment identification constitute the possible strategies to achieve this. A well-developed financial sector creates a sustainable low-cost distribution mechanism for multiple financial products and services across the country. This research has sought to lime light important role played by banks in economic growth and development. Capital market enhances efficient financial intermediation. It increases mobilization of savings and therefore improves efficiency and volume of investments, economic growth and development.

**5.3 Conclusion**

It is incontestable that an efficient and effective financial system is essential for building a sustained economic growth. The success from the financial system can only be achieved through the safety, soundness and stability of the sector coupled with the effective and efficient management of the sector. It has also proved that the development of the financial sector will helped in facilitating the real sector which will result into having a virile economic growth. The Nigerian financial sector has not been virile enough to enhance the real growth that will push the Nigerian economy into realizing her goal of being among the best twenty (20) economies in the world by the year 2020. The intermediation role and investment of the financial sector are not targeted on a long-term basis which is making the real sector of the economy to continue to weak and therefore reducing the productivity level of the economy. Although, all the banks in Nigeria agreed to set aside 10 percent of their profit before tax for equity investments in small scale industries, which was aimed in order to stimulate economic growth and generate employment opportunities for country’s growing population, but the banks are reluctant to release the fund due to the inability of the local entrepreneur to provide collateral and good feasibility study. With these, the growth of the financial sector cannot complement the expected growth in producing sector of the economy. The expansion of the real sector can significantly influence the development of the financial sector if Nigeria is to have growth with a corresponding development The major challenge to the Nigerian financial sector development is how to engender healthy competition in addition to enhancing investments so as to achieve a desired economic growth and maintain its position as one of the emerging economies.

**Recommendation**.

In order to ensure an accelerated economic growth the following recommendations are suggested That there is the need for consistent, transparent and fair policy to all the players in the sector, the need to develop viable and responsive financial services for the poor in Nigeria, government should pay off all creditor contractors so they can pay banks and borrow new loans and also restore some of them to good financial health, there is the need for a resilient and strong institutional development of the sector, a strong emphasis on fund mobilization in order to bring help to the low income people to increase and stabilize their income and assets, the need to evolve an investment friendly interest rate regime supportive of the growth objective of the government. The lower costs of borrowing would induced the desired for credit expansion thereby encouraging investment activities in the country. Also the implementation of tax incentives policies should be maintained. A vigorous sustainable human centered development strategy capable of achieving a structural transformation of the economy, the need for fiscal adjustment as well as the development of more flexible financing option for the government, there s the continuous need for political stability in the country. Also the security of lives and properties should be seriously attended to, government should continue to intensify its efforts at promoting confidence of the public on this sector through adequate and effective regulation and supervision, the reforms in the financial sector should be sustained so as to be able to channel more resources for investment and productive purposes

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