

# Microfinance Banks And Economic Growth Of Nigeria (1999-2018)

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DOI: 10.29322/IJSRP.11.03.2021.p11143

<http://dx.doi.org/10.29322/IJSRP.11.03.2021.p11143>

**Abstract-** The study investigated microfinance banks and economic growth in Nigeria from 1999 to 2018. Secondary data were obtained from Central Bank of Nigeria statistical Bulletin. Data obtained were analyzed using ordinary least square regression techniques. The result of the estimation regression shows that there is a positive relationship between microfinance bank credit and real gross domestic product which represent economic growth. The study therefore recommended that microfinance should be involved in community activity projects to increase the level of economic growth and development in Nigeria

**Index Terms-** Microfinance credit, economic growth, poverty alleviation and inflation

## I. INTRODUCTION

Microfinance is about providing financial services to the poor who are traditionally not served by the conventional financial institutions. Microfinance is mostly used in developing economies where petty traders and Small and Medium Scale enterprises (SMEs) do not have access to financial assistance. From the statement above, we can infer that microfinance recognizes poor and micro entrepreneurs who are excluded or denied access to financial services on account of their inability to provide tangible assets to be used as security for credit facility they want to enjoy from deposit money banks (DMBs).

According to Central Bank of Nigeria (2005), microfinance banks are established to provide diversified, affordable and dependable financial services to the active poor, mobilise savings for intermediation, create employment opportunities and increase the productivity of the active poor in the country, enhance organised systematic and focused participation of the poor in the socio-economic development and resource allocation process, provide veritable avenues for the administration of the micro credit programmes of government and high net worth individual on the non-recourse case basis.

Acha (2012) stated that microfinance is about providing financial services to the poor who are traditionally not served by the conventional financial institutions.

Microfinance banks are supposed to be a bail out for rural empowerment poverty reduction and means of getting loans to foster Small and Medium Scale business in both the rural and urban areas as proposed by the Nigerian government in 2005 when the idea of it came to be. The financing gap to be met by deposit

money banks (DMBs) in Nigeria facilitated the coming into being of microfinance banks.

Nigerian government is striving hard to ensure that economy develops positively and Nigerian leaders are doing all they can to see to it that they provide conducive financial environment and licence banks to provide financial services to the teeming population especially those people in the rural areas, this is one of the reasons government licence microfinance banks to provide financial services to the low people and businesses who have long been denied access to credit facilities to develop their businesses.

Barr (2005) stated that microfinance might help for four reasons: firstly, financial self-sustainable microfinance programmes can contribute directly and at scale, to poverty alleviation and promote market deepening that in turn advances financial development. Second, microfinance may be useful strategy to consider in countries with bad governance where other development strategies face significant barriers. Third, microfinance can help financial market in developing countries to mature, while playing more limited, but useful roles in poverty alleviation in both financially underdeveloped and financially developed countries. Fourth, microfinance can help to break down opposition to, and build support for domestic financial reforms. A lack of access to financial institutions hinders the ability of entrepreneurs in Nigeria to engage in new business ventures inhibiting economic growth and often the sources and consequences of entrepreneurial activities are neither financially nor environmentally sustained. Microfinance banks serve as a means to empower the poor and provide valuable tool to assist the economic development process (Noruwa and Ezike, 2012).

It is against the discussion above that this paper seeks to evaluate microfinance banks and economic growth of Nigeria from 1999 to 2018.

## II. LITERATURE REVIEW

This section of the paper will be divided into three (3) parts:

- i) Conceptual framework
- ii) Theoretical framework and
- iii) Empirical review

### 2.1 Conceptual Framework

#### 2.1.1 Concept of Microfinance

Microfinance is a form of financial development that has as its primary aim poverty alleviation. Microcredit, lending small

sum to poor or near-poor households, achieved prominence in the 1980s, thanks to innovative programs such as the Grameen Bank, launched by Mohammed Yunus, and enthusiastic support from government officials including President Clinton (Barr, 2005). Year 2005 was designated by the United Nations as the International Year of Microcredit.

The Central Bank of Nigeria introduced the microfinance policy regulatory and supervisory framework for Nigerians to empower the vulnerable and poor people by increasing the access to factors of production, primarily capital. To achieve the goals of this phase of its banking reforms agenda, the apex bank seeks to re-brand and re-capitalize Litter to Community Banks, to come under two categories of microfinance banks. They are microfinance banks (MFBs) licenced to operate as a unit within local government and the other licenced to operate in the state or the federal capital territory with a minimum paid up capital base and shareholders funds of N20million and N1billion respectively. About 60% Community Banks migrated to microfinance banks by January 1<sup>st</sup>, 2008 and more microfinance banks have been licenced to operate (CBN, 2008).

Microfinance should be seen as an integral component of a developing country's broader financial development strategy. By demarginalizing microfinance programmes serving the poor, international financial institutions, donor nations, and developing countries may be able to more quickly reach the Millennium Development Goals. The federal and state governments have recognized that for sustainable growth and development, the financial empowerment of the rural areas is vital, being the repository of the predominantly poor in society and in particular the Small and Medium Scale enterprises.

The establishment of microfinance banks is to serve the following purposes according to Central Bank of Nigeria (2005), provide diversified, affordable and dependable financial services to the active poor, mobilize savings for intermediation, create employment opportunities and increase the productivity of the active poor in the country, enhance organized, systematic and focussed participation of the poor in the socio-economic development and resource allocation process, provide veritable avenues for the administration of the microcredit programmes of government and high net worth individuals.

### 2.1.2 Concept of Economic Growth

Dandana and Nwele (2011) stated that economic growth is the increase in the inflation-adjusted market value of the goods and services produced by an economy over time. It is conventionally measured as the percent rate of increase in the real gross domestic product (GDP). Of more importance is the growth of the ratio of GDP to population (GDP per capital which is also called per capital income). An increase in growth caused by more efficient use of inputs (such as physical capital, population or territory) is referred to as intensive growth.

GDP growth caused by increases in the amount of inputs available for use is called extensive growth. Real gross domestic product in this study will serve as the relevant economic growth indicator. Unemployment and high poverty affect national productivity and living standard in Nigerian economy and in variably, economic growth and development.

Microfinance banks serve as a means to empower the poor and provide valuable tool to as the economic growth process.

Access to finance is key to SMEs growth globally. In Nigeria, financial inclusion has been recognized as an essential tool for SMEs development. Lack of access to financial institutions services hinder the ability of entrepreneurs in Nigeria to engage in new business venture thereby inhibiting economic growth (Ashamu, 2014). He stated further that the promotion of micro enterprises in developing countries is justified because of their abilities to foster economic development.

Robust economic growth cannot be achieved without putting in place a well focussed policy to reduce poverty through empowering the people by increasing their access to factors of production, especially credit (Ezike and Abu, 2012).

## 2.2 Theoretical Framework

### 2.2.1 Financial Growth Theory

Berger and Udell (1998) proposed a financial growth theory for small businesses where the financial needs and financing options change as the business grows, becomes more experienced and less informationally opaque. They further suggest that firms lie on a size/age/information continuum where the smaller/young/more opaque firms lie near the left end of the continuum indicating that they must rely on initial insider finance, trade credit and/or angel finance. The growth cycle model predicts that as firm grows, it will gain access to venture capital (VC) as a source of intermediate equity and mid-term loans as a source of intermediate debt. At the final stage of the growth paradigm, as the firm becomes older, more experienced and more informationally transparent, it will likely gain access to public equity (PE) or long-term debt. Problems related to financing are dominant in the literature with regard to small firms. The capital structure of smalls firm differs significantly from larger firms because small firms rely more on informal financial market which limits the type of financing they can receive. The small firm's initial use of internal financing creates a unique situation in which capital structure decisions are made based on limited financing options. It is widely accepted that small firms have different optimal capital structures and are financed by various sources at different stages of their organizational lives (Berger and Udell, 1998).

### 2.2.2 Pecking Order Theory

Pecking order theory was developed by Myers in 1984. The major prediction of the model is that firms will not have a target optimal capital structure, but will instead follow a pecking order of incremental financing choices that places internally generated funds at the top of the order, followed by debt issues, and finally only when the firm reached it's "debt capacity" new equity financing.

Myers and Majluf (1984) noted that this theory is used upon costs derived from asymmetric information between managers and the market and the idea that trade-off theory costs and benefits to debt financing are of issuing new securities. The cost of equity includes the cost of new issue of shares and the cost of retained earnings. The cost of debt is cheaper than the cost of both these sources of equity funds. Considering the cost of new issue and retained earnings, the latter is cheaper because personal taxes have to be paid by shareholders on distributed earnings while no taxes are paid on retained earnings and also no floatation costs are incurred when the earnings are retained. As a result, between the two sources of equity funds, retained earnings are preferred. It has

been found in practice that firms prefer internal financing. If the internal funds are not sufficient to meet the investment outlays, firms go for external finance, issuing the safest securities such as convertible debentures, then perhaps equity as a last resort.

Pecking-order theory has the following assumptions: Firms prefer internal financing to external financing; Firms adapt dividend payout ratio to their investment opportunities. This implies that if investment is low, the dividend payout ratio will be high and vice versa; If the firm only has the choice of external financing, the firm should first issue the safest security. Starting with debt, then the hybrid such as convertible and at the last equity (Myers, 1984).

### 2.2.3 Financial Intermediation Theory

Fredrick (2012) stated that Financial Intermediation Theory was developed by Guttentag and Lindsay (1968). Financial intermediation is the transfer of funds from agencies that have a surplus to agencies that have a deficit through Financial Intermediation (Alexandru & Marius, 2009). Financial Intermediation is based on the regulation of money production and of saving and financing of the economy (Bert & Dick, 2003). The assumption of financial intermediary theory is that at least one party to a transaction has relevant information, whereas the other(s) do not. The criticism of the theory is the applications of theory that is the theory only consider asymmetries in one direction. It may, however, be that there are also information differences in the favour of the other party. Another criticism is the competitive dynamics assumed in the model are simplistic. Myer (2001) assumed a model where equilibrium can be reached on the insure market with every policy traded making zero profits. The theory does not consider substitute products, aggressive entrant to the market trading with negative profits and it also assumes same costs for producing the services for all companies. Taking such factors into account may have a profound effect on the results obtained with the model.

As stated by Paul and Paul (2011), this method of regulation influences the liquidity and solvability of intermediaries involved. Banks have found it increasingly difficult to maintain their profitability due to increased competition, globalization and liberalization of the market. The need for specialized partnerships is seen to be imperative for the long-term growth and sustainability of these Financial Institutions as well as maintaining their liquidity. By comparison, insurance companies have over the years found it increasingly difficult to maintain their competitive advantage in the ever-changing competitive environment. Hamisu (2011) noted that the increasingly competitive environment in the financial services market has resulted in the pressure to develop and utilize alternative delivery channels. With this, banks are striving to ensure that they can garner a huge customer base to increase their loan services to customers.

### 2.3 Empirical Review

Brown, Earle and Lup (2004) employed panel data techniques to analyze a survey of 297 new small enterprises in Romania. They found strong evidence that access to external credit increases the growth of both employment and sales, while taxes appears as constraint to growth. The result suggested that entrepreneurial skills have little independence effect on growth, once demand conditions are taken into account.

Afolabi and Emmanuel (2012) in a paper explored the extent to which microfinance lending impacts on indigenous SMEs access to finance and how the intermediation services of the microfinance banks (MFBs) contributed to or otherwise to the development of SMEs. A total of 800 such indigenous SMEs were identified. Data were obtained from 300 of the identified indigenous SMEs from a questionnaire survey of four (4) states within the country in the Niger Delta region. The result showed positive contribution of microfinance lending to the development of such enterprises. However, it appears that a number of factors including cumbersome process, poorly packaged business plans and perceived high cost of credit limit the access of indigenous SMEs to credit.

Olowe, Moradeyo and Babalola (2013), in their study that investigated the impact of microfinance on SMEs growth in Nigeria. The population of the study consists entire SMEs in Oyo State, though restricted to Ibadan metropolis. Purposive sampling technique was used to select a total of 50 SMEs operators. Person correlation coefficient and multiple regression analysis were used to analyze the data. The results from the study showed that financial services obtained from MFIs have positive significant impact on SMEs growth and economic development of Nigeria.

Ashamu (2014) examines the performance of microfinance institutions (MFIs) in Lagos State. Simple random sampling technique was employed in selecting 110 SMEs that constituted the sample size of the research. Structured questionnaire was designed to facilitate the collection of relevant data used for the analysis with the use of descriptive statistics. Findings from the study showed that operations of MFIs have grown greatly, driven largely by expanding informal sector activities. Study further revealed that the sub-sector faces a number of challenges which have been addressed by the research.

## III. METHODOLOGY

Research design adopted for this study is *ex-post-facto*. For the purpose of this study. Secondary data was used to explain impact of microfinance banks on economic growth in Nigeria for the period 1999-2018.

The population of the study is the entire aggregate of individuals or items relevant to a phenomenon under investigation. The population used for this study is based on CBN publication on microfinance institutions in Nigeria.

### 3.1 Model Specification

The model used to investigate impact of microfinance banks on economic growth in Nigeria in this study followed that of Aliero, Abdullahi and Adam (2013) which is stated below:

$$Y = \beta_0 + \beta_1 \text{MFC}_t + \mu$$

Where:

Y = Real gross domestic product (economic growth). Dependent variable

$\beta_0$  = Slope or constant parameter

$\text{MFC}_t$  = Microfinance institutions credit at time t. Independent variable

$\beta_1$  = Vector coefficient of microfinance institutions credit

$\mu$  = Stochastic term

### 3.2 Model Estimation Techniques

The coefficient of correlation will be used to ascertain the strength of the relationship between the dependent and independent variables. T-test will be used to evaluate the relationship between the dependent and the independent variables to know whether they statistically significant or not.

IV. DATA PRESENTATION AND ANALYSIS

Secondary data that have been gathered for this research were empirically analyzed with the help of Ordinary Least Square (OLS) as presented below:

**Table 1: Real gross domestic product, microfinance bank credits and aggregate microcredit in Nigeria (1999-2018)**

Year	Real Gross Domestic Product (NM)	Microfinance Bank Credit (NM)
1999	393,107.20	2958.30
2000	412,332.00	3666.60
2001	431,783.20	1314.00
2002	451,785.70	4310.90
2003	495,007.20	9954.80
2004	528,576.05	11,353.80
2005	561,931.39	28,504.80
2006	595,821.62	16,450.20
2007	634,251.27	22,850.20
2008	672,202.56	42,753.06
2009	718,977.34	58,215.66
2010	775,525.70	52,867.50
2011	834,160.00	53,319.90
2012	917,576.00	58,651.89
2013	950,461.02	54,517.08
2014	987,521.02	70,968.79
2015	992,556.13	72,523.10
2016	999,463.45	73,456.60
2017	1,009,333.60	77,540.34
2018	1,110,266.96	78,950.78

Source: Central Bank of Nigeria, Statistical Bulletin of various issues 2000 to 2020

**Table 2: OLS Regression Result**  
Summary Output

<i>Regression Statistics</i>	
Multiple R	0.908690902
R Square	0.825719155
Adjusted R Square	0.770163599
Standard Error	280056.1084
Observation	20

**Table 3: Residual Output**

<i>Predicted</i>	<i>Standard</i>	<i>Residuals</i>	<i>Residuals</i>
<i>Observation</i>	<i>352646.2</i>	<i>Residuals</i>	<i>Residuals</i>
1	23283.15035	343934.9497	1.261746
2	26918.12869	350912.6713	1.287344
3	42016.75782	346451.3422	1.270977
4	49191.93235	343915.2676	1.261673
5	60969.86079	351362.1392	1.288993
6	21849.77829	409933.4217	1.503865
7	71683.56866	380102.1313	1.394427
8	165532.8561	329474.3439	1.208696
9	188796.0523	339779.9977	1.246503
10	473990.5328	87940.85716	0.322616
11	272541.2654	322280.3546	1.182304
12	379963.321	254287.949	0.93287

13	710916.9575	-38714.3975	-0.14203
14	968035.9695	-249058.629	-0.91369
15	879104.3787	-103578.679	-0.37998
16	886627.0878	-52467.0878	-0.19248
17	975289.7966	-57713.7966	-0.21173
18	906534.331	102799.269	0.377125
19	1180100.705	-69833.7454	-0.25619

Source: Excel Regression Output

#### 4.1 Data Interpretation and Discussion of Finding

The result of the estimation of regression summarized in the table above shows that there is a positive relationship between Real Gross Domestic Product and microfinance bank credit.

#### 4.2 Discussion of Estimated Model Based on A-priori Expectations

The parameter estimates are:  $b_1=1$

Given the above estimates microfinance bank credit confirms to the a priori expectation. Micro credits on Nigeria's economic growth, however, the results of this study tend to come to the fore when microfinance is viewed as part of Nigeria's deposit money banking system. However, the results of this study represent a negative significant meaning the objective of establishing micro financial in Nigeria has not significantly achieved its set goal in the area of employment generation, accessible to credit by Small and Medium Scale enterprise and economic development of the nation. These banks should be compelled to be more active in the discharge of their functions. They should not sit complacently by expecting rural loan seekers to seek them out. On the contrary, they should comb the rural areas; enter into its nooks and cranny of these areas to sell their activities.

#### 4.3 Explanatory Power of the Model $R^2$ and Adjusted $R^2$

The coefficient of determination  $R^2$  and the adjusted  $R^2$  are used to determine the degree of variations in the dependent variable that is explained by the independent variable.

From the regression result, the  $R^2$  is 0.825719155 while the adjusted  $R^2$  0.770163599. This implies that 97% of the total variations in Real Gross Domestic Product are explained by the variations in Total Microfinance Bank Credits. The 3% not explained could be referred to the stochastic variable 'μ' which involves other variables not included in the model. In other words the variables can be trusted in the determination of Real Gross Domestic Product.

#### 4.4 T-test Statistics

At 5% level of significance, we will test for the statistical significance of the effect of the independent variable.

$DF = n - k$

Where n = number of observations

K = number of parameters

Df = degree of freedom

$Df = 20 - 1 = 19$

Decision rule: if at 0.05 level of significance

Given the degree of freedom (DF)=19

Total Microfinance Bank Credits=85.28157 > 4.91E-08<sub>calculated</sub>  
tabulated

**Decision:** Based on the decision rule stated above, the variables whose t-calculated values exceed their t-tabulated are statistically significant and can individually affect the PR while others are held constant.

Since calculated exceeds tabulated (85.28157 > 4.91E-08) this means that Total Microfinance Bank Credits exert significant impact on Real Gross Domestic Product. Therefore we accept  $H_1$  and reject  $H_0$

#### 4.5 Test of Significance (F-statistic)

F-statistics test the overall significance of the model under study.  $F^*$ -calculated is compared with F-tabulated where  $F^*$ -cal is greater than F-tab we accept the alternative hypothesis ( $H_1$ ) and conclude that the variable is statistically significant in explaining the dependent variable. From the table, it shows that F-cal is 85.28157; and F-tabulated is 4.91E-08 with P-value= 3E-08 at 5% level of significance. We therefore, accept alternative hypothesis and reject null hypothesis. This is because  $F^*$  is greater than the critical values. Thus, it implies that the model is statistically significantly different from zero. In other words, the explanatory variables jointly considered are significantly important in explaining variation in the dependent variable.

#### 4.6 Economic Implications and Policy Relevance of the Results

Based on the empirical analysis of the time series data used for the study, the single regression results revealed that approximately 97% of Real Gross Domestic Product was explained by Total Microfinance Bank Credits.

This implies that the microfinance banks should involve themselves in the community development projects in their catchment areas.

## V. CONCLUSION

From the findings of this study, we conclude that there exist a long-run relationship between microfinance and Nigeria's economic growth. Meaning that if microfinance banks are well managed, they would have significant positive impact on the economic growth and development in Nigeria.

The problem with microfinance in Nigeria has to do with repayment of loans by the borrowers. This problem can be averted if due process is followed by microfinance banks before any facility is disbursed to a borrower.

#### 5.1 Recommendations

- 1) MFIs should lighten the conditions for borrowing and increase duration of loans to their customer by spreading the repayment of loan for a long period of time

- 2) Central Bank of Nigeria (CBN) should create enabling environment for MFIs to gain public confidence since it has shown from the study that MFIs will assist in economic growth and development of Nigeria
- 3) It has shown that high cost of operation has killed many MFIs, management of MFIs should find a way of reducing their operating cost
- 4) It is further recommended that CBN should licence more microfinance banks instead of withdrawing their licence. CBN has just withdrawn the licence of some Microfinance banks
- 5) MFIs should also involve in community development projects by financing community projects that are viable and where they can easily recoup their money
- 6) Government should improve on the state of infrastructural facilities to reduce the transactional costs associated with administration of microcredit in Nigeria

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