

## **The Effect of Restructuring on the Financing Pattern of Development Banks in Nigeria**

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*Studies on the assessment of Development Finance Institutions' financing of enterprises are of utmost policy relevance, particularly for a country with slow pace of economic growth and development like Nigeria. The paper uses data from secondary sources mainly from the annual reports and accounts of the company for all the years covered by the study. Variables such as percentages, ratios, mean and median were used in the analysis. The study employed parametric statistical test of t-test and multiple regression models in the analysis. The variables used in the study were identified as profitability, liquidity, capital adequacy, asset quality and shareholders interest. It is the findings of the study that liquidity is found to be consistently significant in explaining and predicting the financing pattern of the sampled banks. While the shareholders fund, is found to have negative relationship in terms of the financing pattern of the banks. However, there is a significant aggregate impact on DFIs financing pattern by the combined influence of these explanatory variables (liquidity plus shareholders fund). Furthermore, the computation of ratios of the variables (profitability, liquidity, capital adequacy, asset quality and shareholders interest) were presented in twelve variables. The t-test computations for the variables show the real effect on account of the bank's restructuring exercise. It is therefore, the recommendation of the paper that, in order to keep the bank healthy and solvent, there is the need to spur on the post restructuring tempo that guarantees an improved, sound liquidity position. In pursuit of this, the bank needs to maintain a relatively large investment in current assets to avoid the difficulty of paying claims of its creditors.*

**Keywords:** Nigeria, Development Finance Institutions, Banking

### **1. Introduction**

Nigeria as a developing economy comes up with a lot of developmental programs. This is out of concern with the slow pace of economic growth and development of the nation, and recognizing the need to mobilize exceptional resources for investment in the critical sectors of the economy. One of these programs is the establishment of the Development Finance Institutions (DFIs), otherwise known as Specialize Finance Institutions (SFIs) or Development Banks (DBs). They are institutions established to contribute to the development of specific sectors of the economy (Charitononka, 2005). The most important of these institutions is the Nigerian Industrial Development Bank (NIDB) established on January 22, 1964 and conferred with the responsibility of supporting industrial enterprise with equity and credit financing. DFIs notably form part of the financial system of any economy. Nnanna, *et. al.* (2004), submit that the financial sector could be a catalyst for economic growth if it is healthy and well developed. In other words, a country's economic growth is somewhat the function of a healthy and well developed financial sector. According to Gibson and Tsakalotos (1994), the benefits accruable from a healthy and well developed financial system relate to savings mobilization and

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efficient intermediation roles. In the same vein, countries that have made economic breakthroughs in the last two decades demonstrate beyond doubt that the development of entrepreneurship has been the essential condition for growth and development. African governments (Nigeria inclusive) have started to acknowledge the wisdom in the fact that the ability to get out of the current economic woods would, to a large extent, depend on the ability to harness the entrepreneurial potentials visible in their high streets, market places and small, medium and large scale enterprises. As Beyene (2002) summarizes, entrepreneurship is a function of opportunities, technical and commercial skills, entrepreneurial spirit, finance, infrastructure and the overall environment within which the enterprise operates. Against this backdrop, it becomes imperative that special efforts be made to strengthen the private sector so as to enable it function as an engine of growth.

Within that perspective, credit appears as only one piece of a much larger and more complex problem. Charritonenko (2005) however sees DFIs as specialized banks established to contribute to the development of specific sectors of the economy. The latest view typically and properly depicts DFIs' areas of operation to be restricted to few sectors which may have been earmarked as needing special attention. In Nigeria, industry such as mining, education, housing, as well as agriculture, being commonly among such sectors for which DFIs are established (either by individual, firms or governments) to provide medium and long term credit to enterprises in the form of equity or loan financing. The problem of long term credit to finance industry is one of the most crucial challenges hindering enhanced growth in developing countries. DFIs therefore, are the main players at the long term pitch of the financial market as commercial and other similar banks are not tailored to provide such services. The aim of this paper is therefore, to look at the operation of the banks and see the extent to which they revitalize the Nigerian economy.

## 2. Literature review

The concept of development banking revolves around the Provision of adequate supply of capital for capital formation in the desired sector at the appropriate time. According to Garson, *et. al.* (2006), the underlying concept of development banking was that government should intervene in the economy in order to promote optimal conditions for development, notably by setting fixed interest rates and using direct-credit Programs to increase investment in particular economic sectors. Hence, ownership of DFIs is still a preserve or monopoly of governments of many countries.

That supply of investment capital is mainly the interlock of an economy's financial structure and the financial intermediaries that function within that structure. As Caprio *et al* (1997) opined, two types of institutions, financial intermediaries and stock markets, directly influence the financial structure choices of firms. The utmost role of financial intermediaries, such as DFIs is that of monitoring borrowers. Similarly, Diamond (1984) argues, intermediaries have economies of scale in obtaining information. It is within this context that Akintola (1990), views a company's financial structure as exhibiting three facets: government's financing from its own saving/funds, self-financing from enterprises' own profits and voluntary savings. Direct government financing of enterprises is predicated on facts such as the inability or unwillingness of private enterprises to invest adequately in certain sectors, the

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need to eliminate monopolies and the desirability of government intervention in a market economy.

The second source of investment capital is retained profit. Retained profit is a self-financing or re-investment mechanics which allows a company to plough back some portion of its profits rather than dissipating all in dividends. This is regarded as the most desirable source of finance for enterprises because it is cost free, it makes enterprises to be less dependent on financiers and at the same time forms the motive force of a self-sustaining economy. Developing Countries, in the views of Akintola (1990), typically have fewer enterprises which could engage in self-financing to start with. The third source of capital investment for enterprises is voluntary saving through the channel of the financial intermediaries which consist of the commercial banks, insurance companies, finance companies, other contractual saving schemes and even individuals. The fact that commercial banks are generally indisposed to lending long-term capital for investment makes this source no stimulating to enterprises. Researchers have advanced several reasons why commercial banks are indisposed to lending long term capital for investment. Essien (2001) contends that it is because the commercial banks are not tailored to provide long-term financing. Other arguments put forward by researchers as reasons are peculiar to the nature of the financing. For example, Caprio *et al* (1997) notes that, a leading reason for the absence of long term financing is high inflation and unstable macroeconomic policies. Attempts to increase the supply of long term credit, Caprio *et al* (1997) contend, without addressing the inflation problem could easily prove to be short-lived or costly. Most countries of the world, developed or developing, are entangled in this abyss of economic wood. This is because inflation and inconsistent macroeconomic policies are becoming world phenomena. Myers (1997), views that a firm's reliance on long term debt leads to greater distortions in the owner/manager risk. This is similar to the view of Rajan (1992), who says that reliance on long term debt always increase the firm's financing costs and reduces the owner-managers incentives to exert effort and increase efficiency. Caprio *et al* (1997), opines further that long term debt dampens the firm's response to deterioration in market conditions, and enables the firms to avoid exiting the market when the continued operation of the firm has become socially undesirable. This reduction in efficiency is even worse, according to Caprio, *et al* (1997), if long term debt is made available on a subsidized basis. Caprio, *et al* (1997), therefore concludes that long term credit is scare in developing countries and in particular for smaller firms.

Finally, Ofek (1993) in his discourse contends that there is some evidence which confirms that relying primarily on long term debt cannot respond swiftly to adverse shocks. It, indeed, becomes evident from previous researches and accompanied case studies that it is neither feasible nor possible for commercial banks to provide long term financial requirements of industries. More so, it is alleged that scarcity of long term finance is a key impediment to greater investment and growth (Caprio *et al* 1997). It is against this backdrop that governments and other interest groups, in order to facilitate long-term investment funding, found it necessary to create the special financial credit institutions popularly known as Development Finance Institutions (DFIs). DFIs, indeed, have a long history of trying to address these contending issues. This is because they were expected to act as a vehicle through which term finance could be provided for development projects. According Caprio, *et al* (1997), a significant part of World Bank and other multilateral development bank

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lending was aimed at attempting to correct for the dearth of term credit through Financial Intermediaries. Loans extended through DFIs have shown greater characteristics of extended and or long term guarantees. Essien (2001) also contends that, DFIs are the major operators at the long-term end of the financial market. It is against this that this paper finds it of paramount importance to study the financing pattern of development banks, especially as they have been restructured to achieve better performances. The next part of the paper describes the methodology used in the conduct of the exercise.

### 3. Methodology

The paper uses data mainly from the secondary source. This is because the adopted statistical test and the estimation of the model in the study require the use of pooled time series data in the form of financial and market information. The sources of data are the annual reports and accounts of the banks for all the years covered by the study. It also includes such documentation as CBN's statistical bulletin and bullions, BOI corporate briefs, newsletters, magazines, pamphlets. The univariate was used in the analysis with variables such as percentages, ratios, mean and median. The study also employed the parametric statistical test of t-test and multiple regression models.

The dependent t-test uses five classified variables – profitability, liquidity, capital adequacy, asset quality and shareholders interest.

The formula for the dependent t-test is as follows (Trochin, 2006):

$$t = \frac{X_D - \mu_o}{\frac{SD}{\sqrt{N}}}$$

Where:

$X_D$  is the means or the average

$\mu_o$  is the constant and is non-zero

SD is the Standard Deviation of those differences in the equation

N is the number of pairs of cases

The degree of difference used is  $N - 1$

The t-test was run using SPSS computer package, version 13. The goal of the dependent t-test in this study is to compare the computed variables (using the key financial and performance indicators) during the pre-and-post restructuring. The model uses one major criterion variable – loans and advances, and two predictor variables – liquidity and shareholders' funds. The primary goal of the multiple regression models in this study is to examine empirically the extent to which the predictor variables in this research explain the observed pattern of DFIs financing of enterprises in Nigeria. More specifically, the multiple regression models seek to determine the aggregate impact of the two predictor variables on the financing pattern of the Bank of Industry.

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The regression equation developed and tested in this study is thus stated below:

$$\text{LOADV} = \alpha_1 + \beta_1 \text{Liq} + \beta_2 \text{SHF}$$

Where:

**LOADV=** Loans and Advances, representing the money value advanced to various client establishments. It is the proxy for the bank's financing pattern in this study.

**Liq =** Liquidity, representing the difference between current assets and current liabilities of the bank during the period.

**SHF =** Shareholders Fund, representing the share capital and reserves of the bank accumulated during the period.

The model focuses on examining the relationship between loans and advances (as dependent variable) and liquidity as well as shareholders funds (as explanatory variables). The derivative and measurement of the variables are discussed below:

1. Loans and Advances (LOADV): representing loans and advances (Principal and accruing interest) accumulated by BOI during the study period. It is measured by the money value of the sanctions BOI has made to its various client establishments (enterprises) within the study period after deducting provision for doubtful accounts and interest in suspense. The extent of BOI financing involvement is measured by the sanctions and in the study, it is the proxy for actual disbursements advanced to its enterprises.
2. Liquidity (Liq) is measured by the difference between current assets acquired and current liabilities incurred during the study period (see Inanga and Ajayi, (2001).
3. Shareholders' Fund (SHF) is measured by BOI's share capital and reserves as classified and accumulated in the balance sheet of the bank for various years (BOI, 2006).

## 4. Discussions

### 4.1 THE COMPUTATION OF RATIOS OF THE FIVE KEY INDICATORS

Table 4.1 presents the computed ratios of profitability for Bank of Industry (BOI) over the period 1996 to 2006.

**Table 4.1:** Computation of Profitability Ratios for BOI (1996 – 2006)

Year/Ratios	1996 N'000	1997 N'000	1998 N'000	1999 N'000	2000 N'000	2002 N'000	2003 N'000	2004 N'000	2005 N'000	2006 N'000
ROA= PBT Total Assets	<u>39706</u> 658973 1 <u>0.006</u>	<u>4170</u> 517549 2 <u>0.008</u>	<u>20369</u> 499045 1 <u>0.004</u>	<u>22603</u> 986854 0 <u>0.002</u>	<u>26650</u> 961205 5 <u>0.003</u>	<u>445836</u> 567840 3 <u>0.079</u>	<u>(623781</u> ) 727720 9 <u>0.086</u>	<u>620162</u> 834357 9 <u>0.074</u>	<u>105360</u> 1323423 0 <u>0.008</u>	<u>1334160</u> 2360376 9 <u>0.057</u>
ROE= PBT Equity	<u>39706</u> 100000 0 <u>0.004</u>	<u>41270</u> 100000 0 <u>0.041</u>	<u>20369</u> 100000 0 <u>0.02</u>	<u>22603</u> 100000 0 <u>0.023</u>	<u>26650</u> 100000 0 <u>0.027</u>	<u>445836</u> 136932 4 1 <u>0.326</u>	<u>(623781</u> ) 136932 9 <u>0.456</u>	<u>620162</u> 658512 9 <u>0.094</u>	<u>105360</u>   <u>0.016</u>	<u>1334160</u> 1000000  <u>0.203</u>
Interest Income Loans & Adv.	<u>431675</u> 411169 9 <u>0.105</u>	<u>452365</u> 242272 8 <u>0.187</u>	<u>496061</u> 212459 3 <u>0.233</u>	<u>722703</u> 628338 4 <u>0.115</u>	<u>877341</u> 552519 4 <u>0.159</u>	<u>372851</u> 56046 <u>6.653</u>	<u>570561</u> 126448 2 <u>0.451</u>	<u>806709</u> 270327 2 <u>0.298</u>	<u>909361</u> 4457349  <u>0.204</u>	<u>1656690</u> 5990680  <u>0.277</u>

**Source:** BOI Annual Reports & Accounts (various years)

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Table 4.1 above represents computation of profitability ratios for BOI over the period of ten years. The table reveals that year 2002 records the highest return on asset of 0.079 while 2003 records the lowest with a negative of 0.086. This is an indication that restructuring has not significantly added to the value of the bank's ROA. Although there was an improvement in the values during the post as comparable to the pre, except for 2003 that recorded a negative value.

On return on equity, the table shows that year 2002 records the highest value while year 2003 records the lowest, spelling the same trend with ROA. For interest income to loans and advances, 2002 and 1996 record the highest and lowest values respectively. By and large, the table reveals not quite rosy profits of the bank before and after restructuring.

### 4.2 T-TEST COMPUTATIONS FOR RATIOS OF THE FIVE KEY INDICATORS

In order to see the real effect of the financial trends, we compute the various ratios using t-test to assess whether the means of two groups (the pre- and –post restructuring) are statistically different from each other. Table 4.10 presents the t-test computations for BOI over the period 1996 – 2006. The full results are contained in appendix E.

**Table 4.6:** T-test Computations for Profitability Ratios for BOI

Variable	N	Pre-restructuring		Post restructuring		t-value	p-value
		Mean	Standard deviation	Mean	Standard deviation		
$\frac{\text{ROA} = \text{PBT}}{\text{Total Asset}}$	5	0.00460	0.002408	0.02640	0.068814	-0.696	0.525
$\frac{\text{ROE} = \text{PBT}}{\text{Equity}}$	5	0.03020	0.009731	0.3660	0.299088	-0.047	0.964
$\frac{\text{Interest Income}}{\text{Loans \& Adv.}}$	5	0.15980	0.052699	1.57660	2.839217	-1.104	0.332

**Source:** Dependent T-test Result

Table 4.6 above presents the p-values of the variables as 0.525 for ROA; 0.964 for ROE; and 0.332 for interest income to loans and advances. At 5 percent significance level and a degree of freedom of 4, we conclude that BOI's restructuring does not significantly affect its profitability. In other words, there is no significant difference between the pre- and –post restructuring profitability of BOI because the resulted P-values for the variables that compose the financial indicator are greater than the level of significance. This practically holds water with popularly established convention (see Steve, 2009).

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**Table 4.7:** T-test computations for BOI Liquidity Ratios

Variable	N	Pre-restructuring		Post restructuring		t-value	p-value
		Mean	Standard deviation	Mean	Standard deviation		
<u>Loans &amp; Adv.</u> Total Assets	5	0.54600	0.094459	0.21980	0.134049	3.973	0.017
<u>Cash &amp; Banks</u> Total Assets	5	0.29180	0.067522	0.54860	0.061150	-7.025	0.002

**Source:** Dependent T-test Result

Table 4.7 above present's p-values for both loans and advances to total assets, and cash and bank to total assets, as 0.017 and 0.002 respectively, here, it is crystal clear case that the observed chance for both variables that compose liquidity are less than 5 percent chance of getting the observed differences, we therefore, conclude that there is further presence of a significance difference between the pre and –post restructuring liquidity of BOI. Which means that the restructuring exercise carried out by BOI has significantly impacted on its liquidity. In other words, post restructuring BOI means a symbolic robust improvement in its liquidity.

**Table 4.8:** T-Test Computations for BOI Capital Adequacy

Variable	N	Pre-restructuring		Post restructuring		t-value	p-value
		Mean	Standard deviation	Mean	Standard deviation		
<u>Equity</u> Total Assets	5	0.15000	0.047090	0.39900	0.247884	-2.306	0.082
<u>Equity</u> Total Assets	5	0.29340	0.140609	6.10540	10.259622	-1.264	0.275
<u>Total Debts</u> SHF	5	4.54260	1.722230	3.87180	4.790439	0.260	0.808
<u>SHF</u> Total Assets	5	0.19520	0.059972	0.37160	0.265388	-1.481	0.213

**Source:** Dependent T-test Result

Table 4.8 above is a presentation of the P-values for BOI capital adequacy which comprises 0.082 for equity to total assets; 0.275 for equity to loans and advances; 0.808 for total debt to shareholders fund; and 0.213 for shareholders fund to total assets. At 5 percent significance level, we conclude that BOI's restructuring does not significantly affect its capital adequacy level.

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**Table 4.9:** T-Test Computations for BOI Asset Quality

Variable	N	Pre-restructuring		Post restructuring		t-value	p-value
		Mean	Standard deviation	Mean	Standard deviation		
<u>NPL</u> Loans & Adv.	5	0.24080	0.131431	7.99220	11.998435	-1.435	0.225
<u>NPL</u> Equity	5	1.07860	0.936273	0.89820	1.689890	-0.841	0.448

**Source:** Dependent T-test Result

Table 4.9 above presents the P-values for ratios captured under BOI asset quality. The ratios are non-performing loan to loans and advances and non-performing loan to equity with 0.225 and 0.448 respectively. At 5 percent level of significance, we conclude that restructuring does not significantly impact on BOI's asset quality.

**Table 4.10:** T-test Computation for BOI's Shareholders' Interest

Variable	N	Pre-restructuring		Post restructuring		t-value	p-value
		Mean	Standard deviation	Mean	Standard deviation		
<u>Profit after Tax</u> No. of shares in issue	5	0.04240	0.018636	0.23820	0.944936	-0.458	0.671

**Source:** Dependent T-test Result

Table 4.10 above presents the P-value for the only available ratio for shareholders' interest in the study – Earning Per Share (EPS). Shareholders interest in this study, is the surrogate for BOI's potential growth. The resulted P-value shows 0.671 as against the 5 per cent significance level. According to the decision rule, if the P-value is greater than the level of significance, we accept the null hypothesis and if otherwise, we reject the null hypothesis. In this case, our P-value is greater than the significance level; hence, we accept the null hypothesis of the study which states that restructuring does not significantly affect BOI's shareholders' interest which further depicts the bank's potential growth. The overall result from the study is in two folds, although with robust pointers to one key indicator – liquidity. The result from the model indicates a significant positive relationship between loans and advances and liquidity, and a significant negative relationship between loans and advances and shareholders fund.

The significant positive relationship between loans and advances and liquidity imply that an increase in the bank's liquidity position would invariably lead to an increase in the loans and advances for disbursement to enterprises. The significant negative relationship between loans and advances and shareholders fund on the other hand implies that an increase in shareholders fund will not lead to an increase in amount of loans and advances to be disbursed to enterprises. In other words, banks have



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pervasive orientation for accumulation of reserves for future expansion or projects. They are reluctant to increase monies to be made available to enterprises in the form of loans and advances. The tendency to build up reserves is impairment to financing enterprises' valuable projects. Most often than not, the measurement of a bank's health is the extent of its liquidity. However, liquidity is directly related to solvency and inversely related to profitability in the banking sector. The result from the model shows the robustness of liquidity (as an independent variable) in explaining DFIs pattern of financing enterprises in Nigeria with particular reference to BOI as a sample.

The t-test on its part reveals a better liquidity outlook for the bank as a result of the restructuring. In other words, it is evident that there is a significant difference between the pre- and –post restructuring liquidity of BOI. The revelation for other variables (Profitability, Capital Adequacy, Asset Quality and Shareholders Interest) used in the test is contrary. This implies that restructuring of BOI did not impact significantly on these variables except for a part of the capital adequacy (equity to total assets) that is significant at 10 percent.

The paper also investigated the BOI's financing pattern, from the evident regression result the variables that measure up BOI financing pattern are liquidity and shareholders fund (as independent factors) as well as loans and advances (as dependent factor). There has been an established aggregate impact of the independent variable on the dependent variables. The estimated regression relationship for the model is thus:

$$LOADV = 1610666 + 0.821(Liq) - 0.570(SHF).$$

In terms of the fitness of the model, the regression equation stated above, which characterizes BOI financing pattern, shows the established regression analysis to be significant

**Table 4.11:** Determinants of BOI's Financing Pattern from Regression Results

Variable: Intercept	SHF	LIQ	R <sup>2</sup>	AdjR <sup>2</sup>	F-Stat	Durbin Watson
1610666 (2.354)	-0.570 (-2.016)	0.821 (3.624)	0.699	0.613	8.113	2.386

**Source:** SPSS Regression Results

## 5. Conclusion

Since independence up to the period of the oil boom in the 1970s and later the doom in 1980s, there has never been a moment in Nigeria when development financial assistance is paramount and is considered more critical (especially to enterprises like SMEs) than the present period. As a result of the global crisis, which started as financial crises and culminated to economic crunch has resulted to many adverse effects among which is the general decline in market capitalization as its attendant effect. Investors across the globe are divesting their foreign investments back to their various home countries to cushion the effect of the crisis in their domestic markets. Enterprises' access to funds in the Nigerian financial markets (more specifically capital market) is becoming difficult if not a myth. The various SME- support

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institutions/schemes developed over the years within the government, the private sector and government – private sector initiatives, such as the SMIEIS, the SMEDAN and others have become moribund. Despite the intensified search for core investors in privatized companies, the need for development and financing of enterprises cannot be overemphasized. Studies on the assessment of DFIs financing of enterprises are therefore of utmost policy relevance, particularly for a country with slow pace of economic growth and development.

The study revealed that liquidity is a strong determinant of bank's loans and advances. Pursuant to this, BOI need to maintain constant liquidity planning to keep abreast of enterprises' credit needs in the form of loans and advances. This will also provide management an insight on how to monitor the overall risk position of the bank such that credit risk partially offsets interest rate risk assumed in the bank's overall asset and liability management strategy. To keep the bank healthy and solvent, there is the need to spur on the post restructuring tempo that guarantees an improved, sound liquidity position. In pursuit of this, the bank needs to maintain a relatively large investment in current assets to avoid the difficulty of paying claims of creditors and of meeting the needs of enterprises for funds. Furthermore, the bank needs to keep the relationship with its financiers intact, especially, the external public source considered the most important source of capital funds for the DFI. Finally, there is the need for DFIs generally to avoid cost associated with maintaining liquidity position because high liquidity means investment in either low or zero earning assets.

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