



THE EFFECTS OF MONETARY POLICY ON PORTFOLIO MANAGEMENT IN THE NIGERIAN BANKING INDUSTRY

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Abstract: Monetary policy is a crucial factor that deserves ardent study in order to fashion out an approach of augmenting to the management of Nigerian banks' portfolio. To articulately achieve reliable effects of monetary policy on banks there is need to design a portfolio management policy that would drive home the expectations of banking stakeholders. This study which delved into portfolio management in the banking industry and the effects of monetary policy, considered the responses to a questionnaire of the key staff in portfolio/credit management, marketing and administration in six of the existing commercial banks in Nigeria. The sample of 120 workers was drawn randomly to give room for equal representation and to avoid bias in responses. Two research questions were used for the study and statistical package for the social sciences (SPSS) version 21 was used to analyze the data. Percentage was used to rate the responses of the participants. The finding from the study showed that CBN monetary policies on portfolio management have significant effect on the banks portfolio. Also, banks policies on loan management enhances profitability if efficient, sustained and reliable loan policies were put in place. It is therefore recommended that banks should design appropriate policies that would aid their portfolio management strategies and thus enhance their profitability and return to shareholders.

Keywords: Portfolio Management, Monetary policy, Banks loan policy, Deposit money banks'

JEL classifications: B22, E52, E58

1. Introduction

Nigerian banks are crucial propellers of economic activities through the harmonisation of deposits from different customers and made same available in form of loan and loan facilities to the teeming population. The role played by the banks in Nigeria cannot be overemphasised as this is so crucial because it facilitates business activities in small and big enterprises. Lending operations are core to banking activities and the most profitable asset is granting of loan by financial institutions. In many markets, banks have to operate in the economic environment that is characterized by the existence of non obstacles to good portfolio management. When loan is not properly channelled, controlled and administered, it leads to a devastating effect on the banks

goodwill, reducing its corporate profitability and further increase bank distress and failure.

According to Cai and Anjan (2008), in order to ensure effective portfolio management, loan administration is the most important function of the banking industry. It is the most risky and difficult, and at the same time most profitable function performed by banks. The key strategic value a bank put together has always depended upon its ability to manage loan risk. This cannot be properly done without an effective risk assessment, control and follow up strategy. Risk increases when loan principles are violated. Sound banking practices require that the bank management put in place standards for appraising and approving individual loan application to ensure that loans granted are repaid. However, due to poor loan administration caused by loopholes and violation in risk

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assessment and control techniques, bad and doubtful debts still claim a bulk charge on bank profitability causing many banks to witness institutionalised distress and some, total unexpected collapse. Since lending carries a reasonable portion of resource exposure of deposit banks in Nigeria, the ability of a bank to generate much profit is largely a function of effective and efficient management of its lending portfolio.

According to CBN 2013 Monetary policy is a precise step taken by the Central Bank (Monetary Authority) to control the value, supply and cost of money in the economy with a view to actualising predetermined macroeconomic objectives. It is the objective of the apex bank to control the volume of money circulation with the instruments of contractionary and expansionary measures. It is left to how banks' assess their staffs to perform the task given to them in view of the current monetary policy measures in place which will reveal the assessment of how portfolio management is carried out in the best interest of the banks. The impact of monetary policy in management of banks have remained fascinating and intriguing, though very elusive in the process of investment analysis vis-à-vis bank portfolio and liquidity management.

Acharya and Naqvi (2012) refer to liquidity as the speed and certainty with which an asset can be converted back into cash whenever the asset holder desires. A liquid bank stores enough liquid assets and cash together with the ability to raise funds quickly from other sources to enable it meet its payment obligations and financial commitment in a timely manner. Ngwu (2006) views liquidity management as the act of storing enough funds and raising funds quickly from the market to satisfy depositors, loan customers and other parties with a view to maintaining public confidence on banks stability.

In spite of the measures put in place and aimed at protecting depositors and other public interest, the incidence of bank distress and failure has been on the increase in deposit money banks in Nigeria. This is as a

result of increased probability of bank default, reduced performance and bulk charge against profits emanating from ineffective loan and liquidity risk management. Hence, for a bank to be viable and profitable; there must be strategic loan and liquidity risk management policies formulated and implemented in full in line with government monetary policies. The tools for effective implementation of these policies will be anchored on the philosophy and mission of the bank, the overall loan risk strategy, and the loan policies adopted in the realisation of strategic goals and objectives of the banks as well as the expansion prospects of such bank.

The effective management of loan and liquidity risks is inextricably linked to the development of banking technology, which will enable the bank to increase its speed of decision making and at the same time reduce the cost of controlling banking risk. The development of these banking technologies that reduce operating costs and cost of risk control will inevitably yield greater earnings and returns for the bank in terms of contributions and profitability.

II Statement of the Problem

The development of any nation's economy depends to a large extent on the strength of its monetary policy in use and the banking sector (Kolapo, 2019) as cited by Olofinlade, (2020). In Nigeria, the objective and techniques of monetary policy have been changing periodically by the CBN via monetary policy committee. Each set of objectives has produced certain effect on banks' portfolio management. Moreover, this mixed effects of concern that needed clarification is the multi-target use of monetary policy instruments to deposit money banks (DMBs) that are the transmitter of monetary impulses, since DMBs today operate under pressure to meet performance goals set by stakeholders while competition has increased dramatically in a complex, volatile and dynamic economic environment with many of them facing decline in performance (Rose, 1999). Going by the revelation that the solvency of banks is



determined by the quality of their assets and the management of their loan portfolio, the best quality can only be sustained when the best monetary policy suitable is employed.

The spate of development witnessed in the banking sector in Nigeria is monumental. Though, the trend has been highly stable since the post-consolidation exercise which increased the capitalisation of banks to ₦25 billion. In view of this, banks have access to more capital, hence boosting their access to more liquidity for loan transactions which means there is need for efficient loan/portfolio management. However, the major problem was the spate of inability/unwillingness of some customers to pay back the loans they borrowed from the banks, hence crunching their profit margin. There is need therefore to consider the effects of monetary policy on portfolio management of Nigerian banks. Since most banks carried out the monetary pronouncements from the fear of avoidance of CBN penalty.

1.3 Research Questions

- i. Does an effective monetary policy enhance efficient portfolio management of Nigerian banks?
- ii. Does the banks' policy on loan/portfolio management affect banks profitability?

1.4 Objectives of the Study

The broad objective of this study is to examine the effects of monetary policy on portfolio management in the Nigerian banking industry. However, the following are the specific objectives of the study which were to:

- i. examine the effects of monetary policy on portfolio management of Nigeria banks.
- ii. examine banks' policy on loan management and its effects on banks profitability.

2.1 Review of Related Literature

Portfolio management is crucial for the sustenance of any bank and adequate care must be taken towards ensuring its management. There is need to ensure adequate compliance with monetary policies by banks' authorities

in order to maintain an efficient portfolio towards enhancing their corporate performance. Portfolio management policy is a comprehensive process that deals with identifying the target markets, loan extension; loan monitoring and identifying the proceeds. In the assertions of (McNaughton, 1996; Marsh, 2008), portfolio management policy entails the mechanisms, standards and parameters that guide the bank officers in granting loans and managing the loan portfolio under the banking discipline. There are set of guidelines designed to maximize cost associated with loan while maximizing benefits from and that portfolio management policy assist financial institutions' loan department in the extension of loan privileges governed by rules and guidelines established by top management.

According to Jhingan (2010), a bank needs a high degree of liquidity in its assets portfolio the liquidity of assets refers to the ease and certainty with which it can be turned into cash. The bank must hold a sufficient large proportion of its assets in the form of cash and liquid assets for the purpose of profitability. If the bank keeps liquidity the uppermost, its profit will be low. In the other hand, if it ignores liquidity and aims at earning more, it will be disastrous for it. Therefore, in managing its investment portfolio, a bank must strike a balance between the objectives of liquidity and profitability. This balance must be achieved with a relatively high degree of safety.

According to Graham (1990), profitability is always associated with performance and productivity, therefore true pure profit is the increase in wealth that an investor gets out of making an investment taking into consideration all costs associated with it, including the opportunity cost of capital. In the banking industry, every loan granted attracts an interest to the bank. Hence bank lending operations are risky but very profitability. In order to minimize these risks inherent in banking activities, there is need for efficient, effective and strategic loan and liquidity management, which will in



turn accelerate the tempo of profits. Until recently, lending has been the essence of deposit money banks and in fact, now, a colossal part of banks' assets are in loan. As a result, the formulation and execution of a sound lending policy constitute part of the most vital responsibility of bank management. Kargi (2011) opined that well-conceived lending policies and careful loan practices are essential for a bank if it is to perform its loan creating functions effectively and efficiently and at the same time minimize or eliminate the risk inherent in any extension of loan. It is important to note that the type and number of loans a bank will make as well as to whom it will grant loan and at what conditions and circumstances, requires a sound policy decision; adequate care must be taken in the process of arriving at such decisions. Thus, a meaningful periodic appraisal of lending and loan administration of a bank in the light of ever changing environmental conditions is necessary. Another important aspect of lending policies and guidelines is in respect of payment. Loan is commonly believed to be the lifeblood of the economy. If this assertion is correct, then any loan which ceases to flow becomes stagnant. It should therefore be a basic policy of deposit money bank lending that any money loaned should flow back to the bank in form of repayment. A sound bank loan should be collectable from the anticipated income or profit of the borrower rather than from liquidation of any collateral that may be pledged.

Apart from individual loans, it is also important that the overall quality of the loan portfolio and in which way they are carried out be monitored. How elaborate effective and efficient this monitoring is performed depends on the size of the bank, the number of branches a bank has as well as the variation in marketing. There are basically two methods of monitoring bank loans as contained in Gujarati and Sangeetha (2007). The first is the external method where banks use external auditors, examiners and bank inspectors as independent check. The internal method contains three methods. The first method

is called continuing quality control where constant quality control is carried out within each branch at the head office by a loan committee set up to survey and report on the quality of lending. The second method is to establish a loan audit department with a reporting authority directly to the senior manager of the banks via the controller or accountant. The third method is inspection. A team inspects all branches and head office division on a periodic basis. Each inspection is usually carried out as a surprise to examine the documentation of loan, controlling the follow-up of payments or collateral.

2.1.1 Impact of Portfolio Management on Profitability

Portfolio management is a crucial factor towards maintaining a sustained profit level. It is a major concern for bank customers to be aware of the safety of their deposits in any given bank. For this reason, it is very essential for banks to critically assess the customers who demand the extension of loan or loan facility before granting such. This is because a weak and poorly administered loan policy would lead to bad debt in the loan portfolio of banks. This will in turn affects the entire asset strength of the banks which consequently possess a liquidity threat to the bank. In this light, Pandey (2004) advances that the planning, monitoring, collection and management of lent funds is core of the loan department which must be effectively carried out to ensure the survival of the banking industry.

If loan risks increase with the growing volume of loan transactions in banks, bad and doubtful debts will claim a bulk of the supposed profit estimated to be earned by banks. As these risks remain unchecked, the profitability of banks reduces with each transaction. This also reduces the operational performance of bank.

2.1.2 Credit Policy Formulation

The management of credit is propelled with an acute and efficient loan policy formulation. The management of any loan started with the loan policy, the formulation of which is the responsibility of the bank board of directors and management. It is the base for determining what type



of loan to grant to customers. Nwankwo (1980) define loan policy as a blue print containing management guidelines for use by line officer of a bank in the handling of loan applications. Its objective is to provide corporate direction through a standardised procedure, derived from operational interest of the bank, in satisfying the customer loan need but with full cognisance of the prevailing monetary and fiscal policy guidelines of the government. Adekanye (2010), however, identify three basic types of loan policy. They are the restrictive loan policy, moderate loan policy and liberal loan policy. A restrictive loan policy is adopted by a bank that has no plan to grow at a rate that is more than minimal. Such a bank is not willing to take any risk more than minor one and prefer to do business with customer whose paying habit almost never vary within terms.

Moderate loan policy is a mixture of restrictive and liberal policy approaches to loan. It tends to match receivable to provide adequate cash flow, while a liberal policy is a high risk policy with the probability of heavy loss of receivable the danger of such bank survival can be real because they are usually prone to undercapitalisation and occasionally liquidity problem. Therefore, to minimise risks, enhance lending and maintain standard, the loan policy should specify the quantity of loan to be made the type of securities to be accepted and limits for the different types of loan.

2.1.3 Monetary Policy and Portfolio Management

Effective monetary policy is an essential tool for maintaining efficacious portfolio management in the financial institutions in Nigeria. It is unfortunate that a lot of financial institutions have either collapsed or about to collapse due to a dysfunctional subprime lending to firms and people with bad and unreliable credit. The crises that rocked banks in Nigeria is an indication that not only do banks often take excessive risks but the risks differ across banks (Adeusi et. al., 2013). The quality of assets of most banks has deteriorated due to significant dip in equity market indices (BGL, 2010). Monetary policy and banks

play a key role in the development of economic financial system and thus serve as the engines of economic growth (King and Levine, 1993). In order to ensure effective monetary policy on banks' portfolio management, CBN on March 26, 2019 rolled out measures and cut the MPR from 14% to 13.5 % so as to make the entire banking system and their portfolio safe, sound and to constitute a stable environment that could sustain public confidence.

It is worthy of emphasis that Nigerian banks have undergone considerable overhaul and reforms towards repositioning the banking system for effective monetary policies so as to maintain a sound portfolio management strategies. One of the exercises was the assessment of the risk asset quality of banks which prompted the removal of eight Chief Executive Officers and the consequent injection of six hundred billion naira (₦600,000,000,000.00) into the banks in order to avail the banks opportunity of further lending to the public (BGL, 2010). This fund that was injected into the banks availed them access to more cash or liquidity and therefore banks need to develop a sound portfolio policy to avoid a misuse of the fund; thereby optimising its use for the success of the banks.

2.1.4 Concept of Loan and Bank Lending

Lending can be defined as the creation and management of risk assets. According to Agene (1995), lending is defined as a process of analysing loan or loans. It is considered as an important task of bank management because it entails taking financial risk which could lead to difficulty on the part of the customer (borrower) in the repayment of both the capital and interest. According to Osayameh (1986), the principal lending objective of a bank is to provide growth, profitability and liquidity. The term lending covers loans and advances. Lending function represents a significant source of income since the major consideration of the lender is the recovery of both the capital and interest. It is one of the most traditional elements in the relationship between a bank and its numerous customers (Adekanye, 2010).



Asset composition of loans and advances are the main source of income and are expected to have a positive impact on bank performance. Other things constant, the more deposits are transformed into loans, the higher the interest margin and profits. However, if a bank needs to increase risk to have a higher loan-to asset ratio, then profits may decrease. In addition, as bank loans and advances are the principal source of income, we expect that non-interest bearing assets impact negatively on profits (Gul et al., 2011). TL & A/TA is included in the

study of portfolio management of banks' as an independent variable to determine the impact of loans on banks' profitability. Portfolio management is primarily measured by return on assets. Table 2.1 shows the credit/liquidity worthiness level of Nigerian banks from 1958 till 2005. It is noteworthy that commercial banks in Nigeria till date still maintain minimum of ₦25 billion capital requirements.

Table 2.1: Review of Bank's Capital Base (Historical)

YEAR	TYPE OF BANK	AMOUNT	Cumulative No of Banks
1952-1978	Commercial	£400,000:00	45
1979-1987	Commercial	₦ 600 Million	54
1988(Feb)	Commercial & Merchant	₦ 5.0 Million & ₦ 3.0 Million	66
1988(Oct)	Commercial & Merchant	₦ 10.0 Million & ₦ 6.0 Million	66
1989-1990	Commercial & Merchant	₦ 20.0 Million & ₦ 12.0 Million	107
1991-1996	Commercial & Merchant	₦ 50.0 Million & ₦ 40.0 Million	112
1997-2002	Commercial & Merchant	₦ 500.0 Million for all banks	110
2003- 2004	Existing & New (Universal Banking)	₦ 2.0 Billion	29
2005 till date	Universal Banking International Banking	₦ 25.0 Billion ₦ 50.0 Billion	25

Source: Author's compilation, (2020)

2.2 Theoretical Framework

The theory of asymmetric information affirm that it may be difficult to differentiate good borrowers from bad borrowers (Auronen, 2003) as cited by Richard (2011), which may result into adverse selection and moral hazard problems. The theory maintain that in the market, the party that possesses more information on a specific item to be transacted (in this case, the borrower) is in a position to negotiate optimal terms for the transaction than the other party (in this case, the lender) Richard (2011). The party that knows less about the same specific

item to be transacted is therefore in a position of making appropriate decision concerning the transaction. Adverse selection and moral hazards have led to meaningful accumulation of non -performing loans in banks.

In this sense, borrowers should be screened thoroughly by banking institutions in their form of loan assessment. Sourcing for reliable information from prospective borrowers becomes crucial in accomplishing effective screening as revealed by symmetric information theory. Also the banks' lending channel of monetary policy transmission is also a relevant theory for this study which



refers to the routes through which monetary impulses are communicated to the real sector of the economy. Mishkin (1995), argued that to be successful in conducting monetary policy, the monetary authorities must have an accurate assessment of the timing and effect of their policies on the economy, thus, requiring an understanding of the mechanism through which monetary policy affects the economy. The banks' lending channel represents the credit view, in this view, monetary policy works by affecting bank assets (loans) as well as banks' liabilities (deposits). The key point is that monetary policy besides shifting the supply of deposits also shifts the supply of bank loans. In the case of an ease monetary policy that increases bank reserves and bank deposits which ultimately increase the quantity of bank loans available. Where many borrowers are dependent on bank loans to finance their activities, this increase in bank loans will cause a rise in investment (and also consumer) spending, leading ultimately to an increase in total output.

3.0 Methodology

This study focused on the effects of monetary policy on portfolio management in the Nigerian banking industry. Survey research design was adopted. Survey research design was used because it involved collection of data from the field of study through the use of well structured questionnaire. The study was restricted to six commercial banks in Ado- Ekiti in Ekiti State. The banks that were considered are First bank PLC, Stanbic IBTC bank PLC, Polaris bank PLC, First City Monument bank PLC, WEMA bank PLC and Access bank PLC. Structured questionnaires were administered to the staff of these banks in their various offices, especially those in charge of portfolio management such as the department of Marketing, Loan and Advances Unit and those in charge of granting loan facilities. In total about 240 questionnaires were distributed to all the six banks, with each bank having 40 questionnaires and the head of each unit helped in ensuring that they were filled and returned.

The questionnaires were randomly distributed among the workers to avoid bias and to ensure objectivity of result. There were two variables in the test instrument and these are portfolio management as the independent or predictor variable and monetary policy as the dependent or criterion variable. The statistical package for the social sciences (SPSS) version 21 was used for the analysis of the data.

4.1 Presentation of Results and Discussion

It should be recalled that there are two research questions and objectives in the study. Hence, these were analysed accordingly. In order to achieve objective one which examine the effects of monetary policy instruments on portfolio management of deposit money banks' structured questionnaire administered was analysed as detailed

Table 1 Result of Analysis of the Effects of Monetary Policy on Portfolio Management in Nigerian Banks

Items	Responses	Per cent	Position
Strongly Agree	128	53.33	1 st
Agree	70	29.17	2 nd
Undecided	10	4.17	4 th
Disagree	18	7.5	5 th
Strongly Disagree	14	5.83	3 rd
Total	240	100.0	

Source: Author's compilation, (2020)

Table 1 revealed that monetary policy enhances the level of portfolio management of Nigerian banks. From the respondents, it is crystal clear that 64 (53.33%) strongly agreed and 35 (29.17%) agreed that there was effective monetary policy on portfolio management system in the Nigerian banking industry that ultimately contributes to the level of profitability; while a paltry of 7(5.83%) of the respondents strongly disagreed with the fact that there exists a strong portfolio management system in Nigeria. This shows that effective monetary policy has in no small measure contributed to the level of portfolio management of the Nigerian banks.



To investigate the second objective which examine banks' policy on loan management and its effects on banks profitability structured questionnaire administered was analysed as detailed

Table 2 Result of analysis which examine banks' policy on loan management and its effects on banks profitability.

Items	Response	Percentage	Position
Strongly Agree	174	72.5	1 st
Agree	64	26.67	2 nd
Undecided	2	.833	3 rd
Disagree	0	0.0	4 th
Strongly Disagree	0	0.0	4 th
Total	240	100.0	

Source: Author's compilation, (2020)

From table 2 above, the findings shows that 87(72.5%) strongly agreed, 32(26.67%) agreed that policies of banks on portfolio management enhances profitability; while 1(.0833%) was undecided. This shows that in order for banks to maintain a reasonable level of profitability in the banks. Banks must put in place, a sustained, efficient and reliable portfolio management policy. It is important that the policies of the banks on loan portfolio management must significantly and highly affect banks' profitability since banks creates wealth through loan extension and management. It is obvious as the general consensus of the respondents was in favour of the fact that the policies of banks management on loan portfolio will affect the level of profitability.

5.0 Conclusion and Recommendations

Based on the study conducted on the effects of monetary policy on portfolio management in the Nigeria banking industry, the findings revealed that if banks comply with monetary policies the effects will spur banks to have robust, sound and efficient portfolio to manage on behalf of shareholders and at the same time had a robust return to shareholders as dividend due to enormous profit

declared as a result of it efficient and effective portfolio loan management.

It is important to know that effective monetary policy on efficient portfolio management policies of Nigerian banks that would spur the debtors to pay all the loans they have taken were put in place. There are always willing and unwilling borrowers, but when adequate policies are in place to propel the unwilling borrowers to pay what they have borrowed; this will deter erring borrowers, thereby reducing the risk of accumulating non-performing loans, hence optimising the level of portfolio management in Nigerian banking industry.

Efficient policies that would propel unwilling and erring borrowers to pay should be put in place to deter erring defaulters. Not that alone, there should be regular training of workers/staff in portfolio management for efficiency in Nigerian banks portfolio management. In addition to these, banks should design articulate and workable portfolio management policies that would be in line with monetary policy. To cap it all, the lending policies of banks must be efficient and in tandem with global best practices.

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