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The Impact of Bank Credits on the Growth of the Manufacturing Sectors in Nigeria

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Abstract:

Insufficient capital has been considered as one of the factors affecting the performance of the real sector of the economy. The financial institutions that stand in the position of granting loans and advances try to shun lending to these sectors because they believe it could be detrimental to their motive of making profit. This paper therefore investigates the impact of bank credits on the performance of manufacturing sector in Nigeria for the period of 11 years (i.e. 2006-2016). Secondary source and time series data were used. The data were sourced from Central Bank of Nigeria (CBN) statistical bulletin of 2016. The variables considered are manufacturing output share of Gross Domestic Product as dependent variable and bank credit to manufacturing sector, money supply as well as interest rate as explanatory variables. The data were analyzed using Ordinary Least Square (OLS) econometric technique with the aid Statistical Package for Social Sciences (SPSS). The findings show that bank credits to manufacturing sector and interest rate have insignificant impact on manufacturing output while money supply is statistically significant at 5% level of significance. The f-statistic result shows 41.43 with P. value of 0.000 which indicates that the joint variables of bank credits have significant impact on the performance of manufacturing sector in Nigeria for the period under review. The paper concluded that adequate lending to the manufacturing sector will facilitate the growth of the sector and the economy as a whole. The paper therefore recommended that the government should allocate more intervention funds to manufacturing sector in order to boost their contribution to the ailing Nigeria's Gross Domestic Product (GDP) and reduce unemployment rate in the country.

Keywords: Manufacturing sector, bank credit, Interest rate, money supply

1. Introduction

The manufacturing sector is reputed to be the engine of growth and catalyst for sustainable transformation and national development of any economy of the world, (Simbo, Iwuji and Bagshaw, 2012). This is because of its enormous potentials as a tool for creating wealth, generating employment, contributing to the country's Gross Domestic Product as well as alleviating poverty among the citizenry. In advanced economies, manufacturing sector is a leading sector in many respects, (Tawose, 2012). It is an avenue for increasing productivity related to import replacement and export expansion, creating foreign exchange earning capacity; and raising employment and per capita income which causes unique consumption patterns. In Nigeria, the development of the manufacturing sector is an imperative for meaningful and sustainable national growth. Manufacturing sector as a sub-sector of the industrial sector refers to the productions of goods and services through combine utilization of raw materials and other production factors such as labor force, land and capital or by means of production process. It creates investment capital at a faster rate than any other sector of the economy while promoting wider and more effective linkages among different sectors. In terms of contribution to the Gross Domestic Product (GDP), the manufacturing sector is dominant and it has been overtaken the services sector in a number of Organization for Economic Co-operation and development (OECD) countries, (Anyanwu, 2010). The performance of the Nigerian manufacturing sector since independence has been unimpressive and this scenario is a mixture of initial mild growth and subsequent retrogression. At independence, the colonial masters bequeathed to us a manufacturing sector that was weak both in structure and content. To underscore the pivotal and critical role the manufacturing industry plays in capital formation, domestic savings and its effect in the realization of sustainable economic growth and general prosperity in Nigeria, the federal government at different times introduced a number of schemes such as World Bank SME to make available the sum of ₦200 billion as Manufacturers' Intervention Fund. The objectives of the fund include fast-tracking the development of the manufacturing sector of the Nigerian economy by improving access to credit to manufacturers.

The rapid growth of industrial output especially manufacturing output has increased the demand for bank credit on the part of industrial firms. Bank credit can be described as a process of making fund available to another sector of the economy based on some agreed terms in respect of repayment with interest. Loan may be simple, fixed payment, coupon bond and discount bond, (Tawose, 2012). Credit behavior in general terms to any economy, is expected to assist in leveraging economic agents, augment their vulnerability to economic shocks and ultimately enhance economic growth. Ademu, (2006) posits that the provision of credit with sufficient consideration for the sector's volume and price system is a way to generate self-employment opportunities. This is because credit helps to create and maintain a reasonable

business size as it is used to establish and/or expand the business, to take advantage of economies of scale. Government bodies obtain credits to meet various kinds of recurrent and capital. It can also be used to improve informal activity and increase its efficiency. This is achievable through resource substitution, which is facilitated by the availability of credit. He further stressed that credit can be used to prevent an economic activity from total collapse in the event of natural disaster, such as flood, drought, diseases, or fire. Credit can be garnered to revive such an economic activity that suffered the set back.

Bank credit to industrial sector can be regarded as bank loans and advances provided by the financial institutions to industrial sector in order to enhance industrial productivity which by implication leads to economic development. However, some key factors that bring sustained industrial finance must be efficiently and effectively studied as the case of bank credit which is considered to be a blood stream of an economy so as to bridge the gap between the borrower and lender, particularly in a developing economy like Nigeria. The banking sector helps to make these credits available by mobilizing surplus funds from savers who have no immediate needs of such funds and thus channel such funds in form of credit to investors who have brilliant ideas on how to create additional wealth in the economy but lack the necessary capital to execute the ideas (Nwanyanwu, 2010). It is instructive to note that the banking sector has stood out in the financial sector as of prime importance, because in many developing countries of the world, the sector is virtually the only financial means of attracting private savings on a large scale.

Despite the important of bank credits, manufacturing sector still faced the problem of inaccessibility of funds for productive investment which resulted to its poor performance in recent years, (Edirisuriya, 2008). The bank credit stringent conditions and requirements that must be met in granting bank credits made credits not to be accessible by the industrialists. Lack of access to credits on the part of the poor is the major constraints on the economy progress. It is also observed that the cost of bank credit to the industrialist is so enormous as a result of poor infrastructure and inadequate intermediate goods in Nigeria. Hence, the industrialists end up without achieving corporate primary target of maximizing profit. Furthermore, the government policies on bank credit failed to achieve their set targets. Also, given the present government's policy twist of diversifying the economy away from oil towards non oil in which manufacturing sector is central on one hand, and on the other hand increasing the rates of interest on loans as signaled by the recent hike in the Monetary Policy Rate from 12 to 14, calls for the investigation on the important of bank credit which is largely determined by the prevailing interest rate on the manufacturing output in Nigeria.

In light of the above, this paper was carried out to investigate the impact of bank credits on the performance of manufacturing sector in Nigeria. In achieving this objective, the following questions were conducted; what are the impacts of bank credits to the growth of manufacturing sector in Nigeria? Is there any significant effect of interest rate on loan and advances granted by banks and the manufacturing output in Nigeria? This paper is divided into five sections of which the above section is introduction of the study. Section two emphasizes the review of related literature, section three contains methodology, and section four discusses on data analysis and discussion of findings while section five provides for conclusion and policy recommendations.

2. Literature Review

2.1. Concepts of Bank Credit

Credit is an important aspect of financial intermediation that provides funds to those economic entities that can use them in a productive manner. Credit is the money from the lender to the borrower, (Nwanyanwu, 2010). Traditionally, commercial banks are short-term and medium-term lenders. But in the recent decades they now give long-term credit especially through loan syndication. Merchant banks are used to giving loans to individual or group of individuals that have the objective of building houses or financing a long-term project. The functions performed by banks vary from country to country and from one institution to another. For example, special banks are known to have been created to deal specifically with certain problems of economic development. Examples of other banks are: Nigerian Agricultural and Co-operative Bank Limited, Nigerian Industrial Development Bank (NIDB), Nigerian Bank for Commerce and Industry etc. Banks in Nigeria are highly liquid, but they try to shun lending to the agriculture and manufacturing sectors, because they believe it could be detriment to their business aimed, which is profit oriented, This brings about a low credits and a high interest rate spread on loan being given to them, thereby limiting the efficiency of the sectors. Nwanyanwu (2010) identified banks' traditional roles to include, financing of agriculture, manufacturing, and syndicating of credits to productive sectors of the economy. In order to ensure proper distribution of banks' credits, the Nigerian economy was divided into two, the priority and non-priority sectors and a certain percentage of banks 'credits were expected to be allocated to these sectors, as directed by the Central Bank of Nigeria's (CBN) circular 27 of 1993 (Ekezie, 2006). Adediran and Obasan (2010) had observed that the manufacturing sector contributes to a nation's economic development, as it increases the chances of industrialization. Anyanwu, (2000) pointed out that low level of investments has constrained productivity in Nigeria. The poor investments have been traced largely to banks' unwillingness to make credits available to manufacturers, owing partly to the mismatch between the short-term nature of commercial banks' funds and the medium to long-term nature of funds needed by industries. Ajayi (2000) noted that credit implies a promise by one party to pay another for money borrowed or goods and services received. Credit cannot be divorced from the banking sector as banks serve as a conduit for funds to be received in form of deposits from the surplus units of the economy and passed on to the deficit units who need funds for productive purposes (investment). Banks are therefore debtors to the depositors of funds and creditors to the borrowers of funds.

CBN, (2003) suggested that the amount of loans and advances given by the banking sector to economic agents constitute bank credit. Credit is often accompanied with some collateral that helps to ensure the repayment of the loan in

the event of default. Credit channels savings into investment thereby encouraging economic growth. Thus, the availability of credit allows the role of intermediation to be carried out, which is important for the growth of the economy. The CBN further identified the factors that determine lending in Nigeria include contact position of the bank, risk and profitability of various types of bank credit, economic condition, monetary policies, ability and exposure of bank personnel, credit need of the area served and the nature of the source of bank.

2.2. *Canons of Good Lending*

According to Adekanye (1986), the canons of good lending can be summarized into 6 C's credits which are:

- Character – Intention, Willingness to repay and honesty
- Capacity – Management experience, ability to repay
- Capital – Money, security, financial commitment
- Collateral – Asset pledged as security
- Condition – Prevailing economic condition in the economy
- Confidence – Faith of lender in the above

In practice, each financial institution has its own credit policy guidelines tailored to meet its market target and risk acceptable criteria, but fall within the framework of CBN monetary and credit policy guideline.

2.3. *Issues Related with Manufacturing Sector in Nigeria*

The foreign exchange restrictions placed on forty-one (41) items by Central Bank of Nigeria had affected the operations in the various sectors of the economy. It was recorded that fifty (50) of manufacturing companies had closed up business due to the restriction order. These have led to loss of the job in the industries and increased the staggering rate of unemployment. The non-availability of production inputs, high interest rates on credit facilities available to the sectors, poor power-supply, policy inconsistency, poor patronage of locally manufactured products, poor supporting infrastructures, among others are the challenges confronting manufacturers. Over the decades, there has been near collapse of infrastructure, the development has been bad in the country that most businesses groan under the intense pressure due to high overhead cost incurred in providing alternative infrastructure. The inadequate infrastructure and the devaluation of naira have further shrunk down capacity utilization and have led to high cost of production. Due to these factors, the domestic economy witnessed an unprecedented closure of factories and production plants, this assertion of weakening economy, more sectors were being affected by the recession and the profile of unemployment kept rising.

2.4. *Theoretical Framework*

2.4.1. Loanable Funds Theory

This paper adopted the loanable funds theory of interest rate given its vagaries in explaining the dynamics of bank credit and the cost of the credit vis a vis investment decision. According to the theory, the rate of interest is the price of credit which is determined by the demand and supply of loan able funds. The demand for loanable funds has primarily three sources; government, businessmen and consumers who need them for purposes of investment, hoarding and consumption. The government borrows money for constructing public works or for war preparations. The businessmen borrow for the purchase for capital goods and good starting investment projects. Such borrowings are interest elastic and depend mostly on the expected rate for profit as compared with the rate of interest. The demand for loanable funds on the part of consumers is for the purchase of durable consumer goods. Individual borrowings are also interest elastic. The tendency to borrow is more at a lower rate of interest than at a higher rate. Therefore, the demand curve for investment funds according to this theory slopes downward showing that less funds are borrowed at a higher rate and more at a lower rate of interest. The theory also provides a link between commercial bank credits and manufacturing sector output in that, it buttresses the fact that borrowing for investment in the manufacturing sector is interest rate elastic since it is determined by the existing rate of interest.

2.4.2. Finance Led Growth Theory

The finance led growth theory was propounded by Schumpeter (1911). The theory is based on the belief that the activities of the financial institutions serve as a useful tool for increasing the productive capacity of the economy. It is argued that countries with better-developed financial system tend to grow faster. The importance of financial institutions in generating growth within the economy has been widely discussed in the literature. Early economists such as Schumpeter (1911) identified banks' role in facilitating technological innovation through their intermediary role such as supply of credit to the productive sector. He believed that efficient allocation of savings through identification and funding of entrepreneurs with the best chances of successfully implementing innovative products and production processes are tools to achieve this objective. Several scholars thereafter (Shaw 1973, King and Levine 1993) have supported the above postulation about the importance of banks to the growth of the economy. There are different transmission channels through which monetary policy affects economic activities and these channels of transmissions have been broadly examined under the monetarist schools of thought. The monetarist postulates that change in the money supply leads directly to a change in the real magnitude of money.

2.5. Empirical Review

Campbell and Asaleye (2016) examine the financial sector reforms and output growth in manufacturing sector in Nigeria. The study adopted descriptive statistics and Vector Autoregressive Model (VAR) as its statistical tool. The paper is justified given the need to provide empirical evidence on the effectiveness of financial reforms in promoting output growth in the manufacturing sector during the pre and post - reform era in Nigeria. The findings from the statistical and econometric analysis indicate that the financial sector performed better in the post reform era compared to the pre-reform era. Surprisingly, the growth of manufacturing output indicator was low in the post reform era. The correlation coefficient of the financial indicators was likewise low which suggests that the development of the manufacturing sector under financial reforms in Nigeria has not been impressive. Vector Error Correction Model (VECM) results indicate a short run divergence between variables. The paper concludes that Nigeria experienced increase in Gross Domestic Product (GDP) with minimal contribution from the manufacturing sector. This is to say that the increase in GDP does not translate to the development of the manufacturing sector which could have helped to reduce the unemployment problem in the country. Based on the findings the paper suggests the need for proper review of the financial sector reforms introduced to enhance output growth of the manufacturing sector as the sector is critical to the growth of the economy at large due to its multiplier effect on other sectors of the economy. Specific financial concerns through appropriate financial sector reforms should be directed to the reinforcement of the performance of the manufacturing sector. Most of the policies are dynamic in nature, thus the need to ensure consistency through strong and well-established institutions (both financial and political) cannot be overemphasized.

Ebi and Emmanuel, (2014) investigates the impacts of commercial bank credit on Nigeria industrial subsectors between 1972 and 2012. Econometric Error Correction Model (ECM) was employed to estimate the output response of the three subsectors namely: the manufacturing; mining and quarry; and real estate and construction subsectors to commercial bank credits, as well as the response of aggregate output of the entire industrial sector to subsector's output and their commercial bank credits. The results of estimation indicate the following: commercial bank credits impacted positively and significantly on the manufacturing sub-sector in Nigeria, commercial bank credits to mining and quarry is a positive and significant determinant of the current year Mining and Quarry output in Nigeria, previous year bank credits to real estate and construction is a positive determinant of the current year real estate and construction output, bank credits to manufacturing, mining and quarry as well as bank credits to real estate and construction correlated positively with aggregate industrial output with bank credits to real estate and construction having greater and a significant impact on industrial output. Interest rate was not an important determinant of industrial sector and industrial sub-sectors outputs, exchange rate is a negative and significant determinant of industrial sector's outputs in Nigeria. These results point to the conclusion that, increase bank credits to industrial sector is indispensable in stimulating industrial sector growth in Nigeria. John and Terhemba, (2016) examined the effect of commercial bank credit on the manufacturing sector output in Nigeria from 1980 to 2015 using Cochrane-Orcutt method. Five variables of manufacturing sector output, inflation rate, interest rate, loans and advances and broad money supply were used for the study. The variables were tested for unit root using the Augmented Dickey Fuller approach and were found to be stationary at levels. The study found that, inflation rate and interest rate have negative effect on manufacturing sector output while loans and advances and broad money supply have positive effect with manufacturing sector output in Nigeria. The study therefore recommended formulation and implementation of policies that aim at reducing both inflation and interest rates on one hand and on the other hand, increasing both loans and advances as well as broad money supply so as to enhance improvement in the sector's output.

Olanrewaju, Aremo and Aiyegbusi (2015) investigated the effect of banking sector reforms on the output of manufacturing sector in the Nigerian economy between 1970 and 2011 with a view to examining the extent of the impact of banking sector reforms on the manufacturing sector. The study employed annual secondary time series data from 1970-2011, sourced from the Central Bank of Nigeria's statistical bulletin and annual report and statement of accounts, National Bureau of Statistics final accounts and IMF International Financial Statistics (IFS) using the methodology of Cointegration analysis and Error Correction Mechanism (ECM). The empirical results showed that the effects of Bank assets, Lending rate, Exchange rate and real rate of interest on manufacturing output were positively significant but with very low impact. On the other hand, the financial deepening and interest rate spread negatively and significantly impacted on the output growth of manufacturing sector in Nigeria. Overall, the conclusion that emerged from the findings suggests that the effects of banking sector reforms on the output growth of manufacturing sector were significantly low in the Nigerian economy. However, the findings indicated that the impacts of the various banking reforms could vary widely on the economy depending on the time lags involved. Consequently, the policymakers must be prepared to initiate proper counter-cyclical banking reforms that will serve as buffer measures to lessen or abort the negative impacts of any banking reforms on the manufacturing output growth. Thus, a flexible accommodating banking reform regime is advocated for Nigeria.

3. Methodology

This study employed secondary source and time series data for the period of 11years (i.e. 2006 – 2016). The data were sourced from Central Bank of Nigeria (CBN) statistical bulletin of 2016. The variables considered are manufacturing output share of Gross Domestic Product (GDP) as dependent variable and bank credit to manufacturing sector, money supply as well as interest rate as explanatory variables. Quasi-experimental research design was employed for this study because the researcher does not have intention of manipulating the variables considered. The study also employed Ordinary Least Square (OLS) estimation technique with the aid of Statistical Package for Social Science (SPSS) to examine significant impact of predictors on dependent variable.

Model Specification

The model is specified as follows:

MGDP = f (CAM, MS, INTR)

MGDP = $\beta_0 + \beta_1 \text{CAM}_1 + \beta_2 \text{MS}_2 + \beta_3 \text{INTR}_3 + \mu$

In econometric term

Where:

MGDP = Manufacturing output share of Gross Domestic Product

CAM= Bank credits to manufacturing sector

MS = Money supply

INTR= Interest rate

β_0 = Constant term

$\beta_1 - \beta_3$ = coefficient of independent variables

μ = Error term

4. Results and Interpretation

Statistic/Co-Efficients	Results
β_0	-1720.567
β_1	-0.489
β_2	0.463
β_3	177.029

Table 1: Model Results

Source: Authors Compilation Derived From SPSS Version 23

The model for this study can be recalled and re-write as follows:

MGDP = $\beta_0 + \beta_1 \text{CAM}_1 + \beta_2 \text{MS}_2 + \beta_3 \text{INTR}_3 + \mu$

-1720.567 – 0.489CAM + 0.463MS + 177.029INTR

The implication of the model is that holding all the explanatory variables constant, the manufacturing output share of gross domestic product stands at -1720. 567. The co-efficient of money supply and interest rate show positive units at 0.463 and 177. 029 respectively. This indicates that a unit increase in each of the variables will leads to decrease in manufacturing output share of Gross Domestic Product (GDP) while bank credits to manufacturing sectors stood at negative unit which imply that any unit decrease in the variable will leads to the same proportion decrease in manufacturing output share of Gross Domestic Product (GDP) for the period under review.

	T- value	Probability value	Remarks
CAM	-0.531	0.612 > 0.05	Insignificant
MS	4.308	0.004 < 0.05	Significant
INTR	1.542	0.167 > 0.05	Insignificant

Table 2: T-Statistic Results

Source: Authors Compilation Derived From SPSS Version 23

Bank credits to manufacturing sector and Interest rate indicate -0.531 and 1.542 with probability value of 0.612 and 0.167 respectively. This implies that bank credits to manufacturing sector and interest rate are statistically insignificant since; the probability value is greater than 5% level of significant. However, money supply shows a positive effect at 4.308 with probability level of 0.004. This implies that money supply has significant impact on manufacturing output share of Gross Domestic Product (GDP).

Statistic	Results
R Square	0.947
Coefficient of Determination (Adjusted R ²)	0.924
Anova (F)	41.413
Probability value	0.000
Durbin Watson (DW)	1.519

Table 3: Model Validity and Anova Results

Source: Authors Compilation Derived from SPSS Version 20

The coefficient of determinant R² is 0.947 which states that 94.7% of the variation in Manufacturing Output share of Gross Domestic Product (MGDP) is explained by the predictors (CAM, MS and INTR) while the remaining 5.3 per cent unexplained variation is being influenced by other variables outside the model but captured by the error term. While the adjusted R² indicates 0.924 which shows that 92.4% of the variation explained the fitness and generality of the model. The value is expected to be the same or very close to R². The Durbin Watson statistics in the model is 1.519. This falls within the range 0 and 2. A value ranges from zero to two indicates a strong positive correlation while a value from two to four imply a strong negative correlation. The F statistic results show 41.413 with p value of 0.000. Therefore, the p value is less

than 5% level of significance ($0.000 < 0.05$). This can be easily inferred that the joint variables of bank credits have significant impact on the performance of manufacturing sector in Nigeria for the period under review.

5. Findings and Conclusion

The study discovered that bank credits to manufacturing sector and interest rate have insignificant impact on manufacturing output while money supply is statistically significant at 5% level of significance. The f-statistic result indicates that the joint variables of bank credits have significant impact on the performance of manufacturing sector in Nigeria for the period under review. The paper therefore concludes that adequate lending to the manufacturing sector will facilitates the growth of the sector and the economy as a whole.

6. Recommendations

Based on the findings, the following suggestions were made:

- Monetary authorities should endeavor to lower interest rate that will attract the manufacturers to obtain commercial banks' loans.
- The government should allocate more intervention funds to manufacturing sector in order to boost their contribution to the ailing Nigeria's Gross Domestic Product (GDP) and reduce unemployment rate in the country.
- The government should pay more attention to infrastructure facilities, financial institutions, and various supply bottlenecks to guarantee smooth transformation of the manufacturing sector through effective credit financing.
- Monetary policy should emphasize mandatory sectoral allocation of bank credit with appropriate incentives to boost the flow of credit to the manufacturing sectors.
- Bank credits to the real sector (especially manufacturing sector) should be properly monitored to guide against diversion of funds from the main purposes.

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Appendix

YEAR	MGDP	CAM	MS	INTR
2006	2082.49	251.50	3797.91	10.00
2007	2401.19	490.70	5127.40	9.50
2008	2761.55	846.90	8008.20	9.75
2009	3170.82	1190.70	9411.11	6.00
2010	3578.64	1178.10	11034.94	6.25
2011	4527.45	1295.30	12172.49	12.00
2012	5588.82	1771.50	13895.39	12.00
2013	7233.32	2155.90	15160.29	13.00
2014	8685.43	1464.40	17679.29	13.00
2015	8973.77	1870.60	18901.30	11.00
2016	8903.24	2066.50	21607.68	14.00

Table 4: Data on Manufacturing Output Share of GDP, Bank Credits to Manufacturing Sector, Money Supply and Interest Rate (2006-2016)
Source: Central Bank of Nigeria Statistical Bulletin Of 2016

Model Summary ^b							
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics		
					R Square Change	F Change	df1
1	.973 ^a	.947	.924	756.16688	.947	41.413	3

Table 5

Model Summary ^b			
Model	Change Statistics		Durbin-Watson
	df2	Sig. F Change	
1	7 ^a	.000	1.519

Table 6

ANOVA ^a						
Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	71038144.331	3	23679381.444	41.413	.000 ^b
	Residual	4002518.490	7	571788.356		
	Total	75040662.821	10			

Table 7

Coefficients ^a						
Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	-1720.567	997.211		-1.725	.128
	CAM	-.489	.921	-.111	-.531	.612
	MS	.463	.107	.959	4.308	.004
	INTR	177.029	114.799	.170	1.542	.167

Table 8