Financial Inclusion and SME's Growth in Ojo Local Government Lagos State, Nigeria

YUNUS Abdulrasheed Bolaji, **OPEFOLU** Francis Olatunji, Muhammed Lawal **SUBAIR**, **MUSTAPHA** Adamu Zubairu **& AJAYI** Ayodeji Samuel

[1]Department of Accounting, Faculty of Management Sciences, University of Ilorin, Ilorin
[2]Department of Accounting, Faculty of Management Sciences, Ekiti State University, Ado-Ekiti
[3]Department of Accounting & Finance Kwara State University, Malete
[4]Department of Economic and Development Studies Federal University Dustse
[5]Department of Accounting, Lagos State University
yunus.ab@unilorin.edu.ng ,opefoluwaolatunji@gmail.com,
muhammedlawal.subair@kwasu.edu.ng,
zubair.mustapha@fud.edu.ng&ayfavoured4real@yahoo.com

Abstract

This study looks at the connection between the growth of SMEs in Lagos State's Ojo local governments and financial inclusion. As part of their overall strategy for economic and financial growth, many emerging economies aim to promote financial inclusion, which gives low-income households and small businesses greater access to financial services. Some fund providers refuse to lend to people who don't have collateral, which limits people's and businesses' ability to reach higher income brackets. A survey research design was used to direct the investigation. Five SMEs and five financial institutions that was operational between 2007 and 2017. The acquired data's outcomes were examined using to assess the three (3) developed hypotheses; the Ordinary Least Square (OLS) analysis method is used. The benefits of the Pearson Correlation (r = 0.9243; α = 0.01) test, which shows a substantial positive relationship between financial inclusion and SME growth, are attested to by the research findings. As expected, there is a positive link between the variables, and the estimated result of 1.2305 indicates that financial inclusion and SME have a positive relationship. This aligns with the priori anticipation. It is determined that there has been a broad usage of SME credit, with many enterprises taking out bank loans, as SMEs credits have expanded on the supply side. Bank loans are the most popular form of external finance and trade credit on the demand side. The study makes several recommendations, including the implementation of strict policy measures to *increase SME financial inclusion, which will support financial stability and economic growth in Nigeria, and the need to close the significant difference between deposit and lending rates in order to promote savings.*

Keyword: Financial, inclusion, Smes, growth, accessibility, usage

Introduction

The significance of financial inclusion for the growth of small and medium-sized businesses (SMEs) cannot be overstated. The importance of financial inclusion has been highly acknowledged by economies as veritable instrument for capital formation and its importance is not only viewed from prism of capital formation, but also embraced as economic strategy for facilitating transfer of wealth (Bello, Umar & Gawuna, 2023). Financial inclusion is a problem that the government, legislators, and researchers are concerned about. Previous studies have been carried out on the measuring of financial inclusion, bank diffusion, utilization, and accessibility of financing. This study provides a comprehensive overview of a large amount of data and illustrates how SMEs' inability to obtain capital for growth and development often hinders their ability to expand. The local financial system is unable to sufficiently serve the demands of SMEs, which hinders economic growth. This article develops ways to close the financial gap and describes the roles that international and public actors can play in it. It describes the challenges and possibilities faced by international financial institutions. It describes the challenges and chances that international financial institutions may have when working with local intermediaries to assist SMEs in receiving finance in a manner that is both socially and economically sustainable.

Inclusion attempts to enhance access to financial services, Rillo (2021) contends that it is imperative that those who will be directly impacted have a firm grasp of financial affairs. Scholars (Garang, 2021, Ibeachu, 2020; Onaolapo and Odetayo, 2022; Stephen and Sibert, 2021; Godwin, 2021; Pallavi and Bharti, 2023) have acknowledged that financial inclusion is a solution to the problem of small and medium-sized businesses' expansion on a global level. The primary driving force behind Nigeria's attempts to achieve financial inclusion appears to be the Central Bank of Nigeria (CBN). According to the bank's strategy, microfinance plays a crucial role in providing services to small- and medium-sized business (SMEs) owners who are often overlooked or underserved by traditional financial institutions.

This study indicates that SMEs have limited access to funding, particularly when compared to larger enterprises that have access to commercial debt and microfinance. Serving SMEs is occasionally seen by commercial finance as involving undue risks and costs. Microloans, however, are too little to meet SMEs' capital needs. For instance, if a rural farmer needs a loan of ₦7, 000,000.00, it might be too much for the local microfinance group, but too small, risky, and distant for commercial banks. The finance gap is referred to in this study as the "missing middle." it must overcome specific obstacles in theoretical and practical contexts. Stated differently, attempts to tackle the problem must be motivated by a sense of difficulty. This paper states that financial inclusion is necessary to lower the country's poverty rate. Financial services, such as bank accounts and loans, are essential for the development of wealth and the advancement of the economy. SMEs, or small and medium-sized enterprises, have played a critical role in boosting the economy, creating jobs, and having other beneficial benefits. About 250 million micro, small, and medium-sized enterprises—both formal and informal—do not, however, have access to credit lines or loans in developing nations. It is estimated that between 55 and 68 percent of formal SMEs are thought to be underfunded. More barriers for SMEs include inefficient or costly business-to-business payment systems, a lack of appropriate risk management solutions (such as insurance), and a lack of funding for expansion. SMEs' owners also consistently have fewer accesses to financing on a worldwide scale.

Policy makers have appreciated pivotal role of financial inclusion in improving social cohesion and poverty alleviation, thus, policies have been evolved to advance frontiers of financial inclusion, but the increasing level of global financial crimes seems to be impending tides of progress (Bello, Umar & Gawuna, 2023). Therefore, when it comes to addressing gaps in the understanding of financial inclusion, the quality of regulatory legislation, insufficient policy measures, and a lack of internal synergies to achieve financial inclusion are well-known advisory sagas in all nations. All countries are familiar with the advisory sagas over the quality of regulatory regulations, inadequate policy measures, and lack of internal synergies to implement financial inclusion. Small businesses find it difficult to obtain financing through commercial banks, particularly long-term loans, for a variety of reasons. These reasons include a lack of collateral, difficulties establishing creditworthiness, small cash flows, an inadequate credit history, high risk premiums, underdeveloped bank-borrower relationships, and high transaction costs. This study's main goal is to investigate Nigeria's small - and medium-sized business (SMEs) growth and financial inclusion. The specific objectives are to;

i. To investigate how financial inclusion impacts the growth of small and medium enterprises (SMEs) in Nigeria.

ii. To determine if having access to financial resources always translates to a higher level of financial inclusion.

iii. To assess how the use of formal financial services and the offerings of Nigerian banks affect the growth of SMEs in Nigeria.

Conceptual Framework

Financial Inclusion

Financial inclusion is the capacity of an individual to access and use basic financial services that are trustworthy, generally straightforward to use, and adaptable, such as insurance, savings accounts, and loans. Nwanko & Nwanko (2014) define the traditional definition of financial inclusion as the availability and utilization of a broad variety of simple, affordably priced financial services. The availability and use of financial services is one of the primary drivers of economic growth (Sharma, 2016). Financial inclusion pertains to sustainable, relevant, inexpensive, and meaningful financial services for the underprivileged population, especially those residing in rural areas. Reducing income disparities, ending poverty, and accelerating economic growth all depend on disadvantaged areas, underprivileged populations, and underperforming industries having access to low-cost, safe credit and other financial services.

Agarwal (2014) argues that easy access to a sound financial system promotes equal opportunities, aids in the more complete integration of socially and economically marginalized people into society, and enables them actively contribute to progress while preventing financial shocks and crises. Therefore, the process of integrating disadvantaged and vulnerable populations into the structured, standardized financial system is known as financial inclusion. Financial inclusion, as defined by Rangarajan (2008), is the process of making inexpensive financial services (such basic banking, insurance, post office scheme, micro finance, mortgage, etc.) available to vulnerable groups, such as lower income groups and weaker parts. The five A's—availability, awareness, affordability, adequacy, and accessibility—indicate the achievement of total financial inclusion, according to Kumar and Sheel (2015), link to the impact of Small Medium Enterprise's

Small and Medium Enterprises (SMEs)

This study emphasizes how small and medium-sized firms (SMEs) are defined differently in different nations. For instance, the European Union (EU) defines a small business as one that employs less than 50 people and has a combined revenue and balance sheet of no more than 10 million euros. A medium-sized company employs less than 250 people, has a maximum of 43 million euros in assets on its financial sheet, and makes no more than 50 million euros in revenue. While value of assets refers to the balance sheet of the firm, which displays the overall worth of the organization, turnover, or sales, is simply the quantity of sales over the course of a specific accounting period less discounts and sales taxes. In the UK, an industry is considered small if it employs fewer than 200 people and generates less than two million pounds in revenue annually. This definition omits any mention of capital investment. When Americans and Japanese talk about businesses, they usually refer to those with 300–500 employees. Within the United States, the Small Business Administration (SBA) Size Standard Office is in charge of determining the size of SMEs to account for sectoral variations and support initiatives aimed at SMEs. According to SBA (2009), a small business is one that has less than 500 employees.

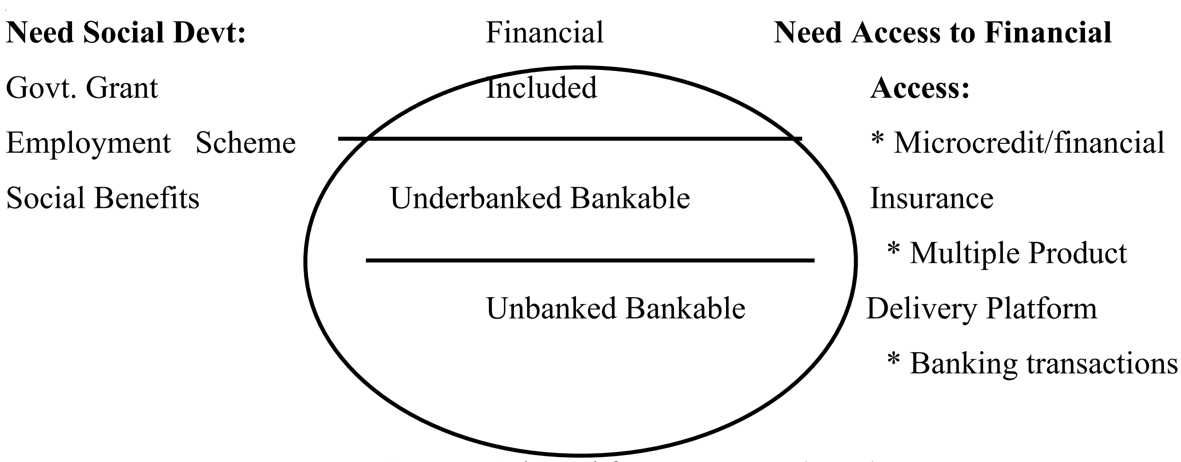
According to the Central Bank of Nigeria's (CBN) Credit Guidelines, any manufacturing or Service Company in Nigeria that has an annual business turnover of less than N1 million Naira, or N500, 000, which was the cap placed on the Agricultural Credit Guarantee Scheme (ACGS), is considered a small scale industry. SMEDAN (2009) states that SMEs account for 90% of all enterprises in Nigeria. Furthermore, according to Culkin and Smith (2000), small businesses account for 47% of sales, 51% of the GDP, and 53% of the labor force in the private sector. They further argued that in all global economies, SMEs make up the largest business sector. However, SMEs can face significant challenges in acquiring credit and other financial services due to nonprime obstacles such lack of collateral, expense, geographic distance from financial centers, bad or nonexistent credit history, and other factors. SMEs play a vital role in the economy by driving growth, fostering innovation, and providing employment opportunities.

Small and Medium Enterprises Adequate Financial Inclusion

It is desirable to develop policies to achieve sufficient financial inclusion for small and medium-sized enterprises. Innovative financial inclusion is the provision of financial services outside of typical financial institution branches in order to serve those who are financially excluded, especially small and medium firm operators (banks and MFIs). Information and communications technology, non-bank retail agents (such post offices), and new institutional arrangements are used to achieve this. Apart from customary banking services, this concept also includes insurance policies, savings programs, and alternatives to informal payment methods (Lyman, et al., 2008). Delivery mechanisms under such financing systems include mobile phone-based systems and those that use information and communications technologies, such as Point-of-Sale (POS) device networks, to transmit transaction details between the retail agent, the customer, and the financial service provider in a branchless banking regime. Bank fees, Know Your Customer levels, and agent banking partnerships are among the new regulations intended to enhance the supply side of financial services delivery.

Literature has also offered numerous suggestions on how to reduce the disparity between the rural poor and financial inclusion. Several of these suggestions—many of which were in the form of models—sought to identify financial exclusion issues exactly as well as the strategies that ought to be employed to raise the impoverished and unbanked to the level of the mainstream. One of these models is the Sustainable Financial Model created by Porteous (2014), which emphasized three key ideas for creating a long-term, sustainable inclusion within an economy: a compliant environment, a business case, and customer expectations. A different model, the Social Development model, depicts society as a pyramid with three segments: the base representing the unbanked, the apex representing the financially included, and the middle representing the underbanked bankable.

Social Development Financial Inclusion Model



Source: Adapted from Porteous (2014)

In this research the base of the pyramid represents the vast majority of people who are not part of the financial system at all and have little to no possibility of ever being so. To get into the under banked bankable category, this population needs social development through government employment programs, subsidies, and social benefits like health and education. Similar to this, in order for the under banked bankable to move into the financially included region, they need access to financial services through banking transactions (deposits, savings, etc.), microcredit/microfinance, micro insurance, multiple product delivery platforms, and the right ecosystem support from the government. The third model, the financial ecosystem model, focuses on how the under banked bankable group's financial integration may contribute to economic growth. Based on the needs of their clients for services like micro insurance, government benefits, microcredit, crop loans, microenterprise finance, and other financial products that support better money management and opportunities for stability and growth, the model advises financial institutions to create a well-thought-out business case.

Theoretical Review

Relevance of the Theories of Financial Inclusion to Small and Medium Enterprises Growth in Nigeria.

Modern Development Theory

Since they provide a traditional approach to financial inclusion and small and medium-sized enterprises (SMEs), which have a favorable effect on economic growth, all of the theories used in this study seem to be appropriate. The best hypothesis to explain the connection between financial inclusion and the growth of SMEs in Nigeria is the twin theory of supply and demand. Furthermore, the supply side and demand side twin theories are driving inclusive growth in the financial sector. The banks are largely expected to mitigate supply-side mechanisms that prevent people from impoverished and disadvantaged social groups from accessing the financial system. However, this study found that the nation's financial inclusion sustainability remains the cornerstone of economic growth in any nation, since financial inclusion will continue to dictate how quickly the nation's financial excluded population's access to capital will close. According to demand-driven finance theory, certain financial developments react positively to economic activity. Conversely, supply-leading finance refers to the establishment of financial institutions in certain areas before the necessity of their services is determined. The ability for the financial sector to simultaneously stimulate growth and engage in growth-inducing activities is the cornerstone of supply-led and demand-following financial theory. They emphasized that the most important issue for development is how well the financial system supports financial institutions. They made the connection between the availability of initiatives, enterprises, and financial institutions and the production, alteration, and growth of industries and other development-focused activities.

Modern development theory focuses on the analysis of growth, relative income differences, and their persistence in unified models. A significant component of many of these models is the inefficiencies of the financial markets, which affect critical decisions about the acquisition of material and human capital as well as career trajectories. For example, under theories that prioritize capital accumulation, deficiencies in the financial system dictate the impoverisher's capacity to borrow funds for investments in tangible assets or education. Ideas that prioritize entrepreneurship hold those deficiencies in the financial system dictate the extent to which gifted but impoverished individuals may acquire outside funding to start companies. Thus, the development of finance, intergenerational income dynamics, and evolution are closely related. Finance has an impact on the efficiency of resource allocation across the economy as well as the relative economic chances for individuals from relatively wealthy or impoverished backgrounds.

This crucial emphasis on the financial sector in economic modeling has been strengthened by the historical evolution of ideas on the links between economic growth and income inequality. It was long believed that the early stages of economic development would always be accompanied by wealth concentrations and inequality. Theorists argued that because large, indivisible investment projects are required to finance during the development process, rapid growth would demand wealth concentration, resulting in a fundamental trade-off between growth and social fairness. The marginal propensity of the rich to save is higher than that of the poor, they pointed out. More broadly, Andrée (2017) speculated that this trade-off meant growing inequality during the early stages of growth until the benefits of growth spread throughout the whole economy.

Demand and Supply Side Twin Theory

The relationship between supply and demand According to Chakrabarty (2011), the Twin Theory is a twin pillar framework that promotes financial inclusion and financial literacy. While financial inclusion functions from the supply side by providing the financial market and services that individuals need, financial literacy encourages the demand side. In an inclusive growing economy, both components have to be present and work together. Ullah et al. (2022) assert that the development of the rural economy is critical to inclusive and equitable growth, as well as to releasing the tremendous potential of those who are presently trapped in poverty and the associated sufferings. According to Mehrotra (2009), both supply-side and demand-side factors influence inclusive growth in the financial system. The banks are largely expected to mitigate supply-side mechanisms that prevent people from impoverished and disadvantaged social groups from accessing the financial system. Despite the risks, financing first-time business owners is crucial for financial inclusion and growth. Reduced income and/or asset holdings are among the supply and demand side issues that have a substantial impact on financial inclusion.

Financial Intermediation Theory

Financial intermediation is the degree to which financial institutions mix surplus and deficit spending units (Ndebbio, 2004). One important question that theories try to answer is why investors lend money to banks, which then lend money to borrowers instead than directly to borrowers. Arguments emphasize banks' capacity to oversee debtors in order to carry out the role of delegated monitoring. Musau (2018). Diamond shows that lower monitoring costs are the source of this comparative advantage. Diamond claims that by issuing secondary financial assets in exchange for the purchase of primary financial assets, intermediaries provide services. If an intermediary provided no services, investors who purchase the secondary securities it created could as well purchase the underlying securities directly and avoid paying the intermediary's fees.

Methodology

Research study

The study employed Ex-post facto Research design. The Ex-post facto research design was chosen because groups with qualities that already exist are compared on some dependent variable. The *Ex post facto* research design examines past occurrences in order to understand a current state. Ex post facto design is justified when manipulating variables is not feasible or ethical, and it relies on retrospective, observational, and correlational data to explore relationships between variables.

Data analysis method

A balance panel data set is constructed because the data set contains all elements observed in all time-frame and static panel data regression analysis is used as the estimation technique because data set for the study is a collection of multi-dimensional data set observed over multiple time periods. The study employed Breusch and Pagan Lagragian Multiplier (BP-LM) test to determine the most suitable estimates between the pooled Ordinary Least Square (OLS) verse random/fixed effects before subjecting the outcome to Hausman test if need be to select the most suitable model between the fixed and random estimates.

Source of Data

To achieve the objective of the study, the secondary data used in the study have been extensively sourced from World Bank database, Central Bank of Nigeria (CBN), and Nigeria Bureau of Statistics (NBS) and annual financial report of deposit money banks at the same time, a hybrid of data was used where necessary as required during the research.

Population of the Study and sampling Technique

The population of this study comprises, information from Central Bank of Nigeria confirmed that Lagos state has the highest number of small and medium enterprises in the country (CBN, 2013). The population is basically centred on banks and owners of the selected Small-medium scale enterprises (SMEs), which comprises of operators in Bakery business, Confectionary centres and Pastry business that are concentrated in the various divisions of Lagos state, Nigeria.

Though, the population of the SMEs' differs from one location to another in Nigeria but the population size of Lagos state which the study strictly based on and made of 11,663 Small and medium businesses which largely includes owners of above stated businesses. However, the study only concentrates on the owners of the

SMEs in Lagos State of Nigeria, since they are directly involved on the issue of financing as well as expansion of their businesses is concerned.

Model Specification

This study would use the panel data methodological approach described in Porteous (2014) to build the model since it lays out the process for information analysis. The functional relationship between financial inclusions and the growth of SMEs is illustrated by the model provided. Usage (U), one of the model's included variables, will act as the explained variable, and other variables, including banking diffusion and credit availability, will act as the explanatory variables.

The model for the research specified as follows:

FI = f (UFS + AC+ BD+ ε)……………. (1)

Where:

Financial Inclusion

= FI

Usage of financial services

= UFS

Access to credit

= AC

Banking diffusion

= BD

Assuming a linear relationship among explanatory variable the explicit form of equation (1) becomes:

FI= $\beta_0 + \beta_1$ufs + $\beta_2$ac + β_3 bd + µt ….(2)

Where:

β_0 is the intercept of the equation, β1, β2, β3 are the parameters of independent variable.

The priori expectation of the model is β_1, β2, $\beta_3 > 0$

Interpretation and discussion of result

The data used for the study are presented and interpreted using the descriptive statistics, followed by the general pooled ordinary least square regression, the random effect generalized least square regression, the fixed effect (within) regression the and lastly the hausman test.

Regression Result for Hypothesis One

	FI	**UFS**	**AC**	**BD**
FI	1.000000	-0.509913	0.009026	0.581990
UFS	-0.509913	1.000000	0.323731	0.600133
AC	0.009026	0.323731	1.000000	0.432590
BD	0.581990	0.600133	0.432590	1.000000

Author’s computation, 2024

Table shows the correlation between the variables. Correlation is used to test two variables that are complementary, or one thing is caused by another. From the above results, it can be seen that there is a negative relationship among financial inclusion and usage of financial services, but positive relationship exists between financial inclusion and access to credit and banking diffusion. Which means holding the above mention variables constant, usage of financial services will have negative impact on financial inclusion while access to credit and banking diffusion will positively influence financial inclusion respectively as shown in table.

Regression Result for Hypothesis Two

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	2.071218	12.20054	-0.169764	0.8700
FI	3.49E-05	3.35E-05	1.039788	0.3330
UFS	0.359971	0.716111	0.502676	0.6306
BD	1.677602	1.309660	1.280945	0.2410
R-squared	0.301451	Mean dependent var		10.68727
Adjusted R-squared	0.002074	S.D. dependent var		2.738000
S.E. of regression	2.735160	Akaike info criterion		5.125544
Sum squared resid	52.36768	Schwarz criterion		5.270233
Log likelihood	-24.19049	F-statistic		1.006926
Durbin-Watson stat	1.605368	Prob(F-statistic)		0.444427

Author's computation, 2024

The intercept of the result is 2.071218, and was found to be consistent with the A priori expectation as it assumed a positive sign, an indication that there is just few component of Access to capital explained by the independent variables. The positive response reported by the result of the intercept may be connected to the fact that access to credit will have a positive impact on SME growth.

The estimated result shows that financial inclusion is 3.4905 which indicate financial inclusion has a positive relationship with access to credit, it thus conforms with the priori expectation; as positive relationship is expected between the variables. The implication of this is that holding other variables constant, a percentage increase in financial inclusion it will cause a 34% access to credit.

Regression Result for Hypothesis Three

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	15.42215	2.491847	6.189044	0.0005
FI	-1.45E-05	1.79E-05	-0.814061	0.4424
AC	0.096785	0.192540	0.502676	0.6306
BD	0.603126	0.719236	0.838565	0.4294
R-squared	0.420116	Mean dependent var		17.26273
Adjusted R-squared	0.171594	S.D. dependent var		1.558230
S.E. of regression	1.418251	Akaike info criterion		3.812014
Sum squared resid	14.08006	Schwarz criterion		3.956703
Log likelihood	-16.96608	F-statistic		1.690459
Durbin-Watson stat	1.810106	Prob(F-statistic)		0.255095

Author’s Computation, 2024

The intercept of the result is 15.42215, and was found to be consistent with the A priori expectation as it assumed a positive sign, an indication that there is just few component of access to capital explained by the independent variables. The positive response reported by the result of the intercept may be connected to the fact that usage of financial service will have a positive impact on SME growth. The estimated result shows that financial inclusion is -1.4505 which indicate usage of financial service has a positive relationship with financial inclusion, it thus conform with the priori expectation; as positive relationship is expected between the variables. The implication of this is that holding other variables constant, a percentage reduction in financial service will cause a -14% usage of financial service. According to the result, access to credit has a figure of 0.359971 which indicates that access to credit has a positive relationship with usage of financial service. This means that holding all other variables constant, a percentage increase in the usage of financial service will cause a 35% increase in financial service, this comply with the A priori expectation, because a positive relationship is expected between the two variables, as it is expected that usage of financial service should positively influence access to credit.

According to the result, banking diffusion has a figure of 0.603126 which indicates that banking diffusion has a positive relationship with usage of financial service. This means that holding all other variables constant, a percentage increase in banking diffusion will cause a 60% increase in usage of financial service, this comply with the priori expectation, because a positive relationship is expected between the two variables, as it is expected that banking diffusion should positively influence usage of financial service.

Discussion of Findings

This study was aimed at examining the impact of financial inclusion on Small and Medium Enterprises on the Nigerian economic growth. Findings from the empirical results in model one (1) to three (3) results indicate relationship between financial inclusion in Nigeria, poverty reduction, economic growth, and financial intermediation over the thirty (30) years period of study.

In this study, it is summarized among others model that one is statistically significant since the Prob. From the table, it shows that F-statistics is3.031131; and Prob (F-statistic) is0.102618. We, therefore, reject null hypothesis and accept alternative hypothesis. This is because it is greater than the critical values or the tabulated value. 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; we can however conclude that banking diffusion has significant influence on SMEs growth in Nigeria.

There is a negative relationship among financial inclusion and usage of financial services, but positive relationship exists between financial inclusion and access to credit and banking diffusion. Which means holding the above mention variables constant, usage of financial services will have negative impact on financial inclusion while access to credit and banking diffusion will positively influence financial inclusion respectively. The intercept of the result is -0.408110, and was found to be consistent with the A priori expectation as it assumed a negative sign.

The estimated result shows that financial inclusion is 1.2305 which indicate financial inclusion has a positive relationship with SME, it thus conform with the priori expectation; as positive relationship is expected between the variables. The implication of this is that holding other variables constant, a percentage increase in banking diffusion will cause a 12% increase SMEs growth.

Conclusion

Based on the analyses and findings in this study, it is well known that financial inclusive growth has recently become one of the world's most important policy goals, and economists and finance analyst have given attention to small and medium enterprises and financial inclusion. SMEs play a crucial role in boosting the economy, increasing employment, and creating industries. Therefore, this study analyzed financial inclusion in Nigeria especially in Lagos State metropolis on the basis of SMEs in terms of supply side, demand side and policy perspectives.

Recommendations

In accordance with the purpose of the study to examine the financial inclusion and small and medium enterprises (SMEs) growth in Nigeria, the following recommendations are therefore made.

i. Providing incentives for banks and other financial institutions to develop SME-friendly products and services.

ii. Encouraging competition among financial service providers to enhance service quality and reduce costs

iii. Creating awareness campaigns to highlight the advantages of using formal banking services over informal ones.

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