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# QUANTITATIVE ANALSIS OF THE IMPACT OF SMALL AND MEDIUM SCALE ENTERPRISES ON THE GROWTH OF NIGERIAN ECONOMY: (1993-2011).

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**ABSTRACT:** *This study is on the quantitative impact of Small and medium scale enterprises (SMEs) on Nigeria's economic growth performance for the sample period 1993 to 2011. The econometric technique adopted for the study was multiple regression method based on ordinary least squares technique. However, in order to avoid the incidence of spurious estimates, evidence from the ADF test conducted revealed that the variables are integrated of order two,1(2). The Johansen test conducted showed evidence of long run equilibrium relationship between small and medium scale enterprises and economic growth. However, in the mean time, output of SMEs (SMEO) does not make any significant contribution to Nigeria's economic growth performance. The study concludes that poor government policies, on tariffs and incentives, bribery and corruption, non-existent entrepreneurial development centers and poor state of infrastructure act as impediments to the growth and development of SMEs in Nigeria. The recommendations are that governments at all levels should endeavor to establish Microfinance institutions for easy access to credit by SMEs, introduce financial literacy in schools, establish entrepreneurial development centers for capacity building, provide enough infrastructure, especially electricity and road net work, and finally establish agencies for control of bribery and corruption.*

**KEYWORDS**: *Small and Medium Enterprises, Economic growth, Inflation, Bank Credit, Interest rates.*

## BACKGROUND TO THE STUDY

The dynamic role of small and medium enterprises as engine of growth in developing countries has been recognized. As observed by Cook and Nixson (2001), the development of small and medium enterprises (SME's) should be seen as attempts towards the achievement of a wider economic and socio-economic objective, including poverty alleviation. As stated by Kuteyi (2013), small and medium Enterprise drives their country's development as they create employment and contribute to the gross domestic product (GDP). In the opinion of Ariyo, (2008); Ayozie and Latinwo (2010) and Muntala et al (2012), there is the greater likelihood that SMEs will utilize labour-intensive technologies thereby reducing unemployment particularly in developing countries and thus have an immediate impact on employment generation.

Small and Medium Enterprises are expected to facilitate the growth and development of human and capital resources towards general economic development and the rural sector in particular. In view of these expected roles from SMEs, the Nigerian government had in the past devised policies and incentives for the development of small and medium scale Enterprises. Such efforts,


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according to Adebusuyi (1997), could be classified broadly into three, namely (i) Incentives (fiscal and export), (ii) Tariff regimes, and (iii) Financial support and technical assistance programme. The fiscal incentives include tax relief for small enterprises during the first six years of operation, granting of pioneer status for a period of five years with a possible extension of two years for enterprises located in economically disadvantaged areas, and provision of relief for investment in infrastructure capital allowances, and minimal local raw material utilization income of 20 percent. Export incentives include the introduction of import duty draw back, export credit and insurance schemes, etc.

To protect SMEs from dumping, the government adopted the use of high tariff rates to discourage importation of some of the industrial goods that could be produced domestically, and in some cases, complete ban on a variety of industrial and agricultural products. To provide funds to small and medium scale enterprises by way of commercial loans, the Bank of Industry (BOI) and the Nigerian Agricultural Cooperative and Rural Development Bank (NACRAB) were established. Also established were National Economic agencies to provide loan scheme for SMEs.

In spite of all these efforts by the government, both at federal, state, and local government levels, to ensure the growth of SMEs in Nigeria, people such as Abereijo et al have identified key factors which they claimed were responsible for their perceived failure of SMEs in Nigeria. Against the backdrop of the interest and belief in the SMEs as a catalyst towards the industrialization and economic growth of Nigeria, this study is aimed at determining the quantitative impact of SMEs in Nigeria's economic growth performance.

This paper is presented into five sections. Section one takes on the background information which comprises the background to the study, research problem, the objectives for the study and the operational hypotheses. Section two takes on the review of related literature, analyzed under theoretical and empirical literature. Section three is the methodology. Section four looks at the discussion of the empirical results, while section five summarizes the findings, draws the conclusion and proffered a recommendation.

**Statement of the Problem**

In many societies, small and medium scale enterprises are the engine of growth. Specifically, in countries such as Malaysia, Thailand, China, and India, SMEs have been responsible for more than 70 percent of exports and this is why these countries, according to Duro (2013) have been growing in leaps and bounds.In Nigeria, SMEs are beset with a myriad of challenges which are in no small measure affecting their growth. The most pronounced, however, is access to funds and effective infrastructure to operate, especially electricity.  As observed by Sacerdoti (2005), even banks with retained liquidity levels in excess of what is required by law have shown reluctance in extending loans to SMEs, especially on long term basis as they are considered highly vulnerable with high credit risk. Small and medium scale Enterprises do not have the muscle to compete with the multinationals in terms of marketing because of what it takes in real terms to market a product. In addition, the amount one needs to produce in order to engage in profitable marketing to break even is not there for the local manufacturers.



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SMEs by their very nature are supposed to be the bedrock of the nation's economy but the operating environment has been very harsh for them to thrive. Currently, most of them can scarcely fund their operations, and the issue of mass or large scale production is ruled out. Some manufacturers have gone under due to unhealthy operating environment occasioned by poor infrastructure, high cost of production, multiple levies and multiplicity of regulatory agencies. In terms of capacity building, very few, of SMEs can afford to attract and retain the right caliber of staff that will take charge of sensitive and high-tech positions in their companies.
In view of the problems confronting SMEs in Nigeria alongside the efforts the government has put in to ensure their growth for them to perform effectively the roles expected of them, this paper is aimed at quantitatively investigating the impact of SMEs on Nigeria's economic growth performance.

**Research Questions**
The questions for which answers are sought from this research are as follows:
**i** To what extent have SMEs impacted on Nigeria's economic growth performance,? and
**ii** To what extent have changes in some policy variables influenced the performance of small and medium scale enterprises (SMEs) in Nigeria.?

**Research Objectives**
The broad objective of this study is to analyze the performance of small and medium scale Enterprises vis a vis Nigeria's economic growth performance. Specifically, the study shall
**i** Determine the impact of SMEs on Nigeria's economic growth performance, and
**ii** Determine the impact of changes in fiscal and monetary policies on the output of SME's in Nigeria.

**Statement of Research Hypotheses**
This study shall be guided by the following hypothesis:
$H_0$: The performance of SMEs have not significantly impacted on Nigeria's economic growth performance
$H_{02}$: Changes in Nigeria's monetary and fiscal policies have not significantly impacted on the output on small medium scale Enterprises in Nigeria.

**Significance of the Study**
This study tries to examine the impact of microfinance Banks on the growth of SMEs and thus economic growth in Nigeria from 1970 to 2011. The study shall give an insight on how job opportunities can be created and how poverty rate can be drastically reduced in the country. The research work will further provide useful information for policy makers for further development of SMEs through Microfinance activities with the view to enhancing both institutional and policy frame work in the sector.The major value-added of this research work will be the proffering of suggestions that will help policy makers in formulating policies that will help improve the growth of entrepreneurial skills among the citizens of Nigeria.



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**Scope and Limitations of the Study**

This research will focus on Nigerian economy using Microfinance Banks located within the country from 1993 to 2011. The secondary data (Time-series data) generated from central Bank of Nigeria statistical bulletin will be relied upon.Though time-series data, in most cases are not error free, besides, the researcher is not unaware of the conflicting nature and the inconsistency of most of the secondary data from different data collecting agencies in developing countries, Nigeria inclusive. For instance, data from Central Bank is always at variance with the data from Bureau of statistics. Researchers are always constrained as to which of the data to use while conducting a research of this nature. This is the major limitation of this research exercise. However, the above limitations notwithstanding, the researcher is optimistic that the present study will be adequate to serve the purpose for which it is intended.

## REVIEW OF RELEVANT LITERATURE

### Theoretical Literature

Development strategists have advocated the aggressive use of small and medium scale Enterprises (SMEs) to accelerate economic growth, especially in developing countries of the world (Daodu,1997). Most African countries are basically agricultural societies, and as observed by Osinowo (1997), with little capital to invest, it seems obvious that the process of industrialization should be based on c the development of the SMEs to link agricultural production with manufacturing activities. According to Arewu and Adeyemi (2011), Small and Medium Enterprises have been considered as the engine of economic growth, and that the major advantages of the SMEs is their employment potential at low capital cost. This is because the SMEs are relatively more labour-intensive than large enterprises. Furthermore, Aremu (2004), contends that the role SMEs play in any country is always in consonance with the country's level of development. Adeyemi and Badmus (2001), in agreement with Aremu (2004) that there is high incidence of poverty in Nigeria, argued that only adequate financing of small and medium scale enterprises will reduce Nigeria's unemployment level. On the belief that jobs can be massively created through the development of SMEs, Gunu (2004) and Aremu (2010) posit that finance to small and Medium Scale Enterprises will provide more income, savings and employment.

The need to promote the industrial sector has continued to be a major concern of most governments worldwide, especially developing countries like Nigeria. With the growth of SMEs, Olorunshore (2002) and Egban (2004), believed that the Nigerian economy will have the potential of being competitive in the global market. In recognition of these potential roles of SMEs, successive governments in Nigeria have continued to express policy measures and programme to achieve industrial growth and development.In recognition of SMEs contribution to Nigerian economy, the strategies and initiatives to promote SME development featured prominently in most of the government's economic development plans with a view to nurturing further growth of the sector. According to Ogwuma (1995), a clear path for accelerating the



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development of SMEs has been charted through the establishment of agencies such as DFRRI, NDE, NAPEI etc, although the challenges before these establishments are daunting.

**An overview of Small and Medium Scale Enterprises in Nigeria**

Nigeria remains a country with very high potential but an equally high inertia to develop. The country is blessed with abundant supply of enormous human, agricultural, petroleum, gas, and large untapped solid mineral resources (Obadan, 2003). Since her independence from British rule in 1960, the country has gone through decades of political instability and this has brought with it a climate of social tension and an unpredictable market for business. The successive forceful takeover of government by the use of military coup and the indigenization policy of the late 70's has put off investors who hitherto saw the country as a large and growing market. Due to the nature of these governments, there is perceived corruption, policy instability, poor infrastructural development and lack of accountability of public funds. For these reasons, the World Bank described Nigeria as a paradox (World Bank, 1996). This is also true for most Sub-Saharan African countries as industrial production has declined or stagnated over the past decades (Lall, 1992).

According to Mambula (1997), since its independence, the Nigerian government has been spending an immense amount of money obtained from external funding institutions for entrepreneurial and small business development programs, which have generally yielded poor results. Unfortunately these funds hardly reach the desired business because they may be lost to bureaucratic bottle necks and end up in accounts of public office holders. Despite these setbacks, the role of small business owned by middle class Nigerians, set up by individual savings, gifts and loans and sometimes sustained by profit cannot be ignored. According to Asmelash (2002), countries that have made economic breakthroughs in the last two decades demonstrated beyond doubt that the development of entrepreneurship has been the sine qua non of economic growth and development. According to Asmelah (2002), the significant role SMEs play in development is acknowledged world over. He cited the work of Schell, (1996), who noted that in developed countries such as the USA, where big corporations are dominant, SMEs still play enormous role in the country's economy.

Also, according to the report of the Indian working group on science and technology for Small- and medium-scale enterprises, SMEs occupy an important and strategic place in economic growth and equitable development in all countries. Constituting as high as 90% of enterprises in most countries worldwide, SMEs are the driving force behind a large number of innovations and contribute to the growth of the national economy through employment creation, investments and exports. Owing to the success of the Asian tigers, interest is running high globally particularly in developing countries that are in the rat race to meet up and reduce the economic and development gap. Chinese and foreign experts estimated that SMEs are now responsible for about 60% of China's industrial output and employ about 75% of the workforce in China's cities and towns (Schell, 1996). These SMEs creates jobs for workers who have been laid off from state-owned enterprises due to the steady transition from communism to a market based economy.



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According to Cook and Nisxon (2000), interest in the role of small and medium-sized enterprises (SMEs) in the development process continues to be in the forefront of policy debates in developing countries. Owing to the relevance of SME's, in 2006, the government of Taiwan launched a $61 million "branding" initiative, which was aimed to push the economy from being production-based to knowledge-based. According to the report in EE Times Asia in August 2006, the so-called "Branding Taiwan Plan" is a seven-year program designed to help promising small-to-medium enterprises (SMEs) in developing their own brand, according to the Taiwanese government. This was initiated with the full consciousness of the ability of SMEs to drive the economy particularly in the medium term. Small businesses employ 72,000,000 people (Asmelash, 2002). More than 90 per cent of the industries in Indonesia, Philippines, Thailand, Hong Kong, Japan, Korea, India and Sri Lanka are small enterprises (Fadahunsi and Daodu 1997).

A 2004 survey conducted by the Manufacturers Association of Nigeria (MAN) revealed that only about ten percent (10%) of industries run by its members are fully operational. Essentially, this means that 90 percent of the industries are either ailing or have closed down. Given the fact that manufacturing industries are well-known catalysts for real growth and development of any nation, this reality clearly portends a great danger for the Nigerian economy. The acting director-general of the association, Mr. Jide Mike, who disclosed this fact, attributed the cause of this sorry state to such factors as poor infrastructure, multiple taxes imposed on manufacturers in Lagos state by all tiers of government and the difficulty in accessing finance. He noted, “The debris of dilapidated manufacturing concerns across the country is the outcome of years of harsh operating conditions”. Jide (2012), also remarked, “In addition to policy somersault, funding remains a challenge to all stakeholders in the manufacturing sector, the several palliatives, including the Small and Medium Industries Equity Investment Scheme (SMIEIS) and other sector-specific incentives notwithstanding”. He added, “In summary, 30 percent of industries in Nigeria have closed down. About 60 percent are ailing companies and only 10 percent operate at sustainable level”. The acting director-general of MAN (manufacturing association of Nigeria) emphasized that low capacity utilization has undermined the competitiveness of manufacturing industries, whose fortunes have been worsened by the impact of globalization. He recalled that at Nigeria's independence in 1960, the manufacturing sector's contribution to national Gross Domestic Product (GDP) was 3.8 percent and that despite the discovery of oil, manufacturing contributed as much as 9.9 percent to the GDP from 1975 to 1981 when capacity building was above 70 percent. Jide (2012), however regretted that the story is different today as the manufacturing sector is back at the independence level as it contributed a mere 4.7 percent to GDP in 2003 while industrial capacity utilization dropped to a paltry 48.8 percent in 2003.

The above is indeed not encouraging as it is representative of the fate of the manufacturing sub-sector of the SMEs. It was said that the large manufacturing companies are even better off given that those of them, which have international affiliation do get succor and support from their parent companies or technical partners overseas. The support and services the multinationals get from their parent companies could be driven by the profit repatriation, expansion of their overseas market and other motivations but overall, the Nigerian economy benefits if only through employment generation. President Olusegun Obasanjo in his address on March 01, 2002 at the commissioning of the headquarters of SMEDAN (The Small and Medium Enterprises


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Development Agency of Nigeria) in Abuja also noted that there was a great disconnection between the SMEs and the large companies in Nigeria, pointing out that the multinational companies dominated business in the country even in the area of finished products. Because of these and other debilitating problems, only about 10 percent of SMEs in Nigeria are into manufacturing.

## Empirical Literature

Using the descriptive research method, Adoyi and Agbo (2009) employed both primary and secondary data to determine the extent to which small business firms have developed Benue sate of Nigeria, and found that 86.3 percent of the small business firms pay their taxes regularly. These taxes increase the revenue base of the state which is used for development purposes. Akingunola (2011) assessed the specific financing options available to SMEs in Nigeria and thir contribution to economic growth performance. The Spearman's Rho correlation was employed to determine the relationship between SMEs financing and investment level. At 10 percent level of significance, the Rho value of 0.643 indicated a significant and positive relationship between SMEs financing and economic growth in Nigeria.

Safiriyu and Njogo (2012), employed primary data instruments, questionnaire and interviews to study the impact of small and medium scale enterprises on employment generation in Lagos state, Nigeria. The results of simple percentages and chi-Square ($X^2$) tests conducted show that small and medium scale enterprises and sustainable development of Nigerian economy are positively related, just as promotion of SMEs and improvements in employment generation are positively related and significant. Availability of finance has been widely viewed as a constraint to the growth of SMEs. Azende (2011), in an empirical evaluation of the performance of small and medium scale Enterprises, Equity Investment Scheme (SMEEIS) in Nigeria used Benue and Nassarawa states as case studies. Using total credit to SMEs as a percentage of Banks' total credit for the period 1993 to 2008, the T-test conducted to determine the extent of relationship between bank loans before and after the introduction of SMEEIS indicated no significant difference between loans disbursed by banks to SMEs. This result, according to him, was due to the fact that the conditions for accessing SMEEIS funds were beyond the reach of the targeted SMEs.

## Summary of Empirical Review

The Table below summarizes the related empirical literature on the impacts of small and medium scale (SMEs) on economic growth.

***Table 1: Summary of Related Empirical Literature***

| ***Author*** | ***Sample and method*** | ***Findings*** | ***Weakness*** |
|---|---|---|---|
| Adoyi and Agbo (2009) | Descriptive statistics ($X^2$) method | The study show that small business firms promotes economic growth in Benue state of Nigeria | The major weakness of the work is that the authors did not employ modern statistical tools in analyzing their model thus making |

| | | | |
|---|---|---|---|
| | | | their findings and recommendations questionable. |
| Akingunola, (2011) | Spearman's Rho correlation method | The study revealed that a significant and positive relation between SMEs and economic growth in Nigeria exists within the sample period. | The study did not test for the long run relationship among the variables and the nature of the time Series to know whether they are stationary or not. |
| Safiriyu and Njogo (2012) | Chi-Square Method and simple percentage | The result indicated a positive relationship between SMEs and economic growth in Lagos state Nigeria | The use of questionnaire as a data collection method has been criticized for its inherent limitations of biased ness by renowned authors, hence, the prescriptions made by the authors based on this method is not only unempirical but also spurious. |
| Azende, (2011) | Simple regression Method | The result showed that there was no difference between loans disbursed to SMEs during and after the introduction of SMEEIS in Nigeria. | There was the presence of serial correlation of the first-order as the Durbin_Watson's statistics reported a coefficient of 1-23476. The regression result was therefore spurious. The present research is thus intended to fill the above gaps. |

**SOURCE: Field Survey, 2014**


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## METHODOLOGY

This study will basically adopt ordinary least squares (OLS) estimation techniques. However, before the application of the OLS, the time series characteristics of the variables will be examined. This will involve conducting unit root or stationarity tests in order to determine their order of integration. Johanson co-integration tests will be conducted to determine the existence of any long run equilibrium relationship among the variables. With log run equilibrium relationship established, error correction model (ECM) or representation will be presented to determine the speed of adjustment of short run relation to unexpected shocks.

### Model Specification:

In order to capture fully the impact of small and medium scale enterprises on Nigeria's economic growth performance, the following specified structural equation will be established and tested:

$$RGDP_t = \beta_0 + \beta_1 SME0_t + \beta_2 BCSME_t + \beta_3 INF_t + \beta_4 INTR_t + \mu_t \quad (1)$$

The following variables – INF, INTR and EXR have been included in the model on the consideration that they are among the proximate determinants of output in any economy. To be able to make more robust conclusions concerning the performance of SMEs in response to changes in some macro policy variables (Fiscal and Monetary policy variables), the parameters of the following structural equation will be estimated and tested:

$$SME0_t = \gamma_0 + \gamma_1 GEX_t + \gamma_2 INF_t + \gamma_3 INTR_t + \varepsilon_t \quad (2)$$

Where:

SME0 = Output of Small and Medium Scale Enterprises
BCSME = Bank Credit to SMEs
INF = Inflation rate
INTR = Interest rate
GEX = Government Expenditure
$\beta_1$- $\beta_4$; $\gamma_1$ - $\gamma_3$ = Estimated Parameters
$\mu_i$ and $\varepsilon_i$ = Stochastic error terms
*A prori expectation* = $(\beta_1 - \beta_4; \gamma_1 > o; \gamma_3 > o)$

## DISCUSSION OF EMPIRICAL RESULT

### Unit Root Results

The long-run characteristics of the variables were determined in order to avoid spurious estimates of the parameters. The integration of the variables of the same order was a motivation to test for the long-run equilibrium relationship. The Johansen co-integration test shown below indicates that the variables were all co-integrated at both 5% and 1% level of significance.



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**Table 1: Johansen Co-integration Test**

| *Eigen value* | *Likelihood Ratio* | *5% percent Critical value* | *Percent Critical value* |
|---|---|---|---|
| 0.719141 | 48.456553 | 36.64 | 42.44 |
| 0.373606 | 30.45828 | 13.78 | 25.32 |
| 0.257827 | 16.268317 | 5.36 | 12.25 |

**Source: E-views Regression Result, 2014**

Having established the existence of a co-integrating relationship among the variables, the parameters of their relationships were estimated, without any fear of arriving at spurious estimates. The ordinary least squares (OLS) are as shown in equation 1 below:

GDP = 498.20 + 0.098SME0 + 0,0057BCSME + 3.127INF – 39.76INT
Se = (247.62) (0.6563) (0.00103) (1.9669) (13.8745)
t = (2.0119) (0.1492) (5.523878) (1.589919) (-2.866)
$R^{-2}$ = 0.6251 F (4, 14) = (8.504642) D-W = (1.1942)

As shown in the ordinary least square (OLS) regression results, all the variables appear with the expected a priori signs. While bank credit to SMEs (BCSME) and interest rate (INT) are significant determinants of our gross domestic product (GDP), output of SMEs (SMEO) and inflation rate are not significant.The adjusted $R^{-2}$ value of 0.625145 indicates that the model explains about 63% of the variability in Nigeria's gross domestic product. An F-value of 8.504642 shows that the joint influence of the explanatory variables is highly significant both at 5% and 1% level in the determination of Nigeria's gross domestic product. With a Durbin-Watson statistic of 1.194238 at 5% level of significance indicates the presence of positive autocorrelation in the model.

In equation 2 below, the impact of Government expenditure (GEX), changes in inflation rate (INF), and interest (INT) on the output of small and medium scale enterprises (SME0) were estimated and tested.

SME0 = -28.91242 + 5.68GEX + 1,281INF + 1.431INT
Se = (105.0633) (1.06) (0.718198) (5.436058)
t = (-0.275190) (0.536018) (1.784295) (0.263202)
$R^{-2}$ = 0.032907 F = 1.204 D-W = 2.24

As shown in the regression results, all the variables are positively related with the output of SMEs. Non of the variables are significant, both at 5% and 10% levels. The adjusted $R^{-2}$ of 0.032907 indicates that only about 3% of the variability in the output of SMEs are determined by changes in government expenditure (GEX), interest rate(INT) and inflation rates(INF). The F-statistic value of 0.342143 implies that the joint influence of the explanatory variables is not significant in explaining changes in the output of SMEs. The unexpected positive relationship between interest rate (INT) and output of SMEs (SMEO) in equation 2 may have been because


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of the high demand for bank credit by SMEs.The insignificant impact of SMEs output on GDP as shown above in equation 1 is a pointer to the fact that SMEs have not been contributing enough towards the growth of aggregate output in Nigeria. Interest rate has also not gone down enough to be able to stimulate the growth of SMEs.

## CONCLUSION

The unimpressive empirical results obtained are reflections of a good number of factors impeding the growth and development of SMEs in Nigeria. Such factors are; (1) Poor state of government policies in the areas of general infrastructure and incentives such as tariffs, and taxes; (2) The inability of SMEs to access credit due to high interest rates; (3) As observed by Oseni, the high level level of bribery and corruption which are contributors to the demise of about 80% of SMEs, and (4) The inability of SME entrepreneurs in keeping proper and up to date records of accounts of their businesses.

## RECOMMENDATION

In view of the findings so far, the recommendations are that:

**(1)** Government at all levels in Nigeria should be encouraged to float Microfinance institutions in order to enable SMEs access enough funds for their businesses. This will enable the poor in their areas to have access to credit without which our strive for financial inclusion and poverty eradication will not be realized.

(2) The central Bank of Nigeria (CBN) should hasten up its proposal to introduce financial literacy in in school's curriculum. The ability of SMEs to keep appropriate and up to date records are what banks require for extension of their credits to individuals and groups.

(3) The CBN as the apex financial institution should establish entrepreneurial development centers across the country to encourage and build capacity for business-minded youths.

(4) Government should increase its efforts towards the provision of infrastructure such as electricity, and transport without which government can not thrive efficiently, and

(5) Government in Nigeria should establish more agencies to assist the existing ones such as the EFCC and ICPC to tackle bribery and corruption headlong, as businesses can not thrive in an environment where bribery and corruption thrive.

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