Original Research Article

IMPACT OF SMALL AND MEDIUM SCALE ENTERPRISES ON ECONOMIC DEVELOPMENT OF NIGERIA

ABSTRACT

Problem

Nigeria has made it one of its primary goals in recent decades to develop its industrial base through the formation, maintenance and expansion of small and medium scale enterprises in order to achieve economic development. Fiscal incentives, grants, support and aid from bilateral and international agencies, as well as specialized institutions, have all been used to help the SME sector thrive. However, SMEs in Nigeria have not performed creditably and so have not played the crucial and lively role that they should have in the country's economic growth and development. As a result, the government, citizens, operators, practitioners, and organized private sector groups have all expressed concern about the situation.

Methodology

Using time series data set from 1991 to 2020, this study utilized the Fully Modified Ordinary Least Squares (FMOLS) to analyze the impact of small and medium enterprises (SMEs) on the development of the Nigerian economy.

Findings

The study found a long-run relationship between small and medium scale enterprise and economic development in Nigeria. Our findings also indicate a unidirectional relationship from gross domestic product to commercial bank loans to SMEs. However, there is no causal relationship between inflation and gross domestic product; interest rate and gross domestic product. And, none of the economic growth indicators report a bi-causal relationship.

Conclusion

The study hereby recommends that government should assist prospective entrepreneurs to have access to finance and necessary information relating to business opportunities to enable them to reduce their operating costs and be more efficient to meet the market competitions.

Keywords: SMEs, FMOLS, Commercial Bank, Economic Development

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INTRODUCTION

In developing economies, small and medium-sized enterprises (SMEs) are widely recognized as the engine of economic growth and equitable development. Thus, after Nigeria's independence in 1960, the government placed a strong emphasis on the development of small and medium-sized businesses as a means of eliminating poverty and unemployment. Aside from the potential for self-sufficient industrialization utilizing local raw resources, SMEs are better positioned to increase employment, ensure equitable distribution of industrial development, and assist the rise of non-oil exports. They are labor-intensive, capital-efficient, and capable of assisting in the creation of the majority of the one billion new jobs required by the end of the century. The introduction of SME in Nigeria may be traced back to 1945, when the important paper No. 24 on "A Ten-year Plan of Development and Welfare of Nigeria 1946" was presented. Small and Medium-scale Enterprise (SME) was once considered an absolute requirement; however, it has gained significance in recent years and is likely to grow in relevance in the future (Basil, 2005).

SMEs have an impact in the following ways: increased use of local raw materials, creation of jobs, encouragement of rural development, development of entrepreneurship, mobilization of local savings, linkages with larger industries, provision of regional balance by spreading investments more evenly, provision of an avenue for self-employment, and provision of opportunity for training managers and semi-skilled workers (Muritala, Awolaja, and Yusuf 2013). SMEs have been properly described as "the engine of growth" and "catalysts for any country's socio-economic transformation" (Anthony and Arthur, 2008).

Small and medium enterprises (SMEs) in Nigeria, on the other hand, have not performed admirably and so have not played the expected important and vital contribution to the country's economic growth and development. The government, citizens, operators, practitioners, and organized private sector groups have all expressed alarm about the situation. Year after year, governments at the federal, state, and even municipal levels have expressed interest in and recognition of the critical role of the SME sub-sector of the economy through budgetary allocations, policies, and statements, and have enacted measures to energize it. Fiscal incentives, grants, support and aid from bilateral and international agencies, as well as specialized institutions, have all been used to help the SME sector thrive.

Despite the efforts and contributions of previous and current governments to promote Nigeria, the contribution of this sector to the economy remains relatively limited in terms of its influence on GDP, unemployment, and poverty reduction. The unemployment rate in this country remains high, and the bulk of the people continue to live in poverty (Ekezie, 1995;

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Bacdom, 2004; Iromaka, 2006). In light of the foregoing, this study investigates the impact of SME's on Nigeria's economic development from 1991 to 2020. The period chosen was determined by the availability of data on SMEs financing in Nigeria. As a result, a full assessment of SMEs and economic development in Nigeria is possible.

Research Questions

i. How does Small and Medium Enterprises (SMEs) affect economic development in Nigeria?
ii. What is the causal relationship between Small and Medium Enterprises (SMEs) and economic development in Nigeria?

Research Hypothesis

i. $\boldsymbol{H0}1$: Small and Medium Enterprises (SMEs) does not affect economic development in Nigeria.
ii. $\boldsymbol{H0}2$: There is no causal relationship between Small and Medium Enterprises (SMEs) and economic development in Nigeria.

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CONCEPTUAL REVIEW

SME definitions are often derived in each country depending on the function of SME in the economy, policies and programs designed by specific organizations or institutions tasked with developing SME, and so on. However, most countries use three parameters: capital investment, volume of production, and business turnover. In industrialized economies such as Japan, Germany, and the United States of America (USA), a small business may be a medium or large-scaled enterprise in a developing economy such as Nigeria. Furthermore, depending on the policy focus of agencies or developing institutions, the definition of SME changes over time. The concept of a small business differs depending on the culture and unique circumstances of the individual attempting to define it. The definitions in use depend on the purposes and the policies which govern the SME sector in a particular country.

According to Jamodu (2000), SME's are classified as micro/cottage industries (1-10 workers), small scale industries (11-100 workers), medium scale industries (101-300 workers), and large scale enterprises (above 1000 workers) (301 and above). Small and medium businesses in Japan with less than 299 employees can obtain capital of up to one hundred million Japanese yen. "Enterprises employing less than 500 workers are generally regarded as SMEs," said Nigeria's Minister of Industry.

The terms "economic development" and "economic growth" are not interchangeable. Growth can be defined as a rise in output (per unit of input), whereas development entails an increase

in output as well as a change in the technological and institutional arrangements that are involved in production. Growth can occur without development, but a country cannot attain economic development without first experiencing economic growth. As a result, economic growth is a subset of economic development, which is not solely a financial phenomenon.

Human welfare is improved by development, which entails increasing the number of commodities and services available to individuals. The more the wealth and benefit, the more output is created. As a result, development is primarily concerned with expanding the volume of business turnover, i.e. the amount of production available for sale.

ROLE OF SMALL AND MEDIUM SCALE ENTERPRISES IN ECONOMIC DEVELOPMENT

Small businesses are known for being more adaptable under challenging and changing situations since their capital intensity is often minimal, allowing them to alter product lines and inputs at a cheap cost (Evbuomwan et al, 2016). The sub-flexibility, sector's adaptability and regenerative tendencies have made it a critical focus for many countries' industrial development, particularly in developing countries (Raji 2000). They are a good way to encourage indigenous entrepreneurship, increase employment opportunities per unit of money spent, and help local technological development. They provide an effective technique of moderating rural-urban migration and resource use due to their extensive dispersion. They contribute to the strengthening of inter-industrial links by manufacturing intermediate products for use in large-scale industries.

Using global standard as an example, Nigeria has a very small number of significant businesses. Peasant agriculture is the most common, accounting for over 95 percent of total agricultural output and employment in Nigeria (Research Dept., CBN, 2000). While the agriculture industry has long been the backbone of the Nigerian economy, accounting for roughly 22% of the country's GDP (NBS, 2015). Non-agricultural SME employment accounts for over 25% of overall employment and 20% of GDP in Nigeria, according to estimates (MSMEDAN, 2007). According to available data, small-scale manufacturers dominate the country's informal manufacturing sector. In terms of the number of individuals employed the percentage distribution across activity sectors ranges from 92 to 98. The number of employees in bakeries, leather manufacturing enterprises, furniture producers, textiles, and construction-related products confirms this.

SMEs can play a significant role in strengthening national economies, relieving poverty, engaging in the global economy, and working with larger firms, according to a 1981 Central Bank of Nigeria research published in National Association for Small and Medium

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Enterprises (NAMSME), 2003. They must, however, be promoted. Governments, businesses, and civil society must all make pledges to help.

PROBLEMS OF ESTABLISHING SMALL AND MEDIUM BUSINESS ENTERPRISE IN NIGERIA

Due to their unique characteristics, SMEs face a slew of unique issues that either directly or indirectly impede their survival and growth, examples are:

a. **Lack of Start-up Capital:** The most difficult type of financing to acquire is early stage funding. At this point, there are two sources of funding available which are; seed capital and startup capital. Seed capital is a modest sum of money required to prove a concept and conduct a feasibility study. Because venture capitalists are usually not interested at this level of investment, it is the most difficult to secure. While start-up cash is required, the feasibility of commercial sales is determined. It's also really difficult to get by.
b. **Lack of Land and Good Locations:** Prior to the establishment of any small-scale enterprise, land must be acquired on which the factory or warehouse will be built. Land is rarely available in urban locations, and when it is, it is extremely expensive for the small-scale entrepreneur. Other critical facilities will be absent in rural areas, where land is likely to be accessible at a lower cost. A good location for our businesses is critical for their long-term survival, but it is tough to come by, and even when it is, the cost will be unaffordable for any small business owner.
c. **Poor Government Policies**: The Nigerian government has been unable to assist entrepreneurs in the formation of small businesses. Instead, one or more unpleasant policies were employed to make life tough for young businesses. The government is primarily concerned with generating cash, ignorant of the fact that it is preventing the formation of new small businesses in Nigeria.
d. **Insecurity of Lives and Properties:** Security threats are one of the most challenging aspects of starting a small business in Nigeria. Even large-scale firms that can afford to hire security personnel are not immune to the societal threat. As a result, many potential investors chose to store their money in banks or use it to buy vacant land for future resale rather than risk their money by starting a business.
e. **Psychological Factors** Fear of Failure, Lack of Creativity, and Lack of Self-Confidence Psychological considerations have also been a major impediment to the formation of small-scale businesses in Nigeria. Although it has never been considered a concern, it has had a significant impact on young entrepreneurs. The majority of

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people does not believe in themselves and believe they are incapable of achieving their goals.

Theoretical Review

Keynesian Economic Theory

Keynesian economic theory asserts that small size businesses play a major role in the economic development of a country. According to the theory, the government can maintain economic stability by making effective financial disbursements to small businesses via micro financing banks. In order for the government to maintain a conductive economic environment for small scale firms, it must assure efficient resource allocation, market regulation, and policy stability on those economic issues that interact with small scale enterprise operations.

The theory assumes that:

i. Small businesses operate in an environment that is coordinated by the interaction of several environmental variables. As a result, small-scale operators should be informed about economic environmental elements that are external to them, but also assist them in becoming more proactive in their operations.

ii. Small businesses operate in a stable economic environment with fixed exchange rates, interest rates, and inflation rates, among other things.

Proportionate Growth Theory

The second theory relating to SMEs is the Gibrat's Law of Proportionate Effect, which was first proposed in 1931 and is a popular standard model of firm growth postulates that:

i. There is no relationship between firm size and growth rate, and enterprise growth rate is to some extent independent of firm size; each firm (large and small) is subject to some unforeseen shocks.

ii. The growth of firm (large and small) depends on their management of shocks. In comparison to large firms, SMEs, because they are tiny and flexible, can readily withstand any type of stress that tries to bring the business down.

Need for Achievement Theory

McClelland's 1965 Need for Achievement Theory is another theory. The desire for achievement theory is a motivational model that focuses on goal-directed behavior rather than numerous needs. Individual and community levels of accomplishment needs differ, which explains differences in economic growth, according to the hypothesis. As a result, raising the

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levels of achievement needs among indigenous populations is the most effective strategy to foster economic development in developing countries. Recent evidence suggests that there is a positive association between the need for achievement and entrepreneurial activities, based on this model. Entrepreneurship with a high demand for success will include more SMEs operations, which will generate wealth, which will then be used to alleviate poverty (Jex & Brith, 2014).

Empirical Literature

Onugu (2005) conducted research on Small and Medium Scale Enterprises (SMEs) in Nigeria: Problems and Prospects using a total of 300 SMEs were chosen at random from a population of 1,500 SMEs. The study found that SMEs in Nigeria have performed below expectations.

Asta and Zaneta (2010) investigated the growing importance of small and medium enterprises (SMEs) and their impact on Lithuania's economic development. They recommend that special attention be paid to processes, trends, and perspectives in SMEs, as well as the pursuit of effective SME performance improvement measures.

According to Aremu and Adeyemi (2011), the majority of SMEs, notably in Nigeria, die within the first five years of operation. It was also shown that between the sixth and tenth years, a lower number of young businesses go out of operation, with only approximately five to ten percent surviving, thriving, and maturing.

Akingunola (2011) examined the different funding choices available to SMEs in Nigeria, as well as their impact on economic growth. The association between SMEs finances and investment level was determined using the Spearman's Rho correlation. The Rho value of 0.643 suggested a substantial and positive association between SMEs financing and economic growth in Nigeria at a 10% level of significance.

Chidi and Shadare (2011) looked at the issues that small and medium-sized businesses (SMEs) in Nigeria face when it comes to human capital development. It was observed that human capital development in Nigerian SMEs is woefully inadequate.

The function of commercial banks in promoting the growth of small and medium-sized businesses in Nigeria was investigated by Safiyaay and Garba (2013). The study found that commercial banks contribute to the financing of small and medium-sized businesses, though their involvement has decreased significantly since the government ended mandated bank credit allocations through Central Bank of Nigeria orders.

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Using the ordinary least square, co-integration, and error correction model, Ilegbinosa, and Jumbo (2015) empirically studied Small and Medium Scale Enterprises and Nigeria's economic growth from 1970 to 2012. The finding shows that SMEs' access to capital had a favorable link with economic growth, whereas interest rates and inflation rates had a negative and positive impact on growth, respectively.

Using the multiple regression approach, Eze and Okpala (2015) conducted a quantitative examination of the impact of small and medium scale firms on the growth of the Nigerian economy for the sample period 1993 to 2011. According to the study, SMEs' output (SMEO) does not have a substantial impact on Nigeria's economic growth.

Evbuomwan *et al* (2016) analyzed the structure of MSMEs in Nigeria, as well as their business features, funding, operations, and restraints, in order to make recommendations on how to employ MSMEs as a strategy for economic development in Nigeria during the current global recession. The study found that MSMEs dominate Nigeria's economic landscape while the most frequently reported issue among MSMEs was a lack of funds.

Data

This study makes use of annual time series data over a 30-year span (1991-2020). The study relies on secondary data from the CBN's statistical bulletin, the National Bureau of Statistics (NBS), and the World Development Indicators (WDI) for the year 2021.

Theoretical Framework and Model Specification

Barro's (1990) endogenous growth model is the foundation of this study. Throughout the preceding decades, various academics have employed these models to investigate indicators that aid in economic growth. Furthermore, classic components such as capital, labor, and technology have witnessed a breakthrough in the growth literature as a result of this development. This study modified Cravo, Gourlay, and Becker's (2012) approach to focus on the importance of SMEs in Nigeria's economic development.

Therefore, the econometric model for this study is specified as:

$$GDP = \beta_0 + \beta_1 CBC + \beta_2 INT + \beta_3 lnINF + \mu_t \ldots\ldots\ldots (1)$$

Where GDP represents Gross Domestic Product (a proxy for measuring economic growth), CBC Commercial Credit to SME sector (a proxy for SMEs), INT represents interest rate while INF is Inflation rate. The betas ($\beta_{0\text{-}3}$) measure each factor's relative significance in explaining the underlying conduct of economic development. For the interpretation of these

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coefficients as elasticity, we convert the above equation through pleasing the natural logs. Therefore Eq. (1) transforms;

$$GDP = \beta_0 + \beta_1 lnCBC + \beta_2 lnINT + \beta_3 lnINF + \mu_t \ldots\ldots\ldots (2)$$

The selection of regressors is generally well-versed by the relevance of the feature to the Nigerian economy and the availability of data during the study period.

Results

Unit Root Test

The stationary test results of the incorporated times series variables in our regression model are presented in Table 1 using the Augmented Dickey-Fuller (ADF) unit-root test. The test results indicate that all the variables that is gross domestic product (GDP), Commercial Bank Credit to SME Sector (CBC), Interest Rate (INT) and Inflation Rate (INF) are not stationary at level but integrated at order one I(1). This indicates that the first-difference of those series is mean reverting and stationary see table 1.

Cointegration Test

A cointegration test was performed using the Johansen (1988) approach to find out the existence or inexistence of a long-run relationship among the variables employed for this study and the results are presented in Table 2.

The results in table 2 indicate three (3) cointegrating equations since the Trace Statistic (59.48193, 21.94385 and 5.390698) are greater that the Critical Values (29.79707, 15.49471 and 3.841466) at 5% significance level respectively. This indicates that there exist three cointegrating vector equations among the considered variables in the order, gross domestic product (GDP), Commercial Bank Credit to SME Sector (CBC), Interest Rate (INT) and Inflation Rate (INF). This implies long-run relationships between small and medium scale enterprises and economic growth in Nigeria during 1991-2020.

Granger Causality Test

Having established the long-run relationship among the variables, the objective of this section is to determine the direction of causality between the dependent variable and the independent variables. The Pair-wise Granger Causality test result is presented in Table 3.

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The granger causality test results in Table 3 indicate that at lag 2 and 5% significance level, the null hypotheses of CBC does not Granger cause GDP, INF does not Granger cause GDP and INT does not granger cause GDP. However, the null hypothesis of GDP does not Granger cause CBC was rejected at 10% significance level. This indicates a unidirectional relationship from gross domestic product to CBC. However, there is no causal relationship between inflation and gross domestic product; interest rate and gross domestic product. And, none of the economic growth indicators report a bi-causal relationship.

Fully Modified OLS

This study relies on the results of the existing pre-estimation tests to base its estimation on the fully modified OLS (FMOLS) method of estimation. The intuition behind this is that when the cointegration relationship between variables is found, the next step is to estimate the long-run parameters. However, classical OLS estimation in presence of cointegration leads to spurious parameters. As alternative methods, is the fully modified OLS (FMOLS) methods proposed by Phillips and Hansen (1990) which accounts for the serial correlation effects and the endogeneity in the independent variables that result perhaps from the existence of a cointegrating relationship. Hence, the FMOLS model provides cointegrating regressions estimates that are optimal and unbiased. Although the FMOLS technique also accounts fully for the disturbances in the short-run dynamics (Dimitrios, Helen and Mike, 2016), this study proceeds to test the speed of adjustment of the relationship back to a long run equilibrium position after a short run disturbance in the previous period see table 4.

The result presented in the table 4 reveals the contribution of small and medium scale enterprise on economic development in Nigeria between 1992 and 2020. From the result, commercial bank loans to SMEs has a significant relationship with economic development, this is in consonance with the *apriori* expectation. Though it has a negative relationship (-0.053653) which indicates that a 1 percent increase in SME performance will lead to 0.05 percent decrease in GDP this can be as a result of ineffective use of the load obtained from the bank for SME.

Also, interest rate has a negative and significant relationship with GDP which is in line with the *apriori* expectation. Hence, 1 percent increase in interest rate will lead to 0.02 percent decrease in GDP for the period of study. However inflation rate has a positive relationship

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with GDP which implies that a percentage increase in inflation will lead to 0.03 percent increase in GDP rate in Nigeria.

The Adjusted R squared of 0.790 indicates that small and medium scale enterprises can explain about 79 percent change in economic development in Nigeria between 1991 and 2020. Also, the result of the diagnostic test reveals that the model is normally distributed because the Jarque-Bera (2.394649) and its probability (0.302001) are not significant at 5 percent level see table 4 .

CONCLUSION

The study examined the contribution of SMEs to economic development in Nigeria within 1991-2020. The study adopted and modified Barro growth model employed for empirical analysis and incorporates commercial banks credit to SMEs, Inflation and Interest rate, while gross domestic product as the regressand.

The highlights of the findings are as follows:

i. The co-integration result indicated a long-run relationship between SMEs and economic development in Nigeria.
ii. A unidirectional relationship from gross domestic product to CBC. However, there is no causal relationship between inflation and gross domestic product; interest rate and gross domestic product. And, none of the economic growth indicators report a bi-causal relationship.
iii. The FMOLS reveals that commercial bank loans to SMEs has a significant relationship with economic development, Also, interest rate has a negative and significant relationship with GDP, while inflation rate has a positive relationship with GDP.

Thus, this study concludes that small and medium scale enterprise have significant effect on economic development in Nigeria.

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RECOMMENDATIONS

The following recommendations are made as a result of the findings:

i. Government should assist prospective entrepreneurs to have access to finance and necessary information and support their productive capacities. This would enable them to reduce their operating costs and be more efficient to meet the market competitions.

ii. SME owners should take insurance policies for their businesses as this may not only help to protect them against uncontrollable risks, but will help to bring them back to their positions whenever they suffer losses.

iii. Prospective business operators should conduct extensive feasibility studies, to evaluate the viability of any proposed business, and to avoid investing in unprofitable ventures.

iv. The lending and financial institution should not be too strict in their lending policies towards the small scale business owners.

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Table 1 Unit Root Test Result

Variables	Unit root in levels			Unit root in first difference			Order of Integration
	ADF statistics	Critical Value	P-value	ADF statistics	Critical Value	P-value	
logGDP	-0.5333	-3.6793	0.8705	-3.7386	-3.6891	0.0089	I(1)
CBC	-1.9383	-3.6793	0.3110	-7.0593	-3.6891	0.0000	I(1)
INT	-1.6438	-3.6793	0.4482	-6.8657	-3.6891	0.0000	I(1)
INF	-1.9515	-3.6793	0.3054	-5.2905	-3.7378	0.0003	I(1)

Source: Author's Computation 2022

Table 2: Cointegration Rank Test Results

Johansen Cointegration Test			
Variables: LOGGDP, CBC, INT, INF			
Lags interval (in first differences): 1 to 3			
Trend assumption: Linear deterministic trend			
Hypothesized No. of CE(s)	Trace Statistic	0.05 Critical Value	Prob.**
None *	111.1190	47.85613	0.0000
At most 1 *	59.48193	29.79707	0.0000
At most 2 *	21.94385	15.49471	0.0046
At most 3 *	5.390698	3.841466	0.0202

* indicates 3 cointegrating equations at 5% level and rejection of the hypothesis at 5% level.
**MacKinnon-Haug-Michelis (1999) p-values.
Source: Author's Computation (2022)

Table 3 Granger Causality Test Result

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Pairwise Granger Causality Tests

Sample: 1991 2020
Lags: 2

Null Hypothesis:	Obs	F-Statistic	Prob.
CBC does not Granger Cause GDP	28	2.41844	0.1114
GDP does not Granger Cause CBC		3.30301	0.0548
INF does not Granger Cause GDP	28	0.70288	0.5055
GDP does not Granger Cause INF		0.33477	0.7189
INT does not Granger Cause GDP	28	0.99922	0.3836
GDP does not Granger Cause INT		1.96461	0.1630
INF does not Granger Cause CBC	28	4.80239	0.0181
CBC does not Granger Cause INF		2.11928	0.1430
INT does not Granger Cause CBC	28	1.40141	0.2665
CBC does not Granger Cause INT		3.37853	0.0517
INT does not Granger Cause INF	28	1.89327	0.1733
		0.18723	0.8305

Table 4 Fully Modified OLS Result

Dependent Variable: GDP
Method: Fully Modified Least Squares (FMOLS)

Sample (adjusted): 1992 2020
Included observations: 29 after adjustments
Cointegrating equation deterministics: C
Long-run covariance estimate (Bartlett kernel, Newey-West fixed bandwidth = 4.0000)

Variable	Coefficient	Std. Error	t-Statistic	Prob.
CBC	-0.053653	0.011501	-4.664953	0.0001
INF	0.003566	0.004106	0.868407	0.3934
INT	-0.020107	0.008403	-2.392862	0.0245
C	11.24224	0.157311	71.46522	0.0000

R-squared	0.812722	Mean dependent var	10.56072
Adjusted R-squared	0.790249	S.D. dependent var	0.498788
S.E. of regression	0.228438	Sum squared resid	1.304596
Long-run variance	0.070857		

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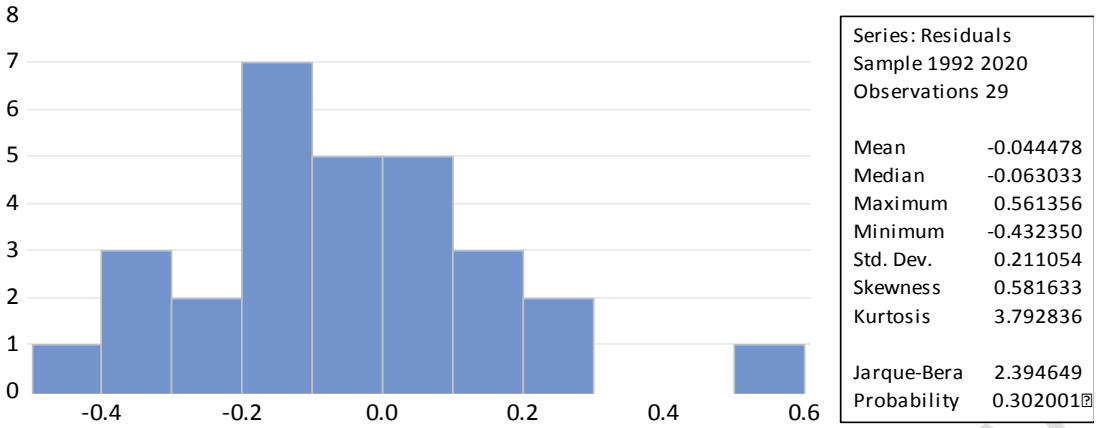

Fig 1: Statistical curve

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