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# Small and medium scale enterprise financing and sustainable economic development in Nigeria

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**Abstract**
This study examined the effect of small and medium scale enterprise financing on sustainable economic development in Nigeria. It utilized secondary data extracted from the Central Bank of Nigeria (CBN) statistical bulletins, National Bureau of Statistic (NBS) reports and publications.
The Human Development Index (HDI) was used as the dependent variable to measure economic development while the independent variables are contribution of SMEs to GDP and deposit money banks' lending to SMEs. The study made use of the Vector Autoregression Estimates in the analysis. The result showed that contribution of SMEs to GDP have positive effect on HDI while deposit money banks' lending to SMEs have negative effect on HDI. The cointegration test also showed a long-run relationship between variables tested. The study suggested among other recommendations that relevant federal government agencies should improve on funding of SMEs, this will enable them increase in productivity.

**Keywords:** medium, financing, economic development, enterprise

## 1. Introduction

In most developing countries, a large population of their human resources are engaged by the informal sector, the International Labour Organization (ILO, 2018) noted that more than 60 per cent of the World's employed population and 85.8% of Africa's population are in the informal economic sector which translates into 60% of the global labour force and 90% of all small- and medium-scale enterprises. The sector is the backbone of economic growth in that it not only contribute significantly to improve living standards, it also bring substantial local capital formation, driving innovative activities and competition in developed and developing economies.

Nigeria, even as a developing country is not left out because the contributions of the informal sector to the development of the country in the past years is evident in the area of employment generation, capital savings and mobilization, efficiency, strong linkages with other sectors, utilization of local technology training ground for entrepreneurs and self-reliance. The sector therefore contributes to the Gross Domestic Product (GDP) and employment and contributes significantly to economic development of Nigeria in general (Omisakin, 1999) [19].

The informal sector centres mostly around the small and medium scale enterprise. It important to note that the Small and Medium Enterprises (SMEs) are key engine to economic growth and development. (Sanusi, 2003) [26] pointed that they play a pivotal role through several pathways that go beyond job creation, they are growth-supporting sectors that not only contribute significantly to improve living standards, but also bring substantial local capital formation and are responsible for driving innovation and competition in developed and developing economies. Ofoegbu, Akanbi and Joseph (2013) [16] affirmed that SMEs are the solution to economic development of several developing countries, including Nigeria. SMEs comprise 97% of the entire economy (Oke and Aluko, 2015) [18], and aid as a base for creating innovation, employment, competition and economic vitality which in the long run results into poverty alleviation and national growth (Ojeka, 2011) [17].

The development of SMEs in Nigeria has not been hitch free. Under colonial rule, for instance, local industries were neglected, and in some cases actively discouraged in favour of import promotion and at independence, small scale manufacturing accounted for only about 15% of manufacturing output. Subsequent national Governments, especially during the early Post-Independence era, promoted import substitution policies aimed at encouraging local production/consumption of goods and services that otherwise would have been imported. Industrial output grew under this policy but this was ultimately to propel Government to the "commanding heights" of the economy. Even so, the '80s, ushered in the "golden era" for SMEs in Nigeria, especially in terms of facilitating their access to credit which led to the establishment of specialized banks.

Terungwa (2012) [27]; Aladekomo (2003) [2]; Ayeni-Agbaje and Osho (2015) [3] among others identified the establishment of financial institutions and initiation of several funding programmes to aid the development of SMEs in Nigeria, and initiation of specialized banks and other credit agencies/schemes to make funding available to the sub-sector. The Small and Medium Industries Equity Investment Scheme (SMIEIS) was established in 2001, to make financial and technical services available to SMEs. SMIEIS made it a prerequisite for all banks to set aside ten percent of their Profit after Tax (PAT) for equity investment and promotion of SMEs.

The established banks were to link up with the Small and Medium Scale Enterprises Development Agencies in Nigeria (SMEDAN) in implementing SMIEIS scheme (Ayeni-Agbaje and Osho, 2015) [3]. The establishment of SMEDAN, in 2003, was Government's major response to tackling the problems of SMEs in a coordinated fashion. With a mandate to promote the development of the SMEs sector of the Nigerian economy, SMEDAN assumed the twin roles of coordination and facilitation as the apex Agency for SMEs development in Nigeria.

Despite these efforts of government yet, the rate of mortality of Small and medium firms in Nigeria is still very high (Ojeka, 2011) [17]. (Ezeh & Onodugo, 2002) [5] also remarked, "In addition to policy somersault, funding remains a challenge to all stakeholders in SMEs, the several palliatives, including the Small and Medium Industries Equity Investment Scheme (SMIEIS) and other sector-specific incentives notwithstanding.

The debate over the effect of small and medium scale industries on developing economics remains a controversial issue. Several studies have assessed the effects of SMEs financing on Nigeria economic growth. Sakanko and Ewugi (2017) [25] found that although the informal sector is a source of income for a large number of people in Nigeria, it is difficult to determine its exact contribution to economic growth and development in the short run.

While some found a significant effect between SMEs and economic growth, others found an insignificant effect. Consequently, it is important to ascertain whether or not SMEs leads to higher economic growth. It is against this background that the study seeks to investigate the effect of small and medium scale enterprise financing on the Nigerian economy.

## 2. Literature Review

The relevance of small and medium enterprises (SMEs) to the Nigerian economy is no longer in doubt. They possess great potentials for employment generation, improvement of local technology, output diversification, development of indigenous entrepreneurship and to drive integration with large-scale industries.

Small and Medium Agency Development Agency of Nigeria (2015) provides a definition of what constitutes micro, small and medium enterprises. The World Bank and the European Union (EU) commission defined SMEs based on the number of employees, assets and annual sales or turnover. According to the EU, SMEs are made up of enterprises which employ fewer than 250 persons and which have an annual turnover not exceeding 50 million euro and an annual balance sheet total not exceeding 43 million euro (EU Commission, 2012). The World Bank also defined SMEs as enterprises with up to 300 employees and total annual sales of up to 15million US dollars.

A working definition by International Labour Organization (ILO) and United Nations Development Programme (UNDP) for SMEs and large enterprises indicates that: employing less than 5 employees including the owner is a micro enterprise; employing 5 to 20 employees is a small enterprise; employing 21 to 99 employees is a medium enterprise; and employing above 99 employees is a large enterprise (UNDP, 2001). The Central Bank of Nigeria (CBN) redefined small enterprises as enterprises as business with turnover of less than 100 million Naira per annum and/or less than 300 employees.

The following are the importance of SMEs in the economy: employment, labour intensity, job creation, efficiency, wages and benefits, social, political and equity justifications, likewise, SMEs are known worldwide to encounter some structural difficulties, problems or limitations, which if confronted can drive them to promote economic growth and development. Some of the principal problems SMEs face in Nigeria include the following: inadequate funding, 40% of SMEs in 128 countries are credit constrained, ( international Finance Corporation, IFC) inadequate infrastructural facilities, low capacity utilization, poor planning and management, poor education and experience, raw material management and choice of appropriate technology, inadequate conducive and enabling environment**.**

The Banker's Committee in Nigeria intervened on 19th June 2001, with a scheme titled the Small and Medium Industries Equity Investment Scheme (SMIEIS). In their view, this was a response to the former president of Nigeria (Olusegun Obansanjo) concern as well as policy measures for the encouragement of small and medium industries as a medium for speedy process of industrialization, sustainable economic growth and development, reduction of poverty and creation of employment. The scheme required all banks operating in Nigeria to save 10% of their profit before tax (PBT) for equity investment in SMEs.

The federal government introduced the Economic Recovery and Growth Plan (ERGP) between (2017- 2020) in recognition of micro, small and medium enterprises as the vehicle for driving national industrial output. The ERGP focuses on integrated, people-centred development planning. Attention is on raising the country's standard of living and prioritized development under four key pillars, viz: agriculture and food security, transport infrastructure (especially roads and rails) as well as energy sufficiency (especially power/petroleum products). Below are some of the programmes implemented to grow the SMEs sub-sector: Development Bank of Nigeria (DBN), CBN/Bankers Committed AGSMEIS, Establishment of a SMEs Rating

Agency, N-Power Scheme, Trader Moni Scheme, Ease of Doing Business/PEBEC, Anchor Borrowers Programme, Conditional Grant Scheme (CGS), One Local Government One Product Programme (OLOP),

The concept of economic growth is seen from different angles based majorly on the level of development experience in the country at that particular period in time. Economic growth brings about a better standard of living of the people and this is brought about by improvement in infrastructure, health, housing, education and improvement in agricultural productivity (Nwaeze, Njoku & Nwaeze, 2014) [13]. The standard of living is measured by the Human development index (HDI) reflecting life expectancy, literacy and command over the resources to enjoy a decent standard of living, (UNDP). HDI is a composite index used to rank countries by level of human development and classify countries as developed, developing and underdeveloped countries. The key components of HDI include data on life expectancy, education and per capita GDP. This composite accounts for income, education and health. A well-developed informal sector is an important complement to the development of human resource in a country therefore; improving educational levels including adult education provides new opportunities to people empowerment. (Etim & Daramola, 2017) [4]. SMEs assist in fostering rural infrastructure development, improvement of living standard of the rural dwellers, utilization of local resources, output expansion, transformation of indigenous technology, production of intermediary goods, and increase in revenue generation to government (Odubanjo 2000, Nnanna 2001 and onwumere 2000) [15, 22].

## Theoretical Review

### Modern Growth Theory

Modern theories emphasize the importance of small and medium-sized enterprises to economic growth and development. This is supported by the works of Berry and Mazumdar (1991) and Levy (1991) [9] in the newly industrializing countries in East Asia like Taiwan and South Korea, and the literature on flexible specialization thesis based on many experiences from SMEs in Western European countries. The modern theories emphasize the importance of subcontracting networks and the economic benefits of agglomeration and clustering for the development of SMEs. According to the modern theories, SMEs play important roles simultaneously:

1. To accelerate economic growth through the growth of their output contributions to gross domestic product (GDP).
2. To reduce poverty through employment creation and income generation effects of their generated output growth.

This is backed by empirical evidence which suggests that there is a positive relationship between growth of SMEs and economic development. The pro-SMEs do not support the classical theories. They argue that SMEs enhance competition and entrepreneurship and thus have economy wide benefits in efficiency, innovation and productivity growth. They also argue that given the necessary support from government and other support agencies, full potential of SMEs can be realized to serve as engines of economic growth and development. In view of this, many international aid agencies, including the World Bank, since the1980s have been giving direct or indirect supports to SMEs to accelerate economic growth and reduce poverty. The World Bank, which supports the modern theories gives three core arguments in support of SMEs in least developed countries (World Bank 2002, 2004). Their first point is that, SMEs enhance competition and entrepreneurship and hence have external benefits on economy-wide efficiency, innovation and aggregate productivity growth. Secondly, SMEs are generally more productive than large enterprises but financial market and other institutional failures and non-conducive macroeconomic environment impede their development. Thirdly, SMEs expansion boosts employment more than large enterprise growth because they are more labour intensive. The World Bank‟s pro-SME policies to developing countries are evident through numerous support programmes they have undertaken.

## Empirical Review

Omonigho (2017) [20] did a study on the effect of SMEs on economic growth in Nigeria, within the same period. Data were analyzed using Pearson Product-Moment Correlation Coefficient (PPMCC). The study disclosed that there is a significant and positive relationship between SME's contribution to Nigeria's Gross Domestic Product (GDP) and Nigeria's GDP from 1982 to 2012.

Saidi, Sodiq and Olushola (2016) [24] examined entrepreneurship and economic growth in Nigeria. The objective of the study is to assess specific financing options available to SMEs in Nigeria and their contribution to economic growth. Asymmetric auto-regressive distributed lag (AARDL) was employed and the results suggests an insignificant direct relationship between positive and negative component of finance for SMEs and Real Gross Domestic Products.

Imoisi and Ephraim (2019) [10] examined the impact of SMEs on economic growth in Nigeria from 1970-2012. In order to achieve this objective, the study polled 84 SMEs for primary data collection as well as statistical records for years 1975-2012 as secondary data. The ordinary least square, co-integration and error correction model was used to estimate the data collected during the period of this study. The variables used include Gross Domestic Product as the dependent variable and Finance Available to Small and Medium Enterprises, Interest rate and Inflation rate as the independent variables. Our result showed that Finance Available to SMEs showed a positive relationship with economic growth while Interest rate and Inflation rate showed a negative and positive influence on economic growth respectively. Thus, we concluded that the independent variables play an important role in determining the impact of Small and Medium Scale Enterprises on economic growth in Nigeria.

Onakoya, Fasanya and Abdulrahman (2013) [21] analyzed the impact of financing small-scale enterprises on economic growth in Nigeria, using a quarterly time series data from 1992 to 2009. The study combined several econometric estimation techniques. The findings shows that loan to small-scale entrepreneurs have a positive impact on the economic performance while interest rate has a negative impact on economic growth. The study thereby concludes that managerial capacity is the worst difficulty facing Small and Mediun Enterprises in Nigeria. Access to capital or finance is necessary but not a sufficient condition for successful entrepreneurial development.

Akingunola, Olowofela and Yunusa (2018) investigated the impact of microfinance on Micro and Small Enterprise (MSE) in Ogun State, Nigeria. There were two research problems. First, it was whether microfinance bank (financial intermediation services) assists MSEs in Ogun State, Nigeria. Second, it was whether microfinance banks assist MSEs in improving the volume of trade they engaged in Ogun State, Nigeria. The purposive and stratified sampling method was used. The survey obtained 408 respondents in MSEs in Ogun State. The research problems were tested with simple regression analysis. Findings from the first problem show that there is a negative relationship between intermediary financial services (credit disbursement) and MSEs. The second finding also shows there is a positive relationship between microcredit and business expansion. The research concludes that businesses that access microcredit have grown averagely regarding business expansion.

Abiola (2012) investigated the effects of microfinance on micro and small business growth in Nigeria. The objectives are: one, to examine the effects of different loan administration practices (in terms of loan size and tenor) on small business growth criteria. Second, to examine the ability of Microfinance-Banks (MFBs) (given its loan-size and rates of interest charged) towards transforming micro-businesses to formal small scale enterprises. The paper employed panel data and multiple regression analysis to analyze a survey of 502 randomly selected enterprises finance by microfinance banks in Nigeria. We find strong evidence that access to microfinance does not enhance growth of micro and small enterprises in Nigeria. However, other firm level characteristics such as business size and business location, are found to have positive effect on enterprise growth.

Relating the empirical review to the topic of study, it is important to note that the human development index gives a more robust measure for economic development in terms of assessing the standard of living for sustainable economic development rather than Gross Domestic Product used by most literatures. This study therefore, made use of the HDI as a measure for economic development to ascertain how financing of SMEs in Nigeria has improved standard of living of individuals.

## 3. Methodology

This study will adopt a hypothetical deductive research design to ascertain the effect of small and medium scale enterprise financing on the growth of Nigerian economy over a period of nineteen (19) years from 2000 to 2019. It utilized secondary data extracted from the Central Bank of Nigeria (CBN) statistical bulletins, National Bureau of Statistic (NBS) reports and publications.

There will be one response/dependent variables which is the Human Development Index (HDI). The independent variables: contribution of SMEs to GDP and deposit money banks' lending to SMEs.

This study will adopt and modify the model of Otugo, Edoko and Ezeanolue (2018) [23] as developed by Nwoga (2007) for a study in Nigeria. The original model of Otugo, Edoko and Ezeanolue (2018) [23] is stated as:

$$GDP = f(SME, GEX, EMG, COR, CBC, LER) \qquad 3.1$$

Where; GDP = Gross domestic product growth rate

SME = Small and medium enterprise captured by SMEs growth rate

GEX = Government expenditure to small and medium enterprise

EMG = Employment generation growth rate

COR = Corruption

CBC = Commercial bank credits to small and medium enterprise

LER = Lending rate to small and medium enterprise

To incorporate the specific objectives, the following models stated in functional form will be estimated:

$$HDI = f(CSMEs, DLSMEs) \qquad 3.2$$

The mathematical form of the model is:

$$HDI = a_0 + a_1CSMEs_{it} + a_2DLSMEs_{it} \qquad 3.3$$

Where: HDI = Human Development Index

CSMEs= Contribution of SMEs to GDP

DLSMEs= Deposit money banks' lending to SMEs

$a_0$ = Intercept of the model

$a_1 – a_2$ = Parameters of the regression coefficients

$e_{it}$ = Stochastic error term

The models will be estimated using the Vector Auto-regression (VAR) Model technique of data analysis and granger causality

## 4. Data Analysis and Interpretation

In this section we presented the analysis and interpretation of the result of econometrics analysis adopted in this work. The first step in this analysis is to describe the variables used in the study before we proceed to carry out stationarity test. Stationarity test was conducted using ADF test and PP test. The result of the ADF and PP test is shown in table 2 and 3.

The characteristics of the data series used in the analysis are presented in table 1.The table shows the summary of descriptive statistics used in the analysis. The mean value was shown to be 0.487500 for HDI, 10158.49 for CSMES and 33990.25 for DLSMES. The median value was shown to be 0.490000 for HDI, 8444.868 for CSMES and DLSMES for 16217.89. The maximum and minimum of the series are 0.540000 and 0.400000 for HDI, 22509.26 and 1020.392 for CSMES, 90176.50 and 10098.28 for DLSMES. The series standard deviations are 0.041406 for HDI, 7621.663 for CSMES and 27540.09 for DLSMES.

**Table 1:** Descriptive Statistics

| | Mean | Median | Maximum | Minimum | Std.Dev | Obs |
|---|---|---|---|---|---|---|
| HDI | 0.487500 | 0.490000 | 0.540000 | 0.400000 | 0.041406 | 20 |
| CSMES | 10158.49 | 8444.868 | 22509.26 | 1020.392 | 7621.663 | 20 |
| DLSMES | 33990.25 | 16217.89 | 90176.50 | 10098.28 | 27540.09 | 20 |

***Source*:** Output Data from E-views 9.0

Unit root test conducted shows that the variables were not stationary at order one and first difference but were stationary at second difference.

**Table 2:** ADF Result at Second Difference

| Variables | ADF Test Statistic | 1% | 5% | 10% | Order of Integration |
|---|---|---|---|---|---|
| HDI | -4.764359 | -3.886751 | -3.052169 | -2.666593 | Stationary |
| CSMES | -4.691342 | -3.886751 | -3.052169 | -2.666593 | Stationary |
| DLSMES | -5.718943 | -3.886751 | -3.052169 | -2.666593 | Stationary |

***Source***: Researcher's E-view result

From the result of ADF test shown in Table 2 it indicates that all the variables was stationary at 2nd difference. This shows that the variables used in the study are integrated in order 1(2). In other to confirm the stationarity of the variables the study also adopted Phillips-Perron (PP) unit root test at intercept.

**Table 3:** PP Result at Second Difference

| Variables | PP Test Statistic | 1% | 5% | 10% | Order of Integration |
|---|---|---|---|---|---|
| HDI | -8.959997 | -3.886751 | -3.052169 | -2.666593 | Stationary |
| CSMES | -4.691342 | -3.886751 | --3.052169 | -2.666593 | Stationary |
| DLSMES | -5.718943 | -3.886751 | -3.052169 | -2.666593 | Stationary |

***Source***: Researcher's E-view result

Phillips-Perron (PP) unit root test in table 5 proves that non of the variables were stationary at level, only HDI was stationary at 1st difference but all of them were stationary at 2nd diff hence the application of Vector Auto regression Estimates in the analysis of the variables.

### 4.1. Co-integration Test

The co-integration test is used in the determination of the long-run relationship that exists between variables. Table 4 shows that long-run relationship (co-integration) exists among the variables. There is one cointegrating equation in the model and is reflected in the trace statistic of Table 8 which shows a value greater than that of the 5% critical value. With the existence of long run relationship, there is need to analyze normalized long run coefficients based on Johansen test. The result of the normalized coefficients shown in Table 5 shows a long-run effect between SMES and human development in Nigeria.

Note: Standard errors in () and t- statistic in [].** implies significant at 1% level of significant. In long run contribution of SMEs to GDP has a positive effect on human development index while deposit money banks' lending to SMEs has a negative effect on human development. The coefficients of CSMES and DLSMES are statistically significant at the 1% level.

## 5. Conclusion

The null hypothesis of no cointegration is rejected against the alternative of cointegrating relationship in the model. The non-stationary of data series and the cointegration of the vector variable in the equations lead to the execution of the second phase of Vector Autoregression Estimates (VAR).

**Table 4:** Presentation of Johansen co-integration result

| Hypothesized No. of CE(s) | Eigenvalue | Trace Statistic | 0.05 Critical Value | Prob.** |
|---|---|---|---|---|
| None * | 0.750952 | 34.31842 | 29.79707 | 0.0141 |
| At most 1 * | 0.394795 | 9.296460 | 15.49471 | 0.3387 |
| At most 2 * | 0.014181 | 0.257083 | 3.841466 | 0.6121 |
| Trace test indicates 1 cointegrating eqn(s) at the 0.05 level | | | | |
| * denotes rejection of the hypothesis at the 0.05 level | | | | |
| **MacKinnon-Haug-Michelis (1999) p-values | | | | |

**Table 5:** Normalized long-run coefficient based on Johansen test

| Dependent Variable HDI | | |
|---|---|---|
| HDI | CSMES | DLSMES |
| 1.000000 | -2.53E-06 | 8.31E-07 |
| | (3.0E-07) | (9.2E-08) |
| | [-8.433] | [9.032] |

***Source***: Output Data from E-views 9.0

**Table 6:** Results of Vector Autoregressive Estimates Normalised on HDI

| Parameters | Coefficient | Standard Error | t-statistic |
|---|---|---|---|
| HDI(-1) | -0.050373 | 0.22894 | -0.22002 |
| CSMES (-1) | 4.72E-06 | 3.8E-06 | 1.25132 |
| DLSMES (-1) | -9.49E-07 | 1.8E-07 | -5.36901 |
| C | 0.701588 | 0.13592 | 5.16185 |

***Source***: Output Data from E-views 9.0

Adjusted R-squared = 0.95 F-Statistic = 66.06249

### 5.1 Short Run Relationship

The result from Table 6 shows that constant (C) and CSMES have insignificant positive effect on HDI while HDI and DLSMES have insignificant negative effect on HDI. A one percent change in one year lag of CSMES will results to a positive change in HDI by 4.72E-06 percent. On the other hand, a one percent change in one year lag of HDI and DLSMES will results to negative change in HDI by -0.050373 percent and-9.49E-07 respectively. On the performance of the individual variables, the results revealed that only one year lag of DLSMES are statistically significant given the high values of their t-statistics.

The adjusted R-squared value of 0.95% indicates that, about 95% of the variations in HDI is explained by the combined effect of the independent variables. It also implies that the model has good fit in explaining the relationship. Similarly, the F-statistic which measures the overall significance of the model showed a high value of 66.06249 which indicates that the effects of SMES on human development index is statistically significant in Nigeria.

## 6. Conclusion and Recommendation

From the result of the analysis, there is no doubt that SMEs are essential for rapid and sustained economic growth and development because of their contribution to GDP, nevertheless, the several challenges specially in terms of funding faced by these SMEs have hindered their productivity.

Based on this, the following recommendations were made:

Relevant federal government agencies to improve on funding of SMEs, this will enable them increase in productivity.

Practical and productive public–private partnerships. This will help fill the infrastructural gap which has been a major hindrance to the growth of SMEs in Nigeria. Since the Federal Government has been unable to address the country's infrastructural need, it is necessary to shift towards PPP as it will enhance performance of SMEs in Nigeria. There is also need to improve on the regulatory framework which has made it difficult for private investors to be attracted to the scheme

Assessing the credit worthiness of SMEs through credit risk database to avoid accumulation of non- performing loans.

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