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Determinants of the Development of Small and Medium Scale Enterprises in Nigeria

Okuneye, Babatunde A. Ph.D[1] Ogunmuyiwa, Michael .S Ph.D[2*]
Department of Economics, Olabisi Onabanjo University, Ago - Iwoye, Ogun State, Nigeria
2*.P.O Box 285,Ota, Ogun State, Nigeria, Post Code: 112101

Abstract
The pivotal roles played by Small and medium scale enterprises (SMEs) in transforming the economies of the developed countries had long been established in the literature. It is disheartening however to observe that the contributions of SMEs to GDP in Nigeria in the last three decades has been quite insignificant and haphazard. Therefore, this paper examines the various factors that determine the growth of small and medium scale enterprises (SMEs) in Nigeria during 1980-2013. The study utilizes the Ordinary Least Square method within the framework of the multiple regression model. The results emanating from the analysis suggest that credit facilities, interest rate as well as inflation rate are key determinants of the growth and survival of SMEs in Nigeria. Thus, the government, through the Central Bank of Nigeria (CBN), should relax the restrictive regulations and operations which discourage borrowings as well as promote intervention programmes through which adequate funds will be easily accessible to prospective investors.
Keywords: Economic growth, Inflation rate, Interest rate, Small and Medium Scale Enterprises
JEL Classification: *O40, E31, E40, L60.*

1.0 Introduction

The fundamental roles played by the small and medium scale enterprises in the process of industrialization and economic growth particularly in terms of significantly contributing to employment generation, income generation and catalyzing development in urban and rural areas cannot be overemphasized (Olutula, 2001; Hallberg, 2000; Olutunla, 2001; Williams, 2006). For instance, in many of the newly industrialized nations, more than 98% of all the Industrial enterprises belongs to the SMEs sub-sector and account for the bulk of the labour force (Sanusi, 2003). It is estimated that SMEs employ 22% of the adult population in developing countries (Kayanula and Quartey, 2000), and provide more employment per unit of capital investment than large-scale enterprises (Inang and Ukpong, 1992).

In Nigeria, SMEs account for about 70% of industrial employment (Adebusuyi, 1997) and well over 50% of the Gross Domestic Product (Odeyemi, 2003). Essentially, SMEs in every country play a key role in the growth and development process, although the extent to which these roles are performed effectively and efficiently largely depends on the degree of development of the financial system and the traditional commercial banks in the country which are responsible for pooling financial resources for the credit needs of SMEs. Yet, substantial gap exists between the supply and demand for loanable funds by SMEs in Nigeria (Anyanwu, 2005). Specifically, in Nigeria, there is a huge supply of both equity and loanable funds in the commercial banking sector which the SMEs did not benefit from. For example, as at the end of the first quarter of 2007, out of 38.2 billion set aside by the banks, only 18. 1 billion or 47.3% were assessed by the SMEs (Central Bank of Nigeria, 2007). Similarly, the yearly Financial Guidelines of the CBN stipulate that banks must commit a minimum proportion of their loan portfolio to the SMEs. However, since the 1970s this requirement was never met. It should be noted that, SMEs operating in developing economies are very vulnerable due to the problems of finance, high costs of doing business and labour market barriers. Also, unfavorable macroeconomic environment has been identified as the major constraint which most often than not discourage financial institutions to fund small and medium enterprises.

Since the attainment of independence in Nigeria, successive governments recognized the relevance of promoting small and medium enterprises as a unique basis for growth. As a result, several micro lending institutions were established to enhance the development of small and medium enterprises. Unfortunately, records indicate that the performance of SMEs in Nigeria has not justified this plethora of credit institutions. Odedokun (2005) notes that in spite of the quantum of credit made available to the sector; the contribution of the small and medium enterprises to GDP was only l3 percent between 1999 and 2004. Therefore, in order to fully develop the growth potentials of SMEs in Nigeria, it is imperative to understand the various factors inhibiting the performance of SMEs in Nigeria. Thus, the main thrust of this paper is to investigate the determinants of the growth and development of small and medium enterprises in Nigeria. The rest of this paper is organized as follows: section 2 provides a review of the existing literature on the small and medium scale enterprises. Section 3 undertakes a performance analysis of the contribution of SMEs to economic growth in Nigeria while section 4 presents and discusses the results of the analysis. Section 5 concludes the paper.

2.0 Review of Past Works

2.1 Conceptual and Definitional Clarifications

A concensus and universally accepted definitions of small scale enterprises have not been well documented in the literature. Perhaps, this could be due to the fact that the classification of businesses requires a subjective and quantitative judgment Ekpenyong, 1992). Small scale enterprises as other concept in the field of economics and management has been relatively dynamic which largely depends on the unique roles the SMEs are expected to play in the growth and development process of their respective economies. These conceptual definitions also change overtime due to variations in some macroeconomics fundamentals such as price level as well as technological advancement. Some of the criteria often adopted in defining small scale include: the staff strength, the size of the business concern, capital requirement, and ownership structure (Oshaghemi, 1999).

In defining small and medium enterprises to suite a particular circumstance, individuals, institutions and governments have adopted several conceptual framework. Prior to 1992 in Nigeria, both the federal government and its agencies had adopted varying definitions at the one time or the other occasioned by the modification in their development strategy. Small and Medium Enterprises Development Agency of Nigeria (SMEDAN) defines these enterprises as those whose total investment was between 100,000 naira and 2 million naira excluding land but including working capital. Similarly, the decree establishing the National Economic and Reconstruction Fund (NERFUND) in 1989 defined SMEs as those whose fixed assets excluding land but including cost of project do not exceed N10 million. However, in 1992, when the National Council on Industry unified these definitions, small scale enterprises (SSEs) are characterized as those business with fixed assets amounting to N1 million but not exceeding N10 million. In 1996, these definition was revised to reflect those enterprises with total cost of above N1 million but not exceeding N40 million naira inclusive of working capital but excluding cost of land. Apart from these definitions, SMEs are by nature identified by some or all of the following yardsticks:

- Separation of ownership from the management thus making policy decisions based on the management structure.
- Existence of formal relationship between employer and employees.
- Adoption of labour-intensive technique of production or fabricated technology.
- Limited access to financial capital which is a major factor that constraints expansion.
- Greater reliance on local resources hence their output have low import content either in capital or raw material inputs.
- They are widely dispersed in major sectors of the economy particularly in manufacturing transportation, communication etc.

2.2 Theoretical Issues

Giving the fact that sourcing for small scale enterprises is a very difficult task and they are incapacitated to set up such business due to lack of fund which invariably hinder the level of their profit. Then, there is need to theoretically examine the determinants of profitability of these SMEs since it has become one of the tools for employment generation and the upliftment of the welfare of the citizens in the face of the downward trend in the global economy and the high rate of unemployment in the less developed countries. Finance, has therefore been identified as a fundamental impediments for the economic survival of SMEs (Da Silva, 2007). Other relevant studies on the relationship as well as the impact of bank finance on the growth of small and medium scale industries include Casson (1982),Steel and Takgil (1983), Kilby (1988), Owualah (1987) and Njoku (2002). Others include Adelaja (2005), Olarenwaju (2001), Udoh (2005), Ubom (2005), Muhota (2005) and UNDP (2007). Finance, whether owned or borrowed, are needed for expansion and profit maximization.

The pecking order theory opines that firms need to prioritize their sources of financing from internal (cash flow or entrepreneur's own capital) to external funding. For most firms, the internal funds are insufficient to undertake the required level of transactions for profitable ventures. Hence, the need for external finance to fill the gap. When the funds that are borrowed by the firms are efficiently utilized, additional assets are created which can in turn be used as security for further borrowing. Thus, accessibility to finance is expected to positively influence the availability of productive resources such as land, labour, capital, equipment and machinery, subject to the constraints of asymmetric information and high cost of loanable funds. For instance, interest rate, being cost of obtaining credit is inversely related to the profitability of the firm since rising interest will force the producers to incur higher costs on production. *Ceteris paribus*, increased quality and quantity of factors of production available to a firm will generate more production; through effective and efficient marketing strategies, firm's performance will be enhanced. In addition, availability of finance equally stimulates bulk purchases of productive resources, which decreases unit cost of production as a result of economies of scale. The reduction in the unit cost of production is also expected to generate an increase in profit. Thus, the improved firm's performance facilitates higher profits, higher growth in sales and employment, wealth maximization as well as increase in societal welfare.

2.3 Performance Analysis of the Contributions of SMEs to Economic Growth in Nigeria

The contribution of Small and Medium Scale Enterprises to economic growth in Nigeria as presented in appendix 1 could be characterized to be policy-driven when juxtaposed with the development of the financial system. The share of SMEs to GDP fell from about N20, 174.7m in 1980 to N1,835m in 1985 ostensibly due to the unprecedented increase in the interest rate from an average of 6% in 1980 to 10% in 1985. However, with the deregulation of the Nigerian economy occasioned by the introduction of the structural adjustment programme (SAP) in July 1986, interest rate in Nigeria became market-driven. This led to the upsurge in the share of the SMEs in GDP from N5,573m in 1987 to N205,553.20m in 1999. It should also be noted that during the same period the commercial Banks' loans to SMEs consistently increased from N22, 018.70m in 1987 to about N947,690m in 1999. For the period under review, the interest rate in Nigeria peaked at 26% in 1993 and this was apparently due to the political crisis that bedeviled the country at that time.

The banking sector reform that was introduced by the CBN in 2001, which was centered on the recapitalization of the financial institutions in Nigeria further increased the contribution of the SMEs to GDP from N175,735.80m in 2001 to N685,696.10m in 2010 and subsequently fell to N606,060.33m in 2013. In addition, the lending rate decline from 19% in 2002 to about 9% in 2008 and subsequently became stable around 10% between 2009 and 2013 apparently due to the strict monetary policy of the regulatory authority. The commercial banks' loans available to the SMEs equally increased from N1,018,155.80m in 2002 to about N5,456,635.15m in 2010 after which it declined to N4,609,922.65m in 2013. It is quite evident from above analysis that, in absolute terms, SMEs have not contributed significantly to economic growth in Nigeria due to its sluggish and haphazard nature.

3.0 Methodology and Empirical Results

3.1 Model Specification

Following the work of Adebusuyi (1997), the determinants of the growth of SMEs can be specified and modeled in this form:

SME/GDP = f (SMLO, INTL, INF, EXR) ………………………...... (i)

SME/GDP = $\alpha_0 + \alpha_1$SMLO + α_2INTL + α_3INF+ α_4EXR + u_i …….. (ii)

Where: SME/GDP = Share of Small and medium Scale Enterprises in GDP
SMLO = Small and Medium Scale Loans from Commercial banks
INTL = Interest rate on Lending
INF = Inflation Rate
EXR = Exchange Rate
α_0 = Constant term of the Estimate
α_1 - α_4 = Slope of the variable / regression coefficient
u_i = Stochastic Variable

In a-priori terms, it is expected that $\alpha_1 > 0$; $\alpha_2 < 0$; $\alpha_3 > 0$; $\alpha_4 < 0$;

3.2 Presentation and Discussion of Empirical Results

The results of the empirical analysis as presented in the Table 1 shows that loans from the commercial banks, interest and inflation rates are significant determinants of the growth of small and medium scale enterprises in Nigeria. In specific terms, a unit increase in the commercial banks' loans will generate a 42% increase in the output of SMEs as a share of the gross domestic product. Similarly, in line with the theoretical postulates, interest rate in Nigeria has a negative but significant relationship with the SME share of GDP even at 1% level of significance. Inflation rate is significantly repressive to the contribution of SME to economic growth. This is quite a reflection of the high level of underdevelopment of SMEs in Nigeria coupled with the fact that a sizable number of them operates within the service sector of the economy.

Table 1: The Determinants of the Growth of SMEs in Nigeria

Variable	Coefficient	Std. Error	t-Statistic	Prob.
SMLO	42.36542	96865.36	4.255699	0.0003*
INTL	-6.354242	5963.212	-7.127926	0.0189**
INF	-96.25463	1526.624	-2.093049	0.0102**
EXR	0.231565	69.35545	1.039284	0.2952
C	5643.636	6961.325	0.049834	0.0000*

* significant @ 1% ; ** significant @ 5%

R-Squared	0.935500	Durbin-Watson	2.016325
F-Statistic	15.25264	Adjusted R-Squared	0.916232
Prob (F-statistic)	0.000000		

Also, both the R^2 and the adjusted R^2 suggest that the explanatory variables account for over 90% of variation in share of small scale enterprises in gross domestic product in Nigeria. The F-statistics which measure the overall significance of the regression model indicates that the model has a good fit. The Durbin-Watson statistics of 2.01 indicates that the problem of serial autocorrelation within the estimated model is less severe.

In summary, the major objective of this study is to validate the determinants of the growth of SMEs in Nigeria. The paper explores the classical ordinary least square (OLS) multiple regression model. The empirical result shows that the growth and economic survival of SMEs in Nigeria is largely determined by commercial banks' loan, interest rate and inflation rate as confirmed by the value of adjusted R^2, f-statistics as well as other estimated parameters. By implication, the entire explanatory variables are statistically sufficient in explaining the determinants of the growth of SMEs in Nigeria.

4.0 Concluding Remarks

Emanating from the results of the study, there is interdependence between the growth of SMEs and bank loans, interest and inflation rates particularly as it relates to its effects on the reduction of unemployment and poverty in Nigeria. It also touches on some of the problems that are hindering the sustainability of small business enterprises in Nigeria. Therefore, judging from the empirical findings, the paper recommends as follows:

a) Government should re-enforce the mandatory minimum credit allocation by banks to SMEs in the Annual Monetary Policy Circular and Guidelines.
b) Policies that will compel commercial banks to relax their restrictive regulations and operations which discourage borrowing and offer more credit facilities for SMEs should be formulated.
c) That most business owners must be advised and encouraged to apply for credits. Banks should be willing to listen to these owners and to grant their request if they meet the required criteria.
d) A blend of monetary and fiscal policy interventions is advocated in order to salvage the retrogressive trend of SMEs development in Nigeria.

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APPENDIX

Appendix 1: Data on the Share of SMEs Output in GDP, Commercial Banks' Loans to SMEs, Interest rates and Inflation rates

Years	*Share of SMEs in GDP (SME/GDP) N'm*	*Commercial Banks' Loans to SMEs N'm*	*Interest Rate (Lending) (%)*	*Inflation Rate (%)*	*Exchange Rate (Weighted)*
1980	20,174.7	14,968.50	6.00	1.75	0.5464
1981	15,802.6	11,413.70	6.00	1.65	0.8132
1982	14,424.7	11,923.20	8.00	9.41	0.6729
1983	13,596.8	9,636.50	8.00	4.61	0.7241
1984	14,470.8	9,927.60	10.00	13.53	0.7649
1985	1,835.00	13,041.10	10.00	33.93	0.8936
1986	5,417.00	16,223.70	10.00	21.10	2.0206
1987	5,573.00	22,018.70	12.75	21.48	4.0179
1988	7,323.00	27,749.50	12.75	13.30	4.5367
1989	10,661.10	41,028.30	18.50	11.65	7.3916
1990	12,383.70	60.268.30	18.50	10.00	8.0378
1991	18,414.10	66,584.40	14.50	21.42	9.9095
1992	30,626.80	92,797.40	17.50	7.16	17.298
1993	35,423.90	233,806.50	26.00	23.22	22.051
1994	58,640.30	160,893.20	13.50	40.71	21.886
1995	80,948.10	248.768.10	13.50	4.67	21.886
1996	85,021.90	337,217.60	13.50	5.39	21.886
1997	114,476.30	42,821,520	13.50	10.18	21.886
1998	172,105.70	487,113.40	14.31	56.04	21.886
1999	205,553.20	947,690.00	18.00	50.47	92.693
2000	192,984.40	701,059.40	13.50	7.50	102.11
2001	175,735.80	1,018,025.60	14.31	12.70	111.94
2002	266,889.50	1,018,155.80	19.00	44.81	120.97
2003	371,897.90	122,596,590	15.75	57.17	129.36
2004	438,114.90	1,426.201.30	15.00	57.03	133.5
2005	371,897.90	1,822,100.00	13.00	72.81	132.15
2006	438,114.90	1,938.002.50	12.25	29.29	128.65
2007	429,230.00	2,450,896.70	13.00	10.67	125.83
2008	456,970.00	3,240,818.50	9.75	10.40	118.57
2009	509,231.20	3,456,925.40	10.25	11.20	121.37
2010	685,696.10	5,456,635.15	10.40	11.75	128.46
2011	550,632.33	4,051,459.50	10.13	11.12	122.80
2012	581,853.00	4,321,673.30	10.26	11.36	124.21
2013	606,060.33	4,609,922.65	10.26	11.41	125.15

Source: Central Bank of Nigeria Statistical Bulletin, 2014.