

IMPACT OF SMALL AND MEDIUM SCALE ENTERPRISES IN NIGERIA ECONOMY

Ujunwa Marycynthia Ejiaso*

Abstract

This study endeavors to find out the potential role of SMEs output in GDP growth for Nigeria considering some macroeconomic variables. While using data from 1991 to 2022, ARDL bound testing approach has been used to incorporate the dynamic perspective in the study. In model estimation, the GDP growth rate has been taken as a dependent variable, whereas, output of small scale industry, inflation rate, interest rate, credit availability to small scale industry have been included as independent variables. The estimation findings of the model confirmed the positive and significant association between output of SMEs and GDP growth in Nigeria. However; the sector still requires a policy design to overcome the challenges of the sector. These policies require a strategy that can cater more growth of the economy through progress of SMEs. It is recommended that there is need for supporting and strengthening the SMEs sector by provision of credit at low interest rate and the government should a conducive environment for these SMEs to thrive.

Keywords: Small and medium scale enterprises, nigeria, ardl bound testing approach, macroeconomic variables, GDP.

1.0 Introduction

It is no longer a surprise that role of SMEs activities has helped in promoting economic growth and development through various channels such as job creation, poverty reduction, income redistribution. Recently, there has been a spur of interest by researchers and policy makers to find the nexus between Small and Medium Scale Enterprise (SMEs) and economic performance of countries. In emerging economies, Small and Medium Enterprises (SMEs) sector is playing an imperative role in establishing industrial base which supports small business activities which further accelerate economic growth (Myslimi & Kaçani, 2016). SMEs have proved a major source of innovation and inventions through generating new ideas, investment and trade (Abor & Quartey, 2010).

For both developing and developed countries, small and medium scale firms play pertinent roles in the process of industrialization and economic growth. These firms typically account for more than 90% of all firms outside the white-collar jobs sector, constituting a major source of employment and generates significant domestic and export earnings. OECD, (2005) stressed that SME development emerges as a key instrument in poverty reduction efforts, therefore, SME obviously contributes to economic, social development and poverty reduction. Globally, SMEs are chief drivers of employment and economic growth. In the U.S.A, SMEs formed over 50 per cent of the non-farm private GDP as well as generated 75 per cent new jobs in the economy. By the end of 2008, it was estimated that the US economy has an estimated population of 300 million, which was sustained by about 6 million businesses; 27% employ less than 20 persons, 22% employ less than 50 persons while about 18% employ less than 100 persons (World Bank, 2001).

Boniface, (2006) posited that SMEs have been mainly recognized as the spine of the economy as well as play an important role to create employment opportunities, improve value of human resources, develop a philosophy of entrepreneurship, supports large scale industries as well as set-up new business opportunities. It has been estimated that SMEs are contributing more than 90 percent of industrial output and employing over 60 percent of labor force in many Asian countries (Veskaisri, Chan, & Pollard, 2007). Many researchers have proved significant role of SMEs ensuing to economic growth and provision of substances for the socio-economic development of the economy (Afolabi, 2013; Hu, 2010; Leegwater & Shaw, 2008). It is of no doubt that SMEs have contributed significantly to regional and sectoral balance through industrialization across different sectors

Historically, Nigeria's industrial strategy emphasized large-scale, capital-intensive industries. However, the decline of many of these enterprises, particularly from the early 1980s, revealed the vulnerabilities of such an approach, especially in a developing economy grappling with foreign exchange limitations, import dependency, and infrastructure deficits. As large industries stagnated or collapsed, the country witnessed growing interest in SMEs as a practical, resilient, and scalable alternative for stimulating growth. SMEs generally require lower capital investments, utilize labor-intensive production techniques, and are better integrated into local communities and supply chains. Consequently, they offer a viable path for reducing unemployment, mitigating poverty, fostering regional balance, and supporting industrialization.

According to a discussion paper by World bank in 2001, SMEs has undergoes several testings, difficulties, failures, challenges and collapse, because of inadequacy in the provision of infrastructure; whereas most of them fail to transform to large scale businesses which is an underlying principle behind the growth and development of SMEs (Transitional Industries). Despite the large number of SMEs in the country, Small and Medium Enterprises (SMEs) in Nigeria have not performed creditably well and hence have not played the expected vital and vibrant role in the economic growth and development of Nigeria. This situation has been of great concern to the government, citizenry, operators, practitioners and the organised private sector groups.

The dearth and paucity of credible and reliable database is one of the main constraints in the development of this sub sector. These could be as a result of challenges they face. In Nigeria, The problems bedeviling the SMEs in Nigeria are multi-faceted. Ekpenyong (1997) and Utomi (1997) identified inadequate capital, inaccessible credit facilities. Taiwo, Ayodeji, and Yusuf (2012) reveals that the most common constraints hindering small and medium scale business growth in Nigeria are lack of financial support, poor management, corruption, lack of training and experience, poor infrastructure, insufficient profits, and low demand for product and services. The unfavorable macroeconomic environment has also been identified as one of the major constraints which most times encourage financial institutions to be risk-averse in funding small and medium scale businesses (Ogujiuba et al., 2004).

Thus, in summing up the discussion, several studies have proved positive association between SMEs and economic growth for developing economies (Bello, Jibir, and Ahmed (2018). Therefore; the main objective of this research is to prove a nexus between SMEs output and GDP growth for Nigeria. The hypothesis of this research is stated in its null form: H₀: Small and medium scale enterprises (SMEs) output growth rate has no significant effect on gross domestic product (GDP) growth rate. The hypothesis will be tested in the course of the study. The study coverer the period spanning 1991-2022.

2.0 Review of Related Literature

SMEs have improved the regional and sectorial economic balance through industrialization across sectors and locations. It also promotes effective utilization of economic resources that are crucial elements of engineering economic growth (Kongolo, 2010; Odedokun, 1988). An efficient strategy to actualizing economic growth and development requires a robust, solid and focused emphasis on the growth and development of Small and Medium Enterprises. Therefore, SMEs is the means to an end of economic growth (Ako, 2001).

2.1 Conceptual Frames

Economic Growth

This is defined as the increase in a country's output of goods and services over time, reflecting an improvement in the overall economic performance. It is measured as the percentage rate of increase in real gross domestic product or real GDP, usually in terms of per capita terms. Growth is often calculated in real terms i.e, inflation-adjusted to eliminate the effect of inflation on the prices of good produced.

According to Mankiw (2016), economic growth is measured by the rise in real Gross Domestic Product (GDP), which indicates a higher standard of living and increased economic activity.

Small Medium Scale Enterprises (SMEs)

Small and Medium-Scale Enterprises (SMEs) are a vital constituent of the global economy, exerting a crucial influence on economic expansion, employment generation, and the advancement of innovative practices.(Etuk & Etuk, 2014). Small and Medium Enterprises (SMEs) are often considered the backbone of any economy, especially in developing countries, due to their contributions to employment, poverty alleviation, and innovation. However, defining SMEs is complex, as it depends on various factors, including the number of employees, annual revenue, and asset base, which vary from country to country. In the context of the European Union, small and medium-sized enterprises (SMEs) are categorized based on their workforce size. Specifically, micro-companies are defined as entities employing fewer than 10 individuals, small firms are characterized by a workforce ranging from 10 to 49 employees, and medium-sized enterprises are delineated by having 50 to 249 individuals in their employment. The Small and Medium Enterprises Development Agency of Nigeria (SMEDAN) provides a local definition of SMEs tailored to the Nigerian context. According to SMEDAN, Micro-enterprises: Businesses with fewer than 10 employees and an asset base of less than 5 million Naira (excluding land and buildings). Small enterprises: Firms with 10-49 employees and an asset base between 5 million and 50 million Naira. Medium enterprises: Companies with 50-199 employees and an asset base between 50 million and 500 million Naira (SMEDAN,2017)

2.2 Studies on Small and Medium Enterprises

Many studies have been carried out by different scholars to find the significance of Small and Medium Scale Enterprises (SMEs) contribution in accelerating economic growth and development. Ogujiuba, Ohuche and Adenuga (2004) looked into credit availability to small and medium scale enterprises in Nigeria. The study used a descriptive research design to investigate the availability of credit to SMEs in Nigeria. Their findings revealed significant barriers to credit access, including interest rates, collateral requirements, and government credit schemes. The study addressed critical research gaps related to bank lending policies, government intervention programs, and financial literacy among SMEs. The findings underscored the need for reforms in the financial sector to improve credit availability and support SME growth, which is crucial for Nigeria's broader economic development. The paper emphasized the need for a sound and efficient financial sector to support small and medium scale enterprise.

Afolabi (2013) found that access to credit positively impacted business expansion, revenue, and employment generation, but high interest rates and limited credit is found to exert negative effect on real gross domestic product, a proxy for economic growth. By focusing on formal financial institutions and providing empirical evidence on the challenges of high-interest rates, the study filled important gaps in the literature related to the long-term growth and development of SMEs in Nigeria.

The study by Ayo-Balogun and OgunSanwo (2019) examines the impact of Small and Medium Enterprises (SMEs) on the growth of the Nigerian economy. The paper highlights the significance of SMEs in promoting economic development, creating jobs, and contributing to the country's GDP. The paper found a positive significant relationship between SMEs activities and economic growth in Nigeria. Safiyaay and Garba (2013) examined the role of commercial banks in enhancing the growth of small and medium scale enterprises in Nigeria. They utilized a detailed quantitative methodology, focusing on secondary data to examine the relationship between commercial bank financing and the growth of SMEs in Nigeria. Their study explored critical variables like loan facilities, SME revenue, employment, and asset growth. It was discovered that commercial banks contribute to financing small and medium scale enterprises though their contribution has declined considerably as the government through Central Bank of Nigeria directives brought to an end the mandatory banks credit allocations. The paper hence

recommended that commercial banks should often create credit on its stringent requirements so that small and medium scale enterprises can benefit maximally from loan advances as large companies do.

Akinguola (2011), in this paper, explored the relationship between small and medium scale enterprises financing and growth in Nigeria. He employed a quantitative research design with a focus on regression analysis to explore the relationship between SME financing and growth in Nigeria. By focusing on key variables such as access to credit, loan amounts, interest rates, and business expansion, the study aimed to fill significant research gaps, including the limited empirical evidence on formal financing institutions, sector-specific challenges, and long-term business growth. The study indicated a significant positive relationship between SMEs financing and economic growth in Nigeria and contributed valuable insights into how financial barriers and policies impacted SMEs' ability to grow and sustain operations in the Nigerian economy.

Kadiri (2012) examines the contributions of small and medium scale enterprises (SMEs) to employment generation in Nigeria. The binomial logistic regression analysis was employed as tools for statistical analysis. The results show that SMEs has not impacted positively on economic growth partly due to poor financing and commitment from the government. The study then suggests that government should provide adequate infrastructure to the sector such as roads, electricity and the needed environment.

Cravo, Gourlay, and Becker (2009) evaluated the activities of SMEs and explored the indirect link of the activities with the development of the economy. The finding shows that the human capital embodied in SMEs may be more important for economic growth than the relative size of the SME sector. Additionally, the authors suggested that development of human capital was essential for the advancement of SMEs and yet more crucial for advancing economic activities. Also, Chinweuba and Sunday (2015) investigate the relationship between SMEs and economic growth of Nigeria. Their findings reveal that SMEs activities are growth enhancing through expansion in output and other various means of survival.

Bello, Jibir, and Ahmed (2018) examined Impact of SMEs in growth and development of Nigeria while highlighting the fact that SMEs are considered as core factor of growth for industrial sector in developing countries. The authors utilized data from 1986 to 2016 using simple regression analysis. The results proved positive and significant correlation between SMEs and growth of output which demonstrates the contribution of SMEs toward economic progress of Nigeria. The study recommended to restrict massive importation of goods that could be produced here and to protect the local producers of SMEs. Okafor, Ugwuegbe, and Chijindu (2016) found the same results between SMEs output and growth in the short run employing Ordinary Least Square method of estimation.

Akugri, Bagah, and Wulifan (2015) investigated the nexus between rapid infrastructural progress and employment in the presence of SMEs in Ghana. The study was based on primary data from 160 respondents from SMEs through random sampling method for the year of 2013. THE studyn employed both primary and secondary data collection techniques. The findings revealed that SMEs were not providing substantial employment opportunities to the youth segment in Ghana and thus most of these enterprises prefer family labor to minimize input costs. It recommended that, entrepreneurs should be encouraged to form cooperatives to enable them access bank credits.

Taiwo, Ayodeji, and Yusuf (2012) and Motilewa, Worlu, Ogbari, and Aka (2015) studied the activities of SMEs in promoting growth. The finding reveals a positive association between SMEs and economic growth. These studies also highlighted several issues which were faced by SMEs including financial constraints, poor infrastructure, lack of training, corruption and poor management. SMEs are a vital sector for economic growth and development, but they face numerous challenges due to internal and external factors. The development of SMEs varies significantly between developed and developing economies, with the latter struggling to establish infrastructure and support systems. In contrast, developed economies

have more established and nurtured SME sectors. The sector's growth and development are influenced by country-specific factors, highlighting the need for tailored approaches to support SMEs in different contexts.

3.0 Methodology

DATA SOURCE

This study collected its time series data from 1991 to 2022 for Nigeria. Data were extracted from CBN Statistical Bulletin, National Bureau of Statistics (NBS) and World Development Indicator (WDI). GDP growth rate have been taken to be the dependent variable, whereas, inflation, interest rate, SMEs Output and Credit availability to SMEs have been used as the independent variable.

Model Specification

Economic growth models developed by Barro (1990); Mankiw, Romer and Weil (1992) have been used by many researchers provide a theoretical framework for the analysis of the factors promoting economic growth. The development in the growth theories and literatures has allowed for other variables to be considered into elements of growth in addition to the traditional factors like capital, labour and technology. Due to this cause, it has brought extension to the growth model to include other SMES in analyzing economic growth. By this, this study pursues approach of Tulio, Becker, and Gourlay (2015) in order to determine growth model while considering output of SMEs.

The mathematical form is represented as

$$GDP = F(INF, INT, SMEO, CSME)..... (1)$$

Model's Econometric Form: the model is expressed in its Econometric form as:

$$(GDP)_t = \alpha_0 + \beta_1(INF)_t + \beta_2(INT)_t + \beta_3(SMEO)_t + \beta_4(CSME)_t + U_t..... (2)$$

Where,

GDP = Gross Domestic Product.

SMEO = Small and Medium Scale Enterprises Output

INF = Inflation Rate

INT= Interest Rate

CSME = Credit availability to Small and Medium Scale Enterprises

Bo = the intercept otherwise known as the intercept term

B1 – B4 = coefficient of the group of regressors (endogenous variables)

U = Error term otherwise known as stochastic term or disturbance term or error term.

Estimation Technique

Autoregressive Distributed Lag Model (ARDL)

Autoregressive Distributed Lag Model (ARDL) which has been presented by Pesaran. and Shin(2002) and further extended by Hashem, Shin, and Smith (2001). This technique provides consistent, reliable and significant estimates of the variables in both time period (long and short run). This technique offers a powerful and flexible framework for analyzing the dynamics of Gross Domestic Product and its underlying determinants. Its ability to handle non-stationary data, capture long- and short-run effects, address endogeneity issues, and facilitate policy analysis makes it a suitable choice for empirical research in this study.

Unit Root Test

Unit root test is used to test for stationarity using unit root tests. Carrying out unit root tests is essential before testing for integration between variables. The Augmented Dickey Fuller (ADF) test is deployed in this study as it accounts for a high test of particularly relevant order serial correlation and ensures that variables have a constant mean and variance.

Co- Integration

Co-integration is a statistical method used to test the correlation between two or more non-stationary time series in the long run or for a specified period. The co integration test helps to identify whether a long run equilibrium relationship exists among the dependent and independent variables.

The ARDL F-bound Test

In this study, the ARDL F- bound test will be employed since it is suitable for detecting the presence of a long run relationship between variables. Firstly, the approach is used when the series are all I(1). Secondly, the unrestricted error correction model (UECM) can be derived from the ARDL bounds testing through a simple linear transformation.

Error Correction Model

It is a model that has a term called, error correction term, which helps to correct for any deviation from long run equilibrium in the short run. . ECMs are typically used when variables are co integrated, meaning that even though the individual series may be non-stationary (i.e., they exhibit trends over time), a linear combination of them is stationary, implying a long-term equilibrium relationship.

4.0 Discussion of Findings of the Study

Table 1: Summary of Unit Root Test

Augmented Dickey-Fuller Unit Root Test

Variables	ADF Test	5% critical value	Order of Integration
GDP	-4.306203	-2.971853	I(1)
INF	-4.306203	-2.971853	I(1)
INT	-4.272824	-3.587527	I(0)
SMEO	-3.784274	-3.568379	I(0)
CSME	-6.752967	-2.967767	I(1)

Source: Researchers' Computation Using Eviews 10.0

The summary of the Augmented Dickey-Fuller (ADF) unit root test presented in Table 1 revealed a mixed order of integration among the series. The stationarity property is determined where the ADF Statistics is less than the critical value at 5 percent level of significance. Moreover, the significant p-value at 5 percent level of significance proves the stationarity status of the series. While Interest rate (INT) and Small and Medium Enterprises Output (SMEO) are stationary at level state, meaning they are zero order variables, I(0). However, variables such as Gross domestic product(GDP), Inflation rate (INF) and Credit to Small and medium enterprises (CSME) are integrated at different orders. This mixed order of integration required the use of ARDL approach. Therefore, the null hypothesis of the presence of unit root can be rejected.

Table 2: Summary of Long Run ARDL Result Estimate

Variable	Coefficient	Std. Error	t-Statistic	Prob.
INF	-2.659028	0.358746	-7.412009	0.0007
INT	2.814332	0.686095	4.101959	0.0093
SMEO	1.26E-05	5.15E-06	2.438568	0.0588
C SME	-0.127218	0.035822	-3.551377	0.0164

Source: Researcher's Computation using E-view 10 .0

Having confirmed that the variables are co-integrated, the parameters of the model were estimated with ARDL model. From the result in Table 4.5, the past value of INT and SMEO have coefficients of 2.81 and 1.26. This implies that Interest rate and small and medium enterprises output have a positive impact on economic growth. This indicates that on average, 1 percent increase in INT and SMEO will increase GDP by 2.81% and 1.26% respectively. Also, the coefficients of INF and CSME, which stood at -2.66 and -0.13 respectively, show that INF and CSME have negative impact on GDP which is the proxy for economic growth. This suggests that 1 percent increase in INF and CSME will decrease GDP by 2.66% and 0.13% respectively.

Table 3: Diagnostics Results

Diagnostic Test	F-Statistics	Prob. Value
<i>X² Breusch-Godfrey LM test</i>	0.4805	0.6591
<i>X² Ramsey RESET test</i>	1.0171	0.3703
<i>X² JarqueBera normality test</i>	0.1198	0.9419
<i>X² Heteroscedasticity test</i>	1.9627	0.2341

The results from table 3 depicts that the regression model passes all the diagnostic tests against serial correlation, functional form misspecification and non-normal errors.

Table 4: Error correction Model For Short run Estimation

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-68.02406	7.340552	-9.266887	0.0002
D(GDP(-1))	0.599298	0.067202	8.917850	0.0003
D(GDP(-2))	0.334587	0.086109	3.885629	0.0116
D(INF)	0.614809	0.213540	2.879123	0.0346
D(INF(-1))	5.446304	0.703049	7.746689	0.0006
D(INF(-2))	3.457539	0.535685	6.454428	0.0013
D(INF(-3))	1.774047	0.231776	7.654155	0.0006
D(INT)	-1.844107	0.399417	-4.616997	0.0058
D(INT(-1))	-8.303240	1.030614	-8.056593	0.0005
D(INT(-2))	-3.096325	0.699023	-4.429504	0.0068
D(SMEO)	1.04E-05	2.26E-06	4.591150	0.0059
D(SMEO(-1))	-9.61E-06	2.18E-06	-4.406606	0.0070
D(SMEO(-2))	-1.47E-05	2.44E-06	-6.024267	0.0018
D(SMEO(-3))	-9.70E-06	2.45E-06	-3.957469	0.0108
D(CSME)	-0.253580	0.033460	-7.578654	0.0006
D(CSME(-1))	-0.196260	0.030653	-6.402694	0.0014
D(CSME(-2))	-0.333556	0.045772	-7.287363	0.0008
CointEq(-1)*	-1.832546	0.196633	-9.319632	0.0002
R-squared	0.983639	Mean dependent var	-1.484402	
Adjusted R-squared	0.952735	S.D. dependent var	10.68915	
S.E. of regression	2.323886	Akaike info criterion	4.759079	
Sum squared resid	48.60400	Schwarz criterion	5.622971	
Log likelihood	-46.24757	Hannan-Quinn criter.	5.015959	
F-statistic	31.82856	Durbin-Watson stat	1.889002	
Prob(F-statistic)	0.000005			

Source: Researcher's Computation using E-view 10 .0

Table 4 depicts the short run estimates of the model as per the criteria i.e. error term should be significantly negative. This implies that the model of the study will converge towards long run in case of occurrence of any shock.

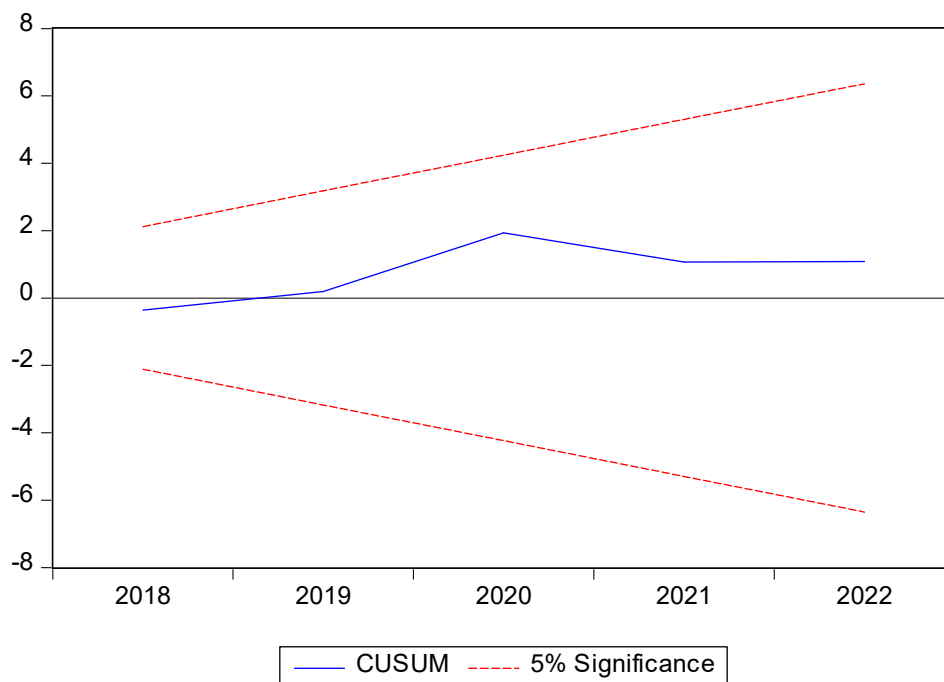


Figure 5: Cumulative Sum Test

Source: Researchers' Computation from E-Views 10

The straight lines represent critical bounds at 5% significance level. The CUSUM test shows that graph of the test do not cross the lower and upper critical limit. The plot of the CUSUM is between the upper and lower critical limit. Therefore, we conclude that the mode is stable at 5 percent level of significance and long-and-short runs estimates are reliable and efficient.

5.0 Conclusion and Recommendation

This study examines the impact of small and medium enterprises output in Nigeria economy. It has been shown in the study that small and medium scale enterprises output has positive and statistical significance on economic growth in Nigeria. Evidence from the theoretical and empirical perspective also shows that increased SME output is very necessary in fostering economic growth. Thus, government expenditure in the small and medium scale enterprises is a useful tool that would help put the economy on the path of development. Investment in small and medium scale enterprises sub-sector will provide job opportunities for teeming youths as well as increasing the level of output of the economy. On the basis of the findings of the study, the following recommendations are proposed for policy action in the country:

1. Governments should assist prospective entrepreneurs to have access to finance and necessary information relating to business opportunities, modern technology, raw materials, market, plants and machinery which would enable them to reduce their operating costs and be more efficient to meet the market competitions.
2. It is also recommended that there is need for supporting and strengthening small and medium scale enterprises by provision of credits to small and medium enterprises at low interest rate

3. Prospective business operators should conduct extensive feasibility studies, to evaluate the viability of any proposed business, and to avoid investment in unprofitable ventures to prevent the death of the enterprise.
4. Governments should encourage and continue to build on current programmes and establish new ones if needed, to improve the levels of managerial competence and skills of the small business owners.
5. Encourage young entrepreneurs to start business decrease unemployment and economic growth.

***Ujunwa Marycynthia Ejiaso**

ue.marycynthia@stu.unizik.edu.ng

Economics Department

Nnamdi Azikiwe University, Awka.

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