Lending to Small and Medium Scale Enterprises and Economic Growth in Nigeria, 1992 - 2011

Jonathan Emenike Ogbuabor
Ifeoma C. Mba
Anthony Orji

Abstract

This study examined the trend of lending to SMEs in Nigeria and the impact of lending to SMEs on economic growth in Nigeria over the period 1992 to 2011 using ordinary least squares methodology. The results indicate that lending to SMEs increases the rate of economic growth in Nigeria. Unfortunately, the trend analysis indicates that lending to the SMEs sector in Nigeria had been on the decline since 1992. Accordingly, the study recommends that various credit schemes targeted at SMEs in Nigeria should be re-energized, coordinated and monitored so that they can effectively impact on the growth and development of the economy. Also, basic infrastructure, such as adequate power supply and passable roads, and satisfactory security of lives/property should be provided for SMEs to thrive in Nigeria.

Keywords: Small and Medium Scale Enterprises; Economic Growth; OLS; Cointegration; Nigeria

1. Introduction

There is no universally accepted definition for small and medium scale enterprises (SMEs) in the literature. This is mainly because different countries use diverse criteria in classifying their SME sector. Examples of such criteria include the value of assets, the number of workers employed and the volume of production or annual turnover (Aremu and Adeyemi, 2011; Ofoegbu, Akanbi and Joseph, 2013; Umar, 1997). According to Aremu and Adeyemi (2011), the federal government of Nigeria in its 1990 budget defined SMEs for the purpose of commercial loan as those enterprises with annual turnover not exceeding N500, 000 and for merchant loan as those enterprises with capital investment not exceeding N2 million (excluding cost of land or a maximum of N5 million). The Nigerian Economic Summit Group, NESG (2002) defined SMEs in Nigeria based on the nature and magnitude of business to include roadside artisans, petty traders, bottled water producers, bakers, local fabricators and their likes. Udechukwu (2003) explained that Nigeria’s National Council on Industry defined SMEs in terms of number of employees as those enterprises with between 10 and 300 employees. This study is anchored on the views of Small and Medium Industries Equity Investment Scheme (SMIEIS) of 1998, which defined SMEs in Nigeria as enterprises with a total capital employed of not less than N1.5 million, but not exceeding N200 million (including working capital, but excluding cost of land) and/or with a staff strength of not less than 10 and not more than 300.

However, in the European Union, SMEs are defined in the Commission’s recommendation of May 6, 2003, based on the following criteria: not more than 250 employees; not more than 50 Million Euros turnover; a balance sheet total of less than 43 Million Euro; and if not more than 25% of the shares of such an enterprise are in the ownership of another enterprise (Ofoegbu, Akanbi and Joseph, 2013). Daft and Marcic (2006) defined a business as small if it has fewer than 500 employees; while Hallberg (2000) defined the lower and upper limits for small scale enterprises at 5 and 100 workers while that of medium scale enterprises is set at 100 and 250 workers respectively. The World Bank (2006) defined medium enterprises as those that have at most 300 employees and an annual turnover not exceeding 15 million US dollars, while small enterprises are those having fewer than 50 staff members and up to 3 million US dollars turnover. In the UK, Sections 382 and 465 of the Companies Act 2006 defined an SMEs as follows: a small company is one that has a turnover of not more than £5.6 million, a balance sheet total of not more than £2.8 million and not more than 50 employees; a medium-sized company has a turnover of not more than £22.8 million, a balance sheet total of not more than £11.4 million and not more than 250 employees (Ofoegbu, Akanbi and Joseph, 2013). Clearly, the concept of small and medium scale enterprises varies from country to country and indeed from industry to industry depending on the developmental stage of the country in question and level of its economic activity and industrial growth.

The importance of SMEs in the growth and development of a country has been widely emphasized in the literature in terms of their role in backward integration, production of goods and services, job creation, income generation, reduction in income disparity, poverty alleviation, entrepreneurial development, technological innovation, skill development and acquisition, encouragement of economic self-dependence and vibrant private sector, among others (Onakoya, Fasanya and Abdulrahmna, 2013; Ofoegbu, Akanbi and Joseph, 2013; Safiriyu and Njogo, 2012; Aremu and Adeyemi, 2011; Ayozie and Latinwo, 2010). Daniel (1994) estimated that SMEs employ 22% of the adult population in developing countries like Nigeria. Indeed, the roles of SMEs in contemporary Nigeria cannot be over stressed. Simply put, SMEs are the panacea for the economic development and growth of indigenous entrepreneurs in Nigeria (Kilby, 1985). In recognition of these multivariate contributions and potentialities of SMEs in Nigeria, especially their importance in promoting economic growth, several micro-lending institutions have been established in Nigeria to enhance the development of SMEs. Some of these institutions include microfinance banks, entrepreneurship development centers (EDCs), Small and Medium Industries Equity Investment Scheme (SMIEIS), the Small and Medium Enterprises Development Agency of Nigeria (SMEDAN), the Nigerian Bank for Commerce and Industry (NBCI), National Economic Reconstruction Fund (Nerfund), the People's Bank of Nigeria (PBN), the Nigerian Export and Import Bank (NEXIM), as well as the liberalization of the banking sector (Ofoegbu, Akanbi and Joseph, 2013).

Despite the numerous economic contributions of SMEs in Nigeria, they still face lots of challenges. According to Basil (2005), these challenges include insufficient capital, inadequate market research, over-concentration on one or two markets for finished products, lack of succession plan, inexperience, lack of proper book keeping, infrastructural inadequacies (such as power supply, water, roads, and so on), inability to separate business and family or personal finances, lack of business strategy, inability to distinguish between revenue and profit, inability to procure the right plant and machinery, inability to engage or employ the right caliber staff, and cut-throat competition. Aremu and Adeyemi (2011) and Sokoto and Abdullahi (2013) noted that SMEs in Nigeria are generally characterized by inadequate capital base, low managerial skills, and high levels of technical inefficiency, which reduce their potential output levels significantly. They further articulated the challenges of these enterprises to include inadequate access to credit; lack of decision-making skills, sound management and accounting practices; and inability of lenders, especially deposit money banks, to objectively assess the risk profiles of SMEs in Nigeria. Sokoto and Abdullahi (2013) further observed that the SMEs in Nigeria suffer the crowding out effect as a result of the unfair competition from foreign investors; and this pushes most of the SMEs in Nigeria to the informal sector.

From the foregoing, it is obvious that one of the major challenges confronting the SMEs sector in Nigeria is lack of funds. This challenge notwithstanding, the SMEs are still critical to the development of the Nigerian economy. Most of the previous studies aimed at understanding the SMEs sector in Nigeria were conducted at firm level using primary data. Unfortunately, such primary data are rarely reliable because most of the SMEs do not keep proper records of transactions. Indeed, a large scope still needs to be covered towards a more comprehensive understanding of this sector in Nigeria, especially at the macro level. Accordingly, the primary objectives of this study are: to examine the trend of lending to SMEs in Nigeria; to ascertain the nature of the relationship between lending to SMEs and economic growth in Nigeria; and to examine the impact of lending to SMEs on economic growth in Nigeria. The study will cover the period 1992 to 2011. The choice of this period is based on data availability. However, this period also falls within the era of post Structural Adjustment Program (SAP) in Nigeria, during which the financial sector was liberalized and a lot of emphasis was placed on various SMEs enhancing programs by the various tiers of government.

The recognition of the critical role of the SMEs towards the growth of the Nigerian economy led to the plethora of micro-lending institutions established to address their funding requirements. Unfortunately, records indicate that the performance of SMEs in Nigeria has not justified the establishment of this plethora of micro-credit institutions. Specifically, Odedokun (1981) notes that in spite of the quantum of credit made available to the manufacturing sector, the contribution of the index of manufacturing to GDP was only 7 percent between 1970 and 1979. This study is therefore strongly justified as means of empirically establishing if lending to SMEs engenders economic growth in Nigeria or otherwise. Besides, the study would be of immense benefit to the government, the financial system, the SMEs operators, existing and prospective investors as well as the economy as a whole. The study will assist the government in further appreciating the enormous significance of the SMEs sector as the engine of growth and development of the Nigerian economy. It will enable the financial system to better understand its role of financial intermediation as it relates to adequate funding of the SMEs sector in Nigeria. The study will enable investors and indeed the general public to further appreciate the potentials inherent in the SMEs sector in Nigeria. This study will enhance the existing literature and deepen the overall understanding of the Nigerian economy.

2. Theories of Growth of Small and Medium Scale Enterprises

Following Ahiawodzi and Adade (2012), this study will be anchored on the following theories of growth of SMEs: the passive learning model and the stochastic and deterministic approaches.

2.1. Passive Learning Model:

Under this model, a firm enters a market without knowing its own growth potential; that is the firm begins to learn about the distribution of its own profitability based on information from realized profits after it had entered the market. By continually updating such learning, the firm may decide to expand, contract, or exit the market altogether. This learning model states that firms learn about their efficiency or growth potentials once they are established in the industry. Firms expand their activities when managers observe that their estimation of managerial efficiency had understated actual levels of efficiency. As the firm ages, the owner's estimation of efficiency becomes more accurate, decreasing the probability that the output will widely differ from one year to another. The implication of this model is that younger firms (mainly SMEs) should have higher and more viable growth rates (Cunningham and Maloney, 2001).

2.2. Stochastic and Deterministic Approaches:

The stochastic growth model, which is also known as the Gibrat's Law, argues that all changes in the size of an enterprise are due to chance. Thus, the size and age of firms have no effect on the growth of SMEs. The deterministic approach assumes, on the contrary, that differences in the rates of growth across firms depend on a set of observable industry and firm specific characteristics (Pier Giovanni et al, 2002).

3. Empirical Literature

Onakoya, Fasanya and Abdulrahmna (2013) examined 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 results indicate that loan to small scale entrepreneurs have a positive impact on the economic performance while high interest rate has a negative impact on economic growth. The study thereby concluded that the greatest problem confronting SMEs in Nigeria is managerial capacity, and that access to capital or finance is necessary but not a sufficient condition for successful entrepreneurial development.

Aremu and Adeyemi (2011) examined small and medium scale enterprises as a survival strategy for employment generation in Nigeria. The study found that the SME sector is the main driving force behind job creation, poverty reduction, wealth creation, income distribution and reduction in income disparities. The study concluded that the SMEs sector presents the propelling force of economic modernization and growth in Nigeria.

Ofoegbu, Akanbi and Joseph (2013) examined the effects of contextual factors on the performance of small and medium scale enterprises in Nigeria, using Ilorin metropolis as a case study. A total of 140 respondents were randomly sampled from the entire SMES in the state. The study employed analysis of variance, Pearsons Correlation technique, Paired sample T-test and logit regression methodology. The results show that contextual factors have significant impact on SMEs; and that SMEs impacted positively on economic growth of the state. Capital, availability of raw materials, enabling environment, power and availability of market have positive impact on SMEs growth while state of the economy and government policy impacted negatively on SMEs growth.

Sokoto and Abdullahi (2013) examined how strengthening the SMEs contributes to poverty reduction in north western Nigeria. Primary data were collected through the administration of questionnaire on a random sample of 400 SMEs in Sokoto and Zamfara States. Secondary data were also obtained from the Nigerian Stock Exchange (NSE) and National Bureau of Statistics (NBS). T-test analysis was used in analyzing the data. The results indicate that large enterprises contribute more in the area of employment provision than the SMEs going by the countrywide data. This contradicts the a priori assumption that small and medium enterprises do contribute to employment generation and use more indigenous technology than large corporations.

Evbuomwan et al (2012) examined the preferences of micro, small and medium enterprises to financial products in Nigeria so as to adequately target them. The survey results indicate that 75.7% of the respondents relied mostly on own funds to finance their businesses; the frequency analysis indicates that inadequate fund/working capital was the most mentioned problem with a percentage share of 60.7% followed by the problem of poor power supply/inadequate infrastructure which took 55.7%. Furthermore, it was found that 86.1% of the respondents would want the Small and Medium Enterprises Equity Investment Scheme to continue. However, 64.7% of the respondents would prefer loan so they can be in full control of their businesses, while only 15.7% preferred equity.

Akingunola (2011) assessed specific financing options available to SMEs in Nigeria and their contribution to economic growth via investment level. The Spearman's Rho correlation test was employed to determine the relationship between SMEs financing and investment level. The analysis reported a significant Rho value of 0.643 at 10%, which indicated that there was significant positive relationship between SMEs financing and economic growth in Nigeria via investment level. The study also used descriptive statistics to appraise certain financing indicators. On the whole, the study recommended that accessibility to relative low interest rate finances should be provided to small and medium enterprises in Nigeria in order to enhance economic growth.

Terungwa (2011) evaluated the performance of the Small and Medium Scale Enterprises (SMEs)

Equity Investment Scheme in Nigeria (SMEEIS), using Benue and Nassarawa States as case study. Secondary data of total credit to SMEs as percentage of banks total credit for a period from 1993 to 2008 were analyzed using paired sample t-test, which tested the significance of bank loans before and after the introduction of SMEEIS. Mean scores and standard deviation was used to present and analyze the primary data obtained via questionnaires. The result shows that there was no significant difference between the loans disbursed by banks to SMEs before and after the introduction of SMEEIS and the conditions for accessing SMEEIS funds was beyond the reach of the predominant SMEs in Nigeria. This shows that SMEEIS, as a formal financing option, has not made any significant impact towards SMEs growth in Nigeria.

Kadiri (2012) examined the contributions of SMEs to employment generation in Nigeria through a sectoral analysis. The Binomial Logistic Regression methodology was employed as tool for statistical analysis. The study found that the sector was unable to achieve this goal due to its inability to obtain adequate business finance; and that virtually all the SMEs that were sampled relied on informal sources of finance to start their businesses.

Woldie, Leighton and Adesua (2008) analyzed the influence of five owner/managers and four firm characteristics on the growth of the firm. The results indicate that SME growth is largely influenced by firm characteristics such as age, sector, legal status and number of employees. Owner/manager characteristics proved seem to influence growth include age, education, previous experience, and three motivation variables, namely finance, employment creation and self-fulfillment. Owner/manager characteristics such as gender and two motivational variables such as desire to be independent and job satisfaction were not seen to exert an influence on SME growth in the sampled firms in Nigeria.

Egbuna and Agali (2013) analyzed the processes involved in business planning, examined the challenges and problems faced by Nigerian entrepreneurs in business planning of Nigeria's Small and Medium Enterprises (SMEs); and how proper planning can promote their businesses. Primary data were sourced from Small and Medium scale businesses in Ile-Ife through administration of structured questionnaire. The data collected were analyzed using descriptive statistics such as tables, charts, frequencies, percentages. The results showed that most entrepreneurs find out the demand of the market more than setting goals and objectives; and that economic instability and access to source of finance were major challenges facing SME's; while proper planning can increase the productivity and profitability of SMEs in Nigeria.

Ahiawodzi and Adade (2012) examined the effect of access to credit on the growth of SMEs in the Ho Municipality of Volta Region of Ghana, using both survey and econometric methods. The survey involved a sample of 78 SMEs in the manufacturing sector from the Ho Municipality. The specified econometric model has firm growth as the dependent variable, and the independent variables include access to credit, total current investment, age of the firm, start-up capital, education level and annual turnover of the firm. Both survey and econometric results show that access to credit exerts a significant positive effect on growth of SMEs in the Ho-Municipality of Ghana.

Idowu (2013) assessed the impact of microfinance on SMEs in Nigeria. Simple random sampling technique was employed in selecting 100 SMEs that were sampled using structured questionnaire while descriptive statistics such as simple percentages, graphical charts and illustrations were used in data presentation and analysis. The results indicate that significant number of the SMEs benefitted from the MFIs loans, though only few of them were able to secure the required amount. Interestingly, majority of the SMEs acknowledge positive contributions of MFIs loans towards promoting their market share, product innovation, and overall competitive advantage of the firm.

3.1. **Research Gaps / Contributions to Knowledge**

The above review of recent empirical literature on SMEs in Nigeria shows that studies that examined the impact of SMEs financing on economic growth in Nigeria are indeed scanty. Most of the previous studies used primary data despite the inherent weaknesses of such data. Even though Onakoya, Fasanya and Abdulrahmna (2013) used time series data, the study relied on ADF unit root test that does not account for structural break. Further, Onakoya, Fasanya and Abdulrahmna (2013) and Ofoegbu, Akanbi and Joseph (2013) were not anchored on any economic theory. Also, majority of the studies did not examine the trend of lending to the SMEs in Nigeria. Clearly, a lot still needs to be done towards a more comprehensive understanding of the SMEs sector in Nigeria. This study is therefore an empirical attempt to fill these gaps in the literature. Moreover, it must be stressed that the important role of the SMEs sector in job creation and poverty alleviation makes this study even more relevant in Nigeria presently.

4. **Methodology**

This study adopted time series analysis, using ordinary least squares (OLS) methodology. The estimation procedure began by pre-testing the time series properties of the data using the Zivot–Andrews unit root test technique since most economic variables have been shown to be non-stationary. The Zivot–Andrews technique provides a more robust result than the usual Augmented Dickey Fuller (ADF) test and also accounts for structural break (Andrews & Zivot, 1992). The test of stationarity was then followed by the Johansen cointegration test which sought to establish whether or not the dependent variable (real GDP growth rate) is cointegrated with the explanatory variables. Here, the confirmation of cointegration relationship means that the long run model cannot be spurious (Johansen, 1998).

The study covered the period 1992 to 2011 in line with the availability of data. All the data were collected from CBN Statistical Bulletin, 2011. Following Onakoya, Fasanya and Abdulrahmna (2013), we specify our model as follows:

$GDPGR = \alpha_0 + \alpha_1 LSME + \alpha_2 RINT + \alpha_3 GEXP + \alpha_4 INFR + \mu$ . . . (1)

Where: GDPGR = real GDP growth rate (proxy for economic growth);
LSME = loans to SMEs as percentage of total loans;
RINT = real interest rate;
GEXP = government expenditure;
INFR = inflation rate;
α_i are the parameters of the model while μ is the error term. Our a priori expectations include $\alpha_1, \alpha_2, \alpha_3 > 0$ and $\alpha_2, \alpha_4 < 0$. RINT, GEXP and INFR are included as related control variables in order to obtain robust estimates.

5. Results and Discussions

The results of the Zivot-Andrews unit root tests indicate that while some of the variables (RINT, INFR) are stationary at levels, others (LSME, GDPGR, GEXP) are stationary after first differencing. However, the Johansen test for cointegration returned a full rank, which indicates the absence of cointegration relationship among the variables. In the absence of a stable long-run relationship among the series, we estimated a short run regression model and the results are presented in Table 1 below:

Table 1: Estimated Short Run Regression Result for the Growth model

Variable	Coefficient	t-statistic	Probability
Constant*	2.435573	2.04	0.060
Δ.LSME	0.4876581	1.24	0.235
Δ.RINT*	0.4097384	2.07	0.057
Δ.GEXP**	-4.619129	-2.62	0.020
Δ.INFR	0.3709528	1.63	0.125

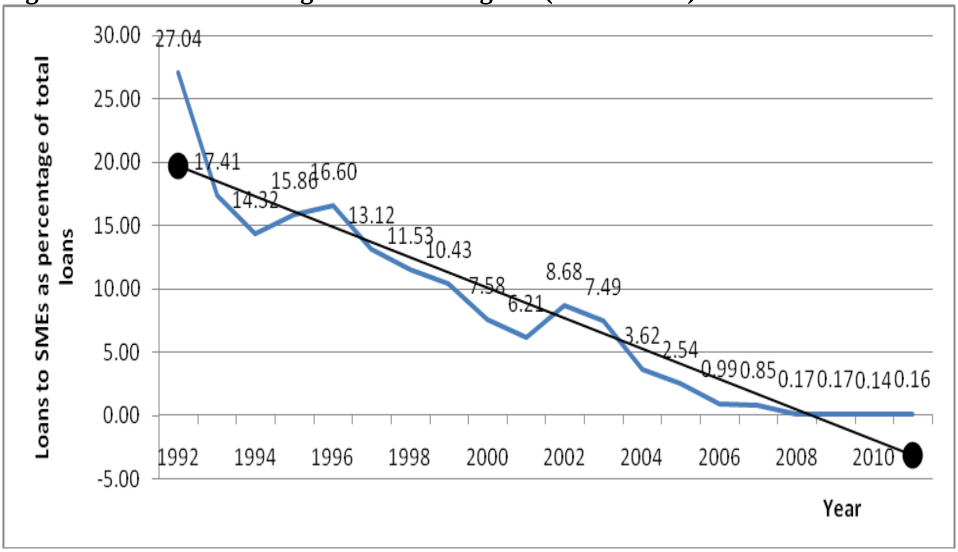
Key: Δ is the difference operator while * and ** denote significant at 10% and 5% levels respectively; R^2 = 0.458; F(4, 14) = 2.95; Prob > F = 0.0581; LR (4) = 11.621; Prob > LR = 0.020

Source: Author's computation using STATA 12

The results in Table 1 above indicate that all the variables conformed to a priori expectations except government expenditure. Even though the coefficient of the lending to SMEs (LSME) is not statistically significant at 5% or 10% level, a unit increase in this variable leads to 49% increase in economic growth rate, ceteris paribus. The implication is that lending to SMEs impacts positively on economic growth in Nigeria, and any policy that encourages lending to this sector invariably encourages the growth of the Nigerian economy. Government expenditure (GEXP) is statistically significant at 5% level; however, a unit increase in GEXP leads to 461% decline in GDP growth rate. This may be due to the perceived high level of corruption in the public sector that makes it

almost impossible for the economy to witness a positive impact of government expenditure in Nigeria.
The results further indicate that the inflation variable, which is not statistically significant, did not conform to a priori expectation; while real interest rate (RINT) has a statistically significant positive impact or effect on economic growth in Nigeria. Overall, the estimated short run model is statistically significant as seen from the probability of the F-statistic and the likelihood ratio. The R^2 of 46% indicates that the three significant regressor variables have explained about 46% of the overall variations in the dependent variable.

Figure 1: Trend of Lending to SMEs in Nigeria (1992 – 2011)



Source: Author's graph with data from CBN Statistical Bulletin 2011
The trend line in Figure 1 above with round caps indicate that the trend of lending to SMEs in Nigeria has been on a steady decline. In 1992, the banking system granted 27.04% of total lending to SMEs. However, the percentage of total lending granted to SMEs declined to 8.68% in 2002, and further declined to 0.16% in 2011. This trend is in conformity with the bulk of previous studies that identified lack of finance as one of the key challenges facing the SMEs sector in Nigeria. Akingunola (2011) attributed the declining trend of lending to SMEs in Nigeria to the fact that: they are considered as high risk borrowers; they generally do not maintain adequate financial records/statements acceptable to lenders; and the transaction costs of lending small amounts to SMEs is relatively high. Ogujiuba, Ohuche and Adenuga (2004) identified the main sources of risks to banks lending to SMEs in Nigeria as lack of information on the true financial conditions and performance of the SMEs, the inefficient judicial system that makes it difficult to enforce contracts, and the poor business environment that is generally risk prone and uncertain such that firms are not able to service debts.

6. Conclusion and Policy Recommendations

This study examined the impact of lending to SMEs on economic growth in Nigeria as well as the trend of lending to SMEs in Nigeria over the period 1992 to 2011 as a means of providing evidence based policies that will enhance the growth and development of the Nigerian economy. The estimated regression results indicate that lending to SMEs (though not statistically significant) increases the rate of economic growth in Nigeria. Unfortunately, the trend analysis indicates that lending to the SMEs sector in Nigeria had been on the decline since 1992. This unacceptable trend has been attributed to the fact that SMEs in Nigeria are considered to be high risk borrowers operating in unfavourable business environment without adequate financial records.

A major policy recommendation which can be drawn from the above findings is that government at all levels in Nigeria, the banking system, donor agencies, and other non-governmental organizations (NGOs) should tackle the challenge of poor financing facing the SMEs sector in view of the potentials of this sector in job creation and poverty reduction in Nigeria. The various credit schemes targeted at SMEs in Nigeria should be re-energized, coordinated and monitored so that they can effectively impact on the growth and development of the economy. Basic infrastructure such as adequate power supply, passable roads, sufficient water supply, as well as satisfactory security of lives and property among other favourable business conditions should be provided so that SMEs can thrive in Nigeria. This study further recommends that SMEs development centres should be established in every local government area in Nigeria in order to harness the abundant resources at the grassroots. Clearly, these policy recommendations should be vigorously implemented so as to grow the Nigerian economy.

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