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Taxation and the Growth of Small and Medium Scale Enterprise (SMEs) in Nigeria: A Case of Selected SMEs in Nasarawa State

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Abstract

Existing literatures on Small and Medium scale Enterprise (SMEs) in Nigeria dwelled more on issues, challenges and prospects of SMEs. On that aspect, several challenges and prospects have been developed and will continue to be developed. Contrary however, there are little micro studies specifically on the impact of taxation on the growth of SMEs in Nigeria. To fill this gap this paper analyzes taxation and the growth of small and medium scale Enterprise (SMEs) in Nigeria: A Case of Selected SMEs in Nasarawa State .The methodology adopted to help achieve the objective of this study is multinomial logistic regression. The result of the multinomial regression, found that over the years the incessant death of SMEs is due to high and complex tax systems that appears to be more harmful than beneficial to SMEs as it increases running costs and slow down growth of SMEs. The paper therefore, submits that if SMEs are to flourish, an appropriate tax policy which will not be an encumbrance to the growth of SMEs needs to be on ground.

Keywords: *Complex taxation, Growth, SMEs, Nigeria*

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Background to the Study

In spite of Nigerian's status as an African economic power house, poverty is wide spread. According to the United Nation's most recent multi-dimensional poverty index (2015), over 67 percent of Nigerians live below poverty line. Unemployment is widespread and majority of Nigerians are frustrated with wide spread joblessness. The Nigeria Bureau of statistics (2014) has it that 30 percent of those under 24 years are unemployed while the World Bank (2014) estimates put the figure to about 80 percent. In a bid to solving this problems, have necessitated the adoption of several economic reform programs from 1986 to date. Some of such reforms is the International Labour Organization (ILO), 1998 conference on the need for policy and legal frame work in setting an environment for the development of Small and Medium scale Enterprise (SMEs) and Organization of Economic Cooperation and Development (OECD) Bologna charta, 2000 on SMEs policies in which governments from OECD countries recognized the role of SMEs and broad policy orientation conducive for their growth. These reforms suggest a critical shift from grandiose, capital intensive and large scale industrial projects based on import substitution to SMEs with immense potentials for self-reliant industrialization using local raw materials that will help boost employment generation, reduce poverty, guarantee even distribution of industrial development and facilitate the growth of non-oil exports (Mba & Izunwanne,2014).

Over the years, SMEs have been an avenue for job creation and empowerment of Nigerians providing about 50 percent of all jobs in Nigeria (Adebisi&Gbenga, 2013). Hence, promotion of SMEs in developing economies like Nigeria will bring about great distribution of income and wealth, economic self-dependence, entrepreneurial development and a host of other positive economic uplifting factors. In a related development, SMEs helps in reducing the migration of people from rural to urban areas (Uzor, 2004). They also, contribute substantially to the country's Gross Domestic Product, export earnings and can easily be established with minimal skill (Udechukwu, 2003).

However, the rate of folding up of these SMEs firms particularly in Nigeria is very high (Ariyo, 2005). According to the Small and Medium scale Enterprises Development Agency of Nigeria (SMEDAN), 2015, 80 percent of SMEs fold up before their 5th anniversary. Among the factors responsible for this untimely fold up are tax related issues ranging from complex taxation to enormous tax burden (Ojochogwu & Ojeka, 2012). Complex taxation seems to be a major threat to the growth of SMEs especially in less industrialized countries. For instance, in Nigeria taxes imposed on SMEs ranges from direct tax which includes income tax charged on business income, employment income; rent income, pension and investment income to indirect taxes such as Value Added Tax (VAT), Corporation tax and excise duties. All these taxes have tendencies of slowing the growth of SMEs as they increase the costs of operation of running SMEs. To compensate for the increased costs of operation, prices on goods are raised thus causing the amounts of sales to go down. The effects of reduced sales are reduced profits, reduced capital base and slow creation of employment resulting to slow growth and increased poverty. Also complex tax systems put disproportionate pressure on smaller business as SMEs resources directed towards multiple tax compliance are resources that could otherwise be used for re-investment to promote future growth.

However, in spite of these dire situations with potential dangers for SMEs, little research has been done to actually underscore the situation. The shortcomings of the previous researches served as a gap for the paper. To fill the gap, this paper investigated the effect of complex taxation on SMEs in Nigeria, a case of SMEs in Nasarawa state. To achieve this objective, this paper is structured into four sections. Section one is the introduction. This section contains the background information about the key question and focus of the paper. It also describes the objective and motivation for the paper. Section two is the theoretical frame work and reviews of the literatures on SMEs. Section three describes the methodology of the paper as well as anticipated impact of the findings. Section forgives the conclusions and policy implications of the paper.

Theoretical Framework

The theoretical framework upon which this paper is based are: the Law of proportionate effect, the stochastic theory of firm's growth and evolutionary theory of firm growth.

The Law of Proportionate Effect

Various authors have postulated theories pertaining to firm's growth. The oldest and most common theory is Gibrat's Law of Proportionate Effect (LPE). This theory was propounded by Gibrat in 1931. The theory has it that the rate of growth of a firm is independent of its initial size. By implication, the law of proportionate effect postulates that the proportionate growth rate of incumbent firms is completely randomly determined and hence independent of systematic factors such as initial size or previous growth rates. In other words, factors that influence firm growth, such as taxation, growth of demand, managerial talent, innovation and organizational structure are distributed across firms in a manner which cannot be predicted from information about firm' s current size or its previous growth performance (Goddard, Ghandi & Gbandi, 2001). Empirical tests of LPE have always yielded mixed results. Thus Mansfield (1962) points out that the previous inconclusive findings about the validity of the LPE emanates from using three different types of samples: (1) all firms (including those that fail to survive during the period); (2) surviving firms only; and (3) well established firms (i.e. firms which have reached the minimum efficient scale (MES) of operation, and thus have exhausted economies of scale). Overall, Mansfield (1962) concludes that smaller firms have higher and more variable growth rates than large firms.

The Stochastic Theory of Firm's Growth

In the late 1970s and 1980s, following a revival of empirical work in the area of the growth of firms, a number of economic theories of firm growth were introduced. One of such theories is the stochastic theory of firm's growth. This theory was developed by Jovanovic in 1982. The theory introduced stochastic elements into conventional growth theory of a firm. In stochastic theory, each firm's cost curve is subjected to randomly distribute firm-specific shocks. Over time a firm learns about the effects of these shocks on its efficiency. Firms experiencing favorable shocks grow and survive. Others do not grow and may decline and even leave the industry. The implication is that large firms' growth is subject to less variation than that of smaller firms.

Evolutionary Theory of Firm Growth

Nelson and Winter (1982) propounded the evolutionary theory of firm growth. The evolutionary approach to firm growth implies that there is some serial correlation in growth. To Nelson and Winter (1982), success breeds success and failure breeds failure. Thus this is in contrast to purely stochastic theories of growth, such as the LPE, which postulate that the proportionate growth of surviving firms is random and hence independent of previous success. The model by Nelson and Winter (1982) avoids strict maximizing assumptions in favour of weaker rationality assumptions, and raises some fundamental questions as to the appropriateness of making strong rationality and informational assumptions on agents who face continuing technological change. Instead of optimizing, agents tend to react automatically to changes in the market environment using routines which are specific to the firm. Successful routines which have produced growth in the past, are likely to do so in the future. It is true that circumstances change, but successful firms have successful routines for changing previous methods to meet new market environments (Hart, 2000).

The relative importance of systematic and stochastic factors in the growth theory may be indicated by the degree of serial correlation in growth. Systematic factors are expected to produce persistent company growth and hence a high degree of serial correlation, in consistency with evolutionary theories of firm growth. This is in contrast to stochastic growth theory such as the LPE which postulate that the proportionate growth of surviving firms is purely random.

Nevertheless, that all the theories discussed above are relevant to the problem under investigation, however, the most appropriate theory to the study is Law of Proportionate Effect—LPE. This is because the theory link the growth of firms to external influences especially taxation.

Empirical Literature

An important aspect of research is the review of related literature sources to discover what has already been done in the specific area of research. Literature review is meant to make the researcher, be familiar with the state of knowledge in the area being studied. Therefore, literature review should be able to interpret research findings relevant to the problems being examined and identify flaws in the works already carried out by earlier researchers. However, extant literatures on the growth of SMEs in Nigeria are mixed and controversial as can been seen below.

Mba and Izunwanne (2014) study issues, challenges and prospects of SMEs in Port-Harcourt city, Nigeria. Using descriptive statistics found that poor financing, inadequate social infrastructures, lack of managerial skills and multiple taxations are the major challenges confronting SMEs in Port-Harcourt. Based on their findings, they recommended that provision of soft loans, capacity building and tax incentives to SMEs operators is imperative to ensure sustained growth of SMEs in the city.

Similarly, Gbandi and Amissah (2014) study financing options for SMEs in Nigeria. Using descriptive statistics, found that SMEs in Nigeria have underperformed despite the fact that SMEs in Nigeria constitute more than 90 percent of the Nigerian businesses, but its contribution to GDP is below 10 percent. Based on their findings, they recommended that developing countries such as Nigeria requiring sustained economic growth must pay attention to SMEs sector and harness their great potential to employment generation and poverty reduction.

In a related development, Kehinde and Sikiru (2014) study financial structure mix: effect on growth and earnings of SMEs in Nigeria. Using descriptive statistics, found that granting pioneering status for tax purpose will go a long way to create a strong earnings base for the SMEs. Therefore, on the basis of their findings, recommended professionalism should be adopted in financial structure mix and management of the SMEs for increased earnings and growth.

In contrast, Abubakar and Yahaya (2013) study strengthening SMEs as a strategy for poverty reduction in North Western Nigerian. Using T- test method of analysis, found that large enterprises contribute more in the area of employment provision than the SMEs. They therefore, on the basis of their findings recommended that government should make a practical approach to poverty alleviation by emphasizing on the strength of the poor and their productive capacity and not on their weaknesses.

Similarly, Machira and Irura (2012) study taxation and SMEs sector growth in Kenya.. Using binary logistic regression, found that there is a significant correlation between taxation and SMEs sector growth. On the basis of their findings, recommended that there should be a friendly tax policy for all start up business preferably a tax holiday or an introduction of a growth limit which can be said to be a level stable enough to sustain tax payment.

In contrast, Ojochogwu and Ojeka (2012), study the relationship between tax policy, growth of SMEs and the Nigerian economy. Using spearman's rank correlation, found that although there is general perception that tax is an important source of fund for development of the economy and provision of social services, a significant negative relationship exists between taxes and the business's ability to sustain itself and to expand. Based on their findings, recommended that inorder to obtain a vibrant and flourishing SME sector, the tax policy needs to be appropriate such that it will not be an encumbrance to the growth of SMEs.

This paper is considered as value addition to the body of knowledge in SMEs for two reasons. Firstly, unlike other studies that are more of macro studies and therefore deductive in nature, this study is a micro study hence inductive in nature. Secondly, while most of the previous studies on the subject matter deal on the issues and challenges facing SMEs in Nigeria, this study focused more specifically on the effect of complex taxation on the growth of SMEs in Nasarwa state.

Methodology

Research Design

The research design adopted for this paper is a cause-effect type that utilizes primary data to evaluate the impact of taxation on the growth of SMEs in Nigeria. The primary data were collected using structure questionnaire. The study investigated three (3) categories of Small and Medium scale Medium Scale Enterprises operating in Nasarawa State who depend largely on it as a major source of their earning. They include Block industry, Bakery and welding respectively. These categories of SMEs were selected on the ground that they are the dominant and trending SMEs in the state.

Population and Sampling

The target population for the study comprises of all SMEs operators in Nasarawa State. However, the study decided to limit the study to Block industry, Bakery and welding. For an SME to qualify as part of the study population, the criteria are the ability of the enterprises to engage at least five (5) paid workers at the current period, having survived in the business for at least five (5) years, the proprietor earns his/her income mainly from the businesses and must be registered with the ministry of commerce and industry. Based on the record of the ministry of commerce and industry in Nasarawa state one hundred and thirty four (134) SMEs in the selected SMEs above met the criteria stated above. Therefore, the population of the study is 134 SMEs that met our criteria. However, for convenience of feasible and effective survey, a sample of 100 respondents was randomly selected for actual field study. Due to the heterogeneity nature of the SMEs, multi-stage sampling technique was used in covering the select SMEs. Our sampling size and procedures is premised on the Yamane's formulae for sample size determination thus:

$$n = \frac{N}{1+N(e)2}$$

Where n = sample size, N = Total population, e = level of significance $(0.05)^2$

$$n = \frac{134}{1+134(0.05)2} = \frac{134}{1+0.33} = \frac{134}{1.335} = 100.37 \sim 100$$

Sources and Instruments of Data collection

The study adopted mainly Primary data that were obtained through the administration of structured questionnaires. The questionnaire was structured and containing simple closed-ended questions formulated in line with the research objectives. It was sub-divided into two parts: Part I dealt with the profile of respondents while part II was on the main research concerns. Each copy of the questionnaire contained a number of questions carefully crafted to address the major issues informing the study.

Method of Data Analysis

The socio-demographical profile of the respondents were measured using nominal scales as a result descriptive statistics, namely frequencies and percentages distributions were used to analyze the socio-demographic variables of the respondents. Influential statistics such as multinomial logistic regression was used to investigate the impact of taxation on SMEs business activities. This is because judging by the magnitude and signs of the coefficient of the explanatory variables (how different types of taxes and unfavourable tax policies) impact on the, dependent variable (SMEs) activities in terms of employment generation, poverty reduction and contribution to (GDP) shows the nature and the extent of the impact.

Hypothesis

H_0 : Taxation has no statistical impact on the growth of SMEs in Nigeria.
H_1 : Taxation has statistical impact on the growth of SMEs in Nigeria.

Presentation and Discussion of Results

The Demographic Characteristic of the Respondents

The total number of questionnaire administered was 100 while the total number of questionnaire returned was 95. This gave a response rate of 95 out of 100, giving a percentage of 95%.Also the non-response rate was 5 out of 100, giving a percentage of 5%. Table 1 below is the descriptive statistics of the demographic characteristics of the respondents.

Table 1: The Demographic Characteristic of the Respondents

	QUESTION	Response	Frequency	Percentage
1	Age	Below 20	5	5.3
		20-30	40	42
		31-40	21	22
		41-50	12	12.6
		51-60	10	10.5
		61 and above	7	7.4
		Total	**95**	**100**
2	Marital status	Single	24	25.3
		Married	55	57.9
		Divorced	16	16.8
		Total	**95**	**100**
3	Experience	Less than 4 years	10	10.5
		5- 10 years	16	16.8
		11- 14years	31	32.6
		14 years and above	38	40
		Total	**95**	**100**
4	**Annual Income**	Less than 100,000	19	20
		100,000-400,000	32	33.7
		400,000-600,000	26	27.4
		600,000-800,000	10	10.5
		800,000-1,000,000	8	8.4
		Total	**95**	**100**
5	**Gender**	Male	79	83.2
		Female	16	16.8
		Total	**95**	**100**

6	**Level of Education**	None Primary Secondary Tertiary	29 30 26 10	30.5 31.6 27.4 10.5
		Total	**95**	**100**
7	**Percentage of income taken as tax**	10 15 20 25 30	13 24 31 27 0	13.7 25.3 32.6 28.4 0
		Total	**95**	**100**

Source: Field Survey, 2018

Table 1 above shows that for the age of the 95 respondents, 5 were below the age of 20, 40 between 20-30 years, 21 between 31-40 years , 12 between 41-50 years , 10 between 51-60 and 7 were 60 and above. The age distribution of the respondents suggests that majority of the operators of SMEs in Nasarawa state are youth. This implies that if their SMEs are not nurtured through simple and ability to pay tax system, coupled with prevailing conflict situations will increase the rate of criminality in the state. According to marital status, 24 were single, 55 were married and 16 divorced. This means that the bulk of the operators of SMEs in the state are bread winners and therefore, the survival of their businesses should be of concern to the state. Among the respondents ,10 have less than 4 years' experience, 16 have 5- 10 years' experience, 31 have 11- 14 years' experiences while 38 have 14 years and above experience.

The implication of this to our study is that the majority of our respondents have outstanding years of experience in SMEs operations and these explicitly add to the robustness of our analysis. In terms of annual income, 19 were on less than 100,000, 32 on 100,000-400,000, 26 on 400,000-600,000, 10 on 600,000-800,000 and 8 were on 800,000-1,000,000. This implies that majority of SMEs operate on low income and may not be able to absorb high and complex tax system. In fact high and complex tax system can easily lead to their early winding up. On the gender dimension of the respondents, 79 were male while 16 were female. This brings to light the disparity in women in SMEs operations in Nasarawa state. The respondents with Tertiary educational qualification were 10, secondary education 26, primary 30 and those with none educational qualification were 29.

This finding has tripartite implications viz: First, is that majority of the operators of SMEs in the state are either illiterate or semi illiterate and may lack adequate information on global SMEs best practices. Secondly, since they possess no requisite certificate for a white collar job, they can be handy tools in hands of politicians to create crisis and finally, if the interest of their businesses are not protected by state, the state may lose their loyalty which may result to militancy. On the responses of the percentage of their income taken as tax, majority of the respondents indicated a very high percentage of 20 and 25 percent. This has the tendency of affecting negatively the level of profit, thereby hindering easy expansion of SMEs that will encourage employment generation, increased income and by implication reduced poverty in the state.

In line with paper's null hypothesis that taxation has no statistical impact on the growth of SMEs business activities, multinomial logistic regression analysis was conducted. This is because while the sign of the multinomial logistic regression captures the nature of the impact, the value of coefficient captures the magnitude of the impact. The result of the multinomial logistic regression is shown in table 2 below.

Table 2: Result of the Multinomial Logistic Regression

Model	13.550974	2	6.77548699	F(2, 415) =	2.60
Residual	1080.92749	415	2.60464457	Prob > F =	0.0754
				R-squared =	0.0124
				Adj R-squared =	0.0076
Total	1094.47847	417	2.62464861	Root MSE =	1.6139

SMEs	Coef.	Std. Err.	t	P>|t|	[95% Conf.	Interval]
HTX	-.2162466	.1202455	-1.80	0.073	-.4526128	.0201196
UFB	-.029077	.1178388	-0.25	0.805	-.2607123	.2025583
_cons	5.567981	.5023176	11.08	0.000	4.580577	6.555385

Source: STATA Output. Where HTX= high taxation system, UFP =unfavorable tax policies

From the result of multinomial regression above, the signs of high tax system (HTX) and unfavorable tax policies (UFP) appeared to be negative. This means that high tax system together with unfavourable tax policies have negative impact on the growth of SMEs in Nasarawa state and by generalization the entire nation. On size, the result revealed that 1% increase in high tax system will reduce the growth of SMEs by 22 % while 1% increase in unfavourable tax policy will reduce the growth of the SMEs by 3%. This finding is in line with the findings of Machira and Irura (2012) on SMEs sector growth in Kenya already reviewed in empirical literature.

Conclusion and Recommendation

The SMEs provide the bedrock of economic growth, spread of opportunities and employment generation. It also provides a strong earnings base for various proprietors of the SMEs. However, over the years the incessant death of SMEs is due to high tax systems. The taxes for SMEs have been more harmful than beneficial as they increase running costs and slow down growth. Most of the SMEs surveyed are faced with the problem of high tax rates, multiple taxation, complex tax regulations and lack of proper enlightenment or education about tax related issues Therefore, the design and application of state tax system represents a significant impediment to formalize and grow SMEs, and for the SMEs to compete in international markets. The findings suggest that, high taxation, and unfavourable tax policy created by the uncoordinated and tax enforcement mechanisms has given rise to significant costs, particularly penalizing smaller and more remote SMEs. This is evident from the fact that the, profits, capital and employment level in these SME's had drastically reduced. It was clear that the SME's in this sector were operating under a heavy tax burden which was prohibiting their growth and development.

Furthermore, employment generation capacities of SMEs are vital in reducing the incidence of poverty among economic agents. One of our major findings in the study is that poverty reduction capacity of SMEs lies to a certain extent on their ability to engage workers sustainably. Therefore, if SMEs are to flourish, simple tax system based on the ability to pay should be implemented as high tax system has been identify as an encumbrance to the growth of SMEs.

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