Abuja Journal of Economics & Allied Fields, Vol. 8(4), Dec., 2018
Print ISSN: 2672-4375; Online ISSN: 2672-4324

Impact of Corporate Tax on Investment Climate of Medium Scale Enterprises: Evidence from Kwara State - Nigeria

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Abstract

Over the years, private sector development is acknowledged globally as an appropriate strategy towards employment generation and general economic growth. However, Poor investment climate has been a significant obstacle to the development and sustainability of this sector and this has served as a cog in the wheel of progress of the overall economic development in many developing nations. This study investigates the relationship between corporate tax and medium scale enterprises' investment in Kwara state. A survey of 120 self- administered questionnaires was undertaking across three manufacturing industries. A total of 80 correctly filled and returned questionnaires were collected and analyzed using simple percentage, one-sample t-test, and correlation and regression analyses. All analyses were carried out within the Statistical Package for Social Sciences. From the results of the tested statistics, the four hypotheses were rejected. The results of the hypotheses reveal a coefficient of multiple determinations is 0.830 which implies that about 83.0% of the variation in investment climate is explained by variables in the model. Therefore, each of the variables in the investment climate (stable electricity, road network and access to finance) contributes significantly to investment decision. More so, correlation between Tax Compliance and Tax education equals 0.860 and same holds for Tax Compliance and Tax Campaign = 0.790, and Tax Education and Tax Campaign = 0.596. These correlation coefficients are highly significant as they are close to 1. The study concludes among others that corporate tax to a large extent has effect on capital accumulation, and it influence investment decision in the study area. It is therefore recommended that the government through various agencies should implement tax laws and policies that stimulate the aggregate level of investment in Kwara state.

Keywords: Corporate tax, Business investment, Tax Policy, Economic growth, Private sector
JEL Codes: E62

1. Introduction

Investment is an integral component of aggregate demand and a major source of economic growth in both developed and developing economies. A change in investment would not only affect aggregate demand but enhance the productive capacity of an economy. Hence, investment plays a vital role in expanding the productive capacity of the economy and promoting long term economic growth (Abiola and Asiweh, 2012). Literatures affirm that in market economy, investment stimulates wealth creation and economic growth. On this premise, private sector (business) investment no doubt remains the engine of growth while the public sector provides the enabling environment. Most significantly, private sector investment contributes to future output, economic growth, current demand and employment generation (Eisner, 1998). However, investment decisions in any economy or sector to a large extent depend on some key factors prominent among which is investment climate – comprises of tax policies, physical infrastructure, access to finance among others. Accordingly, there is much sentiment for encouraging investment, or at least for removing discouraging influences, to permit its economic contributions to be optimal.

The economic notion that there is a relationship between tax laws and investments behavior is founded upon some theoretical foundations put forward by scholars. The political, economic and social development of any country depends on the amount of revenue generated for the provision of infrastructure in that given country. One means of generating the amount of revenue for providing the needed infrastructure is through a well structure tax system. Azubike (2009) is of the view that tax is a major player in every society of the world. The tax system creates a major opportunity for government

additional revenue needed in discharging obligations. The tax system especially tax offers itself as one of the most means of mobilizing a nation's internal and it lends itself to creating an conducive to the promotion of growth. Blumenthal, Christian, & (1998) argue that taxes constitute key revenue to the federation account shared federal, state and local governments.

times, investigation into corporate income its impact on private sector growth has more important. Looking at the corporate rates charge around different business countries of the world, an upward trend is visible in all developed and in few developing countries including Nigeria (Raza, Ali Khan, 2011). The effect of corporate taxes on business investment and exploiting entrepreneurial opportunities is one of the central questions in public entrepreneurial studies. This effect matters greatly for the evaluation and design of tax policy, a key for thinking about economic growth William, Baumol, Robert, Litan, Carl & Schramm, 2007). Hence, of late, many academics, economists, macro-economic researchers and policy makers have become interested in studying the potential effects change in corporate tax on investment decisions emerging economies.

The recent economic recession in Nigeria which is largely caused by serious decline in price of oil in the global market has led to a decrease in the funds available for distribution to the Federal, State and Local Governments. Accordingly, Afuberoh and Okoye (2015) suggestion that there is need for state and local governments to generate adequate revenue from internal sources has therefore become a matter of extreme urgency and importance. This need underscores the eagerness on the part of Federal, State and Local governments to look for new sources of revenue or to become aggressive and innovative in the mode of collecting revenue from existing sources. Part of the major target through which substantial revenue could be mobilized is corporate taxation. Consequently, over the years, corporate tax rate has been increasing while physical development in terms of infrastructures (electricity, good road network among others) that could propel other investments have become dwindling. This inquiry has been a major concern to many potential investors and business owners in Nigeria and especially Kwara state. The purpose of this study, therefore, is to contribute to the frontier of knowledge by investigating the relationship between corporate tax and business investment using Kwara state, Nigeria as the study area. Specifically the study will investigate the extent to which corporate tax rate influences investment decisions among medium scale enterprises, and also assess the impact of tax awareness programmmes on corporate tax compliance by medium scale enterprises

2. Literature Review

Conceptual Clarification

Taxation/Tax/Corporate Tax

The government of any nation has legislative powers to impose on its citizens and businesses any form of tax and at the rate it deemed appropriate (Richardson, 2006). Previous studies agreed that taxation is an obligation on individual and companies to contribute to general social welfarism. In this view, Farayola (1987) described taxation as one of the sources of income for government, such income as used to finance or run public utilities and perform other social responsibilities. Whereas, Ojo (2008) stresses that, taxation is a concept and the science of imposing tax on citizens. Hence, taxation is generally an obligation on individuals and businesses . to contribute to developmental programmes of the government. Tax according to Cassou (1997) is a compulsory levy imposed on a subject or upon his property by the government to provide security, social amenities and create conditions for the economic well-being of the society. Anyanwu (1997) defined Tax as a compulsory payment or levy imposed on income, profit, property, wealth, estate, goods and services of individuals and corporate bodies by the government for the sustenance of its expenditure on numerous activities and for which there is no guarantee direct benefit from the government to the tax payers. According to Ndekwa (2015), people pay tax according to their income and businesses pay tax according to profit made. From the above, it could be deduced that tax is itself a compulsory levy which is required to be paid by every citizen. It is generally considered as a civic duty to citizenry. The imposition of taxation is expected to yield income which should be utilized in the provision of amenities, both social and security and creates conditions for the economic wellbeing of the society.

as physical capital. According to Maqbool, Maaida and Sofia (2010), in the process of investigating the economic performance of any country, one of the key determinants of economic growth is investment. Moreover, most of the countries that grow rapidly invest a considerable fraction of their Gross Domestic Product (GDP) into providing enabling environment for business growth.

According to the United Nation (UN, 2005), investment climate can be explained as access to basic physical infrastructure such as electricity, telephone, water and roads; access to information and advisory services; higher labor productivity; efficient tax administration and tax rates; access to finance; availability and affordability of urban land; business regulations and trade facilitation services, among other elements. On the other hand, business environment connotes all factors that have a bearing on the business such as its strengths, weaknesses, internal power relationships and orientations of the organization; government policies and regulations; nature of the economy and economic conditions: socio-cultural factors: demographic trends; natural factors; and, global trends and cross-border developments. A favourable investment climate provides opportunities and incentives for investors to invest profitably, create jobs, and expand national output thereby increasing private investment and economic growth (World Bank, 2004). Bernal *et al.* (2004) note that improvements in the investment climate in developing countries are key to increasing the flow of investments and, consequently, a higher level of economic growth and development. On this basis, in the world poorest countries, businesses frequently operate under a climate that undermines their incentive to invest and grow. In line with this environment, investors complain about poor infrastructure, particularly power shortages; poor transport; poor telecom connectivity of business locations and inefficient tax administration (Mima and David, 2012; World Bank, 2004).

Small and Medium Enterprises

The term 'Small and Medium Enterprises' (SMEs) has been given different meanings by various scholars and experts in the field of business and management. There is however no universal acceptable definition of the term. It is also important to recognize that definitions changes over a period of time, and depend to a large extent on a country's level of development. For instance, what was large scale in the 1970s may be regarded as small-scale today In the Nigeria economy. Also, what is regarded as small-scale business in one country may be relatively large in another industry or country (Owualah, 1999). The most useful generic definition of small-scale business is perhaps one which might emphasize those characteristics, small-scale firms possessed that make different from those of large firms.

According to Masanai and Fatoki (2012) and Adebayo (2015), there are three prominent characteristics of SMEs in Africa. These are: relatively small share of its market; its owners in personalized manner manages the business enterprise not necessarily through a formalized management structure in large corporations, and finally it is independent as it does not form part of large corporation which can provide a financial umbrella. The above characteristics justifies that SMEs' owners/managers are free in taking their principal decisions and implement such, even though that freedom may be circumscribed by their obligation to outside financial institution. However, the definition of SMEs changes overtime depending on the circumstances because the clarification of businesses into large-scale is a subjective and qualitative judgment (Wolfgang, Kenneth K., Yan Liu, and Dermot, 2014). While a small scale industry is an industry with a total capital employed over 1.5 million naira, but not more than 50 million naira, including working capital but excluding cost of land and /or a labour size of 11 to 100 workers; a medium scale industry is such with a total capital employed of not more than 50 million naira, but not more than 200 million naira, including working capital but excluding cost of land and/or a labour size of 101 – 300 workers

Empirical Review

It is evident in research that high corporate tax is anti-economic growth as it discourages new incentives thereby distorting investment decisions. Ukegbu (2012) studied multiple-tax effect on Gross Domestic Product in Nigeria. The study pointed out the resultant effects of poor investment growth and its low contribution to GDP on Nigeria manufacturing sector due to persistent increase in multiple-taxation. The study found that multiple-taxation has affected the Gross Domestic Product of the country, which has decline from 9.5% in 1975 to 6.65% in 1995, 3.421% in 2010. Similarly, it was further revealed that manufacturing capacity utilization declined rapidly from 70.1% in 1980 to

...% was recorded in 2005 but ... to 45.44% in 2010.

... and Lawson (2006) ... marginal tax rate as witnessed in ... enormous effect on GDP. As ... taxes, individuals get to keep less ... additional earnings. It discourages ... reduce the amount of additional ... is permitted to keep. It also distort ... and encourage individuals to substitute ... tax deductible goods for non- ... that are more desired. High tax rate ... incentives of people to invest in both ... capital. When tax rates are high ... will look for other places to put ... and domestic investment will look for ... abroad were taxes are low. This ... to a reduction in GDP.

... et al (1983), found in a study of 208 ... companies, that the low investment ... was as a result of inadequate ... (rather than general storage of ... low investment opportunities. ... suggested that a policy aimed at ... domestic demand would stimulate ... Kunelgoff and Modigliani (1987) ... a bid to quantity demand, many ... been suggested, including sales, ... and others. But in a study involving ... Kul (1971) demonstrated that sales is ... to explaining investment behavior.

... (1971) estimated a one percent ... of capital as a result of a cut in ... from 52 to 48 persons in 1964. ... using Npi stimulation revealed that ... classification lowering the tax rates ... may actually reduce the Npi of ... whose tax rate is below 35%. ... on foreign investment, the ... has been founded by Moore, ... (1982) as having a weak ... foreign manufacturers'

... their survey of foreign firms in ... executives of such companies ... and local tax rate 15th and 16th ... A survey carried out by Fortunate ... indicated that 20% of the ... and or local taxes on ... as one of the three to five

most important factors in choosing a location. In Nigeria, Mary (1965) found that only six out of twenty-six British companies operating in Nigeria attached much importance to the generous tax incentive offered in Nigeria.

Hakem (1966), in his survey, observed that only 16% respondents selected tax incentive as a factor that influenced their decisions to set up a pioneer industry. In another empirical study carried out by Philip (1969). It was understood that out of 51 companies studies 33 ranked import duty reliefs highest amongst tax incentives available to them. It ranked its second most important. Also, Philips (1969) study 60% of the firms studies thought they probably world set in without tax holiday. 7% were more definite about the unimportance of tax incentives while 35% through otherwise. Other incentives include accelerated depreciation. Hall and Jorgenson depreciation has a 9% reduction in the cost of capital and 17.5% increase in net investment in manufacturing equipment over the period 1854-70.

Theoretical Review

Several theories have been used in literatures to support government influence in private enterprise. Keynesian theory offers useful insights to the understanding of the effect of government intervention and incentives in private enterprises (Ogechukwu, 2011). The Keynesian theory argues that private sector decisions sometimes leads to inefficient macroeconomic outcomes and therefore advocate active policy response by the public sector.

This study adopts the Harberger Capital Tax Theory. Harberger Capital Tax Theory characterized corporate tax as an additional tax levied on capital income originating in the corporate sector, layered on top of the individual income tax collected on capital income from both sectors. He then estimated incidence through the changes in factor prices and product prices that would result from a small increase in the corporate tax. Harberger's main conclusion is probably the most familiar aspect of the paper. In particular, under reasonable assumptions regarding the two sectors' production elasticity of substitution and consumers' elasticity of substitution between the two sectors' products, Harberger showed that the corporate income tax was borne fully by owners of capital, economy-wide. This finding has two important elements. First capital bears the entire tax; it is not shifted to labor

or consumers, the other potential victims in the model. Second, it is all capital, not just corporate capital that bears the tax. Intuitively, the lower after-tax return that would be available in the corporate sector because of the higher tax burden drives capital into the non-corporate sector, pushing down the available non-corporate return and allowing the corporate return to recover.

In equilibrium, the after-tax returns in the two sectors must be equal, and Harberger estimates that this new equilibrium level of after-tax returns will be lower by just the amount consistent with capital bearing the entire corporate tax. Harberger's conclusion, which probably remains the most commonly held view on corporate tax incidence, indicated that the corporate tax was less progressive than under the shareholder-incidence assumption because shareholders as a group (at least in 1962, when pension funds accounted for a much smaller ownership share) were more affluent than owners of capital as a whole, a large share of which is owner-occupied housing. But aggregate capital ownership is more concentrated among higher-income individuals than consumption or labor income, and so the corporate income tax could still be seen as contributing to tax progressivity. Another message of Harberger's work, though, was that the corporate income tax distorted the allocation of capital between corporate and non-corporate uses in a way that an overall capital income tax did not. If the incidence of the two taxes were the same, then the only "contribution" of the corporate tax was gratuitous deadweight loss. Indeed, the subsequent optimal taxation literature supported the notion that taxes that distort production decisions are to be eschewed when sufficient other tax instruments are available (Diamond and Mirrlees 1971). Thus, Harberger's analysis has also lent support to the view that corporate tax is not a necessity or desirable component of an efficient, progressive tax system.

3. Methodology

This research adopts a positivism approach with the use of a survey design. The positivism philosophy generates hypotheses (or research questions) that can be tested and 'allows explanations that are measured against accepted knowledge. Hence, the emphasis is on quantifiable results that lend themselves to statistical analysis. For the purpose of this study, the population of interest consists of medium scale enterprises operating in Kwara State, domiciled in capital city – Ilorin, and who have records of tax payment with the Kwara State Internal Revenue Service till February 2017.

A non-probability sampling design was adopted and a purposive sampling procedure used. In other words, under non-probability sampling the researcher purposively choose the particular units of the universe for constituting a sample on the basis that the small mass that they so select out of a huge one will be typical or representative of the whole (Kothari, 2004). The choice of this sampling design was informed by the homogenous characteristics of large scale enterprises in the selected area.

Primary data was gathered specifically for this work with the use of self-administered questionnaire to obtain opinions directly from respondents, i.e. selected sample. The choice of this method was to increase the commitment of the stakeholders. To obtain the required data/information, a detailed questionnaire was prepared and administered to various companies that constitute the study respondents. A total of one hundred and twenty questionnaires were distributed among the three selected companies – Bioraj Industry Ltd, Tuyil Pharmaceutical Ltd and LUBCON Group. The design of the questionnaire was based on a 5-point Likert attitude scale. Each level of the scale is represented as 5-Strongly Agree, 4-Agree, 3-Undecided, 2-Disagree and 1-Strongly Disagree.

This study adopted both descriptive and inferential statistics for the analysis of data gathered through the questionnaire. The descriptive analysis makes use of such tools as; tables, frequency distributions and percentages. The use of Pearson's Correlation and Multiple Regression were adopted for the inferential statistical analyses. In order to measure the type of relationship that exists between the dependent variable and each of the independent variables, the Pearson's correlation coefficient was used, while regression analysis was adopted to measure the impact among two or more variables.

Research Hypotheses

From the above two hypotheses was raised as follows

Ho_1: Corporate tax rate does not significantly influence investment climate of medium scale enterprises,

Ho_2: Tax awareness programmes have no significant impact on corporate tax

...among nation wide ...carried out using the procedures within the Statistical Package for Social Sciences (SPSS) at a 5% significant level, i.e. $\alpha = 0.05$.

...we used using Pearson ...and hypothesis II (Ho2) was ...analysis. All data were ...

...(Correlation Analysis)

Test of Hypothesis I

Ho: Corporate tax rate does not have any significant relationship on investment climate.

	Tax Rate	Physical Infrastructure	Policy Support
...Correlation	1	.760	.661
Sig. (tailed)		.000	.000
	80	80	80
...Correlation	.660	1	.556
Sig. (tailed)	.000		.014
	80	80	80
...Correlation	.790	.556	1
Sig. (tailed)	.000	.014	
	80	80	80

...Regression Analysis)

Hypothesis II

Ho: tax awareness programmes have no significant impact on corporate tax compliance

...the correlation between tax rate ...coefficient equals 0.760 and this is ...ve ratio for tax rate and policy ...ve policy support and physical ...The correlation coefficients ...to one is 1. These show ...between the variables is strong ...ated.

The Independent variable is Tax Awareness Programmes represented by (TA) while dependent variable is Tax Compliance (TC). TA was proxy by:

Tax Education (TE)
Media Tax Campaign (MC)
Tax Officers Behaviour (OB)

...Regression Analysis)

...mary[b]

...	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
...	.830	.807	.31678	2.761

...(MC), (OB), b. Dependent Variable: (TC)

...the coefficient of multiple ...the implication of this is that ...relation in Tax Compliance ...variables in the model; i.e. ...Media Tax Campaign (MC), Tax Officers Behaviour (OB), while the remaining 20.9% is explained by other factors which are not included in the model. The regression equation (model formulated) proved to be very useful for making predictions since the value of R^2 is close to 1.

Sum of Squares	Df	Mean Square	F	Sig.
312.204	3	85.441	837.406	.0000[a]
48.694	76	.088		
360.898	79			

, TE,MC,OB: b. Dependent Variable: TA

/A table is analyzed to see if e significant. The F-statistic is 76 degrees of freedom using ANOVA table, $F = 837.406$,)5 (sig.). Since p-value < 0.05 null hypothesis is rejected and the alternative accepted. This implies that at least one of the predictors is functional for measuring Tax Compliance, therefore the model is useful.

cients[a]

	Unstandardized Coefficients		Standardized Coefficients		
	B	Std. Error	Beta	T	Sig.
	4.322	.492		9.797	.000
tion	.271	.098	.096	2.395	.004
npaign	.202	.093	.422	4.191	.000
behaviour	.196	.091	.407	6.915	.002

ble: Tax Rate

provides information on the effect ables (the "Estimated Coefficients" dependent variable. The coefficient is 2.395 with p-value of 0.004 less cal value), the coefficient of Media 91 with p-value of 0.000 less than cal value), and the coefficient of our is 6.915 with p-value of 0.002 5% (critical value). This implies that ables has contributed to the model. ue of all the dependent variables are s demonstrated above, we reject H0 hat tax awareness has a significant ompliance at 0.05 significant levels.

can use the values in the **"B"** column **standardized Coefficients"** column, regression equation as:

nce (TA) = 4.322 +0.271(TE) + 0.196(OB)

Findings

of this study was to investigate the orporate tax on business investment m the analyses of hypotheses one, it was hat certain factors influence investment decision in the study area. These factors are physical infrastructure such as stable electricity, good medical facilities, road network, policy support among others determine investment decision. This connotes that decisions to invest in a state could be facilitated by investing in the physical infrastructure and policy support by the government. This finding supports former investigations by Onakoya, Fasanya and Abdulraheem (2013) that poor physical infrastructure such as electricity, good road, access to finance, portable water, good health care among others do not often create a good climate for investment in Nigeria.

From the analyses of hypotheses two, it was established that tax awareness programmes have significantly effect on tax compliance in the study area. This means that creating constant awareness about tax compliance in the media and tax education to the public has significant positive impact on tax compliance among the corporate bodies. This study supported former related studies by (Adebayo, 2015) who found that adequate tax awareness, perceived benefit of tax payment and legal consequence for tax evasion increase tax compliance among corporate organizations in Kwara state. As

findings, it was shown that there is a positive relationship between tax awareness and tax compliance.

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