POLAC MANAGEMENT REVIEW (PMR)
DEPARTMENT OF MANAGEMENT SCIENCE
NIGERIA POLICE ACADEMY, WUDIL-KANO

TAXATION AND SME GROWTH IN NIGERIA: BUILDING RESILIENCE DURING MACROECONOMIC SHOCKS

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Abstract

Small and Medium Enterprises (SMEs) are widely recognized as the engine of economic growth, employment generation, innovation, and poverty reduction in Nigeria. Despite their strategic importance, the sector continues to experience significant challenges arising from persistent macroeconomic shocks, including rising inflation, exchange rate volatility, high interest rates, energy price increases, and fiscal uncertainties. These shocks have increased operating costs, weakened consumer purchasing power, constrained access to finance, and reduced business competitiveness. Within this context, taxation assumes a dual role. While tax revenue remains indispensable for financing public infrastructure and socioeconomic development, an inefficient tax system characterized by multiple taxation, high compliance costs, and administrative complexities may further constrain SME growth. This paper critically examines the relationship between taxation and SME growth in Nigeria within the broader context of macroeconomic shocks and business resilience. Adopting a qualitative review approach and anchored on the Benefit Theory of Taxation, the paper synthesizes contemporary literature, policy reports, and institutional publications to explore how taxation influences SME performance, innovation, and adaptive capacity. It argues that the impact of taxation on SMEs extends beyond statutory tax rates to include the quality of tax administration, compliance procedures, fiscal policy consistency, and the availability of targeted tax incentives. The paper further demonstrates that resilient SMEs increasingly rely on business model innovation, digital transformation, financial prudence, and operational flexibility to withstand economic disruptions. Consequently, tax policy should complement rather than undermine these adaptive strategies. The paper concludes that creating a predictable, transparent, and innovation-friendly tax environment is essential for enhancing SME resilience and supporting sustainable economic development in Nigeria. It recommends simplified tax administration, harmonization of taxes across government levels, digital tax compliance systems, and targeted fiscal incentives for growth-oriented SMEs.

Keywords: Taxation; Small and Medium Enterprises; Business Resilience; Macroeconomic Shocks; Fiscal Policy; Nigeria.

1. Introduction

Small and Medium Enterprises (SMEs) occupy a central position in the economic architecture of both developed and developing economies. Beyond serving as engines of innovation and entrepreneurship, SMEs contribute substantially to employment creation, income generation, industrial development, and inclusive economic growth (Ayyagari et al., 2007). Across many developing countries, SMEs account for the majority of business establishments and constitute an important source of livelihood, particularly where formal employment opportunities remain limited. In Nigeria, the SME sector has continued to expand despite challenging business conditions (Small and Medium Enterprises Development Agency of Nigeria [SMEDAN] & National Bureau of Statistics [NBS], 2021), reflecting the entrepreneurial capacity and adaptability of Nigerian business owners. SMEs operate across diverse sectors, including agriculture, manufacturing, trade, construction, transportation, hospitality, information technology, and professional services, thereby making significant contributions to national output and economic diversification.

The strategic importance of SMEs has become even more pronounced as governments increasingly recognize private sector development as a critical driver of sustainable economic transformation. In Nigeria, public policies have consistently emphasized entrepreneurship development and SME support through institutional interventions, financial inclusion programmes, and regulatory reforms. Nevertheless, the operating environment remains characterized by structural and macroeconomic challenges that continue to undermine business performance. According to the OECD (2023), SMEs globally have become increasingly vulnerable to successive economic disruptions, including inflationary pressures, tightening monetary conditions, supply chain disruptions, and geopolitical uncertainties, necessitating stronger resilience strategies and supportive public policies.

Nigeria's macroeconomic environment has become particularly challenging in recent years. Persistent inflation, exchange rate depreciation, rising borrowing costs, energy price increases following fuel subsidy reforms, and foreign exchange constraints have significantly increased the cost of doing business. These developments have adversely affected production costs, inventory management, working capital requirements, and investment decisions. The World Bank (2024) observes that although recent fiscal and exchange-rate reforms are intended to restore macroeconomic stability and improve long-term growth prospects, businesses continue to face considerable adjustment costs in the short term due to elevated inflation and economic uncertainty.

Within this challenging environment, taxation represents one of the most important instruments of fiscal policy. Governments rely on taxation to mobilize revenue for financing infrastructure, education, healthcare, security, and other public goods necessary for economic development (Musgrave & Musgrave, 1989). A well-designed tax system promotes resource allocation, fiscal sustainability, and market efficiency while creating an enabling environment for private investment. Conversely, poorly administered tax systems characterized by multiple taxation, inconsistent policies, administrative bottlenecks, and high compliance costs may discourage business formalization, reduce profitability, and limit enterprise growth (Atawodi & Ojeka, 2012).

For Nigerian SMEs, the taxation challenge extends beyond statutory tax obligations. Many enterprises contend with overlapping taxes and levies imposed by different tiers of government, frequent regulatory changes, inadequate taxpayer education, and administrative inefficiencies that increase compliance costs (Ilemona et al., 2019; Ilodigwe, 2023). These challenges are particularly significant for micro and small enterprises with limited managerial and financial capacity. Consequently, the burden associated with tax compliance may divert scarce resources away from productive investment, innovation, technology adoption, and business expansion.

The relationship between taxation and SME growth has therefore attracted increasing scholarly and policy attention. Existing studies present mixed findings. On one hand, excessive tax burdens and complex compliance requirements have been associated with reduced profitability, lower investment, business informality, and slower enterprise growth (Adewara et al., 2023; Atawodi & Ojeka, 2012; Ilodigwe, 2023). On the other hand, predictable tax systems, simplified compliance procedures, digital tax administration, and targeted tax incentives have been shown to encourage business formalization, investment, innovation, and long-term competitiveness (Bird & Zolt, 2008; Joshi et al., 2014). Recent evidence also suggests that effective fiscal policy should focus not only on revenue generation but also on creating an enabling environment that enhances enterprise resilience during periods of economic uncertainty (OECD, 2023).

The concept of resilience has gained increasing prominence in contemporary SME literature. Business resilience refers to the capacity of enterprises to anticipate, withstand, adapt to, and recover from adverse shocks while maintaining operational continuity and long-term competitiveness (Duchek, 2020). Rather than merely surviving economic crises, resilient firms continuously modify their business models, adopt new technologies, diversify revenue sources, strengthen financial management, and improve operational efficiency. For many Nigerian SMEs, resilience has become a strategic necessity rather than a competitive advantage.

Business model innovation constitutes an important component of this resilience process. SMEs increasingly leverage digital platforms, electronic payment systems, cloud-based accounting applications, e-commerce, social media marketing, and flexible supply chain arrangements to respond to changing market conditions (Alake et al., 2024). Such innovations not only improve operational efficiency but also facilitate tax compliance through improved record-keeping and digital reporting systems. Consequently, taxation should be viewed not solely as a revenue collection mechanism but also as a policy instrument capable of supporting innovation, productivity, and sustainable enterprise development.

Against this background, this paper examines how taxation influences SME growth within the context of Nigeria's evolving macroeconomic environment. It argues that the effectiveness of taxation should not be assessed exclusively by the amount of revenue generated but also by its capacity to promote entrepreneurship, encourage innovation, and strengthen business resilience. The paper further contends that sustainable SME development requires a balanced fiscal framework in which revenue mobilization objectives are harmonized with policies that reduce compliance burdens, improve tax administration, and incentivize productive investment. Such an approach is essential for enabling Nigerian SMEs to adapt successfully to macroeconomic shocks while contributing meaningfully to employment generation, economic diversification, and sustainable national development.

Research Gap and Contribution of the Study

Although considerable attention has been given to the role of SMEs in economic development, existing discussions often examine SME growth from the perspectives of access to finance, entrepreneurship, infrastructure, and managerial capabilities (Ayyagari et al., 2007; Beck et al., 2005). Similarly, studies on taxation in Nigeria have largely focused on tax compliance behaviour, revenue mobilization, multiple taxation, and administrative challenges (Adewara et al., 2023; Afo & Kim, 2022; Atawodi & Ojeka, 2012; Ilemona et al., 2019; Ilodigwe, 2023; Kingsley et al., 2022). However, limited attention has been given to the interaction between taxation, business model innovation, and SME resilience within the context of persistent macroeconomic shocks in Nigeria.

The existing literature provides insufficient explanation of how tax systems influence the adaptive capacity of SMEs during periods of economic uncertainty. In particular, there is limited exploration of taxation as both a potential constraint and an enabling mechanism for resilience. While excessive tax burdens, compliance costs, and regulatory complexities may weaken SME performance, supportive tax policies, simplified administration, and digital tax systems may encourage formalization, innovation, and sustainable growth.

Furthermore, previous studies have often treated SMEs as passive recipients of economic shocks rather than active organizations capable of developing innovative responses. Even recent Nigerian evidence linking business model innovation to SME resilience (Alake et al., 2024) does not consider the role of the tax system. This paper addresses this limitation by integrating taxation with business model innovation and resilience perspectives. It argues that SME survival and growth during macroeconomic disruptions depend not only on reducing tax burdens but also on creating a tax environment that encourages adaptation, technology adoption, and productivity improvement.

The paper contributes to the literature by providing a conceptual framework linking taxation, SME growth, and resilience in Nigeria. It extends existing discussions by positioning taxation within the broader debate on economic adaptation and business model innovation, thereby offering insights for policymakers, tax administrators, and SME operators seeking sustainable approaches to enterprise development.

2. Literature Review

2.1 Conceptual Review

Taxation

Taxation represents a compulsory financial contribution imposed by government on individuals, businesses, and other economic entities to finance public expenditure and achieve broader economic and social objectives (Musgrave & Musgrave, 1989). Beyond its traditional role as a source of government revenue, taxation serves important regulatory and developmental functions, including income redistribution, economic stabilization, resource allocation, and the promotion of specific economic activities. In developing economies such as Nigeria, taxation has gained increased attention due to the need to reduce dependence on volatile sources of public revenue and strengthen domestic resource mobilization (World Bank, 2024).

The effectiveness of a tax system depends not only on the level of tax rates but also on the broader institutional environment within which taxation operates. A well-designed tax system should demonstrate principles of simplicity, fairness, transparency, predictability, and administrative efficiency (Musgrave & Musgrave, 1989). These principles are particularly important for SMEs because smaller firms often have limited financial, managerial, and technological resources to manage complex tax obligations (Atawodi & Ojeka, 2012).

For SMEs, taxation represents both an obligation and an institutional relationship with government. On one hand, tax payments contribute to the provision of public infrastructure, security, regulatory frameworks, and other services that support business activities. On the other hand, inefficient tax systems may increase operating costs and create barriers to business formalization and expansion (Joshi et al., 2014). Therefore, the effect of taxation on SME growth is largely determined by the quality of tax administration, taxpayer compliance mechanisms, and the extent to which tax policies recognize the unique characteristics and limitations of small businesses.

In Nigeria, tax administration reforms have increasingly emphasized digitalization, taxpayer identification systems, electronic filing, and improved compliance monitoring. The most far-reaching of these are the tax reform laws signed in June 2025 and effective from 1 January 2026, comprising the Nigeria Tax Act, the Nigeria Tax Administration Act, the Nigeria Revenue Service (Establishment) Act, and the Joint Revenue Board (Establishment) Act. Among other provisions, the reforms consolidate several earmarked levies into a single development levy and exempt qualifying small companies from companies income tax, capital gains tax, and the development levy (Federal Republic of Nigeria, 2025). These reforms are intended to enhance revenue collection while reducing administrative burdens. However, challenges remain, particularly regarding multiple taxation, coordination among government agencies, taxpayer awareness, and the capacity of small businesses to comply with evolving requirements (Ilemona et al., 2019; Ilodigwe, 2023). For SMEs operating under difficult economic conditions, the interaction between tax obligations and broader macroeconomic pressures becomes an important determinant of business sustainability.

Small and Medium Enterprises (SMEs)

Small and Medium Enterprises constitute a diverse group of businesses that differ in terms of capital base, number of employees, turnover, ownership structure, and operational scope. Although definitions vary across countries and institutions, SMEs are generally classified based on measurable criteria such as employment size and asset value (Ayyagari et al., 2007). In Nigeria, the classification of SMEs is primarily based on employment and asset considerations, as provided by the Small and Medium Enterprises Development Agency of Nigeria (SMEDAN & NBS, 2021).

SMEs are recognized as important contributors to economic development because of their ability to create employment opportunities, promote entrepreneurship, encourage innovation, and support local economic activities (Ayyagari et al., 2007). Their relatively flexible structures allow them to respond quickly to changing consumer preferences and emerging market opportunities. Unlike large corporations, SMEs often operate with simpler organizational arrangements, enabling faster decision-making and adaptation.

Despite these advantages, SMEs are among the most vulnerable categories of businesses during periods of economic uncertainty. Their vulnerability arises from several factors, including limited access to finance, inadequate infrastructure, dependence on local markets, weak managerial capacity, and limited ability to absorb sudden increases in operating costs (Beck et al., 2005; OECD, 2023). Consequently, macroeconomic shocks often have disproportionate effects on SMEs compared with larger firms.

The Nigerian SME sector illustrates this vulnerability. Although SMEs contribute significantly to employment and economic activity, many businesses operate within an environment characterized by high production costs, unstable electricity supply, foreign exchange challenges, and regulatory uncertainties (SMEDAN & NBS, 2021; World Bank, 2024). These constraints influence their ability to invest in technology, improve productivity, and achieve sustainable growth.

In this paper, SME growth is understood broadly to include not only increases in sales, profitability, and assets but also improvements in productivity, innovation capacity, and employment. Such growth is shaped by internal capabilities as well as by the external policy environment, of which taxation is an important part (Ilemona et al., 2019; OECD, 2023).

Macroeconomic Shocks

Macroeconomic shocks refer to unexpected economic events or policy changes that significantly affect economic conditions and business operations. These shocks may originate from domestic sources, such as fiscal policy changes, inflationary pressures, currency instability, and energy price adjustments, or external sources, such as global financial crises, commodity price fluctuations, pandemics, and geopolitical disruptions (OECD, 2023).

For Nigerian SMEs, macroeconomic shocks have become increasingly frequent and complex. Inflation has significantly affected input costs, transportation expenses, wages, and consumer purchasing power. Exchange rate volatility has increased the cost of imported raw materials, machinery, and technology, particularly for SMEs dependent on foreign inputs. Similarly, energy-related challenges have increased reliance on alternative power sources, thereby raising operational expenses (World Bank, 2024).

Macroeconomic shocks affect SMEs through multiple channels. First, they increase production and operating costs, reducing profit margins. Second, they weaken consumer demand as households adjust spending patterns. Third, they increase uncertainty, making business planning and investment decisions more difficult. Finally, they constrain access to finance as financial institutions become more cautious during periods of economic instability (Beck et al., 2005; OECD, 2023).

However, economic shocks do not necessarily lead to business failure. Their effects depend significantly on the adaptive capacity and resilience of individual firms. SMEs that possess strong managerial capabilities, flexible strategies, diversified income sources, and innovative business models are more likely to survive and recover from adverse economic conditions (Alake et al., 2024; Duchek, 2020).

Business Resilience

Business resilience refers to the ability of an enterprise to anticipate, absorb, adapt to, and recover from disruptions while maintaining continuity and pursuing future growth opportunities (Duchek, 2020). Unlike traditional approaches that focus primarily on crisis survival, contemporary resilience thinking emphasizes adaptability, innovation, and continuous transformation.

For SMEs, resilience involves developing capabilities that enable firms to respond effectively to changing business environments. These capabilities may include financial flexibility, technological adoption, strategic partnerships, customer diversification, efficient resource management, and innovative approaches to service delivery (Duchek, 2020; OECD, 2023).

The experience of Nigerian SMEs demonstrates that resilience increasingly depends on business model innovation. Many enterprises have adopted digital payment platforms, online marketing channels, remote service delivery models, and alternative supply arrangements to manage economic pressures. Such innovations enable SMEs to reduce costs, access wider markets, improve customer engagement, and strengthen competitiveness (Alake et al., 2024).

Taxation interacts with business resilience in several ways. A burdensome tax environment may reduce the financial resources available for innovation and adaptation (Adewara et al., 2023). Conversely, a supportive tax framework, including simplified compliance procedures and targeted incentives, can encourage SMEs to invest in productivity-enhancing activities (OECD, 2023). Therefore, tax policy has important implications for the resilience and long-term sustainability of SMEs.

2.2 Theoretical Framework

The relationship between taxation, SME growth, and business resilience can be examined through several theoretical lenses. However, because the central concern of this paper is whether the tax system constrains or enables SMEs, the study is anchored on the Benefit Theory of Taxation, which directly addresses the exchange relationship between taxpayers and the state.

Benefit Theory of Taxation

The Benefit Theory of Taxation, a long-standing principle of public finance, suggests that individuals and businesses should contribute to government revenue in proportion to the benefits they receive from public services and infrastructure (Musgrave & Musgrave, 1989). The theory views taxation as an exchange relationship between taxpayers and government, where tax payments provide the resources required for the delivery of services that support economic activities.

Applied to SMEs, the theory implies that taxation can contribute positively to enterprise growth when tax revenues are efficiently converted into productive public goods. Reliable infrastructure, transportation networks, security, regulatory institutions, and business support programmes can reduce operating costs and enhance competitiveness. In such circumstances, taxation becomes an investment in the broader business environment rather than merely a financial burden. Consistent with this view, SME operators surveyed in Enugu State strongly agreed that applying tax revenue for the visible benefit of small businesses would ease the problems associated with multiple taxation (Ilodigwe, 2023).

However, the practical relevance of this theory depends heavily on the effectiveness of government institutions. Where businesses perceive limited benefits from taxation due to inadequate infrastructure, inefficient public services, or regulatory weaknesses, taxation may be viewed primarily as a cost. This perception can negatively influence tax compliance behaviour and weaken the relationship between SMEs and tax authorities (Afo & Kim, 2022; Atawodi & Ojeka, 2012).

In the Nigerian context, the theory highlights the importance of linking tax revenue mobilization with visible improvements in the business environment. For SMEs facing rising operational costs and macroeconomic uncertainty, the value derived from public expenditure becomes a significant factor influencing whether taxation supports or constrains resilience.

The Benefit Theory is adopted as the anchor of this study because it explains both sides of the argument advanced in the paper. Where tax revenue is converted into reliable infrastructure, security, and business support, and where the tax system itself is simple and predictable, taxation strengthens the operating environment that SMEs need to absorb and adapt to macroeconomic shocks. Where, conversely, taxes are multiple, costly to comply with, and weakly linked to visible public benefits, they drain the resources SMEs require for innovation and adaptation. The theory therefore provides a coherent basis for examining taxation as either a constraint on or an enabler of SME growth and resilience in Nigeria.

3. Discussion of Results

This section presents and discusses the results of the review, drawing together the conceptual, theoretical, and empirical literature on how taxation shapes SME growth and resilience in Nigeria.

3.1 Taxation and SME Growth in Nigeria

The relationship between taxation and SME growth in Nigeria remains complex and multidimensional. While taxation is necessary for financing government activities and creating the institutional environment required for economic development, the structure and administration of the tax system significantly influence how SMEs operate, invest, and expand. For SMEs, the impact of taxation is not determined solely by statutory tax rates but also by compliance procedures, administrative efficiency, transparency, and the overall business environment within which taxes are imposed (Atawodi & Ojeka, 2012; Ilemona et al., 2019).

Nigeria's tax system has undergone several reforms aimed at improving revenue generation, broadening the tax base, and enhancing compliance, most recently through the 2025 tax reform laws (Federal Republic of Nigeria, 2025). These reforms have become increasingly important due to the country's need to reduce dependence on oil revenue and strengthen domestic resource mobilization (World Bank, 2024). However, the success of tax reforms must also be assessed based on their implications for productive sectors, particularly SMEs that often operate with limited financial capacity and managerial resources.

3.2 Tax Burden and SME Performance

Tax burden remains one of the major concerns affecting SME performance in Nigeria. Although taxation is a legitimate obligation of businesses, excessive tax obligations relative to business capacity may reduce profitability and restrict resources available for reinvestment. SMEs generally operate with smaller profit margins compared with larger firms; therefore, additional financial pressures arising from taxes, levies, and compliance requirements can significantly influence their survival and growth prospects.

The effect of tax burden on SMEs is particularly significant during periods of macroeconomic instability. When inflation increases the cost of raw materials, transportation, labour, and energy, businesses experience declining profit margins (World Bank, 2024). Additional tax obligations during such periods may further constrain their ability to maintain operations, invest in technology, or expand into new markets.

However, it is important to distinguish between taxation itself and inefficient tax administration. A properly designed tax system should not necessarily discourage business activity. Instead, the challenge arises when tax obligations are unpredictable, poorly coordinated, or imposed without consideration of prevailing economic conditions. Therefore, the focus of tax policy should be on achieving a balance between revenue mobilization and enterprise sustainability.

Empirical evidence from Nigeria suggests that tax-related pressures influence SME performance through their effects on profitability, investment capacity, and operational efficiency. Studies on SMEs indicate that high tax rates, complex filing procedures, and compliance difficulties contribute to reduced willingness among small business operators to expand their enterprises. In particular, Atawodi and Ojeka (2012) found that high tax rates and complex tax procedures were significant factors affecting tax compliance behaviour among SMEs in North-Central Nigeria.

3.3 Multiple Taxation and Compliance Challenges

One of the frequently cited challenges facing Nigerian SMEs is multiple taxation. Multiple taxation occurs when businesses are subjected to similar or overlapping taxes, levies, and charges by different levels of government (Ilemona et al., 2019). This issue increases the financial and administrative burden on enterprises, particularly small businesses that may lack specialized accounting and tax personnel.

For SMEs, compliance costs extend beyond the amount of tax paid. They include the time spent understanding tax requirements, maintaining records, preparing documentation, interacting with tax officials, and responding to regulatory demands. These indirect costs may discourage entrepreneurs from formalizing their businesses or divert resources away from productive activities (Joshi et al., 2014).

The challenge of multiple taxation also creates uncertainty in business planning. Entrepreneurs require a predictable regulatory environment to make investment decisions, but inconsistent tax demands may make it difficult for SMEs to estimate future costs and profitability. This uncertainty is particularly harmful during periods of economic shocks when businesses require flexibility and financial stability.

Efforts to address multiple taxation through harmonization, improved coordination among tax authorities, and clearer assignment of taxing responsibilities are therefore essential. A simplified tax environment would reduce compliance costs and encourage SMEs to operate formally, thereby expanding the tax base over the long term.

Empirical studies have consistently identified multiple taxation as a significant constraint on SME operations in Nigeria. Ilodigwe (2023) reported that multiple taxation makes it difficult for SMEs in Enugu State to carry out production activities, reduces their production and service-rendering capacity, and makes their management more difficult. Similarly, Adewara et al. (2023) found that multiple tax burdens and multiple tax administration were significantly and negatively related to the financial performance of SMEs in Ekiti State, and Kingsley et al. (2022) reported a negative relationship between multiple taxation and SME performance in Kaduna State, suggesting that excessive tax demands may reduce profitability and hinder business expansion. Ilemona et al. (2019) likewise examined the effect of multiple taxes on the growth of Nigerian SMEs, using the expansion rate of the businesses as a measure of growth.

3.4 Tax Compliance and Informality among SMEs

A significant proportion of Nigerian SMEs operate within the informal sector (SMEDAN & NBS, 2021). While informality provides opportunities for entrepreneurship and income generation, it also limits access to formal financing, government support programmes, and structured business development opportunities.

Tax compliance is closely linked with formalization. Many informal businesses remain outside the tax system due to concerns about compliance costs, regulatory complexity, and limited awareness of tax obligations (Joshi et al., 2014). However, excessive enforcement approaches without adequate taxpayer education and support may discourage formalization rather than promote it.

A more effective approach involves simplifying compliance procedures, improving taxpayer education, and demonstrating the benefits of formal participation. When SMEs perceive tangible advantages from formalization, such as access to credit, government programmes, business support services, and improved market opportunities, they are more likely to comply voluntarily.

The transition from informal to formal business operations is particularly important for SME resilience. Formal businesses generally have better access to financial services, improved record-keeping practices, and stronger capacity to withstand economic disruptions.

The challenge of tax compliance among SMEs is influenced by several factors, including awareness, perceived fairness of the tax system, administrative complexity, and taxpayer education. Research on Nigerian SMEs indicates that improving compliance requires not only enforcement mechanisms but also simplified procedures and stronger engagement between tax authorities and businesses (Atawodi & Ojeka, 2012). Afo and Kim (2022) found that factors influencing SME tax compliance in Nigeria include institutional and behavioural considerations affecting voluntary compliance.

3.5 Digital Tax Administration and SME Development

Digital transformation has become an important component of modern tax administration. The adoption of electronic tax registration, online filing systems, digital payment platforms, and automated compliance processes has the potential to improve efficiency and reduce administrative burdens (Bird & Zolt, 2008).

For SMEs, digital tax administration can provide several benefits. First, it reduces physical interactions with tax authorities and lowers transaction costs associated with compliance. Second, it improves transparency and record management. Third, it supports the broader digital transformation of businesses by encouraging the adoption of accounting and financial management technologies.

The relevance of digitalization extends beyond tax administration to broader SME resilience. Digital technologies can improve record keeping, financial management, customer engagement, and operational flexibility. Recent evidence from Nigerian SMEs suggests that technology-driven business model innovation contributes to resilience by enabling enterprises to adapt their operations during periods of uncertainty (Alake et al., 2024).

However, digital tax systems must consider the realities faced by many Nigerian SMEs, including limited digital skills, inadequate internet access, and technological constraints. Without appropriate support mechanisms, digitalization may unintentionally exclude smaller enterprises that lack the capacity to adopt new systems (Bird & Zolt, 2008).

Therefore, successful digital tax reform requires not only technological platforms but also taxpayer education, infrastructure development, and continuous engagement with SMEs. When properly implemented, digital taxation can strengthen compliance while supporting business modernization.

3.6 Tax Incentives and Innovation-Oriented SME Growth

Tax incentives represent an important policy mechanism for encouraging investment, innovation, and entrepreneurship. Governments often use tax incentives to support strategic sectors, promote technological adoption, encourage research and development, and stimulate economic growth (OECD, 2023).

For Nigerian SMEs, targeted tax incentives can provide resources that support innovation and competitiveness. Such incentives may include simplified tax regimes for small businesses, investment allowances, exemptions for specific categories of enterprises, and support for technology-driven businesses. The exemption of qualifying small companies from companies income tax, capital gains tax, and the development levy under the 2025 tax reform laws is a recent example of this approach (Federal Republic of Nigeria, 2025).

However, the effectiveness of tax incentives depends on their design, transparency, and accessibility. Incentives that are complicated to access or poorly communicated may have limited impact, particularly for SMEs with weak administrative capacity. Consequently, tax incentives should be simple, transparent, and aligned with broader SME development objectives.

Within the context of macroeconomic shocks, tax incentives can strengthen resilience by enabling SMEs to preserve cash flow, invest in productivity improvements, and adopt innovative business models. For example, incentives supporting digital adoption may help SMEs transition to online platforms, improve operational efficiency, and access new markets.

3.7 Taxation and Business Model Innovation during Economic Shocks

Macroeconomic shocks have accelerated the need for SMEs to rethink traditional business approaches. Rising costs, changing consumer behaviour, and supply disruptions have encouraged many Nigerian SMEs to adopt innovative strategies for survival and growth (Alake et al., 2024).

Business model innovation involves redesigning how businesses create, deliver, and capture value. For SMEs, this may include adopting digital sales channels, diversifying products and services, forming strategic partnerships, improving supply chain management, and introducing cost-efficient operating models.

Taxation interacts with these innovation strategies in important ways. A supportive tax environment can provide SMEs with the financial flexibility required to invest in innovation. Conversely, excessive compliance burdens may reduce available resources for adaptation.

The relationship between taxation and innovation is therefore not simply about reducing tax obligations. Rather, it involves designing tax systems that encourage productive investment, improve transparency, and reward enterprises that contribute to economic transformation. SMEs that successfully integrate innovation with effective financial and tax management are more likely to withstand economic shocks and achieve sustainable growth.

4. Conclusion and Recommendations

Small and Medium Enterprises remain central to Nigeria's economic transformation, employment generation, and entrepreneurial development. However, their ability to contribute effectively to economic growth is influenced by the challenging environment in which they operate, particularly persistent macroeconomic shocks involving inflation, exchange rate instability, rising operating costs, and regulatory uncertainty.

This paper has examined taxation as an important factor influencing SME growth and resilience. The analysis demonstrates that taxation can have both positive and negative implications for SMEs. While taxation provides government with resources needed to create infrastructure and public services that support business activities, poorly designed tax systems may increase operational burdens and limit enterprise development.

The effect of taxation on SMEs is therefore determined not merely by tax rates but by the broader quality of tax administration, institutional effectiveness, compliance procedures, and policy consistency. Simplified tax systems, effective digital administration, targeted incentives, and improved taxpayer engagement can transform taxation from a constraint into an instrument for promoting sustainable enterprise development.

The paper further highlights that resilience among Nigerian SMEs increasingly depends on business model innovation. Enterprises that adopt digital technologies, improve financial management practices, diversify operations, and develop adaptive strategies are better positioned to withstand economic disruptions. Consequently, tax policy should support rather than hinder these innovative responses.

For Nigeria to achieve sustainable SME development, taxation policy must move beyond a narrow revenue collection approach toward a developmental framework that balances fiscal objectives with enterprise growth. A tax system that focuses exclusively on revenue extraction without supporting enterprise development may weaken the very businesses needed to expand the tax base in the long term. A resilient SME sector requires collaboration among government institutions, tax authorities, financial institutions, business associations, and entrepreneurs. Through coordinated reforms, Nigeria can create a tax environment that encourages formalization, innovation, investment, and long-term economic resilience.

Based on these conclusions, and in order to balance revenue mobilization with SME development, the following recommendations are made:

i. Simplification and Harmonization of SME Tax Obligations

The complexity of tax compliance remains a major constraint for SMEs in Nigeria. Multiple taxes, overlapping responsibilities among government agencies, and frequent regulatory changes increase compliance costs and create uncertainty for business owners. Tax authorities should continue efforts toward harmonizing taxes and reducing unnecessary levies imposed on SMEs. A simplified tax framework with clearly defined obligations would improve voluntary compliance, encourage business formalization, and reduce administrative costs for both taxpayers and government agencies. Simplification should also involve developing SME-specific tax guidelines written in accessible language, since many small business owners lack professional tax expertise.

ii. Strengthening Digital Tax Systems and Support Mechanisms

Digital transformation provides an opportunity to improve tax administration and reduce compliance challenges. Electronic registration, online filing, and digital payment systems can enhance efficiency, transparency, and convenience. However, digital tax reforms should be accompanied by adequate support for SMEs through training programmes, awareness campaigns, and technical assistance. Digital tax platforms should also be affordable, user-friendly, and accessible to businesses with varying levels of technological capacity.

iii. Development of Targeted Tax Incentives for Innovative SMEs

Tax incentives should be strategically designed to support enterprises that contribute to productivity, innovation, employment creation, and economic diversification. Rather than providing broad incentives that may have limited developmental impact, policies should focus on SMEs investing in technology adoption, skills development, research activities, and sustainable business practices. In the context of macroeconomic shocks, incentives supporting digital transformation, renewable energy adoption, and local production can help businesses reduce vulnerabilities associated with external economic pressures.

iv. Improving Coordination among Government Institutions

Effective SME taxation requires cooperation among federal, state, and local government institutions. Weak coordination contributes to overlapping tax demands and inconsistent regulatory experiences for businesses. Clear responsibilities among tax authorities should be established to minimize duplication, create a more predictable business environment, and ensure that SMEs are not subjected to unnecessary compliance pressures.

v. Promoting Financial Management and Tax Awareness among SMEs

Many SMEs struggle with taxation partly because of weak financial management systems. SME development programmes should therefore incorporate financial literacy, accounting practices, and tax education. Improved financial management capacity would enable SMEs to maintain accurate records, access financing opportunities, make better investment decisions, and comply effectively with tax requirements. Professional bodies, universities, business associations, and government agencies can play important roles in providing capacity-building programmes tailored to SME needs.

vi. Encouraging Business Model Innovation for Resilience

Tax policy should be integrated with broader economic strategies aimed at strengthening SME resilience. SMEs cannot depend solely on tax reliefs; they must also develop internal capabilities that allow them to respond effectively to economic disruptions. Government support programmes should encourage innovation through digital skills development, entrepreneurship training, technology adoption, and access to business advisory services.

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