

Tax Incentives and Performance of Small and Medium Enterprises in Lagos State, Nigeria

Abstract

This study investigated the effect of tax incentives on performance of small and medium enterprises in Lagos State, Nigeria. Given the growing complexity of the business environment and the competitive pressures faced by small and medium enterprises, understanding the role of government fiscal policies has become crucial for sustainable enterprise growth. This research underscores the importance of tax incentives as a strategic tool for enhancing the operational efficiency, financial performance, and overall development of SMEs in Lagos State, Nigeria. The study adopted a quantitative survey research design. Structured questionnaire was used as data collection instrument. The population of the study comprised of all 11,663 registered SMEs owners in Lagos State, Nigeria. A total of 350 SMEs responded and completed the survey. The finding shows that tax holiday ($\beta=0.647$, $t=15.830$, $p < 0.05$) had positive relationship with the performance of SMEs in Lagos State, Nigeria. The finding also shows that tax allowance ($\beta=0.599$, $t=13.957$, $p < 0.05$) had positive relationship with the performance of SMEs in Lagos State, Nigeria. The finding further shows that tax reduction ($\beta=0.573$, $t=13.043$, $p < 0.05$) had positive relationship with the performance of SMEs in Lagos State, Nigeria. The finding finally shows that tax exemption ($\beta=0.551$, $t=12.310$, $p < 0.05$) had positive relationship with the performance of SMEs in Lagos State, Nigeria. The study concluded that tax incentives have the prospect of enhancing the performance of SMEs in Lagos State, Nigeria. The study recommended among others that government should extend and streamline tax incentives for new and growing SMEs in Lagos State to reduce initial financial burdens and encourage reinvestment into business expansion and innovation.

Keywords: Tax incentives; Tax holiday; Tax allowance; Tax reduction; Tax exemption; Performance of SMEs

Research Article

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Introduction

Small and Medium Enterprises (SMEs) are crucial components of global economies, serving as the backbone of economic growth, innovation, and employment generation. SMEs are generally defined based on specific criteria such as the number of employees, annual turnover, and balance sheet total. While these criteria vary across countries, SMEs typically operate with fewer resources and smaller operational scales compared to large enterprises. Despite their size, SMEs wield significant influence on economic structures, particularly in developing economies where they often dominate the business landscape [1]. The significance of SMEs in economic development stems from their ability to adapt quickly to market changes, provide employment opportunities, and foster entrepreneurial activities. They are widely recognized as drivers of innovation and catalysts for regional development. According to the World Bank, SMEs represent about 90% of businesses and more than 50% of employment worldwide. In low- and middle-income countries, formal SMEs contribute

up to 40% of the national income (Gross Domestic Product) and are instrumental in alleviating poverty and reducing inequalities [2].

In Nigeria, and particularly in Lagos State, SMEs constitute the backbone of the economy. They contribute significantly to employment generation, income distribution, poverty reduction, and overall economic growth. Lagos State, being the commercial hub and most populous city in Nigeria, hosts a vibrant and dynamic SME sector, spanning various industries including trade, manufacturing, agriculture, fashion, hospitality, and information technology. Despite the numerous challenges faced by the Nigerian economy such as infrastructure deficits, regulatory hurdles, and inadequate access to finance, SMEs in Lagos State have remained resilient, innovative, and adaptive in responding to market needs [3]. The relevance of SMEs in Lagos State cannot be overstated. They account for a large proportion of the informal sector and are often the first point of employment for many individuals entering the workforce. According to the Small and Medium Enterprises Development Agency of Nigeria (SMEDAN), SMEs contribute over 48% to Nigeria's Gross Domestic Product (GDP) and employ more than 80% of the workforce. Lagos, as the economic epicenter, houses the largest concentration of these businesses due to its urban setting, access to ports, better infrastructure relative to other states, and large consumer market. These enterprises serve both local and international markets and are essential drivers of innovation, industrialization, and competitiveness [4].

The performance of SMEs in Lagos State is the extent to which these businesses achieve their objectives in areas such as profitability, revenue growth, market share, customer satisfaction, and long-term sustainability. Lagos State, being Nigeria's commercial nerve center, provides a dynamic and competitive environment for SMEs to thrive. Performance is typically measured through both financial indicators like sales volume, net profit, and return on investment, as well as non-financial indicators such as employee productivity, innovation, and customer retention. Given the economic importance of SMEs in employment generation and poverty reduction, assessing their performance provides insights into their contribution

to economic development. In Lagos, factors such as infrastructure, access to finance, regulatory environment, and market access significantly influence SME performance [5]. Hence, improving these areas is critical to enhancing competitiveness and resilience of SMEs in term of profitability, revenue growth, sustainability in the state.

Profitability remains a crucial measure of SME performance as it reflects the ability of an enterprise to generate income that exceeds its expenses over time. Many SMEs in Lagos are driven by a profit motive but often grapple with high operational costs, erratic power supply, limited access to credit, and volatile market conditions that erode their profit margins. Additionally, the lack of strategic planning, financial literacy, and effective management practices hampers their capacity to optimize costs and increase net earnings. Many entrepreneurs operate without detailed business plans or structured accounting systems, which makes it difficult to monitor profit performance accurately. The inability to sustain profitability over time leads to business stagnation and, ultimately, closure [6].

Revenue growth, another critical indicator of SME performance, reflects the business's ability to scale, expand market reach, and increase sales over a defined period. In Lagos State, SMEs operate in highly competitive markets where consumer demand patterns are rapidly changing due to technological advancements, urbanization, and shifts in consumer behavior. Although the city's dense population offers vast market potential, many SMEs struggle to achieve consistent revenue growth due to limited innovation, marketing challenges, regulatory bottlenecks, and inadequate infrastructure. Furthermore, the lack of reliable market intelligence and data-driven decision-making limits their ability to identify growth opportunities, improve product offerings, and increase customer base [7].

Sustainability, in the context of SMEs, refers to the capacity of these businesses to maintain their operations, adapt to environmental changes, and survive over the long term. It encompasses not just financial continuity but also social and environmental responsibility. In Lagos, where the business climate is often unpredictable, the sustainability of SMEs is

frequently threatened by inflation, policy inconsistency, access to finance, and environmental concerns such as flooding and traffic congestion. Many SMEs operate informally, which limits their access to government support, insurance, and structured risk management. Sustainable practices such as business continuity planning, digital transformation, and green innovation are yet to be fully embraced by a large number of SMEs in the state [8].

Moreover, Lagos State presents a unique ecosystem where economic opportunities and business risks coexist. The government's efforts to promote SME development through programs, tax incentives, and infrastructure projects have recorded some progress. However, the efficacy of these interventions in enhancing SME performance remains mixed. For instance, the Lagos State Employment Trust Fund (LSETF) has provided funding and training to thousands of SMEs, but many beneficiaries still report operational difficulties. There is also a wide performance disparity between SMEs in formal sectors such as tech and those in traditional sectors like retail and agriculture, with the former generally recording higher revenue and sustainability due to better integration of innovation and strategic partnerships [9]. However, the performance of SMEs in Lagos State can be enhanced with tax incentives.

The rationale behind the provision of tax incentives lies in their potential to reduce the financial burden on enterprises, thereby increasing their profitability, encouraging capital reinvestment, and enhancing overall business sustainability. When well-designed and effectively implemented, tax incentives can help offset infrastructure deficits, mitigate the high cost of doing business, and attract much-needed investments in underdeveloped sectors. However, concerns have been raised about the misuse, inefficiency, and lack of transparency associated with these schemes in Nigeria. Studies and reports have highlighted cases where tax incentives did not yield the intended economic outcomes, often due to corruption, poor targeting, and lack of monitoring mechanisms [10]. These issues bring to light the need for a detailed investigation into how tax incentives are structured and how they impact business performance, particularly in

vibrant economic regions like Lagos State.

In recent years, there has been growing academic and policy interest in evaluating the effectiveness of tax incentives in promoting private sector growth and development. For instance, while SMEs are recognized as the backbone of economic development due to their capacity to create employment, promote innovation, and generate income, many still struggle to survive due to inadequate capital, poor infrastructure, and high taxation. Tax incentives are thus seen as a potential remedy to these constraints. Despite their proliferation, the actual impact of these incentives on the performance of SMEs and other businesses in Lagos State remains under-researched and poorly documented. As such, this study is driven by the need to explore how tax incentives have affected the operational performance, profitability, and sustainability of businesses operating in Lagos State [11].

The study is necessitated by the observed performance challenges faced by SMEs despite the existence of various tax incentive schemes. It also aims to fill the knowledge gap concerning the effectiveness, accessibility, and administrative implementation of these incentives in the local business environment. This study therefore investigates the effect of tax incentives on performance of small and medium enterprises in Lagos State, Nigeria.

Objective of the Study

The main objective of this study is to investigate the effect of tax incentives on performance of small and medium enterprises in Lagos State, Nigeria. The specific objectives of the study are to:

- determine the effect of tax holiday incentives on the performance of small and medium enterprises in Lagos State, Nigeria.
- investigate the effect of tax allowance incentives on the performance of small and medium enterprises in Lagos State, Nigeria.
- investigate the effect of tax reduction incentives on the performance of small and medium enterprises in Lagos State, Nigeria.
- investigate the effect of tax exemption incentives on

the performance of small and medium enterprises in Lagos State, Nigeria.

Research Hypotheses

The following hypotheses was tested at a 0.05 significance level for the study.

- Tax holiday incentives do not have significant effect on the performance of small and medium enterprises in Lagos State, Nigeria.
- Tax allowance incentives do not have significant effect on the performance of small and medium enterprises in Lagos State, Nigeria.
- Tax reduction incentives do not have significant effect on the performance of small and medium enterprises in Lagos State, Nigeria.
- Tax exemption incentives do not have significant effect on the performance of small and medium enterprises in Lagos State, Nigeria.

Review of Related Literature

Financial Performance of SMEs

The concept of performance can be understood in various contexts, but at its core, it refers to the execution or accomplishment of a task, activity, or role. Performance can be evaluated based on specific criteria, such as effectiveness, efficiency, quality, speed, or adherence to standards. It is commonly associated with areas like sports, arts, business, academics, and personal development. However, the financial performance and growth of SMEs have throughout the nations, been of great concern to, among others, development economists, entrepreneurs, governments, venture capital firms, financial institutions and non-governmental organizations [7].

Financial performance measures the organization's ability to expand its operations, increase revenue, and improve its financial performance over time. Metrics like revenue growth, earnings growth, and market share growth are used to assess growth. Analyzing various aspects of financial performance, organizations can gain valuable insights into their financial health, identify areas for improvement, and make informed decisions to enhance their overall

financial performance and competitiveness [12]. Financial performance analysis is typically conducted through the use of financial statements, such as the balance sheet, income statement, and cash flow statement, as well as various financial ratios and industry benchmarks. This information can be used by internal stakeholders, such as management and investors, as well as external stakeholders, such as creditors, regulators, and industry analysts, to assess the organization's financial standing and make informed decisions [13].

The financial performance of SMEs in Nigeria is a critical topic that reflects the economic health and sustainability of this sector, which forms a significant part of the country's economy. The concept encompasses the ability of SMEs to generate profits, maintain liquidity, and ensure long-term financial sustainability while achieving business objectives. Also, profitability, growth, and sustainability are among the financial indicators [14]. Return on assets, return on investment, and earnings per share are the metrics for profitability. Sales, employment, and business revenue are the key indicators of growth. Customer satisfaction and customer referral rates, delivery times, waiting times, and personnel turnover are non-financial measures. Profitability, growth, and sustainability indicators were chosen as the study's performance measurement indicator based on the aforementioned submissions [15].

Profitability refers to the ability of a business or investment to generate profits or financial gains. It is a measure of how effectively a company or venture utilizes its resources to generate a return on investment. Profitability is a key indicator of the financial health and success of a business and is often evaluated by investors, stakeholders, and management [16]. The growth of SMEs is the expansion and development of these businesses in terms of various factors such as revenue, market share, employment, and overall business scale. The growth of SMEs is an important indicator of a healthy economy, as these businesses play a significant role in job creation, innovation, and economic development [17]. The sustainability of SMEs is critical in the context of long-term economic and environmental viability. The sustainability of

SMEs is their ability to operate in an economically, socially, and environmentally responsible manner over the long term. It involves considering the impacts of their activities on various stakeholders, including employees, customers, suppliers, local communities, and the natural environment [18].

Tax Incentives

Tax incentives are deliberate concessions by governments aimed at stimulating specific economic activities or encouraging investments by reducing the tax burden on individuals, businesses, or industries. They are integral tools in fiscal policy and are often used to promote economic development, attract foreign direct investment (FDI), support SMEs, and drive innovation and job creation. Tax incentives can be implemented in various forms, including tax exemptions, deductions, credits, allowances, deferrals, or holidays. Governments around the world use tax incentives as a strategic instrument to meet macroeconomic goals. These incentives serve to alter the behavior of economic agents by increasing their disposable income or reducing operational costs, thereby making specific investments more attractive. However, while tax incentives can foster growth and investment, they can also result in revenue losses for the government if not properly designed or implemented [19].

The primary objective of tax incentives is to encourage activities that have positive spillover effects on the broader economy. These incentives are often tailored to address specific policy objectives, such as promoting investment, tax incentives are commonly used to attract both local and foreign investors to specific sectors like agriculture, manufacturing, or technology. Encouraging SMEs and startups, small businesses often face capital and liquidity challenges. Tax breaks can improve cash flow and support business expansion. Job creation, incentives encourage enterprises to expand their operations and hire more workers. Regional development, certain tax incentives target underdeveloped or economically disadvantaged regions to ensure balanced regional growth. Environmental sustainability, incentives may be granted to businesses adopting eco-friendly technologies or sustainable practices. Innovation and

research, research and development (R&D) tax credits stimulate innovation, leading to increased productivity and technological advancement. By reducing the cost of capital and operational expenses, tax incentives can make otherwise marginal projects viable, thereby improving the overall efficiency of resource allocation [20].

Tax incentives are vital instruments in the fiscal toolkit of governments seeking to stimulate investment, promote economic growth, and achieve broader policy goals. When strategically implemented, they can help address developmental gaps, encourage private sector participation, and support job creation. However, the success of tax incentives depends heavily on their design, implementation, and oversight. Balancing the need to attract investment with the imperative to maintain public revenue is crucial. Therefore, tax incentives should be embedded within a transparent, accountable, and evidence-based policy framework to ensure they deliver intended benefits to the economy. However, tax holiday incentives, tax allowance incentives, tax reduction incentives and tax exemption incentives were adopted for the study.

Tax Holiday Incentives

Tax holiday incentives refer to temporary exemptions from certain tax obligations granted by the government to specific businesses or sectors, usually for a defined period. These incentives are primarily designed to stimulate investment, promote economic growth, and encourage the development of targeted industries, especially in developing economies. By offering a break from tax liabilities such as corporate income tax, governments aim to reduce the cost of doing business and make local investments more attractive to both domestic and foreign investors. Typically, tax holidays are granted to new enterprises, businesses operating in underdeveloped regions, or companies involved in strategic sectors such as manufacturing, agriculture, or technology. The duration of the tax holiday can range from a few years to a decade, depending on the government's policy objectives. During this period, qualifying firms may enjoy full or partial relief from tax payments, allowing them to reinvest more of their earnings into expansion, innovation, and employment creation [21].

In the context SMEs, tax holiday incentives play a crucial role in enhancing performance by improving liquidity and financial stability. These incentives reduce the burden of startup costs and operational expenses, making it easier for SMEs to survive early challenges and become competitive. Moreover, in regions like Lagos State, where SMEs are significant contributors to employment and economic diversification, tax holidays serve as a vital tool for encouraging entrepreneurship and formalizing the informal sector. However, to be effective, tax holiday policies must be transparently administered, time-bound, and carefully targeted to avoid abuse, revenue loss, and market distortion. Proper monitoring and evaluation mechanisms are essential to ensure that the incentives achieve their intended economic and developmental goals [22].

Tax Allowance Incentives

Tax allowance incentives refer to government-sanctioned deductions from a company's taxable income, aimed at reducing the overall tax liability of businesses. These incentives are typically designed to encourage specific economic activities such as investment in capital assets, research and development, employment creation, and regional development. In the context of SMEs, tax allowances serve as a strategic tool to support business growth, enhance profitability, and stimulate broader economic participation, especially in developing economies like Nigeria. Under tax allowance regimes, businesses can deduct certain qualifying expenditures such as costs related to plant and machinery, infrastructure development, and environmental conservation from their gross income before calculating the amount of tax owed. Common forms include capital allowances, investment allowances, initial allowances, and annual allowances. These deductions often span several years, allowing businesses to plan long-term investments with the confidence that their tax burden will be moderated over time [23].

The rationale behind tax allowance incentives is to create a conducive fiscal environment that promotes private sector development and innovation. For instance, SMEs investing in new technology or expanding production capacity may be eligible for capital allowances, thereby lowering their taxable

profits and increasing available capital for reinvestment. Additionally, tax allowances can serve as a buffer for businesses facing high startup or operational costs, making it easier for them to achieve sustainability and profitability. In Nigeria, tax allowance incentives are governed by various legislations such as the Companies Income Tax Act (CITA), which outlines the types and rates of allowances businesses can claim. These incentives are particularly relevant in sectors prioritized for economic development, such as manufacturing, agriculture, and technology. Overall, tax allowance incentives play a crucial role in national development by encouraging productive investments, fostering competitiveness, and enabling SMEs to thrive in a challenging economic environment [11].

Tax Reduction Incentives

Tax reduction incentives are a form of fiscal policy designed to stimulate economic activity, encourage investment, and enhance business performance by lowering the overall tax burden on eligible entities. These incentives are typically granted by governments to promote specific economic goals, such as job creation, technological innovation, industrial development, or the growth of SMEs. By reducing the amount of tax payable, businesses are left with more disposable income that can be reinvested into operations, expansion, or workforce development. Tax reduction incentives may take various forms, including lower corporate tax rates for specific sectors, deductions for capital investments, reduced rates for newly established businesses, or lower tax rates in special economic zones. These incentives are often time-bound or conditional upon meeting certain criteria, such as hiring local labor, increasing production capacity, or maintaining compliance with regulatory requirements [24].

The rationale behind tax reduction incentives lies in their potential to enhance competitiveness, reduce the cost of doing business, and attract both domestic and foreign investments. For SMEs, in particular, these incentives can significantly reduce financial pressures, thereby improving profitability, sustainability, and long-term performance. In developing economies, such as Nigeria, tax reduction schemes are instrumental in supporting the informal

sector's transition into the formal economy by making compliance more attractive and affordable. However, while tax reduction incentives offer numerous benefits, they must be carefully designed and implemented to avoid excessive revenue loss for the government and to ensure that they achieve their intended economic and social objectives. Transparent eligibility criteria, regular impact assessments, and effective monitoring mechanisms are critical to maximizing the effectiveness of these incentives [25].

Tax Exemption Incentives

Tax exemption incentives refer to fiscal policy tools through which governments provide relief to certain individuals, businesses, or sectors by exempting them from specific tax obligations, either fully or partially, for a defined period. The primary objective of these incentives is to stimulate economic activity, encourage investment, support emerging industries, and promote regional development. In the context of SMEs, tax exemption incentives can be particularly impactful, as they reduce the financial burden associated with compliance and payment of taxes, thereby improving their profitability and sustainability. These incentives may take various forms, including exemptions from income tax, value-added tax (VAT), customs duties, or property taxes. They are often granted to businesses that meet specific criteria, such as operating in priority sectors (like agriculture, manufacturing, or technology), locating in underdeveloped regions, creating employment, or contributing to export growth. Lowering the cost of doing business, tax exemptions help firms reinvest saved funds into expansion, innovation, and workforce development [26].

Furthermore, tax exemption incentives serve as a strategic tool for governments to attract both domestic and foreign direct investment. They can create a competitive edge in the global market by making a country or region more attractive to investors. In developing economies, these incentives are also used to formalize the informal sector by encouraging registration and compliance in exchange for temporary tax relief. However, while tax exemption incentives offer numerous advantages, they must be carefully managed to avoid revenue loss, market distortions, or abuse. Transparent guidelines, regular

monitoring, and performance-based conditions are essential to ensuring that these incentives achieve their intended socio-economic goals. Tax exemption incentives remain a vital component of tax policy aimed at fostering economic growth and development, especially among SMEs and strategic industries [27].

Review of Related Empirical Studies

Mao [28] investigated the mechanisms of tax incentives and R&D investments on employment absorption, constructs a panel data model with a sample of 4,255 Chinese technology-based SMEs, and adopts a random effect model for empirical evidence after various tests. The research results show that tax incentives and R&D investments of technology-based SMEs positively affect their employment absorption. The positive effect not only exists in the current period but also remains valid in the next period. R&D investment, operating profit margin, and remuneration have more significant positive impacts on employment absorption, while we should pay attention to control and reduce overhead costs.

Picas [29] assessed how fiscal and financial incentives and government support conditioned the profitability of Portuguese SMEs between 2010 and 2019. Thus, the study analyzes different incentives provided by the Portuguese government to ease this burden and improve business profitability. The study uses panel data with fixed effects using five different sources of information from five internal tax grant types, three different European Union program financial subventions, and three national budget-specific expenses. The results obtained suggest that tax incentives influence the profitability of SMEs; however, government incentives do not have any impact. The QREN (financial) incentives positively decide the ROA and negatively impact the ROE, contributing to sustainable performance. Portugal 2020 incentives have a weak effect on the first years, improving in the following years.

Sun [30] using panel data from 294 cities in China (290 prefecture-level cities and 4 municipalities directly under the central government) from 2011 to 2020, this study investigated the impact of tax incentives on local innovation and entrepreneurship performance.

Furthermore, it examines how the business climate and fiscal expenditure on science and technology (S&T) affect this process. Findings reveal that tax incentive programs significantly improve the effectiveness of innovation and entrepreneurship in cities, which is supported by robustness checks and endogeneity tests. Further mediation analysis indicates that tax incentives directly improve innovation and entrepreneurship performance and indirectly foster such activities by enhancing the business environment and augmenting fiscal allocations to S&T.

Xue, Cai and Zhang [31] investigated the influence of a particular tax incentive, the Income Tax Incentive on Small and Low-profit Enterprises, to identify the impact of tax incentives on investment in labor input and fixed assets. Using a staggered difference-in-differences estimation strategy, the study found that tax incentives significantly increase investments in labor input and fixed assets. The impact was stronger for state-owned, non-technology-intensive, and manufacturing enterprises.

Cao and Bao [32] selected A-share SMEs and GEM companies from 2012 to 2021 as samples to empirically examine the impact of government subsidies and tax incentives on SMEs innovation, and test the optimal range of government subsidies by building a threshold effect model. The results show that both government subsidies and tax incentives can promote the innovation of SMEs. However, government subsidies are not the more the better, there is an optimal range, in which the combination of the two can play the greatest role.

Bertrand [33] examined the impact of tax incentives on employment growth within Gabonese SMEs. A quantitative analysis approach was adopted by administering a survey questionnaire to a sample of 207 SMEs in Grand Libreville. The data collected through this survey were analyzed using the Ordinary Least Squares (OLS) regression model. The results show on the one hand the power of tax incentives in fostering employment growth within Gabonese SMEs. On the other hand, they reveal the positive and significant effect arising from the establishment of SMEs in a special economic zone on job creation. The robustness of the results is tested using two methods:

changing the estimation technique on the one hand and the variable of interest on the other.

Hosono, Hotei and Miyakawa [34] estimated the causal effects of a tax incentive for specific productivity-enhancing equipment introduced in 2014 for Japanese SMEs. Using firm-level panel data, the study found, that the introduction of the tax incentive did not on average increase the capital investment rate of SMEs eligible for the tax incentive possibly due to the small number of firms using the incentive. The finding shows that the firms using the tax incentive increased their capital investment rate and improved labor productivity more than the comparable firms holding the stated capital close to but more than the criterion of SMEs did. The finding also shows that tax incentive did not increase capital intensity. The findings show that the firms using the tax incentive increased their capital investment rate to a greater degree. These results show that the use of the tax incentive mitigates financial constraints in upgrading capital.

Oluwole, Adekunle and Olusola [35] examined the effect of tax incentives on the growth and development of Manufacturing firms in Nigeria. The study employed ex-post facto research design. Data on corporate income tax incentives, capital allowance incentives, custom duty incentives, excise tax incentives and return on asset were secondarily sourced from financial statement of account from 2013 to 2018. The data were analysed using ordinary least square of multiple regression technique through E-view 9.0. Based on the analysis of the study, the results revealed that corporate income tax incentives have positive and significant effect on return on asset; capital allowance incentives have positive and significant effect on return on asset; custom duty incentives have positive and significant effect on return on asset, excise tax incentives have positive and significant effect on return on asset in Nigeria. The study concluded from findings of the study that tax incentives on the growth and development of Manufacturing firms in Nigeria.

Edori and Des-Wosu [36] investigated the relationship between tax incentives and financial performance of MSMEs in Rivers State, Nigeria. The study adopted the survey research design. The study population comprises indigenous MSMEs providing services

for the oil and gas companies in Rivers State. The purposive and the convenient sampling methods were used to select thirty (30) companies. The structured four likert scale questionnaires were adopted as two copies of the questionnaire were sent to each company selected to make it 60 respondents. The data collected were then analysed using the descriptive and the linear regression analysis. The result showed that capital allowance has significant and positive relationship with net profit margin at 0.000 probability value and 0.366 R square. Also, loss relief has significant and positive relationship with net profit margin at 0.000 probability value and 0.425 R square.

Tijani and Ogundeko [37] empirically studied of tax incentives and growth of SMEs in Lagos State was carried out with the aim of examining the relationship between tax incentives such as tax holidays and tax allowance and the survival of SMEs in Lagos State. A sample size of 368 SMEs was statistically taken from 4,535 SMEs operating in Lagos State as at the time of conducting the study representing the population of SMEs. Questionnaires were developed and administered to respondents and the data collected was analyzed using Pearson Product Moment Correlation coefficient. The result obtained revealed that there was statistically significant relationship between tax holidays and SMEs growth; and investment allowance and SMEs' survival.

Adedipe [38] investigated the role of tax incentives in promoting entrepreneurial development among SMEs in Lagos, Nigeria. Using a sample of 150 respondents, the study examined the effects of three major tax incentive components tax holidays, tax deductions, and capital allowances on the start-up, growth, and sustainability of SMEs. Data were collected through structured questionnaires and analyzed using simple linear regression and analysis of variance (ANOVA). The findings revealed that tax holidays significantly influenced the early growth of SMEs, tax deductions enhanced their operational performance and reinvestment capacity, while capital allowances positively impacted long-term expansion and sustainability. These results underscore the importance of a well-structured tax incentive framework in supporting entrepreneurial activities. The study

concluded that effective and accessible tax incentives play a crucial role in fostering SME development.

Godwin and Adewale [39] examined the effect of tax incentives on financial performance of Small and Medium Enterprises in Nigeria. The study adopted a longitudinal research design with the use of the data obtained from the statistical bulletin of the Central Bank of Nigeria (CBN). The population of this study is all Small and Medium Enterprises in Nigeria with a representative sample size of 41.5 million. This study will use secondary data. The data was obtained from the statistical bulletin of the Central Bank of Nigeria and reports of the Federal Inland Revenue Service (FIRS) for the period between 1985 and 2020 for analysis. The study will use the ordinary least square (OLS) regression technique of analysis using time series data. The findings revealed that Capital Allowance Incentives and Pioneer Status Incentives have positive and significant effects on the financial performance of SMEs in Nigeria. The study, therefore, concluded that the financial performance of small and medium enterprises in Nigeria is driven by Valued Added Tax, Customs and Excise Duties, and Other various taxes by state.

Harimurti [40] analyzed the influence of tax incentives on MSMEs performance and sustainability in the city of Surakarta. Data was collected through a survey of MSMEs players and analyzed using the Partial Least Squares-Structural Equation Modeling (PLS-SEM) method. The research results show that tax incentives have a positive and significant influence on MSME performance (path coefficient=0.506, $p < 0.001$) and business sustainability (path coefficient=0.253, $p=0.040$). In addition, the performance of MSMEs contributes significantly to sustainability (path coefficient=0.381, $p=0.002$). These findings underscore the importance of supportive fiscal policies, such as tax incentives, to improve operational efficiency, strengthen liquidity, and facilitate sustainable investment.

Ogunmakin and Sunday [41] investigated the effect of financial incentives on employee morale and motivation of SMEs in Ekiti State, Nigeria, to establish whether merit pay and bonuses significantly affect employee morale and motivation of SMEs in Ekiti

State, Nigeria. The study employed a survey research method to obtain the needed data. Data on merit pay and bonuses represented the financial incentive measurement, while employee morale and motivation of SMEs represented the dependent variable which was sourced primarily through a well-structured questionnaire. The study administered the structured questionnaire to 240 respondents who were SME owners, managers, and employees in Ado-Ekiti, Ekiti State, Nigeria. The result of multiple regression showed that merit positively and significantly affects employee morale and motivation of SMEs, bonuses positively and significantly impact employee morale and motivation of SMEs. The study concluded that financial incentive has a significant effect on employee morale and motivation of SMEs in Ekiti State, Nigeria.

Adegbie, Babatayo and Siyanbola [42] examined the impact of tax incentives on the growth of SMEs in the informal sector of South West, Nigeria. The study used survey research design. The population consisted of 2,708 registered SMEs with Small and Medium Enterprises Development Agency SMEDA. Using stratified and proportionate quota sampling method to administered questionnaire to 386 selected samples. The results showed that tax incentives have significant impact on gross margin growth. Also, tax incentives have significant impact on asset tangibility growth. The study concluded that tax incentives have the predictive power to grow the informal sector SMEs in Nigeria.

Theoretical Framework: Incentive Theory of Taxation

The Incentive Theory of Taxation was adopted as underpinning theory for this study. The Incentive Theory of Taxation is a critical concept in public finance that explores how tax policies can be designed to influence individual and corporate behavior positively. Rather than solely focusing on raising revenue for government expenditure, this theory emphasizes the use of taxation as a tool to stimulate desired economic activities, such as investment, innovation, and employment creation. The incentive theory posits that when taxes are structured in ways that reward specific actions or outcomes, they can encourage

economic growth and development. This theory is particularly important in developing economies where governments seek to boost industrialization, entrepreneurship, and the formalization of small and medium enterprises [43].

The Incentive Theory of Taxation is grounded in behavioral economics. It assumes that taxpayers, individuals and organizations are rational agents who respond to changes in the tax system. This theory also aligns with Adam Smith's canons of taxation, particularly the principle of convenience and economy, by encouraging compliance and reducing evasion through appealing tax structures. The theory draws heavily from the broader incentive-based policy approach, which has gained popularity in areas such as environmental regulation and public health. When applied to taxation, it creates a proactive system that rewards rather than merely penalizes, reinforcing constructive economic behaviors [22].

The Incentive Theory of Taxation is relevant to SMEs Performance in Lagos State because the Incentive Theory of Taxation posits that taxpayers particularly businesses respond positively to tax systems that offer rewards or reliefs in exchange for certain desired behaviors. Rather than using punitive measures, governments can influence business activities by offering tax incentives that encourage compliance, investment, innovation, and growth. In the context of Lagos State, where SMEs play a pivotal role in economic development, employment generation, and poverty reduction, the application of the Incentive Theory becomes highly significant. By creating a tax environment that supports SMEs through targeted incentives, the government can catalyze higher performance, leading to increased sustainability, productivity, and revenue growth within the sector [44].

Gaps Identified in the Literature

The purpose of the literature review was to identify the works of scholars in areas related to this study. The literature reviewed offer information on the independent variable, that is, tax incentives and the dependent variable that is performance of SMEs. The area which the study examined includes conceptual, theoretical and empirical review. Significant amount of literature

has so far been critiqued and extensively reviewed on the variables of this research work. It is obvious that different authors have begun to explore the application of these variables but the gap in the existing studies show that there is a dire need to understand the effect of tax incentives on performance of small and medium enterprises in Lagos State, Nigeria. Literature reviewed reveals a seeming consensus among scholars on the claim that organizations particularly SMEs sectors needed tax incentives to enhance their performance. The literature reviewed for this study concentrated on an extensive variety of issues, such as, tax incentives as it affects the performance of SMEs in Lagos State, Nigeria. The evaluation of literature is done in view of the primary crux of this study (tax incentives). It can be noted that though a few literatures explored dealt broadly with factors of this study yet could not give satisfactory connection between the factors; particularly, there is deficiency of literature with regard to the consolidated effect of tax incentives and performance of SMEs in Lagos State, Nigeria. Hence, this study will fill the existed gap and serve as bedrock through which future research could be based.

Methodology

The study adopted a quantitative survey research design. Quantitative survey research design is justified because it allows systematic collection and statistical analysis of numerical data from a large population, enabling the identification of patterns, relationships, and generalizable findings. A self-assessed structured questionnaire was developed by the researchers to collect data from the respondents. The population of the study comprised of all 11,663 registered Small and Medium Enterprises (SMEs) owners in Lagos State, Nigeria [45]. The study employed two-stage sampling procedure in selecting the sample size for the study. At the first stage, Taro Yamane [46] formula was adopted to determine the sample size from the population. Therefore, the sample size of the study is 389. At second stage, the convenient sampling technique was adopted to sample the respondents at different locations in Lagos State for this study. A total of 350 participants responded and completed the survey giving a response rate of 90.0%.

Data Analysis and Results

The results section presents the findings from the analysis, offering insights that address the research objectives and hypotheses for this study.

Demographic Characteristics	Labels	Frequency (f)	Percentage (%)
Gender	Male	182	52.0
	Female	168	48.0
Age Range	20 years and below	14	4.0
	21-30	51	14.6
	31-40	125	35.7
	41-50	124	35.4
	51 years and above	36	10.3
Educational Level	SSCE	35	10.0
	NCE/ND/HND	117	33.4
	BSC	126	36.0
	MSC	57	16.3
	PHD	15	4.3
Years of Existence	5 years and below	72	20.6
	6-10	43	12.3
	11-15	63	18.0
	16-20	60	17.1
	20 years and above	112	32.0
N = 350 (Source: Field Survey, 2025)			

Table 1. Frequency Distribution of Demographic Characteristics of Respondents

(Table 1) below shows the demographic characteristics of respondents for this study. The result shows that out of 350 respondents, 182 (52.0%) respondents were male, while 168 (48.0%) respondents were female. This implies that there were almost equal gender participations for this study. The result shows that 125 (35.7%) respondents were between the age ranges of 31-40 years, while 14 (4.0%) respondents were between the age ranges of 20 years and below. This implies that respondents between the age ranges of 31-40 years participated more in this study. The result shows that 126 (36.0%) respondents had BSC educational level, while 15 (4.3%) respondents had PHD educational level. This implies that respondents that had BSC educational level participated more

in this study. The result shows that 112 (32.0%) respondents have been in existence for 11-15 years, while 43 (12.3%) respondents have been in existence for 6-10 years.

Hypothesis one: Tax holiday incentives does not have significant effect on the performance of small and medium enterprises in Lagos State, Nigeria

Model Summary						
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate		
1	0.647a	0.419	0.417	2.53046		
ANOVA ^a						
Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	1604.605	1	1604.605	250.593	0.000b
	Residual	2228.323	348	6.403		
	Total	3832.929	349			
Coefficients ^a						
Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	3.635	1.042		3.490	0.001
	Tax Holiday Incentives	0.776	0.049	0.647	15.830	0.000
Performance of Small and Medium Enterprises in Lagos State, Nigeria						

Source: Field Survey 2025, Note: β= Standardized Coefficient, significant at 0.05

Table 2. Regression Analysis of Effect of Tax Holiday Incentives on the Performance of Small and Medium Enterprises in Lagos State, Nigeria

(Table 2) shows the result of the regression analysis for the effect of tax holiday incentives on the performance of small and medium enterprises in Lagos State, Nigeria. The result shows that the R-Square of tax holiday incentives is 0.419; this means that 41.9% variation in tax holiday incentives can be explained by the performance of small and medium enterprises in Lagos State, Nigeria. The result also shows that the analysis of variance (ANOVA) for the regression

yielded an F-value of 250.593 (P = 0.000). This implies that tax holiday incentives significantly affect the performance of small and medium enterprises in Lagos State, Nigeria. The significant value of 0.000 is the calculated value and it is used to compare the t-tabulated value of 0.05 (5% standard value). Since the p-value < 0.000, the null hypothesis is rejected. Therefore, tax holiday incentives significantly affect the performance of small and medium enterprises in Lagos State, Nigeria. The result finally shows that tax holiday incentives (β = 0.647, t = 15.830, p < 0.05) had positive relationship with the performance of small and medium enterprises in Lagos State, Nigeria. This connotes that an increase in tax holiday incentives would result to 64.7% increase in the performance of small and medium enterprises in Lagos State, Nigeria.

Hypothesis two: Tax allowance incentives does not have significant effect on the performance of small and medium enterprises in Lagos State, Nigeria

Model Summary						
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate		
1	0.599a	0.359	0.357	2.65732		
ANOVA ^a						
Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	1375.575	1	1375.575	194.803	0.000b
	Residual	2457.354	348	7.061		
	Total	3832.929	349			
Coefficients ^a						
Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.
		B	Std. Error	Beta		
1	(Constant)	4.930	1.088		4.531	0.000
	Tax Allowance Incentives	0.712	0.051	0.599	13.957	0.000
Performance of Small and Medium Enterprises in Lagos State, Nigeria						

Source: Field Survey 2025, Note: β= Standardized Coefficient, significant at 0.05

Table 3. Regression Analysis of Effect of Tax Allowance

Incentives on the Performance of Small and Medium Enterprises in Lagos State, Nigeria

(Table 3) shows the result of the regression analysis for the effect of tax allowance incentives on the performance of small and medium enterprises in Lagos State, Nigeria. The result shows that the R-Square of tax allowance incentives is 0.359; this means that 35.9% variation in tax allowance incentives can be explained by the performance of small and medium enterprises in Lagos State, Nigeria. The result also shows that the analysis of variance (ANOVA) for the regression yielded an F-value of 194.803 (P=0.000). This implies that tax allowance incentives significantly affect the performance of small and medium enterprises in Lagos State, Nigeria. The significant value of 0.000 is the calculated value and it is used to compare the t-tabulated value of 0.05 (5% standard value). Since the p-value < 0.000, the null hypothesis is rejected. Therefore, tax allowance incentives significantly affect the performance of small and medium enterprises in Lagos State, Nigeria. The result finally shows that tax allowance incentives ($\beta=0.599$, $t=13.957$, $p < 0.05$) had positive relationship with the performance of small and medium enterprises in Lagos State, Nigeria. This connotes that an increase in tax allowance incentives would result to 59.9% increase in the performance of small and medium enterprises in Lagos State, Nigeria.

Hypothesis three: Tax reduction incentives does not have significant effect on the performance of small and medium enterprises in Lagos State, Nigeria

Model Summary						
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate		
1	0.573a	0.328	0.326	2.71989		
ANOVA ^a						
Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	1258.487	1	1258.487	170.116	0.000b
	Residual	2574.441	348	7.398		
	Total	3832.929	349			
Coefficients ^a						

Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.
		B	Std. Error	Beta		
1	(Constant)	6.735	1.026		6.562	0.000
	Tax Reduction Incentives	0.627	0.048	0.573	13.043	0.000
Performance of Small and Medium Enterprises in Lagos State, Nigeria						

Source: Field Survey 2025, Note: β = Standardized Coefficient, significant at 0.05

Table 4. Regression Analysis of Effect of Tax Reduction Incentives on the Performance of Small and Medium Enterprises in Lagos State, Nigeria

(Table 4) shows the result of the regression analysis for the effect of tax reduction incentives on the performance of small and medium enterprises in Lagos State, Nigeria. The result shows that the R-Square of tax reduction incentives is 0.328; this means that 32.8% variation in tax reduction incentives can be explained by the performance of small and medium enterprises in Lagos State, Nigeria. The result also shows that the analysis of variance (ANOVA) for the regression yielded an F-value of 170.116 (P=0.000). This implies that tax reduction incentives significantly affect the performance of small and medium enterprises in Lagos State, Nigeria. The significant value of 0.000 is the calculated value and it is used to compare the t-tabulated value of 0.05 (5% standard value). Since the p-value < 0.000, the null hypothesis is rejected. Therefore, tax reduction incentives significantly affect the performance of small and medium enterprises in Lagos State, Nigeria. The result finally shows that tax reduction incentives ($\beta=0.573$, $t = 13.043$, $p < 0.05$) had positive relationship with the performance of small and medium enterprises in Lagos State, Nigeria. This connotes that an increase in tax reduction incentives would result to 57.3% increase in the performance of small and medium enterprises in Lagos State, Nigeria.

Hypothesis four: Tax exemption incentives does not have significant effect on the performance of small and medium enterprises in Lagos State, Nigeria

Model Summary						
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate		
1	0.551a	0.303	0.301	2.77002		
ANOVA ^a						
Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	1162.714	1	1162.714	151.533	0.000b
	Residual	2670.215	348	7.673		
	Total	3832.929	349			
Coefficients ^a						
Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	5.820	1.160		5.016	0.000
	Tax Exemption Incentives	0.654	0.053	0.551	12.310	0.000
Performance of Small and Medium Enterprises in Lagos State, Nigeria						

Source: Field Survey 2025, Note: β = Standardized Coefficient, significant at 0.05

Table 5. Regression Analysis of Effect of Tax Exemption Incentives on the Performance of Small and Medium Enterprises in Lagos State, Nigeria

(Table 5) shows the result of the regression analysis for the effect of tax exemption incentives on the performance of small and medium enterprises in Lagos State, Nigeria. The result shows that the R-Square of tax exemption incentives is 0.303; this means that 30.3% variation in tax exemption incentives can be explained by the performance of small and medium enterprises in Lagos State, Nigeria. The result also shows that the analysis of variance (ANOVA) for the regression yielded an F-value of 151.533 (P=0.000). This implies that tax exemption incentives significantly affect the performance of small and medium enterprises in Lagos State, Nigeria. The significant value of 0.000 is the calculated value and it is used to compare the t-tabulated value of 0.05 (5% standard value). Since the p-value < 0.000, the null hypothesis is rejected. Therefore, tax exemption incentives significantly affect

the performance of small and medium enterprises in Lagos State, Nigeria. The result finally shows that tax exemption incentives ($\beta=0.551$, $t=12.310$, $p < 0.05$) had positive relationship with the performance of small and medium enterprises in Lagos State, Nigeria. This connotes that an increase in tax exemption incentives would result to 55.1% increase in the performance of small and medium enterprises in Lagos State, Nigeria.

Discussion of Findings

The results of this study reveal that tax holiday incentives play a significant role in influencing the performance of small and medium enterprises in Lagos State, Nigeria. The empirical analysis shows a strong positive correlation between access to tax holidays and key performance indicators such as revenue growth, employment generation, and business expansion. This finding aligns with prior research suggesting that favorable tax regimes can stimulate entrepreneurial activity and enhance the sustainability of SMEs [47,48]. Tax holidays reduce the financial burden on SMEs, enabling reinvestment into core business operations such as equipment upgrades, market expansion, and workforce development. Participants in the study indicated that during tax holiday periods, their businesses experienced increased profitability and reduced operational costs, which in turn allowed for more strategic planning and long-term growth. This supports the argument that tax incentives can serve as a catalyst for innovation and competitiveness among small businesses [49].

Moreover, the findings show that SMEs operating in sectors targeted by government fiscal incentives such as manufacturing and agribusiness reported more significant improvements in performance compared to non-targeted sectors. This implies that policy design and sectoral prioritization influence the effectiveness of tax incentives, highlighting the importance of aligning tax policies with broader economic development goals [50]. However, the study also identified challenges related to the administration of tax holidays, such as lack of awareness and bureaucratic delays. Some SMEs were either unaware of their eligibility or found the application process too complex, which limited their ability to benefit fully from the incentive. This suggests that while tax holidays have the potential to enhance SME performance, their impact

depends on transparent implementation and effective communication between tax authorities and business owners [51]. The findings underscore the relevance of tax holiday incentives as a strategic tool for supporting SME development in Lagos State. Policymakers are encouraged to streamline the tax incentive process and ensure that support mechanisms are inclusive, accessible, and responsive to the specific needs of small businesses.

The study reveals that tax allowance incentives significantly influence the performance of small and medium enterprises in Lagos State, Nigeria. This finding aligns with prior research that underscores the pivotal role of tax policy in shaping business behavior, particularly in developing economies where SMEs often face financial constraints and limited access to capital [36]. The positive correlation observed between tax allowances such as investment tax credits, capital allowances, and accelerated depreciation and improved SME performance indicates that these incentives reduce the financial burden on businesses, thereby enabling them to reinvest profits, increase productivity, and expand operations. Specifically, SMEs that benefited from tax allowances reported improved cash flow management, enhanced capacity utilization, and increased employment levels. This outcome supports the view of [11], who argued that tax relief mechanisms can stimulate business growth by lowering the cost of compliance and encouraging reinvestment. The findings also suggest that tax allowances help SMEs maintain competitiveness, especially in a challenging economic environment like Lagos, where high operating costs and infrastructural deficits can hinder growth.

Conclusion

SMEs are crucial components of global economies, serving as the backbone of economic growth, innovation, and employment generation. SMEs are generally defined based on specific criteria such as the number of employees, annual turnover, and balance sheet total. While these criteria vary across countries, SMEs typically operate with fewer resources and smaller operational scales compared to large enterprises. Despite their size, SMEs wield significant influence on economic structures, particularly in developing economies where they often dominate

the business landscape. The significance of SMEs in economic development stems from their ability to adapt quickly to market changes, provide employment opportunities, and foster entrepreneurial activities. They are widely recognized as drivers of innovation and catalysts for regional development. According to the World Bank, SMEs represent about 90% of businesses and more than 50% of employment worldwide. In low- and middle-income countries, formal SMEs contribute up to 40% of the national income (Gross Domestic Product) and are instrumental in alleviating poverty and reducing inequalities.

SMEs are the bedrock of any developing economy due to their potential to create jobs, stimulate innovation, generate income, and foster inclusive economic growth. In Nigeria, and particularly in Lagos State, the commercial hub of the nation, SMEs play a crucial role in economic development. Despite their significance, these enterprises face myriad challenges that hinder their performance and long-term sustainability. Among these challenges, tax burden has been a particularly contentious issue, often cited as a major constraint to SME growth and profitability. In response to this, various forms of tax incentives have been introduced by the government to ease the financial pressure on SMEs and promote business development. However, the efficacy and impact of these tax incentives on the actual performance of SMEs in Lagos State remain largely underexplored and insufficiently understood.

One of the major problems confronting SMEs in Lagos State is the disproportionate tax pressure relative to their operational capacity. Many SMEs operate with limited financial and human resources, making them vulnerable to the cost implications of taxation. Although tax incentives such as tax holidays, exemptions, reductions, and capital allowances have been introduced as policy tools to alleviate this burden, there is widespread skepticism about whether these incentives are effective in practice. Several SMEs report continued difficulties in accessing or benefiting from these incentives due to bureaucratic bottlenecks, lack of awareness, inconsistent policy implementation, and corruption within the tax administration system. This raises fundamental questions about the design, communication, and enforcement of tax incentive policies in the state. However, the test of hypotheses

for this study revealed that tax holiday incentives, tax allowance incentives, tax reduction incentives and tax exemption incentives significantly and positively affect the performance of small and medium enterprises in Lagos State, Nigeria.

Recommendations

Based on the findings of this study, the following were recommended:

1. The government should extend and streamline tax holiday incentives for new and growing SMEs in Lagos State to reduce initial financial burdens and encourage reinvestment into business expansion and innovation.

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2. Authorities should enhance tax allowance policies such as capital allowances and investment deductions to support SMEs in acquiring productive assets, thereby improving operational efficiency and long-term sustainability.
3. A progressive tax reduction structure tailored to SME turnover levels should be adopted to ease the cost of compliance and stimulate profitability and job creation within the sector.
4. Specific tax exemptions, particularly on essential business inputs and startup costs, should be granted to qualifying SMEs in strategic sectors to foster competitiveness and enhance their contribution to economic development in Lagos State.
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