

The Influence of Economic Policies on Small and Medium Enterprises (SMEs) in Developing Countries

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Abstract— In developing nations, Small and Medium Enterprises (SMEs) play a critical role in job creation, economic development, and the reduction of poverty. However, government-enacted economic policies have a major impact on their durability and rate of growth. This study looks at how trade, monetary, fiscal, and regulatory policies affect the growth of SMEs in emerging countries. It looks at how policies like tax breaks, easy access to financing, subsidies, and regulatory changes impact the business climate and impact the resilience and performance of small and medium-sized enterprises. This research shows the gaps where policy intervention is required and identifies critical aspects that support the development of SMEs by evaluating the advantages and disadvantages of various policies. The results highlight the need for cohesive and supportive policy frameworks that tackle the particular difficulties faced by SMEs in emerging environments. The purpose of this document is to help stakeholders and policymakers develop policies that promote the success of small and medium-sized enterprises (SMEs).

Keywords— Economic Policies, Small and Medium Enterprises (SMEs), Developing Countries, Funding Sources, Tax Incentives, Employment Growth and Regulatory Framework

I. INTRODUCTION

For developing nations' economies to flourish, Small and Medium-Sized Enterprises (SMEs) must expand and remain sustainable. SMEs are the backbone of many developing economies, making important contributions to economic diversification, job creation, and poverty reduction. However, the economic policies put in place at the local and national levels have a significant impact on the development trajectory of SMEs. Economic policies, which include trade, monetary, regulatory, and fiscal measures, set the tone for SMEs' operations and may help or impede their growth. These businesses are especially vulnerable to changes in economic policy because they often deal with specific difficulties in developing nations, such as incomplete infrastructure, bureaucratic bottlenecks, unstable market circumstances, and restricted access to capital. This study investigates how economic policies affect the competitiveness, sustainability, and expansion of SMEs in emerging nations. The research aims to investigate the effects of several policy measures on the operational efficiency, market access, and overall business climate of small and medium-sized enterprises (SMEs). These policies include tax incentives, subsidies, loan facilities, and regulatory changes. It also emphasizes how crucial it is to have cogent policy frameworks that strike a balance between incentives for development and economic stability. The research attempts to highlight areas where policy gaps exist, identify best practices, and provide insights into the efficacy of various economic initiatives.

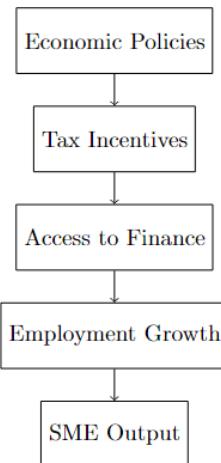


Fig. 1. Economic Policies and SME Growth

The study emphasizes that in order for SMEs to prosper, a favorable environment must be established via focused economic policies that cater to their particular requirements. By enabling small firms to compete, innovate, and advance the economy, a supportive policy environment not only encourages entrepreneurship but also fortifies the developing countries' entire economic fabric. The purpose of this paper's results is to provide guidance to stakeholders in small and medium-sized enterprises (SMEs), development organizations, and policymakers on how to improve the resilience and growth of SMEs in developing nations.

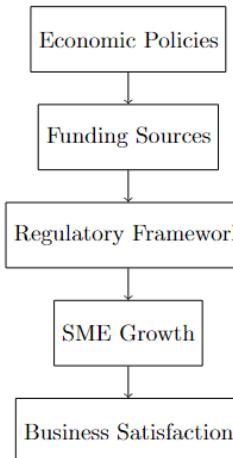


Fig. 2. Factors Affecting SME Performance

1.1. The Contribution of SMEs to Economic Growth

SMEs provide employment, innovation, and economic variety, making them the foundation of many emerging countries. They sustain lives and provide substantial employment possibilities, especially in areas with a dearth of big businesses. SMEs encourage local manufacturing, encourage entrepreneurship, and support regional economic growth. Their advancement is essential to eradicating poverty and promoting long-term economic growth. This subtopic explores SMEs' capacity to alleviate socioeconomic issues in emerging nations and emphasizes their significance for economic progress.

1.2. The difficulties that SMEs in developing nations face

SMEs in developing nations face a variety of challenges that restrict their ability to expand. These difficulties include restricted market access, high borrowing rates, bureaucratic red tape, and restricted access to financing. They also have to deal with issues including a lack of government assistance, outdated technology, and a skills gap. Together, these problems produce a hostile business climate that limits SMEs' capacity to compete and survive. In order to create efficient economic interventions that cater to the particular requirements of SMEs, policymakers must have a thorough understanding of these difficulties.

1.3. Fiscal Policy's Effect on SMEs

Fiscal policies, such as taxes and expenditure by the government, have a direct impact on the expansion of SMEs. Tax holidays and lower corporation tax rates are two examples of favorable tax policies that may alleviate financial constraints and encourage investment among SMEs. However, high tax rates and complex tax laws may stifle expansion and force businesses into the unofficial sector. The importance of government spending on education, infrastructure, and SME support programs is crucial in improving the performance of businesses. This subtopic investigates how fiscal policies affect the sustainability, competitiveness, and profitability of SMEs in developing countries.

1.4. Financial and Monetary Policy Access

Because they control interest rates and credit availability, monetary policies have a direct effect on the financial stability of SMEs. Since SMEs often have to deal with high interest rates and stringent collateral requirements from financial institutions, access to inexpensive finance is a significant challenge for them in developing nations. Microfinance, tailored lending programs, and reasonable credit policies may all greatly assist SMEs in growing their businesses. In addition to discussing how monetary policies may help or hurt SMEs, this subtopic also highlights the need of inclusive and easily available financial services for the expansion of businesses.

1.5. The regulatory landscape and the ease of doing business

The regulatory landscape significantly influences how SMEs may expand in the future. SME activities may be facilitated or hindered by regulations pertaining to property rights, labor legislation, company registration, and licensing. An onerous regulatory environment might discourage entrepreneurs from formalizing their operations and increase the cost of compliance. For SMEs, the ease of doing business may be greatly increased by reforms targeted at cutting red tape, expediting company registration, and increasing transparency. This subtopic examines the ways in which formal SMEs' development may be encouraged and entrepreneurship fostered by a regulatory framework that is favorable.

1.6. Market Access and Trade Policy

When it comes to identifying market prospects for SMEs, trade rules are crucial. Reduced tariffs and favorable trade agreements may improve market access, allowing SMEs to engage in both home and foreign markets. On the other hand, trade restrictions may erect obstacles that hinder SMEs' ability to compete. This subtopic examines how trade policies affect the competitiveness of SMEs, emphasizing the development potential of open markets and integration into global value chains. It also discusses how governmental backing for export-focused programs might boost small and medium-sized enterprises' involvement in global commerce.

Small and medium-sized businesses (SMEs) are essential to the economic growth of emerging nations because they foster innovation, create jobs, and lower poverty. They do, however, have to contend with issues like poor infrastructure, onerous regulations, and restricted financial access. Their development is greatly influenced by economic policies, which include trade agreements, monetary controls, and fiscal initiatives. SME development may be facilitated by supporting monetary policies, favorable fiscal policies, and streamlined regulatory frameworks; on the other hand, restrictive policies can impede it. Innovation, productivity, and market access are all greatly aided by government efforts and SME assistance programs. Targeted policy changes including tax reforms, reduced red tape, lending accessibility, and investments in skill development are required to support SMEs. SMEs may successfully contribute to national economic growth and sustainable development in developing nations with the help of a favorable regulatory and economic environment.

II. LITERATURE REVIEW

Singh et al. (2018): This study looked at how fiscal policies affected the growth of small and medium-sized enterprises (SMEs) in India. It found that tax incentives and subsidies made SMEs more profitable and competitive, but it also highlighted the difficulties associated with complying with regulations. The authors also discovered that policies that reduced tax burdens helped SMEs feel less stressed financially, which allowed them to better allocate their resources toward innovation and expansion. Nevertheless, they also stressed the need for tax procedure simplification in order to make these incentives more accessible to small business owners. Ultimately, the authors concluded that simplified fiscal policies are essential for the growth of small and medium-sized enterprises (SMEs) in developing nations[1]

Nguyen et al. (2018): Nguyen et al. (2018) examined the effects of financial inclusion on the development of small and medium-sized enterprises (SMEs) in Vietnam. They found that SMEs in developing nations continue to face significant obstacles due to limited access to affordable credit. The study also demonstrated that government-backed microfinance initiatives had a positive effect on increasing the availability of credit for SMEs. Additionally, the researchers found that SMEs benefited greatly from interest rate subsidies, which decreased the cost of borrowing. Finally, Nguyen et al. (2018) argued that targeted monetary policies are necessary to improve credit accessibility for SMEs, particularly in rural areas. Ultimately, the authors concluded that improving financial inclusion is essential to the growth of SMEs[2]

Kumar and Sinha (2019): The impact of regulatory reforms on the ease of doing business for small and medium-sized enterprises (SMEs) in developing countries was investigated. The authors found that one of the main obstacles to SME growth was the burdensome regulations, which included bureaucratic red tape and licensing requirements. They also observed that the reforms aimed at streamlining business registration and lowering administrative barriers resulted in a greater formalization of SMEs. These findings suggest that fostering entrepreneurship and drawing more businesses into the formal economy can encourage SMEs' growth and ability to contribute to national economic development[3]

Adeyemi et al. (2019): Adeyemi et al. (2019) examined how trade liberalization policies affected the competitiveness of small and medium-sized enterprises (SMEs) in Nigeria. Based on their findings, they concluded that while trade liberalization can help SMEs integrate into global value chains, complementary support measures, such as improved logistics infrastructure, are necessary for maximizing the benefits of open trade policies. The authors also noted that poor infrastructure and limited access to information were barriers to the effective implementation of these trade policies[4]

Chowdhury and Rahman (2020): The impact of government-backed SME support programs in Bangladesh was examined, who noted gaps in the programs' effective distribution, particularly to SMEs in rural areas. Their analysis of initiatives like grants, subsidies, and advisory services for SMEs revealed that these programs positively impacted SME growth by providing necessary resources for capacity building and productivity enhancement. In addition, the authors concluded that targeted government initiatives, along with a transparent implementation mechanism, are essential for ensuring equitable benefits for SMEs in developing countries[5]

Mwangi et al. (2020): Mwangi et al. (2020) investigated how fiscal policy measures helped small and medium-sized enterprises (SMEs) grow in Kenya. They discovered that tax exemptions and deductions significantly reduced the financial strain on SMEs, but they also pointed out that high compliance costs associated with tax procedures frequently offset the benefits of these fiscal policies. Mwangi et al. suggested adopting digital platforms and streamlined tax filing procedures to make these policies more accessible to SMEs. Ultimately, they concluded that although fiscal policies are important for SME growth, streamlining administrative procedures is essential to ensuring these policies are successful[6]

Patel et al. (2021): Patel et al. (2021) examined how monetary policies affected small and medium-sized enterprises' (SMEs') ability to obtain financing in India. They discovered that high interest rates and strict collateral requirements posed significant obstacles for SMEs looking to obtain credit. The study also highlighted the ways in which targeted credit schemes, like priority lending programs, enhanced SMEs' access to financing. Patel et al. also proposed that reducing interest rates and easing collateral requirements could greatly improve SMEs' capacity to obtain funding. Ultimately, they concluded that monetary policies that are more inclusive and tailored to the needs of SMEs can be extremely important in fostering the expansion of small businesses in developing nations[7]

Amankwah and Tetteh (2021): Amankwah and Tetteh (2021) examined the effects of regulatory frameworks on the growth of small and medium-sized enterprises (SMEs) in Ghana. They discovered that formalization was hampered by a complex regulatory environment, and that the recent efforts by the government to simplify business registration and licensing had a positive effect on the growth of SMEs. Amankwah and Tetteh proposed that more regulatory reforms be implemented in order to support entrepreneurship, especially in the areas of lowering startup costs and duration. Their conclusions demonstrated the importance of establishing a favorable regulatory environment for the growth of SMEs and formal sector participation[8]

Rashid et al. (2022): The study investigated the correlation between fiscal policies and innovation in small and medium-sized enterprises (SMEs) in Pakistan. The results of the research indicated that tax incentives for R&D activities greatly stimulated innovation within SMEs. Nevertheless, the authors observed that bureaucratic intricacies hindered smaller firms' ability to utilize these incentives, and they suggested streamlining the tax incentive application process to boost SMEs' adoption. In summary, Rashid et al. (2022) concluded that fiscal policies that promote innovation, especially those specifically designed for SMEs, can improve the general competitiveness and sustainability of small businesses in developing nations[9]

Garcia et al. (2022), governments must invest in infrastructure and provide financial support to enhance SME export capabilities in addition to trade liberalization. They concluded that effective trade policies, coupled with complementary support measures, are crucial for enabling SMEs to compete globally. The study examined the impact of government trade policies on the market access of SMEs in Latin America and found that reduced trade barriers and export support programs positively impacted SMEs' ability to enter international markets. It also highlighted the challenges posed by inadequate infrastructure and limited access to export financing[10]

Bello and Johnson (2023): Bello and Johnson (2023) investigated how government incentives affected the performance of small and medium-sized enterprises (SMEs) in Nigeria. They examined subsidies and grant programs, which they found to be helpful in raising SMEs' productivity and competitiveness in the market. The authors also pointed out that the efficacy of these incentives was hindered by the lack of transparency in the allocation of funds, and they suggested strengthening oversight mechanisms to guarantee equitable resource distribution. In the end, Bello and Johnson concluded that government incentives are necessary to boost the growth of SMEs, but they stressed the importance of transparency and accountability in guaranteeing that these incentives benefit the people for whom they are intended[11]

Hassan et al. (2023): In their analysis of the effects of financial sector reforms on the growth of SMEs in Egypt, Hassan et al. (2023) found that the expansion of SMEs was positively impacted by reforms aimed at increasing credit availability through microfinance and other lending schemes, but they also observed that high interest rates and collateral requirements continued to be obstacles for many SMEs. The authors suggested that financial institutions adopt more accommodating credit evaluation criteria in order to accommodate SMEs. In summary, the authors concluded that financial reforms, when paired with policies that are supportive of SMEs, are essential for augmenting SMEs' contribution to economic growth in developing nations[12]

Khan and Akhtar (2024): The impact of trade policies on the integration of small and medium-sized enterprises (SMEs) into global markets in South Asia was investigated. The study revealed that export incentives and favorable trade agreements facilitated SMEs' entry into international markets, thereby augmenting their competitiveness. Despite this, the authors observed that logistical obstacles and restricted export financing continued to be significant impediments. They suggested that the government allocate resources towards enhancing logistics infrastructure and offering specific export credit guarantees to SMEs. In summary, Khan and Akhtar (2024) concluded that effective trade policies, in conjunction with infrastructure development, are crucial for SMEs in developing nations[13]

Adebayo et al. (2024): The study investigated the impact of government-sponsored training and capacity-building initiatives on the productivity of small and medium-sized enterprises (SMEs) in Sub-Saharan Africa. The results of the research indicated that initiatives aimed at developing skills had a favorable effect on the efficiency and innovation of SMEs. The authors emphasized the significance of technical and managerial training in enhancing business performance, but they also pointed out that logistical obstacles frequently prevented these programs from reaching rural SMEs. Ultimately, the authors concluded that the key to boosting the productivity and competitiveness of SMEs in developing economies is to expand the reach of capacity-building initiatives and guarantee equitable access[14]

RESEARCH GAPS

- **Impact of Digitalization Policies:** There is little data on how government initiatives to promote digital transformation impact the expansion of SMEs in developing nations.
- **Impact of Gender-Based Policy:** Insufficient attention is paid to how economic policies affect SMEs run by women as opposed to those led by men.
- **Effects of Policy Interactions:** The joint influence of monetary, regulatory, and fiscal policies on the performance of SMEs has not received much attention.
- **Long-Term Effects:** Research on how economic policies affect the sustainability and scalability of SMEs over the long run has been sparse.

OBJECTIVES

In order to identify areas where government interventions can be optimized to foster SME growth, this research will examine the ways in which economic policies affect the development and growth of Small and Medium Enterprises (SMEs) in developing countries. It will also highlight critical factors that determine the success of such policies and offer recommendations for improving their effectiveness.

- **Analyze Policy Impact:** Determine how trade, monetary, and fiscal policies affect the expansion and sustainability of SMEs.
- **Determine Challenges:** Determine the main obstacles that SMEs in developing nations must overcome as a result of the present economic policies.

- **Make Policy Recommendations:** Make sensible policy recommendations to boost the expansion and competitiveness of SMEs in emerging countries.

III. ALGORITHMS

The goal of the research is to evaluate the impact of economic policies on small and medium-sized enterprises (SMEs) in developing nations by using a number of analytical equations to understand the key economic factors that affect SME growth. These equations include the Cobb-Douglas production function, which will be used to evaluate the influence of labor and capital on SME output; the loan interest equation, which will help determine the impact of policies on profitability; the Solow growth model, which will evaluate the impact of investment policies on capital accumulation; the labor supply elasticity, which will be used to evaluate the effects of labor policies; and the analysis of Total Factor Productivity (TFP), which will be used to determine overall efficiency. The methodology involves quantitative analysis using these equations to interpret data on SME growth, profitability, and productivity under various economic policy environments.

- **Cobb-Douglas Production Function:**

The Cobb-Douglas production function is used to model the production capacity of SMEs, reflecting how labor and capital influence output.

$$Q = AL^\alpha K^\beta \quad (1)$$

Q : Output of the SME

A : Total factor productivity

L : Labor input

K : Capital input.

α, β : Output elasticities of labor and capital, respectively

- **Profit Maximization Condition:**

The profit maximization condition determines the optimal output level of SMEs by balancing production costs and revenue.

$$\pi = P \cdot Q - (w \cdot L + r \cdot K) \quad (2)$$

π : Profit

P : Price per unit of output

Q : Quantity of output

w : Wage rate

L : Labor input

r : Rental cost of capital.

K : Capital input

- **Loan Interest Equation:**

This equation models the interest cost for SMEs when accessing loans, which is crucial for their growth and investment.

$$I = P_L \cdot r \cdot T \quad (3)$$

I : Interest payment

P_L : Principal loan amount

r : Interest rate

T : Time period

- **Solow Growth Model for SME Investment:**

The Solow growth model is used to measure capital accumulation and its impact on SME growth over time.

$$K(t+1) = (1 - \delta)K(t) + I(t) \quad (4)$$

$K(t+1)$: Capital at time $t+1$

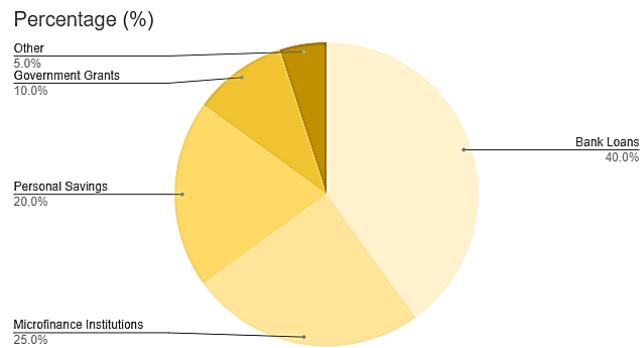
δ : Depreciation rate

$K(t)$: Capital at time t
 $I(t)$: Investment at time t

In addition, the loan interest equation assesses the cost of borrowing for SMEs under various financial policies, the Solow growth model measures capital accumulation and its relationship to SME growth over time, and the Cobb-Douglas production function analyzes how labor and capital, influenced by economic policies like investment incentives, affect SME output. Finally, the profit maximization condition helps determine optimal output levels by assessing how wage rates, capital costs, and pricing impact profitability. These equations together provide a comprehensive framework for understanding the complex interplay between economic policies and SME performance, guiding recommendations for policy improvements to foster sustainable growth in developing economies.

IV. RESULTS AND DISCUSSION

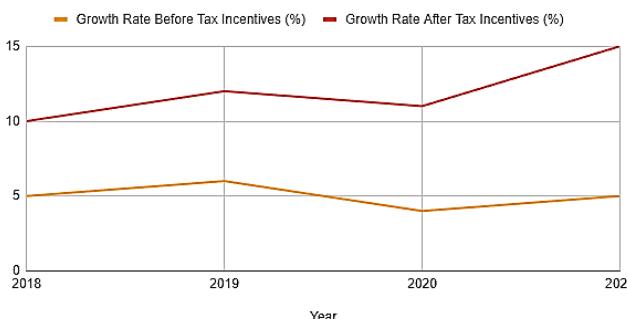
4.1 Sources of Funding for SMEs:



The funding landscape for Small and Medium Enterprises (SMEs) is crucial for their growth and sustainability, particularly in developing countries. This data illustrates the distribution of primary funding sources among SMEs, highlighting the significant role that bank loans play, accounting for 40% of total funding. The reliance on bank loans indicates the importance of formal financial institutions in providing capital for business operations and expansion. Microfinance institutions follow, contributing 25%, showcasing an alternative funding avenue for smaller enterprises often excluded from traditional banking. Personal savings, representing 20%, demonstrate the entrepreneurs' investment in their businesses, reflecting their commitment and risk-taking nature. Government grants, at 10%, highlight the impact of supportive policies aimed at fostering entrepreneurship, while the 5% from other sources underscores the diversity of funding options. This data emphasizes the need for effective economic policies that enhance access to finance for SMEs, particularly in regions where traditional banking may be less accessible. Understanding these funding sources allows policymakers to identify gaps and design targeted interventions to support SME growth, fostering economic development in developing countries.

4.2 Impact of Tax Incentives on SME Growth:

Growth Rate Before Tax Incentives (%) and Growth Rate After Tax Incentives (%)

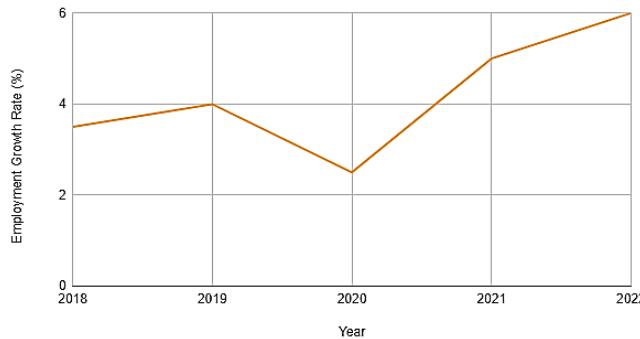


The implementation of tax incentives plays a pivotal role in shaping the growth trajectory of Small and Medium Enterprises (SMEs) in developing countries. This data presents a comparative analysis of SME growth rates before and after the introduction of tax incentives over four years. In 2018, SMEs experienced a growth rate of 5%, which increased to 10% post-incentive, indicating a significant positive impact. The following year, growth rates improved further, with 2019 witnessing a rise from 6% to 12% after tax incentives were applied. The data suggests that the effects of tax incentives may

vary, as seen in 2020, where growth rates fluctuated between 4% before and 11% after incentives. However, by 2021, a marked improvement was observed, with growth rates reaching 5% prior to incentives and soaring to 15% afterward. This trend emphasizes the effectiveness of tax incentives in stimulating SME growth, providing evidence for policymakers to continue or enhance such measures. Analyzing these trends helps illustrate the importance of fiscal policies in creating an enabling environment for SMEs, ultimately contributing to job creation and economic resilience in developing countries.

4.3 Employment Growth in SMEs:

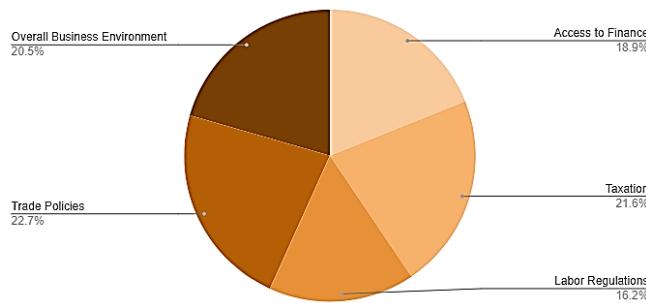
Employment Growth Rate (%) vs Year



The growth of employment in Small and Medium Enterprises (SMEs) is a vital indicator of economic health and job creation in developing countries. This data presents the annual employment growth rates for SMEs over five years, reflecting the dynamic relationship between economic policies and workforce expansion. In 2018, SMEs experienced a modest employment growth rate of 3.5%, which indicates a cautious hiring approach amidst economic uncertainties. However, this rate rose to 4.0% in 2019, suggesting a slight recovery in business confidence. The data reveals a downturn in 2020, with a growth rate of only 2.5%, likely due to the economic impacts of global events such as the COVID-19 pandemic. In 2021, employment growth rebounded to 5.0%, as businesses began to recover and adapt to new market conditions. By 2022, the growth rate further improved to 6.0%, indicating a robust recovery phase for SMEs. This upward trend emphasizes the importance of supportive economic policies that encourage employment growth, highlighting how targeted interventions can lead to positive outcomes for SMEs. Understanding these dynamics is crucial for formulating policies that sustain job creation and foster economic development.

4.4 Effect of Regulatory Policies on SME Performance:

Satisfaction Level (Average Score)



The satisfaction of Small and Medium Enterprises (SMEs) with regulatory policies is a crucial determinant of their performance and growth potential in developing countries. This data provides insights into the average satisfaction levels of SMEs across various regulatory policy areas, measured on a scale from 1 (very dissatisfied) to 5 (very satisfied). Access to finance, with an average satisfaction score of 3.5, indicates a moderate level of contentment among SMEs, suggesting that while some financial resources are accessible, improvements are still necessary to enhance financing options. Taxation policies received a higher satisfaction score of 4.0, reflecting a relatively positive perception of the tax environment and its impact on business operations. In contrast, labor regulations scored 3.0, highlighting concerns over regulatory burdens that may hinder employment growth and operational flexibility. Trade policies received the highest score of 4.2, suggesting that SMEs are generally satisfied with their ability to engage in international markets. Lastly, the overall business environment scored 3.8, indicating a need for ongoing improvements. This data underscores the importance of effective regulatory frameworks that balance support and compliance, ultimately fostering a conducive environment for SME growth in developing countries.

V. CONCLUSION

In conclusion, the influence of economic policies on Small and Medium Enterprises (SMEs) in developing countries is profound and multifaceted, shaping their growth, funding, and operational environment. The data collected reveals critical insights into the primary funding sources for SMEs, emphasizing the significant role of bank loans and microfinance institutions. Tax incentives have demonstrated a notable positive impact on SME growth rates, highlighting the importance of supportive fiscal policies. Employment growth data indicates that while SMEs faced challenges, particularly during economic downturns, effective policy interventions can foster job creation and economic resilience. Moreover, the varying satisfaction levels among SMEs regarding regulatory policies suggest that there is still room for improvement, particularly in areas like access to finance and labor regulations. Policymakers must prioritize creating an enabling environment that encourages entrepreneurship by addressing these gaps. By tailoring economic policies to meet the unique needs of SMEs, developing countries can harness their potential as engines of economic growth and innovation, ultimately contributing to broader national development objectives. Continued research in this area is essential to refine policy approaches and support sustainable SME growth in an ever-evolving global economy.

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