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# **EFFECT OF MONETARY POLICY ON SMALL MEDIUM SCALE ENTERPRISES PERFORMANCE IN NIGERIA (CASE STUDY OF SELECTED SMES IN EKITI)**

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## **Abstract**

*Different economic policies, such as fiscal, trade and monetary policies among others are often initiated and implemented by the government with the primary objective of stimulating economic growth in most cases. These policies are external factors capable of influencing the workings of different business entities. Therefore every business should strategise to cope with these policies since they might not be able to live above them. Recently, series of monetary policies are introduced and implemented by the monetary authority in Nigeria thereby causing upsurge in the interest rate, this development has the tendency of impacting cost of doing business. Hence, this study intends to measure the effect of the change in interest rate on the profitability and investment level of SMEs owners in Ekiti state. In order to achieve these objectives, primary data were used; well-structured questionnaire was designed and administered to population of the study made up of selected 415 SMEs owners across the 16 local governments in the state adopting descriptive methods of analysis. Results of the study indicated that increased interest rate has lowered SMEs profitability and investment level. Thus, it is recommended that monetary authority should initiate monetary policies that are business friendly, which would keep the interest rate moderately low and capable of engendering business growth and investment.*

**Keywords:** Monetary policy, SMEs performance, Interest rate, Investment, Profitability, Business growth

## **INTRODUCTION**

Given the important role played by Small and Medium Scale Enterprises (SMEs) in engendering economic development, the sector has been accorded significant recognition in most economies as they are often described as efficient and prolific job creator, seeds of big businesses and fuel of national economic engines. From the foregoing claims it is obvious that vibrant and viable SMEs are capable of stimulating desired economic growth and development if made to operate under a conducive environment where there is lesser external

factors that can impact on their activities negatively (Edward & Senyo, 2017).

Lionel & Saul (2018) submitted that Small and medium scale enterprises are germane to economic development of any nation, which with time becomes the focus for public policy meant to enhance employment and reduce unemployment either in developed or developing economies. With the immense contribution of SMEs to overall growth and development of a nation by stimulating gross domestic product, reducing



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unemployment, curbing inflation and mitigating other social ills among populace, this sector is found to be confronted with myriads of challenges that include infrastructural facilities deficiencies such as deplorable road network, poor telecommunication system, epileptic power supply. Other factors are trade policies such as tariffs and quotas that impinge their workings, also monetary policies that come in form of changing interest rate and unstable exchange rate can as well influence SMEs.

Infrastructural facilities availability in most of the developing nations, Nigeria not excluded, is inadequate while limited available ones are found to be in worrisome or deplorable state. These facilities are supposed to aid smooth running of business activities and contribute to their growth and development positively by lessening cost of production of business owners in such an environment where such is in abundant supply. Series of studies in the time past from developed nations have confirmed positive contribution of amenities such as good road network, regular power supply, good communication system and others to growth and development of business entities in developed nations. However, opposite is the case in most developing nations where infrastructural deficiency is the order of the day, this anomaly causes rise in production cost, reduction in profit margin and lessening employability capability of firms (Lionel & Saul 2018).

Trade policies are put in place by government primarily to stimulate economic growth and at the same time ensure that other economies of the world are not grown at the expense of the domestic economy. Albeit, when most of these policies are not implemented with

caution they may hamper growth of SMEs, especially those that are into physical conversion or belong to real sector of the economy. Earlier researchers have found that tariff imposition increases production cost of domestic producers as quota limits their export capacity and access to imported raw materials; all inhibiting SMEs expansion (Madinatou, Simon, & Yin 2022)

Government, in most cases, rely on proceeds generated through taxation to foot her bills in most fiscal years. Meanwhile most firms have gone into extinction as a result of double taxation mostly imposed on businesses in developing nations. Majority of these firms, even at infancy do not enjoy government subsidies or tax holiday to aid their rapid growth as they are newly floated. The narrative seems to be different in developed nations from what is obtainable in Nigeria where double taxation stifles SMEs to death (Bamidele, Yusuf & Olusola 2023)

Moreover, different monetary policies are initiated and implemented continuously within Nigerian economy, not all of these are in favour of SMEs at all times. As a matter of fact, interest rate which is the cost of borrowing has been found to be taking an upward trend incessantly for than a fiscal year, similarly exchange rate which determines units of domestic currency required to attract a unit of a foreign currency is seen unstable and equally changing on daily basis. All these factors are never without implications, for this reason the study intends to put focus on the effects of changes in monetary policy on performance of SMEs by specifically finding out:

- (i) Effect of exchange rate changes on SMEs performance in Ekiti State.
- (ii) Effect of interest rate changes on SMEs performance in Ekiti State.



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**LITERATURE REVIEW**

This section consists of review of related literatures that focus on the implications of monetary policies on workings of different business entities especially small and medium scale enterprises that are perceived to be pivotal to the growth of economy and its ultimate development. Some of the literatures reviewed showed strong negative influence of these policies on SMEs growth while few others indicated that these changes in monetary policy exerted positive impacts on SMEs.

Charity, Asha, Lucy & Agas (2021) assessed impact of monetary policy on the growth of Small and Medium scale Enterprises (SMEs) in Nigeria. Secondary data were sourced on monetary policy variables such as interest rate, inflation rate, money supply and exchange rate. Necessary diagnostics tests such as unit roots, co integration tests were carried out to confirm the suitability of the data. One of the variables was not stationary at I(1) while others were. Hence, need for the use of Autoregressive Distributed Lag (ARDL) technique of analysis. Interest rate and inflation were found negatively related to SMEs output, however, they remain statistically insignificant. Meanwhile, money supply and exchange rate were positively related to SMEs output and statistically significant in determining such.

A cross country analysis aimed at determining the influence of monetary policy on the performance of SMEs in some selected African countries like Nigeria, Ghana and Gambia was conducted using Autoregressive Conditional Heteroscedasticity (ARCH) method of analysis and secondary data on variables such as interest rate, exchange rate, inflation rate and credit were pooled. Results showed that exchange rate and interest rate positively impacted SMEs

output in Nigeria, however, inflation rate and credit have negative effect on the output of the SMEs. In the case of Ghana, interest rate has direct effect on SMEs performance; however, it is exchange rate that has positive impact on SMEs output in Gambia (Isola & Mesagan, 2018).

Other related study assessed impacts of monetary policy transmission channels on the performance of real sectors in selected sub-Sahara African countries. In detecting this transmission mechanism a system of Generalised Methods of Moments (GMM) was used. The chosen explanatory variables are credit, interest rate and exchange rate. From the analysis, it was found that credit and exchange rate channels positively impact agricultural activity while interest rate exerted major negative influence on agricultural sector. Albeit, credit and exchange rate channels were found to have indirect impact on manufacturing while interest rate channels had paltry effect on manufacturing sector (Ifeoma, Augustine, Josaphat & Ebere, 2023).

Micheal (2022) explored the influence of the monetary policies on the surviving ability of SMEs. Ordinary Least Square (OLS) technique of estimation was found suitable. OLS results indicated that lending rate is negatively correlated with SMEs growth while money supply, commercial bank credit and advances are positively correlated with SMEs growth. Hence, it was submitted that monetary policies are crucial for the survival of SMEs. Effects of high lending rates on SMEs in Sierra Leone were investigated. The study is unique in the sense that it combined use of primary and secondary data for the purpose of analysis. Incidence of high lending rate on SMEs performance was confirmed, as authors' quantitative and qualitative analyses showed that high interest rate on loan is often caused by high inflation rate



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which is reported disadvantageous to the SMEs owners because of its implication on the ability of SMEs owners in servicing their loans and ultimately making the firms to go bankrupt. It was confirmed by more than 90% of the respondents that low interest rate is capable of promoting SMEs growth.

Effects of selected macro economic variables on the performance of SMEs in Nigeria was conducted using four major variables that include; interest rates, exchange rate, inflation rates and general private consumption while SMEs performance was measured in terms of wholesale/retail contribution to Gross Domestic Product (GDP). Interest rate was found having trivial effect on wholesale and retail contributions to GDP in Nigeria. But exchange rate indirectly and significantly affected wholesale/retail sub-sectors. Generally, unfavourable effect of exchange rate on SMEs in Nigeria was however reported. Meanwhile, inflation and private expenditure respectively have positive and negative influence on SMEs in Nigeria (Nzubechi, Gideon, & Ifeoma2023).

In an attempt to assess monetary policy matter influence on business development in sub-sahara African led to cross country study carried out by (Agbonrofo & Olusegun, 2023). Monetary indices such as interest rate and exchange rate statistically and significantly impact only in the long run and without immediate influence on business value added as found through Auto regressive Distributed Lag model results. Nonetheless, credit effect has statistical significance in two periods, short and long term, on manufacturing value added in Sub-Saharan Africa region.

Sun Funesh and Tian So Lai (2021) analysed both instantaneous and joint dynamic effects of trade openness, interest

rate, and exchange rate on manufacturing performance in Malaysia employing Auto-Regressive Distributed Lag means of estimation. The analysed data showed that effect of the rate of change, both in exchange rate and lending rate are minor while economic crisis as a variable has major indirect effect on manufacturing growth in Malaysia.

Moreover, comparative analytical impacts of interest rate and tax payments on the growth of small businesses in Ghana, using firms' employment growth as yardstick, had been conducted. The regression coefficient of lending interest rate on firms' growth was found negative, likewise tax levied. Comparatively, the perceived taxes on firms' growth was very small as the authors concluded that monetary policy instruments such as interest rates have more impacts on small business growth than fiscal instruments such as taxes (Opuni & Edward, 2017).

## MATERIALS AND METHODS

### Study Areas, Data Source and Sampling.

For the purpose of this study, samples of SMEs were taken across all the local councils in Ekiti State forming selected study areas given the distinct characteristics of each of these local councils, likewise the general attributes in relation to their population size and other demographic factors. The empirical research made use of primary data gotten through the administered questionnaire to some selected SMEs across the 16 local government areas in the month of February, 2024.

The sampling technique is purposive sampling method that is non-probability random sampling methods which selects sample based on the knowledge of a population enabling us to determine the number of chosen SMEs operators that





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totalled 415 across 16 local governments corresponding to 25 from each local government with the exception of Ado-Ekiti that doubles as capital seat and local government headquarter having 40 respondents. Intuitively, the level of economic transactions going on within the metropolis should under normal circumstance be higher than that of other communities within the state given its population size. Data collection took the researchers about two and half months.

### Analytical Technique

Descriptive statistics were adopted to explain the effects of monetary policy such as changing interest rate, exchange rate, money supply and others on SMEs performance in Ekiti State, Nigeria, using percentages and frequencies. Similarly, correlation analysis between SMEs performance and some selected monetary variables were examined. The two chosen technique of analysis are considered suitable for this study in that it would enable the researchers have the direct views of the respondents on effects of monetary policy changes on their business activities while correlation analysis to find out the direction of relationship between vital variables of choice in the study.

## FINDINGS AND DISCUSSION OF RESULTS

Table 4.1 presents the demographic characteristics of the respondents. Respondents' age falls between 25 and 56 years above. The age range 25-35 has the highest percentage that stood at 49.36%, this percentage almost doubles the population of the respondents whose age bracket is within (36-45) with just 25.32%. Meanwhile, summation of the percentages of those that their age brackets are within both (46-55) and (56 and above) is half size of age range (25-35). Intuitively, it could be submitted that the very active population

are involved in business activities, considering population of respondents whose age ranges between 25 and 55, whose total percentage stood at 90.87%. This is not surprising, because these population groups are in their prime as far as life is concerned; hence, they are expected to be highly productive besides the fact that is the stage when their demand for money in implementing many economic transactions and meeting basic needs of life often rise. This corroborates earlier findings (Simon & Shepherd 2014).

More than 50% of the sampled population claimed to have been married while a little above 40% are still single. This shows that more married people are engaged in either small or medium sized business activities. This becomes necessary because of the need to meet their immediate family needs and to be socially responsible in the larger society. This is in tandem with previous study (Alfonso, Amparo & Juan, 2023). With the gender figures, more males are involved in small and medium scale business activities, they almost tripled the number of female respondents. This shows that in every four sample, at least three would be male. This might not be unconnected with the fact that male has a greater financial responsibility starting from making provision for his immediate household. In some tribes or cultures, it is seen as a taboo for the head being fed by the spouse.

Educational attainment statistics revealed that number of people with Higher National Diploma or its equivalence (Bachelor of Science) more than double summation of the percentage of people with National Diploma and Master and above. This implies that all sampled population are educated and out of every four respondents sampled, at least one of them would have



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minimum qualification, that is, National Diploma while two possess either Higher National Diploma or Bachelor of Science degree however probability of seeing one with masters' degree is not very high. This suggests that majority of the people into SMEs operation can code and decode information which under normal circumstance should positively influence the functioning of their businesses. This lends credence to past survey and its assertion that education is a booster of business growth. Ali and Norliiazhia (2018) found a very strong positive relationship

between educational level and SMEs performance in Libya. This submission aligns with other authors' view that perceived business education (especially formal education) and training as impetus for business growth and development (Paul, 2022) However, other studies carried out earlier that examined influence of manager's education found that these dependent variables were insignificant in stimulating SMEs performance in Accra Metropolis which is in sharp contrast with recent studies, (Edward & Senyo, 2017).

**Table 4.1: Respondent's Demographic Characteristics**

| Characteristics                | Frequency | Percentage | Mean  | SD     |
|--------------------------------|-----------|------------|-------|--------|
| <b>Age</b>                     |           |            |       |        |
| (Years)                        |           |            |       |        |
| 25 -35                         | 195       | 49.36      | 28    | 1.325  |
| 36 -45                         | 100       | 25.32      |       |        |
| 46 -55                         | 60        | 15.19      |       |        |
| 56 and above                   | 40        | 10.13      |       |        |
| <b>Marital Status</b>          |           |            |       |        |
| Single                         | 165       | 41.77      | 1.95  | 0.395  |
| Married                        | 220       | 55.69      |       |        |
| Divorced                       | 10        | 2.54       |       |        |
| <b>Gender</b>                  |           |            |       |        |
| Male                           | 293       | 74.18      | 1.02  | 0.1650 |
| Female                         | 102       | 25.82      |       |        |
| <b>Education Level</b>         |           |            |       |        |
| National Diploma               | 97        | 25.56      | 2.114 | 1.002  |
| Higher National Diploma/Degree | 229       | 57.97      |       |        |
| Masters and above              | 69        | 17.47      |       |        |

Source: Authors' Computation, 2024.

Table 4.2 gives the frequency and percentage distribution of monetary policy on some identified socio-economic variables. It is generally and widely accepted that monetary policy changes often and highly impacts on the workings of business within the economy, since the associated variables are external to the business. Hence, most businesses, if not all,

cannot live above these factors; rather they strategise to cope with them.

Statistics indicated that about 98% of the respondents complained about the severity of monetary policy changes and its negative consequences on performance of small and medium scale enterprises appearing in form of business size reduction as caused by



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shrinking and insufficient capital base required for expansion thus limiting productive capacity of those SMEs into physical conversion. More so, about 99.49% of the respondents complained about the significant negative impact of the hike in interest rate on performance of their businesses while less than 1% claimed that upward trending interest rate has positive effect on their businesses. This hike in cost of borrowing has lowered investment, reduced production, and diminished income as confirmed from sampled SMEs owners which are caused by inaccessibility to cheap loanable funds required for enhanced performance of the business. This result is in tandem with earlier findings which showed that rising interest rate often causes most businesses to phase out untimely (Ebire & Onmonya 2018).

Business owners at various levels, SME owners not exempted, often procure their raw materials via domestic and foreign sources. In the time past as respondents claimed, these raw materials could be sourced on credit with promise to make payment at a later date. However, interest rate instability has changed the narrative such that procurement and supply are done on cash basis as against the old traditions that allowed clients have access to raw materials on credit. Close to 99% of sampled population confirmed that interest rate changes have had significant negative impacts on procurement of raw materials. This is not surprising because effects of interest rate change cut across sectors in the economy such that change effect felt by SME owners has equally been felt by SME suppliers. Our results are consistent with earlier reports (Bamidele, Yusuf, & Olusola 2023).

Exchange rate is very germane when inputs are to be procured from outside the domestic economy since local currency

remains invalid for such transaction but convertible currencies such as US dollar, Pounds Sterling and Euro are now relevant for such international economic transaction. Of late within Nigerian economy, exchange rate is continuously seen taking an upward trend, as naira is weakening virtually on daily basis. This weakening of domestic currency is never with a consequence which may be negative for those procuring greater percentage of their capital goods from foreign nations. The implication is that more units of naira would now be required in acquiring capital goods due to depreciation of domestic currency. This has eventually placed limit on the ability to acquire desired level of capital required for both transformation and service rendering purposes as said by the respondents. The result is in conformity with earlier studies that confirmed negative influence of volatile exchange rate on business growth (Charity, Ashea Lucy, & Agas 2021), as over 90% of SME owners claimed that impacts of exchange rate fluctuations on their business performance is major and negative. This negative effect has further manifested in form of production reduction due to use of obsolete technology, limiting and or retarding business growth, resulting in lay off of workers and eventual closure of the entity due to inability of the business to acquire modern tools that is trending, capable of meeting taste and preference of nowadays consumers. These findings also corroborate earlier work (Isola, & Mesagan, 2018).

Lending rate is the cost of borrowing, as this rate rises, overhead of the business also rises correspondingly thereby causing profit of the business to diminish. Also exchange rate rise is synonymous to rising international price culminating in high cost of transacting at the international market. These rising costs often cause profit of SME to deplete, thus limiting their



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expansion rate as about 91% of the respondents claimed. This result lends credence to study earlier conducted by (Micheal, 2022).

Overall 98.74% of the respondents in their general assessment of the effect of monetary policy on business growth within Ado Ekiti Metropolis and other selected

communities from the remaining 15 local government areas in Ekiti state have submitted that monetary policy influence on growth of SMEs in recent time is quite inimical, as most businesses could no longer operate optimally, some have been stifled to death while many others are struggling to survive.

**Table 4.2. Frequency and Percentage Distribution of Monetary Policy on other Socio-Economic Variables**

| variables   | frequency | Percentage |
|---|-----------|------------|
| <b>Monetary Policy Effect on Business Workings</b>                                    |           |            |
| Low   | 07        | 1.77       |
| Moderate  | 25        | 6.33       |
| Very High   | 363       | 91.90      |
| <b>Effects of Interest rate changes on Loan Accessibility/Repayment</b>               |           |            |
| Negative  | 341       | 86.33      |
| Moderate  | 52        | 13.16      |
| Positive  | 02        | 0.51       |
| <b>Interest rate changes effect on input procurement</b>                              |           |            |
| Less Significant  | 05        | 1.27       |
| Significant   | 56        | 14.18      |
| Highly significant  | 334       | 84.55      |
| <b>Exchange rate changes effect on Capital Acquisition</b>                            |           |            |
| Insignificant   | 04        | 1.02       |
| Less Significant  | 28        | 7.09       |
| Very Significant  | 363       | 91.89      |
| <b>Exchange rate changes on raw materials procurement</b>                             |           |            |
| Insignificant   | 03        | 0.76       |
| Less significant  | 35        | 8.86       |
| Very significant  | 357       | 90.38      |
| <b>General Effects of Exchange and interest rates changes on firms' profitability</b> |           |            |
| Positive  | 05        | 1.26       |
| Indifferent   | 31        | 7.85       |
| Negative  | 359       | 90.89      |
| <b>Monetary Policy Effect on Business Growth</b>                                      |           |            |
| Insignificant   | 05        | 1.26       |
| Less Significant  | 35        | 8.87       |
| Highly Significant  | 355       | 89.87      |

Source: Authors' Computation, 2024.

Table 4.3.1 presents correlation analysis between capital acquisition of small and

medium scale enterprises and lending rate. The association between the two elements





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was established through the use of Pearson Product-moment correlation coefficient. Necessary preliminary diagnostics tests were carried out to prevent violation of normality, linearity and homoscedasticity assumptions. There was a strong, negative correlation between the two variables { $r=-$

0.55,  $n=395$ ,  $p<.0005$ }, with high level of lending rate associated with low capital acquisition among small and medium scale enterprises' owners. This result is in line with earlier findings (Joseph, Mohmad, & Samuel 2022)

**Table 4.3.1: Correlation between Capital Acquisition and Lending Rate**

| Variables       | Business Growth | Lending Rate |
|-----------------|-----------------|--------------|
| Business Growth | 1               | -0.55        |
| Lending Rate    | -0.55           | 1            |

Source: Authors' Computation, 2024

Table 4.3.2 shows the correlation analysis between business growth of SMEs and exchange rate. The relationship between the two variables was arrived at adopting Pearson Product-moment correlation coefficient. Formal tests were done on the data to avoid breaking the assumptions of normality, linearity and homoscedasticity.

There was strong negative correlation between the two variables { $r=-0.59$ ,  $n=395$ ,  $p<=.0005$ } with high exchange rate associated with reduced level of business growth. The result was in line with earlier findings (Nzubechi, Gideon, & Ifeoma 2023).

**Table 4.3.2: Correlation between Business Growth and Exchange Rate**

| Variables           | Capital Acquisition | Exchange Rate |
|---------------------|---------------------|---------------|
| Capital Acquisition | 1                   | -0.59         |
| Exchange Rate       | -0.59               | 1             |

Source: Authors' Computation, 2024

**CONCLUSION**

The study had investigated influence of monetary policy changes on the performance of Small and Medium Scale Enterprises (SMEs) in Nigeria, using some SMEs in Ekiti State were randomly selected as case study. Effects of the changing monetary policy variables such as exchange rate and interest rate were measured. A negative and strong correlation was found between interest rate and capital acquisition suggesting that as interest rate takes an upward turn, ability of business enterprises to acquire capital

diminishes and vice versa. Also, the association between rising exchange rate and business growth is negative and very strong pointing to the fact that currency depreciation retards the growth of small and medium scale enterprises. It is therefore recommended that the monetary policy makers should initiate policy that would keep values of these rates moderately low and stable for considerable period of time in such a way that it would not cause rise in production cost and ultimately fuelling inflation.

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