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MONETARY POLICY AND THE FINANCING OF SMALL AND MEDIUM SCALE ENTERPRISES IN NIGERIA

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Abstract

The paper evaluated the effect of monetary policy and the financing of small and medium *scale enterprises in Nigeria. Data were collected from CBN statistical bulletin for twenty five (25) years. Expost facto design was employed for the study. Ordinary least square multiple regression was used for the analysis. The findings showed that INR has no significant relationship with financing of small and medium scale enterprises, EXR has negative relationship with financing of small and medium scale enterprises and INF has no significant relationship with financing of small and medium scale enterprises at 5 percent level of significance during the period of the study but the combination of these variables had positive and significant effect on entrepreneurial growth in Nigeria during the period of the study. The researchers therefore recommend that: monetary authorities should reduce interest rate atleast to a single digit to enable small and medium scale enterprises obtain funds at a reduced cost in order to boost their businesses, monetary authorities should do their possible best to ensure that our exchange rate appreciates so that funds obtained by small and medium scale enterprises can be valuable to transact business, monetary authorities should also tackle the problem of inflation in our country so that funds obtained by small and medium scale enterprises can be useful for business transaction.*

Key words: Monetary Policy, Small and Medium Enterprises, Interest Rate, Exchange Rate, Inflation Rate etc.

INTRODUCTION

According to albusiness.Com (2010) and Emmanuel & Daniya (2012), Small and Medium Scale Enterprises (SMEs) is used mostly in the European Union and in international organization such as the world trade organization. The term SMEs is commonly used in the United State of America, European Union, South Africa, India etc. The European Union, mainly Germany limits small and medium scale enterprises to two hundred and fifty (250) employees, Belgium limits it to one hundred (100) employees, America has it to be any business with fewer than one hundred (100) employees is classified as ‘‘small scale’’ whereas medium scale business refers to any business with less than five hundred (500) employees. In India, the limit is five hundred (500). Small and micro enterprises have played a pivotal role in the overall industrial and economic development of the economy of India. In South Africa, the term small, micro and medium scale enterprises (SMMEs) is used rather than SMEs. In Nigeria, the term small and medium scale enterprises (SMEs) is generally used and the limit is five hundred (500). Recently, the European Union has standardized the concept by categorizing enterprises with less than ten (10) employees as ‘‘small scale enterprises’ and those with fewer than two hundred and fifty (250) employees as ‘‘medium scale enterprises’’.

From the forgoing, it can be deduced that small and medium scale enterprises are enterprises that can employ at most five hundred (500) employees at a time and it has been proved to be back bone for economic growth and development of every country. SMEs account for about 39% of the manufacturing output and about 33% of the total export of the country. Kayode (2001) and Hassan (2003) enumerated various schemes that have contributed to the growth of small and medium scale enterprise in Nigeria. The industries credit scheme (ICS) was introduced in 1971 as a revolving grant by the federal and state government in Nigeria to assist in meeting the credit need of SMEs on a relatively more liberal condition than in private lending institutions, Agricultural Credit Guarantee Scheme Fund of 1978, established to mitigate varied forms of agricultural risks to which farmers are exposed. Various states supervised small scale credit schemes came on stream including the People’s Bank which was established in 1989. Other states ventures in this regard include various phases of Small and Medium Scale Enterprises Schemes (SMEs) as well as the National Economic Reconstruction Fund (NERFUND).

Monetary policy is a conscious action undertaken by the monetary authorities to change or regulate the availability, quantity, cost or diection of credit in any economy in order to achieve a stated economic goal (Nzotta 2004; Ihenetu 2021). It is the combination of discretionary measures designed to regulate and control the money supply in an economy by the monetary authorities with the view of achieving a desired macro-economic goals. The goals of monetary policy are to reduce inflation, reduce unemployment, stabilize the exchange rate, stabilize price level, accelerate of economic growth and development, balance of payment equilibrium etc (CBN 2020).

Small and medium scale enterprises (SMEs) financing depends on the type and nature of monetary policy that a country adopt. If the monetary policy is contractionary, the SMEs financing will be minimal but if the policy is expansionary, then the SMEs will be adequately financed. Expansionary policy of monetary authorities mean that the monetary authorities will reduce their minimum rediscount rate (MRR) now called monetary policy rate (MPR) which will push out money into the economy and SMEs will have enough money.

This research work fills the research gap by examining monetary policy and financing of SMEs in Nigeria from1995– 2019, analyzing monetary policy, interest rate, exchange rate and inflation against level of SMEs contribution to GDP in Nigeria.

OBJECTIVES OF THE STUDY

The main objective of the study is to examine the effect of monetary policy on the financing of small and medium enterprise in Nigeria. Other specific objectives include:

1. To evaluate the effect of interest rate on the financing of SMEs in Nigeria.
2. To examine the effect of exchanging rate on the financing of SMEs in Nigeria.
3. To determine the effect of inflation on the financing of SMEs in Nigeria.

STATEMENT OF HYPOTHESES

In line with the objectives, the following hypotheses are formulated in a null from, they are:

Ho_1: There is no significant effect between interest rate (INR) and the financing of small and medium enterprises in Nigeria

Ho_2: There is no significant effect between exchange rate (EXR) and the financing of small and medium enterprises in Nigeria.

Ho_3: There is no significant effect between inflation (INFL) and the financing of small and medium enterprises in Nigeria.

LITERATURE REVIEW

a) Conceptual Framework

The following concepts need to be understood as they relate to the subject matter

i. Small and Medium Scale Enterprises

European union has standardized the concept of small and medium scale enterprises by categorizing enterprises with less than ten (10) employees as ‘‘small scale enterprises’ and those with fewer than two hundred and fifty (250) employees as ‘‘medium scale enterprises’’. In summary, small and medium scale enterprises are enterprises that have between 10 to 250 employees or in some countries 500 employees.

ii) Monetary Policy

Monetary policy is a conscious action undertaken by the monetary authorities to change or regulate the availability, quantity, cost or diection of credit in any economy in order to achieve a stated economic goal (Nzotta 2004; Ihenetu 2021). It is the combination of discretionary measures designed to regulate and control the money supply in an economy by the monetary authorities with the view of achieving a desired macro-economic goals. The goals of monetary policy are to reduce inflation, reduce unemployment, stabilize the exchange rate, stabilize price level, accelerate of economic growth and development, balance of payment equilibrium etc (CBN 2020).

The main aim of monetary policy could be either to decrease the amount of the money in circulation in the economy (contractionary policy) or to increase the supply of money in the economy by reducing the interest rate, reserve requirements etc. This is called expansionary monetary policy. The expansionary monetary policy aimed at lowering unemployment rate and stimulating economic growth through entrepreneurial activities (Ihenetu 2021).

iii. Inflation rate – Inflation is the persistent rise in the price of goods and services in the country. Most times, it is caused by demand pull, cost push or hyperflation. While demand pull inflation is as a result of excess money chasing too few goods, cost push is caused by workers asking for the increment in wages which makes the sellers of goods and services to increase their prices. Hyperinflation is the situation whereby the velocity of the inflation has come to a point that it becomes difficult to manage because the momentum of the inflation is uncontrollable (Ihenetu 2021).

iv. Exchange rate – This is the rate of the value of naira (as in the case of Nigeria) to another country currency value. The exchange rate is very important because the value of Nigeria currency may be valueless in the world market if the value of naira is depreciating. It will have direct effect on the economy. The value of goods and services imported such as car etc will be high if our naira value is low, therefore government agencies responsible, have to put up a policy to safeguard the value of naira (Ihenetu 2021).

v. Interest rate – This is amount paid to obtain funds from a bank or any other financial institutions (Ihenetu, 2021). Interest rate gives a signal to the amount of money supplied into the economy. High interest rate will mean low money supply and less economic activities in the country and low interest rate will mean high supply of money into the economy. Neither of these extreme is good for the growth of the economy. Therefore monetary authorities have to project the interest rate that will stimulate growth in the economy. The most preferred interest rate that will boost the economy has been adjudged to be single digit interest rate (Ihenetu 2021).

b) Theoretical Framework

The theories relevant to the work are thoroughly examined in this work

i. Commercial Loan Theory

This was propounded by Adam Smith in 1776. The theory stated that short-term loans advanced to finance businesses are the most liquid loans that banks could make. These are self-liquidating loans because the goods being financed will soon be sold. The loan finances a transaction and the transaction itself provides the borrower with the funds to repay the bank. The goods move quickly from the producers through the distributors to the retail outlet and then are purchased by the ultimate cash-paying consumer. The essence of the theory is that short term loans are preferred by banks as they would be repaid from the proceeds of transactions they facilitated and financed (Ihenetu 2020).

Small and medium scale enterprise secure loan from bank to finance their businesses, boost the business and expand it so that the proceeds from the business will repay the loan and at the same time keep the business moving. Monetary policy of a particular country determine the amount of the funds secured from the bank

ii. Quantity Theory of Money

Quantity theory of money was propounded by Irvin Fisher who existed between 1867-1947. The theory was encapsulated in his book the purchasing power of money. The theory emphasized the transactions demand for money in terms of the velocity of money in circulation. This is because money acts as a medium of exchange and facilitates the exchange of goods and services (Jhingan 2011). In Fisher's Equation of Exchange, $MV = PT$ (cause and effect relationship), M is the total quantity of money, V is its velocity of circulation, P is the price level, and T is the total amount of goods and services exchanged for money. The right hand side of this equation PT represents the demand for money which 'depends upon the value of the transactions to be undertaken in the economy, and is equal to a constant fraction of those transactions.' MV represents the supply of money which is given and in equilibrium equals the demand for money. The whole essence of the theory is that the demand for money is equal to money supply by the monetary authorities. If more money is supplied to the small and medium scale enterprises, the production of goods and services will also increase though the price level may as well increase.

iii. Monetary Theory

This is propounded by Friedman in 1956. The theory is based on the fact that money supply influences the economic activities. He advocated that when there is money supply in the economy, such as currency and other high instrument (Money market instruments), they will exert much power leading to the provision of more funds to SMEs. He further argue that the economy may not always be in full equilibrium and cannot be operating in full employment level of real GDP in the short run, but in the long run, there will be a link between money supply price level and real GDP. According to him, in the short run, the money supply only affect the price level which led to inflation, but in the long run, the real variables such as norminal national income, interest rate and prices are controlled through monetary policy of the government (Liberto & Estevez 2021). The essence of the theory is that money supplied by central bank, can affect the financing of SMEs in the economy.

3. METHODOLOGY

According to Ihenetu (2008), research design is a blue print, framework for collecting and analyzing data. The researchers employed expost facto design. The fact that the data were original from CBN statistical bulletin and adopted for the study necessitated the choice of the design. Furthermore, the researchers want to evaluate the effect of monetary policy on financing of small and medium scale enterprises in Nigeria.

The data were purely from secondary sources. CBN statistical bulletin 2019 provided the data for the analysis. Purposive sampling method was employed for the work. The sample size is 25 years (1995-2019). The researcher employed ordinary least square multiple regression for the analysis.

The model specification is given as:
FSME= f(INR, EXR, IFR). This functional model was trans- modified into the mathematical form by the introduction of the constant α, β and error term μ as:
This can be transmodified as:

$$FSME = \alpha + \beta_1 INR + \beta_2 EXR + \beta_3 IFR + \mu$$

Where FSME = Financing of Small and Medium Enterprises
INR = Interest Rate
EXR = Exchange Rate
IFR = Inflation Rate
α = constant variable
$\beta_1, \beta_2, \beta_3, \beta_4$ = Coefficient of independent variables (slope)
μ = error term.

4. DATA PRESENTATION AND ANALYSIS

Table 4.1. Financing of Small and Medium Scale Enterprises (FSME), Interest Rate (INR), Exchange Rate (EXR) and Inflation (INF) in percent (1995 – 2019).

Year	FSME	INR	EXR	IFR
1995	15.86	72.84	84.58	51.6
1996	16.60	29.27	79.60	14.3
1997	13.12	8.53	74.63	10.2
1998	11.53	10	84.37	11.9
1999	10.43	6.62	92.53	0.2
2000	7.58	6.93	109.55	14.50
2001	6.21	18.87	113.45	16.50
2002	8.68	12.88	126.90	12.20
2003	7.49	14.03	137.00	23.80
2004	3.62	15	132.85	10.00
2005	2.54	17.86	129.00	11.60
2006	0.99	8.23	127.00	8.50
2007	0.85	5.39	116.80	6.60
2008	0.17	11.58	131.25	15.10
2009	0.17	12.56	148.10	12.00
2010	0.14	13.72	148.81	11.80
2011	0.16	10.84	156.70	10.30
2012	0.13	12.22	155.76	12.00
2013	0.13	8.48	155.74	8.00
2014	0.12	8.06	168.00	8.00
2015	0.10	9.01	197.00	9.60
2016	0.07	15.68	305.00	18.60
2017	0.07	16.52	306.00	15.40
2018	0.29	12.09	307.00	11.40
2019	0.71	11.4	307.00	11.98

Source: CBN statistical bulletin 2019

Key: FSME = Credit to Small and Medium Scale Enterprise/Total credt * 100

Aprior expectation: A negative significant effect is expected between monetary policy variables such as INR, EXR, INF and financing of small and medium scale enterprises (FSME).

The data were analyzed to achieve the stated objectives. In all, three hypotheses were tested for the study. Ordinary least square multiple regression was used for the analysis. The result of the analyses is summarized below:

Table 2. Ordinary Least Square Multiple Regression

Model Summary[b]

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.742[a]	.550	.486	3.94279	.418

a. Predictors: (Constant), INF, EXR, INR
b. Dependent Variable: FSME

ANOVA[a]

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	399.494	3	133.165	8.566	.001[b]
	Residual	326.458	21	15.546		
	Total	725.952	24			

a. Dependent Variable: FSME
b. Predictors: (Constant), INF, EXR, INR

Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	8.262	2.298		3.595	.002
	INR	.190	.149	.452	1.277	.216
	EXR	-.041	.011	-.547	-3.606	.002
	INF	-.026	.211	-.042	-.121	.904

a. Dependent Variable: FSME
Source: *SPSS version 23*

From table 2, INR, EXR, INF are the independent variables whereas the FSME is the dependent variable. The result of the analysis shows that INR has no significant relationship with financing of small and medium scale enterprises, EXR has negative relationship with financing of small and medium scale enterprises and INF has no significant relationship with financing of small and medium scale enterprises at 5 percent level of significance during the period of the study. The r^2 0.550 implies that variation in all the explanatory variables account for 55% of the variation in financing of small and medium scale enterprises. F – Statistic measures the overall significance of the model. The F-statistic is 8.566 and the probability of F-statistic is 0.001 is far less than 0.05 power of test. This means that monetary policy has significant effect on financing of small and medium scale enterprises in Nigeria.

CONCLUSION AND RECOMMENDATIONS

Based on the findings of the study, the following recommendations have been made to guide the policy of government:

1. Monetary authorities should reduce interest rate atleast to a single digit to enable small and medium scale enterprises obtain funds at a reduced cost in order to boost their businesses.

2. Monetary authorities should do their possible best to ensure that our exchange rate appreciates so that funds obtained by small and medium scale enterprises can be valuable to transact business.

3. Monetary authorities should also tackle the problem of inflation in our country so that funds obtained by small and medium scale enterprises can be useful for business transaction.

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