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Effect of Economic Indicators on the Performance of Small and Medium Scale Enterprises in Nigeria

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ABSTRACT: The study examined the effect of economic indicators on the performance of small and medium scale enterprise in Nigeria with a particular reference to south-eastern geographical area. The study investigated the effects of inflation rate, interest rate and exchange rate on the performance of small and medium scale enterprises. The research work was anchored on resource-based theory. The study adopted a cross-sectional survey research design. The population of the study was 1560 while the sample size was 296. Multiple regression analysis statistical technique was used to test the hypotheses formulated to guide the study. The study found that inflation has a significant negative effect on the performance of SMES in South-East, Nigeria. Interest rate has a significant negative effect on the performance of SMES in South-East, Nigeria. Also, the study discovered that exchange rate has a significant negative effect on the performance of SMES in South-East, Nigeria. The study recommended that there is a need for efficient management of inflation rate in such a way to stimulate the economic growth. Government and policy makers should try more in regulating the interest rates and other credit facilities, making sure that they are accessible and affordable to all SMES in Nigeria. Also, federal government should come up with economic policy and regulatory framework that will maintain fixed exchange rate in Nigeria.

I. INTRODUCTION

Economic environment includes factors and trends related to income levels and the production of goods and services. Economic conditions affect how easy or how difficult it is to be successful and profitable at any time because they affect capital availability, cost, and demand (Thompson, 2012). Economic trends also affect the purchasing power of these markets. Accordingly, it is not enough for a population to be large or fast growing, as in many developing countries, to offer good market opportunities; the economy must provide sufficient purchasing power for consumers in order to satisfy their wants and needs (Linnemann, 2016). Convincingly, economic trends in different parts of the world can affect trading activities in other parts of the world. For example, changes in interest rates in Germany affect the value of the dollar on world currency markets, which affects the price and subsequently sales of American exports and imports (Clay, 2005). Interestingly, market opportunities are a function of both economic size and growth. Nigeria economy is characterized by fluctuating macro-economic indicators with continuous drop in oil prices at the international market and government intension to diversify the economy and promoting the local content agenda, the current negative performance index of manufacturing sector in relation to the contribution to GDP and the potential the sector

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has for the economy in terms of employment, government revenue, foreign earrings and potential contribution to GDP, any effort toward this direction should be considered an effort in the right direction. Therefore, SMEs exposure to these risks is not without consequence on performance, as this is a line charge on SMEs earnings. Lending in excess of inflation rates is viewed as pre-requisite for successful and sustainable financing ‘‘positive interest rate" (Buckley, 2009). The excessive high-interest rate in Nigeria had strongly discouraged long-term investments and constrained the ability to grow with nominal interest rates varying from 20-30% the private sector is unable to borrow to finance long-term investment.

Obuwuru, Oluwalaye and Okwu (2011) posited that economic environment of a business are such factors as economic growth, interest rates, exchange rates and inflation rates. These factors have major impacts on how small and medium scale enterprises operate and make decisions. They also noted that interest rates could affect the extent to which Small and medium scale enterprise grows and expand. Exchange rates could affect the cost of exporting goods and supply price of imported goods. Ogundele (2005) noted that economic factors is a vital concern to small and medium scale enterprise business, that the economic environment goes a long way to determine and define opportunities for the performance of small and medium scale enterprise. This is because an expanding economy provides operational scope for the establishment of new ones. However, a period of recession can bring about failures and probably liquidations of the organization. It is of paramount importance that the management should be able to distinguish between short run phenomena and more fundamental changes in its assessment of overall economy. Therefore this study examine the effect if economic factors on the performance of small and medium scale enterprise in south-East, Nigeria.

Interestingly, the modern business owner or manager operates in a more dynamic environment. Contributing, Obuwuru, Oluwalaye and Okwu (2011) posited that economic factors that influence the performance are; unemployment, demand and supply trends, economic growth, lending rates, interest rates, exchange rates and inflation rates. These factors have major impacts on how small and medium scale enterprises operate and make decisions. They noted that interest rates could affect the extent to which Small and medium scale enterprise grows and expand. Exchange rates could affect the cost of exporting goods and supply price of imported goods. Adeoye (2012) opines that economic variables have been complex both in form and impact on the performance of small and medium scale enterprise business in Nigeria. He further stated that in the contemporary Nigerian economic environment, performance of the Nigerian Small and medium scale enterprise is predicted on factors such as low sales, high cost of production, low capital utilization, lack of foreign exchange to source the needed input, poor power supply and low quality of goods and services. It has been argued that the persistent poor performance of the SMEs sector in Nigeria is mainly due to massive importation of finished goods, inadequate financial support and other variables which has resulted in the reduction in capital utilization and output of the manufacturing sector of the economy (Tomola, Adebisi & Olawale, 2012). Increased globalization, emerging markets, and high competition have made the economicenvironment to become turbulent and unpredictable. Macroeconomic uncertainty, volatility, and risk on firms are having an effect on their profitability and especially in developing countries like Nigeria.

Pertinently, financial factors such as hyperinflation/deflation, high-interest rates and increasing exchange rates are some of the factors in the current economic environment that are affecting the performance of SMEs.SMEs capacity to meet up with investment demands, financing demands, and transactions are limited in respect to financial ability and access to funding, which are either from equity source or through debt financing Furthermore, in Nigeria, the level of growth in SMEs sector has been affected negatively because of high lending rates, which invariably is responsible for high cost of production (Adibiyi, 2001 & Rasheed, 2010). Okafor (2012) further observed that the level of Nigerian SMEs sector performance has continued to decline because of low implementation of government budget and difficulties in assessing raw materials. Regrettably, empirical evidence is lacking or limited with little documentation showing how macroeconomic variables impact on the performance of manufacturing sector in Nigeria. Therefore the thrust of this study is to examine the effect of economic indicators on performance of small and medium scale enterprises in south-eastern part of Nigeria.

Objectives of the study

The main objective of the study is to investigate the effect of economic indicators on the performance SMEs in South-East of Nigeria. The specific objectives of the study are to:

1. Examine the effect of inflation rate on the performance of SMEs in South-East, Nigeria.

2. Determine the effect of interest rate on the performance of SMEs in South-East, Nigeria.
3. Investigate the effect of exchange rate on the performance of SMEs in South-East, Nigeria.

Research questions

Given the objectives of the study, the following research questions were formulated to guide the study:

1. To what extent does inflation rate affect the performance of SMEs in South-East, Nigeria?
2. To what degree does interest rate influence on the performance of SMEs in South-East, Nigeria?
3. To what extent does exchange rate affect the performance of SMEs in South-East, Nigeria?

Hypotheses

The following hypotheses were formulated in their null structures to guide this research

Ho_1: Inflation rate has no significant effect on the performance of SMEs in South-East, Nigeria.

Ho_2: Interest rate has no significant influence on the performance of SMEs in South-East, Nigeria.

Ho_3: Exchange rate has no significant effect on the performance of SMEs in South-East, Nigeria.

Significance of the study

This study is expected to benefit the following stakeholders: the firms, managers, researchers, government and the general public. The proper understanding of the economic environment will help firms to determine opportunities formulation of policies, government and SMEs Researchers and scholars. This research is expected to provide useful knowledge in formulation of policies and a regulatory framework for running campaigns of advocating factors affecting the SMEs. This study will also give insight to the marketers on how to effectively harness their marketing activities to meet up with the challenges in their economic environment. The economic environmental analysis of the marketer makes their tasks easier in dealing with business challenges, image building and meeting with competition to achieve performance and growth. In addition, this research is expected to help marketers in aligning its marketing activities with the realities in its marketing environmental. This is because the interaction between the business and its environment is imperative to give direction for growth and expansion of the business showing their sensitivity to the environment within which they are domiciled. Also, this study will help managers in aligning its activities with the realities in its economic environmental. This is because the interaction between the business and its environment is imperative to give direction for growth and expansion of the business showing their sensitivity to the environment within which they are domiciled. It is expected that this study will give insight to the managers on how to effectively harness their activities to meet up with the challenges in their economic environment. This study will also provide empirical and theoretical materials for scholars and researcher who will like to venture into related area of research. The findings of this work are expected to provide serve as a reference source of materials for further related research. The result of this study will be invaluable to researchers and scholars, as it will form a basis for further research.

Scope of the Study

This study is limited to investigating the effect of economic factors on the performance of small and medium scale enterprises. The variables used in the study are inflation rate, interest rate and exchange rate. They served as the variable scope of this study. This study selected 36 small and medium scale enterprises in South-East, Nigeria as the geographical scope of this study. The unit scope covered the employee and owners of the thirty-six selected small and medium scale enterprise in South-East, Nigeria.

II. REVIEW OF RELATED LITERATURE

Conceptual Framework

Small and Medium Scale Enterprises

The definition of small and medium scale enterprise is varied from country to country. The definitions in use depend on the purpose those definitions are required to serve and the policies which govern the cooperative small and medium scale enterprise sector. However, the three parameters generally applied by most countries are the worth of the business; number of workers employed; and, volume of production or turnover of business (Onugu & Uzondu 2015). Evidence from the United States of America has it that the small business administration has various definitions depending on the type of industry. For instance, manufacturing and mining businesses with fewer than 500 employees are considered as small businesses while businesses in wholesale trade industries are expected to be fewer than 100 employees. For other industries such as retail and construction, businesses are classified based on annual revenue. Also, in Ghana, for example, the ministry of Industries uses a definition involving multiple criteria of turnover, fixed assets and the number of employees. However, the criteria such

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as turnover and volume of output are influenced by management effectiveness and efficiency which vary from one industry to another (Ajayi, 2002).

Exchange Rate

The exchange rate is the rate at which a currency is measured or exchange with another currency. Using the flexible exchange rate system, the price of currencies is determined by supply and demand of the currency in the foreign exchange market. Using the flexible exchange rate system the price of currencies are determined by supply and demand of the currency in the forex market. Given the frequent changes of supply and demand influenced by numerous external and internal factors, this new system is responsible for currency fluctuations (Abor, 2015). The fluctuations expose companies to foreign exchange risk (Pandey, 2009). Moreover, economies are getting more and more open with international trading and as a result companies become more exposed to foreign exchange rate fluctuations. Generally, companies are exposed to three types of foreign exchange risk: translation exposure, transaction exposure and economic exposure (Osoro & Ogeto, 2014). Agyei-Ampomaha, Mazouzb and Yin (2012) discovered that the determinants of currency exposure are model dependent while the cross-sectional results suggest very little or no relationship between firm-specific factors and currency exposure. Similarly Zakaria (2013) also examined the impact of exchange rate volatility on trade using regression analysis, the results, from regression analysis show that Malaysian exports to the US and Japan are significantly related with exchange rates volatility.

Interest Rate

Interest rate affects all sectors of the economy through the cost of debt and the availability of money and credit and this could affect a firm's ability to access external sources of fund. Fiscal policies affect a firm’s after tax net cash flow, its cost of capital and potentially the demand for its products, and survival. Prior to interest rates liberalization, interest rates were determined through administrative controls and after liberalization by market forces (Wachira, 2009). These factors that now determine interest rates include; inflationary expectations, the real rate of interest differentials, excess liquidity and domestic and foreign interest rate differentials, i.e. when there are no restrictions on capital movements. According to Cargill (2011), there exists two approaches used to determine interest rate; liquidity funds approach and loan able funds approach. In addition, these approaches assume that the level of income and employment determined in the real section of the economy are constant. Increases in the nominal interest rate intensifies the aggregate rates of failure or default (Wadhwani, 2016; Robson, 2016), as firms are financed with high variable rate, firm may unable to increase their debt through borrowing and, therefore, unavoidably face liquidity risk as a result of cash shortage. Interest rates have been observed to have diverse impact on SMEs performance. High interest rates are likely to curb business investments and innovation. Rising interest rates could also increase loan defaults in the banking system and SMEs business financing and affect business revenues and profits negatively. When interest rate is raised, the general effect is to lessen the amount of money in circulation, which works to keep inflation low. On the other hand, lower interest rates give companies an opportunity to borrow money at lower rates, which allows them to expand their operations and also their cash flows. When interest rates are declining, the economy is expanding in the long run. Appropriate interest rates should therefore be set to maintain inflation at desired levels while encouraging economic development.

Inflation Rate

Inflation is defined as a persistent increase in general price levels in an economy over time. Inflation effectively reduces the purchasing power of a country’s currency. Low or medium levels of inflation in a country can have a positive effect on the SMES business sector, in that it can act as an incentive to production. High levels of inflation however can harm company’s profitability by affecting the cost of inputs as well as reducing final demand for its output (Meyers, 2011). Ultimately the effect of inflation on a firm is determined by the nature of its operations as well as its competitive environment. A firm which experiences an inelastic demand for its products may be able to cushion itself from adverse impact of inflation by transferring the price increases to final consumers, thus leaving its margin untouched. The same could be said of a company operating in a sector with low levels of competition (Meyers, 2011). From liquidity point of view, inflation is likely to result in an erosion of the real value of any financial claims outstanding an opposed to the nominal value of such claims which may find it with receivables whose real value is diminished, thus inflation harms lenders and tend to benefit borrowers (Myers and Steward, 2014). Platt, (2015) states that while distressed firms may prefer no growth strategy; external pressures such as inflation may cause their sales to rise exogenously and develops a new sustainable growth rate formula that describes how much growth the firm with no debt capacity can endure. Pertinently, when inflation in a country is more than that in a competitive country, the exports from former country will be less attractive compared to the other country. This means there will be fewer sales for those country goods both at home and abroad and that will create a larger trade deficit. At the same time, high inflation in a country weakens its competitive position in the international market (Davidson & Weil, 2015). In addition, Loto (2012) investigated the determinants of output expansion in the Nigerian SMEs sectors from 1980 to 2010. It was found that inflation rate play the highest significant role in explaining SMEs sector output expansion in Nigeria.

Empirical Review

Owolabi (2017) examined the impact of economic characteristics and financial performance of selected Small and medium scale enterprises in Nigeria. This study investigated the impact of economic characteristics of Small and medium scale enterprise operating environment represented by; government expenditure, inflation rate, interest rate and exchange rate fluctuations on financial performance of selected small and medium scale enterprises. The study adopted an ex-post facto research design. Stratified and random sampling methods were used to select 31 small and medium scale enterprises in Nigeria. The study used a regression analysis technique to test the formulated hypotheses. The findings revealed that the impact of economic characteristics on firm's financial performance existed but in diverse magnitude; economic characteristics proxy by interest rate, rate of inflation, exchange rate and Government expenditure showed a negative and significant relationship with the performance of Small and medium scale enterprise. Also, it was discovered that there is an overall negative significant relationship between economic characteristics on the performance of small and medium scale enterprise.

Abubakar (2015) examined the impact of economic factors on SSBs performance in Kano and Sokoto states. Questionnaire methods were used to collect data from the sampled SSBs. The data was analyzed using multivariate discriminant analysis and multiple regression technique in order to assess the level of performance as well as establish the significance of the relationship. The findings of this study clearly show that SSBs record low performance within the period studied and economic factors have significant impact on their performance in Kano and Sokoto states. The study recommends that government should create enabling environment for both existing and potential investors in the sector, through provision of adequate infrastructures, financial support and formulation of policies favorable to SSBs.

Okwu, Bakare and Obiwuru (2013) studied business environment, job creation and employment capacities of small and medium enterprises using Lagos State, Nigeria. The study employed descriptive approach to examine job creation and employment capacities of SMEs in relation to the Lagos State business environment. Analysis was based on ten elements of the business environment and two indicators of SMEs' relevance. The study used a composite of survey and co relational research designs to gather relevant information from which data for analysis were derived. Through survey, target population and sample size were determined. The target population used was 456 SMEs. The sample size was 228 while a convenience sampling technique was used. The findings revealed that inadequate access to external finance, competitive pressures, multiples taxes and other fees as well as corrupt practices were among the militating factors against the SMEs, while socio-cultural elements availability and costs of labour services did not constrain the enterprises. The study recommended practical policy measures to drive the traditional measures of providing external finance, tax and other incentives and infrastructure.

Onugu and Uzondu (2015) determined the influence of the socio-economic characteristics of cooperative members on the performance of their small and medium enterprises in Onitsha metropolis of Anambra State, Nigeria. A sample of 99 entrepreneurs, drawn from 10 cooperative societies in Onitsha North and Onitsha South Local Government Areas were sampled for the study. The findings showed that socio-economic characteristics (sex, age, education, cooperative experience as well as income) influenced significantly the performance of their SMEs. Also, it was found that the three characteristics; cooperative experience, level of income and education, explained significant variations in the gross margin

III. METHODOLOGY

This research work adopted a descriptive survey method. The target population of this study is made up of all the management, senior and junior staff of the selected SMEs totaling 1560. A sample size of 296 was determined using Ball and

Gall statistical formula. Primary source of data was used. The primary source was used. The instrument used for data collection was the questionnaire. In addition, a five-point Likert scale was used to generate the data for the analysis. Participants were asked to indicate their level of agreement with each statement/item from 5(Strongly Agree), 4(Agree), 3(Undecided) 2(Strongly Disagree), 1(Disagree). The reliability of the instrument was established based on Cronbach alpha result of 0.709 using test re-test method while for the validity; four research experts validated the instrument. The data generated through the instrument were analyzed while multiple regression analysis was used to test the hypotheses formulated exclusively for this study. In addition, the multiple regression analysis was conducted to assess the relative predictive power of the independent variables on the dependent variable. The statistical package for social sciences (SPSS) version 25 was employed to test the hypotheses.

The regression model is represented as:

$Y = \alpha + \beta_1X_1 + \beta_2X_2 + \beta_3X_3 + ẹ$

Where; Y = Performance

X_1 = Inflation Rate

X_2 = Interest Rate

X_3 = Exchange Rate

α = Constant

β = Coefficient of parameters X_1 to X_3

ẹ = Error term

IV. RESULTS

Table 1 shows the coefficient of determination (R^2) which measures the strength of the effect of independent variables on the dependent variable which has the value of 0.70. This implies that about 70% of the variations in firm's performance were explained by joint variations of the predicting variables. This was supported by adjusted R^2 of 0.504. Importantly, in order to check for autocorrelation in the model, Durbin-Watson statistics was employed. Durbin-Watson statistics of 1.879 as shown on table 1 portrayed that the variables in the model are not auto-correlated and also that the model is reliable for predications. Furthermore, the f-statistics value of 4.272 in table 2 with its corresponding f-statistics probability of 0.002 shows that the independent variables jointly have significant effect on the dependent variable. This entails that interest rate, inflation rate, and exchange rate collectively were able to determine the variations in performance of small and medium scale enterprises in south-east of Nigeria. On a similar note, table 3 presented the coefficient of the individual variables as well as their corresponding probability values. Interestingly, inflation rate has a regression coefficient of -0.159 with a corresponding probability value of 0.003. The implication is that the inflation rate has a significant but negative effect on the performance of small and medium scale enterprises in south eastern Nigeria. Furthermore, interest rate has a regression coefficient of -0.091 with a corresponding probability value of 0.026. This implies that interest rate has a significant but negative effect on the performance of small and medium scale enterprises in south eastern Nigeria. On a similar note, exchange rate has a coefficient value of -0.110 and its corresponding probability value of 0.036. This shows that exchange rate has a significant but negative effect on the performance of small and medium scale enterprises in south eastern Nigeria.

Table 1: Multiple Regression Analysis Model Summary Result

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.265[a]	0.700	.504	3.241	1.879

a. Predictors: (Constant) = Inflation rate, Interest rate, Exchange rate
b. Dependent variable: performance of SMEs

Table 2: Multiple Regression Anova Result

Model		Sum of Squares	Df	Mean Square	F	Sig.
	Regression	179.546	4	44.886	4.272	.002[b]
1	Residual	2384.937	227	10.506		
	Total	2564.483	231			

a. Dependent Variable: Performance of SMEs
b. Predictors: (Constant), Inflation rate, Interest rate, Exchange rate

Table 3: Multiple Regression Coefficients Result

Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.
		B	Std. Error	Beta		
1	(Constant)	18.311	2.121		8.632	.000
	Inflation rate	-.159	.053	-.194	3.014	.003
	Interest Rate	-.091	.054	-.128	2.112	.026
	Exchange Rate	-.110	.052	-.140	2.674	.036

Dependent variable: performance of SMEs

Test of Hypothesis One

Ho: Interest rate has no significant positive effect on the performance of SMEs in South-east, Nigeria

H1: Interest rate has a significant positive effect on the performance of SMEs in South-east, Nigeria

Based on the result on table 3, interest rate has a t-statistics of 2.112 and a probability value of 0.026 which is statistically insignificant. Therefore, we reject the null hypothesis and accept the alternative hypothesis which states that interest rate has a significant effect on the performance of SMEs in South-east, Nigeria.

Test of Hypothesis Two

Ho: Inflation rate has no significant effect on the performance of SMEs in South-east, Nigeria

H2: Inflation rate has a significant effect on the performance of SMEs in South-east, Nigeria.

Based on the result on table 3, inflation rate has a t-statistics value of 3.014 and a probability value of 0.003 which is statistically significant. Therefore, we reject the null hypothesis and accept the alternative hypothesis which states that inflation rate has a significant effect on the performance of SMEs in South-east, Nigeria.

Test of Hypothesis Three

Ho: Exchange rate has no significant effect on the performance of SMEs in South-east, Nigeria

Hi: Exchange rate has a significant effect on the performance of SMEs in South-east, Nigeria

Based on the result as presented on table 3; exchange rate has a t-statistics of 2.674 with its corresponding probability value of 0.036, which is statistically significant. Therefore, we accept the alternative hypothesis and reject the null hypothesis and we conclude that exchange rate has a significant effect on the performance of small and medium scale enterprises in south-eastern, Nigeria.

V. DISCUSSION OF FINDINGS

This work examined the effect of economic indicators on the performance of SMEs in South-eastern Nigeria. The hypotheses earlier formulated to guide the study were tested using multiple regression analysis. At the end of the analysis, the following were discovered. Inflation rate has a significant but negative effect on the performance of SMEs in South-east, Nigeria. This finding is consistent with the findings of (Davidson & Weil, 2015; Packer, 2017; Loto 2012) that found that there is a negative but significant correlation between inflation rate and the performance of SMEs. Also, interest rate has a significant but negative effect on the performance of SMEs in South-east, Nigeria. This finding is consistent with the findings of (Wadhwani, 2016; Robson, 2016 and Wachira, 2009) that found in their studies that interest rate had a negative but significant influence on the performance of small and medium scale enterprises. In addition, exchange rate had a significant but negative effect on the performance of SMEs in South-east, Nigeria. This finding conforms to the findings of (Osoro & Ogeto, 2014, Abor, 2015; Zakaria 2013 and Agyei-Ampomaha, Mazouzb & Yin, 2012) whose findings revealed a significant negative effect of exchange rate on the performance of small and medium scale businesses/enterprises.

VI. CONCLUSION AND RECOMMENDATIONS

This study ascertained the effects of economic indicators on the performance of SMEs in South-east, Nigeria. From the analysis, the study shows that inflation rate had a significant negative effect on the performance of SMEs in South-east, Nigeria. Interest rate had a significant negative influence on the performance of SMEs in South-east, Nigeria, and exchange rate has a significant negative effect on the performance of SMEs in South-east, Nigeria. Therefore, the study concludes that economic factors had a significant negative effect on the performance of SMEs in South-east, Nigeria. The major contribution made by this study is that the study provides empirical evidence that can aid government and policy formulators in managing economic factors related to performance of SMEs in Nigeria. The study further contributed to knowledge by updating the existing literatures on the effect of economic factors on the performance of SMEs. This research will help to advance the literature as well as the knowledge concerning the economic parameters affecting the performance of small and medium scale businesses in Nigeria. It is expected that people could use the findings of this research to solve problems they might face in them in their various businesses. Based on the findings of this study, the following recommendations were made:

1. The study recommended that there is a need for efficient management of inflation rate in such a way to stimulate the economic growth for improved performance of SMEs in Nigeria.
2. The Government and also the policy makers should put more efforts in regulating the interest rates of loan and other credit facilities, ensuring that they are accessible and affordable to all SMEs in South-east, Nigeria.
3. The federal government should come up with economic policy and regulatory framework that will maintain fixed exchange rate in South-east, Nigeria.

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