ECONOMIC ENVIRONMENT AND THE PERFORMANCE OF SMALL SCALE ENTERPRISES IN NIGERIA

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Abstract

The study examined Economic environment and the Performance of Small Scale Enterprise in Nigeria. The study employed quantitative research design of which secondary data were collected from journals and Central Bank of Nigeria's Statistical Bulletin for the period of 1986-2020. Data collected were analyzed usingdescriptive statistics and regression analysis aided by Eviews7. Four null hypotheses were developed and tested to examine the impact of selected components of economic environment on the performance of small scale enterprises in Nigeria at 0.05 significant levels. The study found that inflation rate has astatistically insignificant positive effect with a coefficient value of 0.001154 and probability value of 0.9025. Whereas, interest rate, with a negative effect has a statistically significant effect with coefficient value of -0.124756 and the probability value of 0.0010. Exchange rate and money supply have statistically significant positive effect on the growth of small enterprises in Nigeria with coefficients of 0.014658 and 0.000142 and probability value of 0.0003 and 0.0010 respectively. The study therefore concludes from the findings, that the economic environment of small enterprises in Nigeria between 1986 and 2020 have impacted significantly on the performance of small scale enterprise via their contribution to GDP. The study recommends that government should come up with measures to ensure that price level does not fluctuate significantly in such a manner that can lead to poor small enterprise's performance.

Key words: *Economic environment, Small firm performance, Contingency theory, Unit root, Regression analysis.*

1. Introduction

Small Scale Enterprises (SSEs) have been fully recognized by Federal, State, Local governments and development experts as a pivotal instrument of economic growth and development either in developed or developing economies (Ihua, 2004). They assist in the development of local technology, better utilization of local raw material, reduction of unemployment, viable source of income to individual and governments (Oyelaran-Oyeyinka, 2020). The entrepreneurial environment in most parts of the world, especially, in Nigeria is marked with dynamism and complexities. The complex nature of entrepreneurial environment is due to the presence of many factors that interact within the environment which are characterised by variableness

(Tambari et al., 2018) Theories, for instance Keynesian Economic Theory and contingency theory have highlighted the importance of stable environment in the development of enterprises. Theproponents of contingency theory opine that firm performance is the result of a proper alignment of firm design with the context it operates in (Donaldson, 1995).

Many people hold the view that the economic environment in Africa in general and Nigeria in particular, unlike Europe, poses a great challenge to the efficiency of SSEs operations.Empirical studies have shown that among other environmental factors, small scale enterprises performance is very sensitive to economic environment as a stimulus which is a composite of many parameters such as inflation, interest rate, money supply, exchange rate, government tax, and many others (Shane, 2014; Adeli et al., 2016; Saghir & Aston, 2017). The effect of various economic factors have been investigated by different researchers as stated below: inflation (Abel, 2012; Saghir & Aston, 2017**),** interest rate **(**Chukwuma & Chukwuma, 2015; Gikombo & Mbugua, 2018), exchange rate (Halim, 2017; Lawal & Akanbi, 2020) and money supply (Bekeris, 2012; Batarseh, 2021). However, findings from these empirical studies have not been unanimous on the impact of these factors on firm's performance. For example, Abel's (2012) finding of significant effect of inflation on business performance in Kenya was contradicted by Saghir & Aston's (2017) finding of insignificant effect of inflation in the UK. Similarly, while Halim (2012) found a significant positive impact of exchange rate on productivity, Lawal and Akanbi (2020) found a very low positive impact of exchange rate on business performance.

Apart from this, most of these studies were on general business performance which does not allow the impact of the variables on small enterprises to be glaring. Furthermore, Nigeria also has the disadvantage of not been a major beneficiary of research efforts in this area when compared to some African countries and most Asian and Europe countries. Empirical review of literature has shown that most Nigerian scholars that have

conducted related research used data spanning pre and post deregulation/liberalisation era. This does not allow the full impacts of most of these variables, arising from their volatilities, to be effectively captured as they were mostly regulated officially during the pre- deregulation period. All these failings of previous empirical works in this area have a weakening effect on any knowledge built on them and also underscore the necessity for further investigation into issue. It is obvious from the aforementioned that economic factors, despite their importance, have not been comprehensively studied in relation to their effects on small enterprises in Nigeria. This constitutes a problem yearning for empirical solution.

To this extent, therefore, this study seeks to investigate the impact of economic factors on the performance of Small Scale Enterprises in Nigeria from 1986 - 2020 with a focus on inflation rate, interest rate, money supply and exchange rate. In pursuit of this aim, the following hypotheses will be empirically tested:

Ho_1: Inflation rate has no significant impact on the performance of Small Scale Enterprise in Nigeria.
Ho_2: Interest rate has no significant impact on the performance of small Scale Enterprise in Nigeria.
Ho_3: There is no significant effect of exchange rate on the performance Small Scale Enterprises in Nigeria.

Ho_4: Money supply has no significant impact on the performance of Small Scale Enterprise in Nigeria.

Apart from this introductory section, the remaining part of the paper is structured as follows: section two reviews previous empirical work relevant to this study, section three explains the methodology adopted in this study for data collection and analysis, section four presents and analyses data for the study and section five summarises the findings from the study upon which conclusion is drawn.

2. Literature Review

2.1 Conceptual Review
2.1.1 Economic Environment
Entrepreneurial environment has been conceptualized as the totality of the factors that affect, influences or determines the operations or performance of a business, determines what is possible for the organisation to achieve, provides the lifeblood for the organisation by providing a market for its products and by serving as a source of resources. Therefore, for an organization to succeed, it must interact with its environment because it supplies the organisation with inputs that are necessary for its products. Every organisation exists within an extensive and complex environmental network. One type of environment that has been found to impact businesses regardless of size is the economic environment (Orogbu et al., 2018).

Economic environment is a vital concern to small businesses and entrepreneurial enterprises. The overall economic climate tends to determine to a large extent the performance of such organisations. This is because an expanding economy provides a thriving space for many enterprises in existence as well the establishment of new firms. Contrariwise, acontraction can lead to failures and liquidation of firms.

The components of economic environment has been identified by Pasha and Myers (1998), Achillah (2011) and Orogbu et al. (2018) to include inflation, interest rate, exchange rate and money supply. Stability in all of these factors results in the overall stability of entrepreneurial environment which invariably leads to a healthy growth of small enterprises. Asiedu (2002) views economic stability as a function of low inflation, stable exchange rate, price stability, and low and stable interest rate.

Inflation Rate
Aguiar and Broner (2006) refer to inflation as a continuous or maintained increase in the prices of services and goods in the long run. This results to more money in circulation chasing few goods. Low-income earner's purchasing power is also reduced. Inflation in a country, either low or medium levels can have a positive effect on the business sector, in that it can act as an incentive to production. High levels of inflation however can be detrimental to company's performance and profitability by affecting the cost of inputs as well as reducing final demand for its output (Myers, 2001). According to Polleit (2011), inflation causes a rise in general price making goods and services expensive to the common market targeted by SSE businesses. This poses a great challenge to SSE owners since they are the ones who have to increase the prices to match up the high cost of production, or acquisition of raw materials (Polleit, 2011).

Interest Rate
Interest rate can be defined as the cost expressed as a percentage of the principal (the amount borrowed) charged by the lender to the borrower for lending the money. The interest is a cost to the borrower while to the lender it is a source of revenue. (Darfor & Agyapong, 2010; Bello, 2018)). Higher interest rates deter prospective borrowers and increase the default risk of a loan portfolio already held, thus high interest rates may adversely affect financial institutions whose chief activity is lending funds (Jalilvand & Harris, 2009; Bello et al., 2019).

Exchange Rate
Samuelson and Nordhaus (2010) define the exchange rate as prices of one currency expressed in terms of another. It can be expressed as either a direct or indirect quotation. Exchange rate affects the relative prices between domestic and foreign goods and the foreign demand for local goods (Ncube & Ndou, 2011). The price of currencies is determined by supply and demand of the currency in the foreign exchange market. Given the frequent changes of supply and demand influenced by various external and internal factors, the values of most currencies frequently fluctuate. These fluctuations expose companies to foreign exchange risk (Osoro & Ogeto, 2014).

Money Supply

Ristanović (2010), defined Money supply as the total stock of assets that are generally acceptable as medium of exchange within an economy at a particular time. The determination of which items are to be included in the measurement of money supply is related to the level of financial liberalisation, or sophistication in a country. Money plays a significant role in almost everything. Nonetheless, when there is too much money around, it can do more harm than good for an economy. Bannock (2015) and Batarseh (2021) argued that if money supply is growing faster than the rate at which output and income are growing, then this will result in an increase in prices, which will lead to a fall in people's standard of living.

Small Scale Enterprises

A review of several journal articles on Small Scale Enterprises (SSEs) shows that Small Scale Enterprises can be defined in various ways depending on country, institutions and the purpose. For instance, the Central Bank of Nigeria (2013) defines Small and Medium Scale Enterprises (SMEs) as an enterprise that has an asset base (excluding land) of between N5Million – N500Million

and labour force of between 11and 300. Small enterprises according to SMEDAN those enterprises whose total assets (excluding land and building) are above Ten million Naira but not exceeding One Hundred Million Naira with a total workforce of above ten, but not exceeding forty-nine employees (NBS-SMEDAN National Survey, 2017). For the purpose of this research, adopts the SMEDAN's definition since it follows the International Standardsfor Industrial Classification (ISIC).

Small Enterprise Performance

Small enterprise performance implies itsability to meet its goals and objectives by efficiently and effectively utilising available resources (Dickson, 2014). Performancecan be looked at in terms of competitive performance, financial performance, and productivity, flexibility, resource utilization, and innovation. Firmage and size have been identified as critical determinants of an enterprise's performance (Benson, 2014).
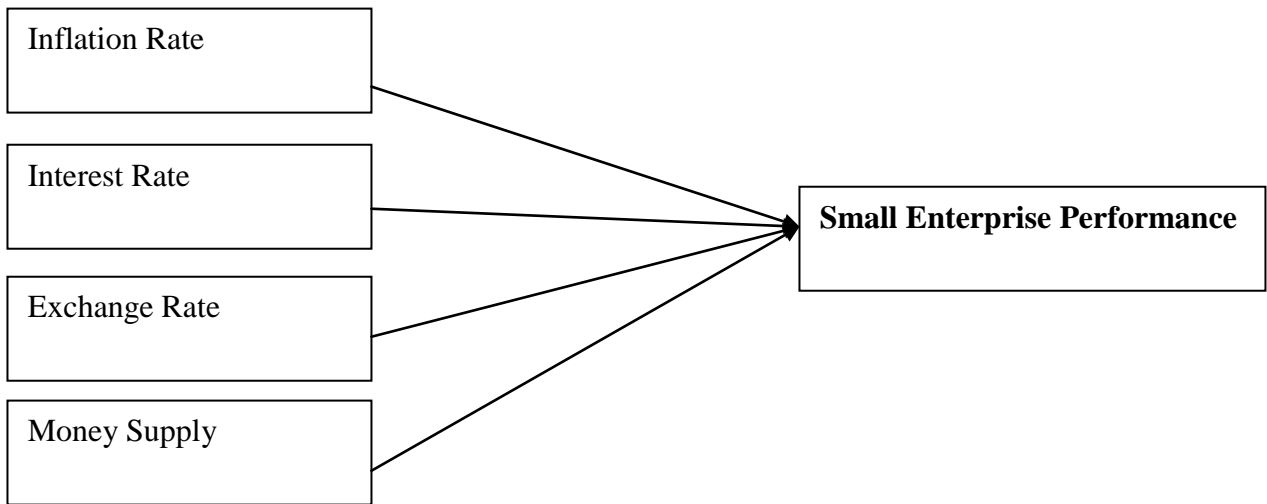
Economic Environment

Fig 1: Conceptual Framework
Source: Author's Compilation (2022)

This study is underpinned by the contingency theory developed by the Austrian psychologist Fred Edward Fiedler in 1964 (Fiedler, 1967; Bello, 2015). According to the theory, firm performance is the result of a proper

alignment of firm design with the context it operates in, (Donaldson, 1995). Contingency theory suggests that in order to be effective, SSEs must be consistent with other aspects of the organization and/or external environment. Contingency decisions within SSEs have largely been understood on the basis of external and internal fit. External fit, also termed vertical alignment, requires that the practices of SSEs must match the environmental conditions faced by the organization, while the internal fit (also termed horizontal alignment) requires SSEs to work together to communicate the same message and deliver the same desired outcome. Failure to achieve this fits between environmental context and SSEs practices will ultimately lead to suboptimal performance.

The relationship between economic environment and firm's performance have been investigated by some researchers (Abubakar, 2010; Bekeris, 2012; Chukwuma & Chukwuma, 2015; Adeli, et al., 2016; Gachuhi, 2016; Saghir & Aston, 2017; Gikombo & Mbugua, 2018; Orogbu et al., 2018; Tambari et al., 2018). Gachuhi (2016) and Abubakar (2010) investigated the impact of economic environment on performance of firms in Kenya and Nigeria respectively and found significant positive relationship between economic factors and enterprises in both countries. The impact of inflation rate, interest rate and exchange rate on performance of small enterprises were investigated by Adeli et al. (2016) in Iran, Gikombo & Mbugua (2018) in Kenya, Saghir & Aston (2017) in the UK, Chukwuma & Chukwuma (2015) in Nigeria, Orogbu et al. (2018) in Nigeria and Lawal and Akanbi (2020) in Nigeria. Apart from the findings of Saghir & Aston (2017) that show that inflation has insignificant effect on firm's performance in the UK and Orogbu et al. (2018) that found a negative impact of each of the variables on firm's performance in Nigeria, other findings were unanimous on the significant effect of the variables on firm's performance in their respective countries. Similarly, Batarseh (2021) and Omodero (2019) established in their studies that money supply causes inflation which has negative effect on small business performance and economic growth.

3. Methodology

This study employed a quantitative approach using descriptive survey research design. Secondary data covering thirty one years on SSEs performance and economic variables for the same period were used. The data were obtained from Central Bank of Nigeria statistical bulletin from 1986-2020.

The variables of the study were divided into dependent and independent variables. The dependent variable is small scale enterprises performance which was measured in terms of the contribution of small enterprises to national GDP from 1986 – 2020. The independent variable in this study is economic environment which was captured using four dimensions, namely: inflation rate measured as percentage change in the prices of goods and services within the period, interest rate cost expressed as a percentage of the principal (the amount borrowed) charged by the lender to the borrower for lending the money, exchange rate measured in real term and money supply measured in terms of broad money supply (M_2).

The econometric modelling and the estimation technique of ordinary least square (OLS) were used to predict the functional relationship between the dependent variable (Y) and the independent variable (X). The linear function is stated below:

$$Y = \beta_O + \beta X + \varepsilon \qquad . \qquad . \qquad . \qquad . \qquad . \qquad . \qquad . \qquad . \qquad 1$$

However, before estimation is made, the series will be transformed so as to bring all the variables into a common standardized form. This implies the use of the log linear form of the model to overcome some of the weaknesses of the linear model (Gideon &Uji, 2019). The log linear model is stated below:

$$\ln SEP_t = \beta_0 + \beta_1 \ln IFR_t + \beta_2 \ln INR_t + \beta_3 \ln EXR_t + \beta_4 \ln MN_S + \varepsilon_t . . \qquad . \qquad . \qquad 2$$

Where ln = Natural log of each variable,   SEP = Small Enterprise Performance

   IFR = Inflation Rate,   INR = Interest Rate,   EXR = Exchange Rate, MNS = Money Supply

5

The a priori expectations of the study are as stated below: the intercept (β_0) is expected to be positive; inflation rate, exchange rate and money supply are expected to have positive signs while interest rate is expected to have negative signs. That is: $\beta_0 > 0$; β_1, β_3 and $\beta_4 > 0$; $\beta_2 < 0$.

4. Results and Discussion

The Augmented Dickey Fuller (ADF) unit root test result is summarised in the table 1 below:

Table 1: Unit Root Test Result

Variable	Critical value at 5%	t-statistic	p-value	No. of unit Root
SEG	-2.966263	-5.241172	0.0002	l(1)
IFR	-2.967767	-6.729514	0.0000	l(1)
INR	-2.967767	-4.457979	0.0014	l(1)
EXR	-2.967767	-5. 779985	0.0000	l(1)
MNS	-2.967767	-12.75011	0.0000	1 (1)

Source: Author's Computation (2022), using Eviews 7

The unit root test presented in Table 1 shows that all the variables became stationary at first difference with critical values lower than their respective t-statistics.

Table 2: Descriptive Statistics Results

	EXR	IFR	INR	MNS	SEG
Mean	92.86942	20.45781	13.62500	5740.736	12436.86
Median	115.2551	12.80000	12.08000	1387.640	973.3200
Maximum	305.8000	72.80000	28.02000	24140.63	54581.58
Minimum	2.020600	5.400000	7.430000	23.81000	74.56000
Std. Dev.	74.70900	18.54084	5.041537	7790.619	17669.05
Skewness	0.480283	1.546887	1.045154	1.178318	1.119378
Kurtosis	2.981714	4.009375	3.478815	2.953898	2.771986
Jarque-Bera	1.230696	14.12037	6.131533	7.407814	6.752021
Probability	0.540453	0.000859	0.046618	0.024627	0.034184
Sum Sq. Dev.	173024.5	10656.65	787.9300	1.88E+09	9.68E+09
Observations	34	34	34	34	34

Source: Author's Computation (2022), using Eviews 7

Table 2 shows the summary statistics of all the variables under study. It shows the absence of outliers since the mean value of all the variables fall within their respective minimum and maximum values. Looking at the standard deviations of the variables from the mean values, it is obvious that money supply and small enterprises contribution to GDP are the most unstable while interest rate is the least volatile within the period. Exchange rate and inflation rate are also shown to be unstable during the period.

The Jarque-Bera test shows that with the exception of EXR, whose probability value is greater than 0.05, other variables (SEG, IFR, INR and MNS) are normally distributed since their probability values are less than 0.05.

Table 3: Regression Result

Variable	Coefficient	Std Error	t-statistic	Prob.
C	6.876773	0.547621	12.55754	0.0000
lnIFR	0.001154	0.009333	0.123630	0.9025
lnINR	-0.124756	0.033733	-3.698330	0.0010

lnEXR	0.014658	0.003579	4.095677	0.0003
lnMNS	0.000142	3.19E-05	4.460315	0.0001
R-square = 0.916987; F-statistic = 74.51325; Durbin-Watson = 0.677561 Prob (f-statistic)= 0.000000				

Source: Authors compilation (2022), using Eviews7

From the table above, the R-square value is 0.9166937 which shows that the independent variables (inflation rate, interest rate, exchange rate, and money supply) included in the model together explained 97.9% of the variation in the independent variable (small enterprise growth) while 2.1% of the total variation in the independent variable is explained by variables not included in the model. . The F-value of 74.51325 with the corresponding probability value of 0.000000 measured the adequacy of the regression model and the overall influence of inflation rate, interest rate, exchange rate and money supply on small enterprise growth. Since P= 0.000000 which is greater than 0.05 level of significance, the model has a good fit. The Durbin-Watson value of 0.677561 indicates presence of positive autocorrelation.

From the regression result, the constant parameter (βo) is positive at 6.876773. This means that if all the independent variables are held constant, SEG as a dependent variable will on the average increase by 6.88 percent. Having presented the result of the Ordinary Least Square test as shown in the table above, the researcher proceeded to test the hypotheses of the study as follows;

H_{O1}: Inflation rate (IFR) has no significant impact on small enterprise growth in Nigeria.
The value of the coefficient obtained from Ordinary Least Square result for inflation rate shown in Table 3 is 0.001154 with a probability value of 0.9025 at 0.05 level of significance. This implies that a percentage increase in inflation rate will leave the performance of small firms almost unchanged. This result is shown not to be statistically insignificant since the p-value is more than 0.05 critical values. Therefore, the study fails to reject the null hypothesis which states that inflation rate has no significant impact on small enterprise performance in Nigeria. The positive coefficient, though insignificant,

confirms the assertion that inflation in a country, either low or medium levels can have a positive effect on the business sector, in that it can act as an incentive to production (Aguiar & Broner, 2006). The result is in tandem with the findings of Saghir and Aston (2017) that shows that inflation has neutral effect on firm's performance in the UK. It however contradicts the findings of Orogbu et al. (2018) that found a negative impact of inflation on firm's performance in Nigeria.

H_{O2}: Interest rate (INR) has no significant impact on the performance of small scale enterprises in Nigeria.

The result obtained from the Ordinary Least Square (OLS) result as shown in Table 3 indicates that the coefficient value for interest rate is -0.124756 and the probability value is 0.0010. The result indicates that a percentage increase in interest rate will bring about 12% decrease in the contribution of small enterprise to Gross Domestic product (GDP). At 0.05 level of significance, this result is statistically significant since the p-value of 0.0010 is less than the 0.05 critical values. The study therefore rejects the null hypothesis of no significant effect of interest rate on small enterprise growth. This result is in agreement with the findings of Adeli et al. (2016) in Iran, Gikombo and Mbugua (2018) in Kenya, and Chukwuma and Chukwuma (2015) in Nigeria. The result is a reflection of the complaints by owners of small firms in Nigeria that interest rate in Nigeria, which has been a double digit for sometimes is a major challenge to their smooth operations (Bello, 2018).

H_{O3}: There is no significant effect of exchange rate on the performance Small Scale Enterprises in Nigeria.
The value of the coefficient obtained from the Ordinary Least Square (OLS) result for exchange rate shown in Table 3, is 0.014658 with a probability value of 0.0003 at 0.05 level of significance. This result shows that a

percentage increase in exchange rate will cause 1% increase in small scale enterprise contribution to GDP. This result is shown to be statistically significant since the p-value is less than 0.05 critical values. Therefore, the study rejects the null hypothesis which states that there is no significant effect of exchange rate on the performance Small Scale Enterprises in Nigeria. This result is supported by the findings of Tambari et al., (2018) in a research they conducted in Nigeria but out of harmony with the findings of Orogbu et al. (2018) who found that exchange rate impact negatively on performance.

H_{O4}: Money supply has no significant impact on the performance of Small Scale Enterprise in Nigeria.
The result obtained from the Ordinary Least Square result as shown in Table 3 indicates that the coefficient value for money supply is 0.000142 and probability value of 0.0001. This implies that a percentage increase in money supply will leave the performance of small scale enterprises unchanged. At 0.05 level of significance, this result is statistically significant since the p-value of 0.0010 is less than the 0.05 critical values. The study therefore rejects the null hypothesis of no significant impact of money supply on small enterprise performance. This result contradicts the finding of Bekeris (2012) who evaluated the impact of macroeconomic indicators upon SMEs' profitability in Lithuania and found that monetary base was not statistically significant and had no strong correlation with corporate profitability and Omodero (2019) whose study showed that broad money supply (M2) has an insignificant negative influence on RGDP in Nigeria, but has a significant positive effect in Ghana. Money plays a significant role in almost everything. Nonetheless, when there is too much money around, it can do more harm than good for small firms. Bannock (2015) argued that if money supply is growing faster than the rate at which output and income are growing, then this will result in an increase in prices, which will lead to a fall in people's standard of living with its resultant negative impact on investment.

5. Conclusion and Recommendations
The study investigated economic environment and the performance of small scale enterprises in Nigeria using time series data collected from the Central bank of Nigeria from 1986 to 2020. The ordinary least regression model was used to analyse the data with the aid of Eviews version 7. Four hypotheses were tested on the impact of inflation rate, interest rate, exchange rate and money supply on the performance of small enterprises in Nigeria. Apart from the first null hypothesis on the impact of inflation on small enterprise performance which was retained, others were rejected following the significant nature of their impacts. The inference from these results is that economic environment impacted significantly on the performance of small scale enterprises in Nigeria from 1986 to 2020. Following this inference made on the basis of the findings, the researcher makes the following recommendations:

i. The government should come up with measures to ensure that price level does not fluctuate significantly in such a manner that can lead to poor small enterprises' performance.

ii. The study recommends that small enterprise owners should seek alternative sources of capital since interest rate on bank loans affects their performance negatively. This could be done by seeking for long –term loans from the capital markets.

iii. Central Bank of Nigeria should continue to maintain an investment friendly exchange rate that will better the performance of small scale enterprises in Nigeria.

iv. Monetary authority should be cautious in injecting liquidity into the economy in order not to jeopardise the performance of small scale enterprises. Liquidity should be actively regulated and kept at a level that is compatible with small enterprises' wellness.

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