EFFECT OF EXCHANGE RATE FLUCTUATION ON THE GROWTH OF SMEs PERFORMANCE IN NIGERIA (2013-2024)

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Abstract

*This study investigated the effect of exchange rate fluctuation on the growth of SMEs performance in Nigeria from 2013 to 2024. The objectives of this study were to investigate the effect of exchange rate volatility on the performance of SMEs, and to examine the effect of interest rate and inflation rate on the performance of SMEs. This study employed ex-post facto research design as the event under study has already taken place. Data for this study were obtained through secondary source. This data included SMEs Industrial Output, Gross Domestic Product, exchange rate, inflation rate and interest rate from 2013-2024 Central Bank Annual Reports and National Bureau of Statistics (NBS) Reports. Data were analyzed using linear regression method and Pearson Product Moment Correlation to test the hypotheses in order to show the relationship between variables. The major findings of this study showed that exchange rate fluctuation has significant effect on SMEs performance (Coefficient of Determination, R^2, is .689 (68.9%)), as it destabilizes the purchasing power of SMEs which results in decline in SMEs output. Findings also revealed that the relationship between inflation and SMEs performance is significant (R^2 is (.880), P>.01 (0.000 <.01); the relationship that exists between inflation and SMEs performance is inverse (*r =-.14158*) relationship. The study concluded that an increase in interest rate causes decline in SMEs output and vice-versa, therefore recommended that policy makers should not totally rely on exchange rate depreciation policy to influence SMEs industrial output but should complement it with other macro-economic policies.*

Keywords: Exchange Rate, Interest Rate, Inflation Rate, SMEs Performance

1.0 INTRODUCTION

Small and Medium Enterprises (SMEs) survival and viability are critical to economic progress in every economy. SMEs are predicted to impact areas such as local raw material consumption, job creation, and rural advancement through economic empowerment, entrepreneurial abilities, and

skills among a large and capable population. On this assumption, Valdez, Garcia, and Maldonado (2016) have claimed that the economy of any nation is defined by the contributions of all sectors, notably small and medium enterprises (SMEs). The importance of SMEs in the national economy cannot be overstated, considering their involvement in rural economic change. Because of their importance, policies affecting SMEs' growth and survival have drawn the attention of policymakers worldwide. Similarly, business owners are debating the survival and viability of SMEs. The sustained interest in this sector is due to the importance of SMEs in the economy and the fact that their performance, particularly in Sub-Saharan Africa, has been below average (Danladi & Uba, 2016) .

According to Adeniran, Yusuf, and Adeyemi (2014), the Naira has declined steadily from the 1980s, with an all-time low of Naira to a dollar in 2024. The exchange rate compares two currencies (Owolabi & Adegbite, 2013). When one currency buys another, the exchange rate reflects the relative strength of the two currencies. The price of one currency in terms of another is known as an exchange rate, and it is a crucial factor in every country's decision-making. It's the exchange rate of one currency for another or one unit of foreign currency for one local currency unit (Fapetu & Oloyede, 2014). The supply of foreign exchange is influenced by demand, governed by an economy's output. Based on this concept, successive administrations have introduced flexible exchange rates and managed float policies, but their implementation has been inconsistent and lackluster, contributing to the naira's instability.

In the foregoing, past and present administrations have employed various exchange rate policies to promote economic growth and development. However, different exchange rate regimes imposed in the past have led to chronic exchange rate swings and depreciation of the native currency. The assumption that government efforts towards exchange rate administration will boost SMEs' survival and economic growth has proven to be a mirage. The economy is characterized by low manufacturing capacity utilization, high inflation, heavy debt burden, high unemployment rate, high-income inequality, and poverty. Similarly, it is argued that exchange rate fluctuations cause SMEs' increased mortality. Previous research suggests a steady exchange rate is vital for SMEs' survival, economic growth, and development (Edokobi, Nwagbala & Okpala, 2020). Investors and people in business prefer a steady exchange rate to one that causes investment uncertainty and risk. It becomes imperative to investigate the effect of exchange rate fluctuation on the growth of SMEs performance in Nigeria.

2.0 Empirical Review

Adelowokan, Adesoye and Balogun (2015) viewed exchange rate as one foreign currency unit's price in the local currency. A currency's exchange rate is its price relative to another's. It's the amount of one currency needed to buy another's. According to Jhingan (2010), the exchange rate is the price of one currency for another. Aliyu (2011) noted that a rising exchange rate increases imports and decreases exports, whereas a falling rate increases exports and decreases imports. Decreased currency rates cause a shift from foreign to domestic goods. This scenario causes importing countries' trade income to swing to exporting countries, which affects both exporting and importing countries' economic growth (Aliyu, 2011).

The exchange rate plays a crucial role in the international economic enterprise because no nation is economically independent of others due to various output and endowment levels. Therefore, exchange rates are crucial to every country's economic growth and development engaged in international trade. Exchange rates connect two countries' price systems, allowing global trade to compare goods and services directly in internal market relationships between domestic and global prices. The currency rate affects a country's balance of payments by affecting imports and exports. The exchange rate affects international trade prices, affecting countries' balances of payments (Hossain, 2002). A recent study on exchange rate effects on the economy has produced conflicting results. Literature shows that exchange rate volatility affects economic growth. Edwards and Yeyati (2003) found that flexible exchange rates boost growth. Thus, actual exchange rate depreciation boosts economic growth (Hausmann, Pritchett & Rodrik 2005).

2.1 Foreign Exchange Rates and Implications in the Economy

According to Englama (2010), the rate at which Nigerian currency is exchanged for another currency is unstable. He claims that the currency rate is an initial price in independent economies like Nigeria because it affects nearly all other prices. According to Mori, Asid, Lily, Mulok and Loganathan (2012), the exchange rate converts one country's currency into another. He went on to say that the foreign exchange rate is kept stable by arbitrage, in which speculators buy foreign exchange in one market when the rate is low and sell it in another when the rate is high. Like other developing countries, Nigeria faces several challenges, including a lack of monetary resources and a need to enhance investment. Investments in developing countries are met by inflows of capital from rich countries in aid or foreign direct investment (Aliyu, 2011). Obansa, Okoroafor, Aluko

and Eze (2013) noted that FDI is critical in determining the capital infusion that stimulates industrialization in underdeveloped nations by bringing better production techniques (Obansa et al. 2013). As a result, maintaining an investment inflow into emerging markets is critical. Exchange rate volatility is a risk that international traders and investors face in the global market. As a result, fluctuating exchange rates reduce trade volume and capital investment.

Asher (2012) on the other hand, observed that exchange rate variations in developed countries cause worldwide market volatility. As a result, currency rate fluctuation in developing countries can lead to economic instability (Asher**,** 2012). Exchange rate uncertainty affects FDI by causing the host country's currency to depreciate. Because the home currency increases foreigners' relative wealth by increasing the attractiveness of the host country for FDI, firms can buy assets in the host country for a low price. As a result, there is a theory that the host country's currency depreciation increases FDI. In contrast, increasing the host country's currency should reduce FDI. However, according to Danladi and Uba (2016), interest rate variance is also accountable for the detrimental side impact of foreign direct investment in Nigeria's economy.

2.2. Exchange Rate and Economic Growth

Asher (2012) studied the impact of a fluctuating exchange rate on Nigerian economic growth from 1980 to 2010. According to the data, the exchange rate positively impacts economic growth. From 1970 to 2003, Akpan (2008) studied the foreign exchange market and economic growth in Nigeria's developing petroleum-based economy. The data revealed a positive relationship between economic growth and the exchange rate.

Obansa, Okoroafor, Aluko, and Millicent (2013) studied the relationship between the exchange rate and economic growth in Nigeria between 1970 and 2010. According to the findings, the exchange rate has a considerable impact on economic growth. They concluded that liberalising the exchange rate promotes the Nigerian economy by enhancing economic growth. Azeez, Kolapo, and Ajayi (2012) studied the influence of exchange rate volatility on Nigerian macroeconomic performance from 1986 to 2010. They discovered that the exchange rate had a positive relationship with GDP. Adebiyi and Dauda (2009) utilised an error correction model to show that trade liberalisation encouraged growth in the Nigerian industrial sector while stabilising the currency rate market between 1970 and 2006. They believed in a positive and significant relationship

between industrial production and genuine export. According to the data, deregulation positively impacts exports due to exchange rate depreciation. On the other hand, actual exchange rate volatility has been reported to impact emerging-market investment negatively. The negative effects are magnified in countries with open economies and undeveloped financial institutions.

2.3 Performance of Small and Medium Scale Enterprises

Small and Medium Enterprises have been dubbed the "backbone" of practically all economies worldwide due to their significant impact on the long-term development of both emerging and developed countries. SMEs also support economic development, poverty reduction, job creation, and customised services (Atarere, 2016). Hence, SMEs are an important part of most countries' growth strategies, and they are especially crucial for developing countries like Nigeria. The performance of small businesses is regarded as a key driver of economic development. The requirements for SMEs to access the global market and update their position within it are getting increasingly difficult due to competition (Longenecker, Moore, Petty & Palich (2016). SMEs play a distinctive role, however, it has been stated that SMEs in Nigeria do poorly in terms of survival and GDP contribution (Atarere, 2016).

Many factors contribute to SMEs' poor survival rate and low GDP contribution. According to Ojeyinka (2019), internal factors such as entrepreneur competencies, dedication, resources, and strategy choice limit SMEs' performance. External factors that hinder SMEs' performance include competitors, culture, technology, infrastructure, and government regulation. In addition, Onugu (2005) identified three major issues that impede SMEs in Nigeria: managerial issues, access to finance/capital, and infrastructure issues. Inconsistency in government policy and bureaucracy, environmental difficulties, taxes and levies, challenges with current technology, unfair competition, marketing issues, and a shortage of raw materials locally are other factors. In Nigeria, government policy, notably exchange rate policy, impacts SMEs' performance.

2.4 Exchange Rate Fluctuation and SMEs Performance

The official and parallel markets frequently see the Naira-Dollar exchange rate rise. Researchers such as Aliyu, Ajibola, Omotosho, Adetoba, and Adeleke (2015) have linked Naira's constant depreciation to the country's current oil price fall, which began in 2015 and continues now. The economic situation impacts every industry, including small and medium businesses (SMEs). SMEs

have been described as an important sector for growth and development in developed and developing nations. Small and Medium Enterprises (SMEs) are an important sector for economic growth, poverty reduction, and job creation in developing nations, according to Mori, Asid, Lily, Mulok and Loganathan (2017). It is also a method for accelerating economic growth and quick modernization in various economies.

Exchange rate is a vital concept that represents the prices at which currencies trade for one another. It is significant because it connects the economy's general price level to global prices. According to Ali et al. (2015), an exchange rate is an important tool in the monetary policy framework of the economy. As a result, the exchange rate is used to maintain economic equilibrium. The country's current economic status, according to researchers, is precarious. Because SMEs rely heavily on short-term financing, they are particularly vulnerable to a severe economic scenario

2. 5 Related Empirical Literature

Tonye and Nwikina (2023), in their study on the effects of exchange rate and interest rates on the manufacturing sector performance in Nigeria revealed that exchange rate and interest rate is significant in predicting the performance of the manufacturing sector. The study further concluded that there is a strong correlation between the country’s exchange rate and interest rate. Ukwadinamor and Adeyemo (2020) conducted a study on exchange Rate and SMEs Development in Delta State. The study found that exchange rate has positive significant effect on SME development in Delta state. The study concluded that exchange rate appreciation results in increased imports and a declined export whereas exchange rate depreciation leads to export expansion thereby discouraging import. However, Omolola, Rasaki and Addo (2023) in their study on exchange rate fluctuation and the manufacturing sector performance found that devaluation of currency in the Nigerian manufacturing sector has significant effect on the sector’s overall performance. Thus, the shift of exchange and interest rate has high volatility leading to negative impact on the performance of the manufacturing sector. In the same vein, the impact of currency rates on the performance of Nigeria's Small and Medium Enterprises was also researched by Edoko, Nwagbala, and Okpala (2018). According to the study, interest rate and currency rate volatility are two of the most pressing challenges SMEs confront. The study found that exchange rate fluctuations have a significant impact on the performance of SMEs. Udoh, Gbande, and Acha researched the impact of monetary policy on the growth of small and medium businesses in Nigeria

(2018). The study discovered that SMEs' inability to access forex causes them to perform poorly. Nsofo, Takson, and Ugwuegbe (2017) studied how exchange rate volatility affected economic development from 1981 to 2015. The study revealed that exchange rate volatility and foreign direct investments have a negative impact on economic growth. Ojeyinka (2019) observed a significant connection between exchange rate volatility and manufacturing sector performance between 1981 and 2016. In this study, the ARDL estimation approach was employed in analysing the yearly time-series data. According to the study, exchange rate volatility has a significant and positive impact on the manufacturing sector's performance.

2.6 Theoretical Framework

The theoretical foundation for this research is monetarist theory. Variations in the money supply, according to monetarist theory, are the major factors of economic development and business cycle behaviour. The entire output and pricing levels of the economy are affected by differences in the money supply. The function of the government in regulating the money supply is emphasised in monetary theory. As a result, monetary policies are designed to influence an economy's output, influenced by the interest rate, which affects the cost of capital and productive sector investments (Mishkin, 2007).

The Purchasing Power Parity Theory, which describes the relationship between product prices and currency rates depicts the theoretical thrust. The concept of purchasing power can be traced back to the 16th century Salamanca School in Spain (Davarajan, 1993). The central principle of the PPP is that the equilibrium exchange rate is proportional to the relevant purchasing power parity of the national currencies involved, implying that changes in exchange rates destabilise a country's purchasing power and thus have a significant impact on investment and trade (Davarajan, 1993). The PPP theory assumes that the exchange rate and the price levels of the two legal tenders are inexorably connected.

3.0 Materials and Methods

The research examines the effect of exchange rate fluctuation on the growth of SMEs performance in Nigeria (2013-2024) for 12 years (2013–2024). The variables utilised in the study, as well as the model specification, were chosen based on known theoretical correlations and the availability of data. The link between independent variables (INTR, EXR, INFL) and dependent variable (SMEs Industrial Output) is expressed as:

$SMEOPUT = b_0+b_1INTR+b_2EXR+b_3INFL$

Where

SMEOPUT = SMEs industrial output,

INTR = Interest Rate

EXR = Exchange rate

INFL = Inflation Rate

B_0 is the intercept parameter, B_1, B_2, B_3 are coefficient of the variables

4.0 Results

The estimated linear relationship is tested using simple regression Y = f(x) to find out the characteristics of the time series data. The model specification, results of the correlation and regression analyses are presented below.

Table 4.1: Empirical data on Gross Domestic Product, Industrial Output, Interest Rate Exchange rate and Inflation rate from 2013-2024 ('billion)

YEAR	GDP	SMEOPUT	INTR	EXRAT	INFL
2013	80,092.56	18,27372.44	12.00	157.31	9.2
2014	89,043.62	17,28180.89	16.55	158.55	7.98
2015	94,144.96	12,83724.67	14.9	193.27	10.6
2016	6,895.20	15,89273.77	9.37	304.5	15.68
2017	7,795.76	17,82093.785	8.00	305.5	16.52
2018	9,913.52	18,82093.64	7.20	306.5	12.09
2019	11,411.07	16,02013.26	6.48	307.0	11.40
2020	14,610.88	19,52013.40	9.00	379.550	11.5
2021	18,564.59	29,52013.60	11.68	379.500	11.5
2022	17,282.0	86,41214.40	16.50	448.0	21.09
2023	259,000.0	124,27441.20	18.75	899.0	28.92
2024	273,800,0	125,59828.56	26,75	1,738.7	34.19

Source: Central Bank of Nigeria 2013-2024 Annual Report

The hypotheses were tested considering the dependent and independent variables, SMEs Industrial output and Exchange rate using simple linear regression analysis.

Hypothesis One

H_0: Exchange rate volatility has significant effect on SMEs performance.

H_1: Exchange rate volatility has no significant effect on SMEs performance

Tablev4.2 **Model Summary[b]**

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics					Durbin-Watson
					R Square Change	F Change	df1	df2	Sig. F Change	
1	.830[a]	.689	.667	20062.13760	.689	31.023	1	10	.000	.755

a. Predictors: (Constant), EXR
b. Dependent Variable: SMEs Performance

Coefficients

Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.
		B	Std. Error	Beta		
1	(Constant)	-80000.057	22701.700		-3.524	.003
	EXR	831.112	149.216	.830	5.570	.000

a. Dependent Variable: SMEs Performance

The regression above analysis' coefficient of determination, R^2, is.689 (68.9%), showing that the independent variable (EXCHANGE RATE) explained 68.9% (percentage) of the dependent variable (SMEOPUT). As a result, the variable plays an important role in determining the dependent variable (SMEOPUT). The alternative hypothesis that exchange rate volatility has a major impact on SMEs is accepted (Since P-value (.000) < 0.01)

Hypothesis Two

H_0: Interest rate volatility has no significant effect on SMEs' performance.

H_1: Interest rate volatility has significant effect on SMEs' performance

Table 4.3: Correlation Coefficient Table showing the Relationship Between Interest Rate Volatility and SMEs Performance

	Correlations		
		SMEs Performance	INTEREST RATE
SMEs	Pearson Correlation	1	-169
Performance	Sig. (2-tailed)		.000
	N	12	12
INTEREST RATE	Pearson Correlation	-169	1
	Sig. (2-tailed)	.000	
	N	12	12

The correlation analysis revealed that the interest rate coefficient is negative (-.169) with a P-value (.000<0.01). This means there is a significant relationship between the variables. In addition, the

inverse relationship (r = -.169) is implied by the coefficient (-ve). As a result, an increase in interest rate leads to a decrease in SME output, whereas a decrease in interest rate leads to an increase in SME output. Because the p-value is less than 0.01, H_0 is accepted, implying that interest rate volatility and SMEs' performance are related.

Hypothesis Three

H_0: The rate of inflation has no significant effect on the performance of SMEs

H_0: The rate of inflation has significant effect on the performance of SMEs.

Table 4.5 **Model Summary**

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics				
					R Square Change	F Change	df1	df2	Sig. F Change
1	.938[a]	.880	.868	1584532.82714	.880	73.218	1	10	.000

a. Predictors: (Constant), INFLATION

b. Dependent Variable: SMEs PERFORMANCE

Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	95.0% Confidence Interval for B	
		B	Std. Error	Beta			Lower Bound	Upper Bound
1	(Constant)	2172608.459	1032046.286		-3.615	.005	-6030151.588	-1431066.735
	INFLATION	-14158.612	58224.809	.938	8.557	.000	368481.619	627947.536

a. Dependent Variable: SMEs PERFORMANCE

The coefficient of determination R^2 is (.880) at P <0.01 (0.000 <.01), according to the regression analysis results. This results implies that the relationship between inflation and SMEs performance is significant (P <.01). In addition, inflation has a negative (-ve) value in the model. This indicates that the connection (r = -.14158) is inverse. H_1 is acceptable since the p-value is less than 0.01, indicating that the association between inflation and the performance of SMEs is significant. Thus, the rate of inflation has significant effect on the performance of SMEs.

4.1 Discussion of Findings

Results from the simple linear regression analysis for hypothesis one revealed that the coefficient of determination R^2 = .689(68.9%), coefficient of the independent variable (EXR = .830) and p-value = 0.000 < 0.01). As a result, the exchange rate has a substantial impact on the success of

SMEs. The analysis outcomes support Owolabi and Adegbite (2013) conclusions that the exchange rate has a considerable impact on SMEs' performance. The correlation analysis for hypothesis two found a significant association between interest rate and SME performance (P <.01 (0.000 <.01)). As a result, the association is significant. Also, the interest rate coefficient is negative (-.169), implying that the relationship is an inverse one (r = -.169). As a result, an increase in the interest rate causes a fall in SME output, whilst a decrease in the interest rate causes an increase in SME output. This result is consistent with Robson (2016), who found that because firms are financed with a high variable rate, they may not raise output due to the high-interest rate. The coefficient of determination R^2 is (.880), P<.01 (0.000 <.01), according to the regression analysis three. It indicates significant association between the variables (p<.01). In addition, inflation has a negative (-ve) value in the model. This indicates that the connection (r = -.14158) is inverse. As a result, an increase in inflation produces a decrease in SME output, whilst a decrease in inflation causes an increase in SME output. This finding is consistent with Adeniran, Yusuf, and Adeyemi (2014) findings, who found that the inflation rate has an inverse relationship with SMEs' performance and economic growth, a unit change in the inflation rate causes a corresponding decline in SMEs' production.

5.0 Recommendations

The following recommendations, based on the research findings, would assist Nigeria in achieving economic growth and development.

i. The level of money supply in the economy should be increased by enacting measures to subsidize domestic export commodity production. It is expected that lower imports will raise the exchange rate value.
ii. It is also proposed that policymakers should not rely solely on exchange rate depreciation to stimulate economic growth. They should also implement macroeconomic policies such as monetary and fiscal policies simultaneously.
iii. The Nigerian government should subsidize foreign exchange (forex) for Nigerian manufacturing sectors to increase output. Subsidizing forex for manufacturers will help lower production costs, which are currently expensive.

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