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Naira Devaluation and its effects on the Performance of Small and Medium Enterprises in Awka-South, Anambra State, Nigeria

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Abstract

The recurring devaluation of the Nigerian Naira has raised concerns about its implications for various sectors of the economy. The study examines the root cause of Naira devaluation and its effect on the performance of small and medium enterprises in Awka-South, Anambra State and possible solutions to leverage on to promote overall economic growth in Nigeria. The study was anchored on J-curve theory. Secondary sources of data via the internet, newspapers, newsletters, libraries and other documented materials pertinent to the study were used. The findings indicated that there is a positive relationship between naira devaluation and performance of SMEs in Awka-South, Anambra State, Nigeria. The study therefore concludes that naira devaluation has significant effects on various aspects of the economy, including the volume of imports, financial performance, and development of indigenous entrepreneurial businesses. A devalued naira typically leads to an increase in the cost of imported goods, which in turn can reduce the volume of imports. However, this can also lead to inflation, making it difficult for businesses to operate and for consumers to afford essential goods. The study recommends that the Nigerian government should focus on policies and initiatives that promote overall economic growth. This can be achieved by implementing measures to improve infrastructure, streamline regulatory frameworks, and provide access to finance and technology. This will help to mitigate the impact of naira devaluation on the country's economy. SMEs should also diversify their export destinations to reduce reliance on a single market. This will help them capitalize on favorable exchange rates in different countries and mitigate the impact of currency fluctuations.
Keywords: Naira devaluation, SMES performance, economy

Introduction

Naira devaluation affects the profitability of SMEs if not mitigated with management measures. The recurring devaluation of the Nigerian Naira has raised concerns about its implications for various sectors of the economy. While devaluation is often undertaken to enhance export competitiveness and address trade imbalances, its impact on inflation, import costs, and overall economic stability has been a subject of debate in today's Nigerian economy (Oyinlola, 2020). Nigeria has experienced multiple currency devaluations over the years, with the most recent one happening this year 2023. The naira, Nigeria's official currency, has been devalued several times due to numerous reasons, including falling oil prices, high inflation etc. The Nigerian economy greatly relies on crude oil exports, which make up over 90% of its foreign exchange earnings and the country,in the past few years has experienced a decline in the global oil prices, which has put significant pressure on the naira. As a result, the Central Bank of Nigeria (CBN) has devalued the naira several times in recent years to handle the currency's exchange rate (Udo, 2020).

The drop-in price of oil globally has recently left nations like Nigeria who run oil based economy without prior diversification of her economy in economic. As discussed above, the current devaluation of the Naira is linked to shocks emanating from the falling oil price driven by a global supply glut and a declining world demand for crude oil. As at 24th April 2023, crude oil price traded at US$77.73/barrel (WTI Crude) and US$81.57/barrel (Brent Crude). For a developing oil exporting nation like Nigeria, falling oil price will mean loss of revenue to the government, pressure on the country's foreign reserves, and an exchange rate crisis. To manage this crisis, the devaluation of naira was implemented. This challenge brought about by exchange rate fluctuations is eventually leading to pressure on the government to devalue the Naira (Ajayi & Oyekale,2019). This has affected other sectors of the economy. SMEs, which is essential for economic growth, can be affected by this economic change because devaluation can increase import costs, affect inflation, alter access to finance, and create uncertainty. Conversely, it can enhance export opportunities (Udegbunam & Ezejiofor,2020). With the devaluation of the naira, the cost of imported raw materials has increased, leading to an increase in production costs. This increase in production costs has affected the profitability of entrepreneurial businesses in the country. It has also affected access to credit for entrepreneurial businesses in Nigeria and the value of collateral pledged for loans has reduced, making it difficult for entrepreneurial businesses to access credit. This difficulty in accessing credit has affected the growth and expansion of entrepreneurial businesses in Nigeria (Adeyemo, Oyewole, & Adedeji, 2018).

The devaluation of the naira also affects the ability of entrepreneurial businesses to compete in international markets. As the value of the naira decreases, businesses that export their products or services will find that they can sell their products or services more cheaply in international markets. However, this also means that it becomes more expensive for businesses to import raw materials or equipment, which may limit their ability to compete in international markets. The question remains whether the government has done enough to build an enabling climate for companies to produce locally and earn more foreign exchange? Without a doubt, devaluation can be used as a fiscal policy tool to deter imports, achieve balance of payment, enable and promote businesses, but Nigeria isn't there yet, as most SMEs still depend on goods and services from other countries to stay afloat. Devaluation of the Naira without adequate policies being put on ground would be dangerous as small medium scale businesses would have to pay more to import finished products from other countries.

However, with the recession experienced Nigerian economy from the second quarter of 2016 till date, there is a need to ascertain the effect of the various government policies in the economic growth process in Nigeria. Moreover, the effectiveness of accompanying policy measures to mitigate the negative consequences of devaluation requires examination. Understanding the nuanced challenges arising from Naira devaluation is essential for devising comprehensive strategies that promote sustainable economic growth and development (Umeora&Onyeaju, 2017).

Conceptual Clarifications

Naira Devaluation

Naira devaluation simply means the official lowering of the value of the Naira within a fixed exchange rate system (Wikipedia). It involves intentionally reducing the value of Nigeria's currency, impacting various aspects of the economy. Naira devaluation refers to the deliberate reduction in the value of the Nigerian currency relative to other currencies, a situation where the Nigerian currency, the Naira, loses value in relation to other major currencies such as the US dollar, Euro, and British Pound. The devaluation of Naira is often used as a policy tool by the Central Bank of Nigeria to manage the country's economic performance. Devaluation or depreciation of a country's currency is usually triggered when the country is experiencing an adverse Balance of Payment or of Trade (BOP/BOT) crisis or by worsening economic conditions transmitted into the domestic economy from the foreign market (World Bank 2000).

Small and Medium Scale Enterprises (SMEs)
Small and Medium Scale Enterprises (SMEs) refer to businesses with relatively limited resources, including capital, workforce, and operational scope, compared to large corporations. They form a vital component of the business landscape, operating across diverse sectors like retail, services, manufacturing, and technology. These businesses are characterized by their localized focus, direct owner involvement, and significant contributions to local economies. They play a critical role in driving economic growth, job creation, and innovation in many economies. SMEs encompass a wide range of industries and sectors, including manufacturing, services, retail, and technology startups. Due to their size, SMEs are often more agile and responsive to market demands, contributing to local economic development (Hisrich, Peters & Shepherd, 2017).

Reasons for Devaluation in the Nigerian Economy
Fall in the price of oil: In Nigeria one of the key factors driving the devaluation of the naira has been the fall in the price of oil. Nigeria is a major exporter of crude oil, and when the price of oil falls, it can lead to a reduction in the amount of foreign currency coming into the country. This can put pressure on the naira, as there is less demand for the currency from foreign buyers. Nigeria's heavy reliance on oil exports makes its economy vulnerable to oil price fluctuations. Devaluation can incentivize non-oil exports, promoting economic diversification and reducing the nation's dependence on oil revenue (Adegboye& Aluko,2017).

Foreign Exchange Reserves Preservation: Devaluation can be used to conserve foreign exchange reserves, which are crucial for servicing external debt, maintaining import coverage, and stabilizing the exchange rate. A controlled devaluation can help prevent rapid depletion of reserves. The high level of government debt in Nigeria has contributed to the devaluation of the naira. When a country has a high level of debt, it can put pressure on the currency, as investors may become concerned about the country's ability to pay back its debts. This can lead to a reduction in demand for the currency, which can lead to devaluation (Owoye& Omisakin,2015).

Trade Imbalance and Current Account Deficit: Nigeria has historically faced trade imbalances and current account deficits due to its reliance on oil exports and high import dependence. Devaluation can make exports more competitive and imports relatively costlier, thus helping to correct these imbalances in the economy (Egwaikhide& Ojameruaye,2015).

Attracting Foreign Direct Investment (FDI): Devaluation can make the Nigerian economy more attractive to foreign investors by lowering the relative cost of investing in the country. This can stimulate capital inflows and support economic growth (Ajide & Raheem, 2019).

Balancing the Budget and Fiscal Sustainability: A devalued currency can improve government revenue by increasing the Naira equivalent of oil exports. This can help bridge budget deficits and contribute to fiscal sustainability (Obansa& Ayuk,2019).

Addressing Inflationary Pressures: Devaluation can make imports more expensive, contributing to import-driven inflation control. However, there's a trade-off as devaluation might also lead to cost-push inflation through higher import costs (Nwachukwu & Aja,2017).

Benefits of Naira Devaluation
Export Competitiveness: Devaluation makes domestically produced goods and services more affordable for foreign buyers. This can enhance the competitiveness of Nigerian exports in

international markets, potentially leading to increased export revenue and a more diversified economy. (Udegbunam, & Ezejiofor,2019).

Trade Balance Improvement: By making imports more expensive, devaluation can discourage the consumption of foreign goods and encourage domestic production. This can help correct trade imbalances by reducing import expenditures and increasing export earnings (Ibeabuchi, 2018).

Foreign Debt Repayment: For a country with significant foreign-denominated debt, devaluation can lower the real burden of debt in domestic terms. This can make debt repayment more manageable and ease financial pressures (Olapitan,2016).

Tourism and Foreign Investment: Devaluation can attract foreign tourists and investors by making the country more cost-effective for them. Tourists find their spending power increased, while investors can acquire assets at a lower cost in terms of their own currency (Ibrahim & Adepoju, 2020).

Export-Led Growth and Economic Diversification: A devalued currency can stimulate non-oil exports, encouraging economic diversification away from oil dependency. This contributes to more sustainable economic growth and reduces vulnerability to oil price fluctuations (Fowowe, 2017).

These benefits collectively emphasize how controlled and strategic devaluation can positively impact the Nigerian economy, driving export-led growth, improving the trade balance, easing foreign debt repayment, attracting tourism and foreign investment, and promoting economic diversification. It's important to note that while devaluation offers benefits; its implementation requires careful consideration of potential drawbacks and overall economic strategies.

Drawbacks of Naira Devaluation

While naira devaluation can have several benefits for the Nigerian economy, there are also some potential drawbacks to consider. These include:

Higher Inflation: One of the major drawbacks of naira devaluation is the potential for higher inflation. Devaluation can lead to higher prices for imported goods, which can then spill over to other sectors of the economy. This can erode the purchasing power of Nigerians and increase the cost of living. According to a report by the International Monetary Fund (IMF), Nigeria experienced a significant increase in inflation following the devaluation of the naira in 2016.As a result of theInflationary Pressure, devaluation can lead to an increase in the cost of imported goods, which may contribute to inflationary pressures. This is especially concerning for countries like Nigeria that heavily rely on imports for various consumer and intermediate goods (Nwachukwu & Aja,2017).

Increased Borrowing Costs: Naira devaluation can also lead to increased borrowing costs for the government and private sector; this is because a weaker currency makes it more expensive to borrow in foreign currency. This can further strain the country's already high debt burden (Igbodika, 2016).

Imported Input Costs for Businesses: Industries relying on imported raw materials and components face higher production costs due to devaluation. This can reduce their competitiveness and profit margins, potentially leading to downsizing or decreased investment. This can also lead to a negative Impact on Standard of Livingof Nigerians, particularly those on fixed incomes because devaluation can lead to higher prices for goods and services, which can then reduce the purchasing power of those on fixed incomes (Afolabi, & Kazeem, 2020).

Uncertainty for Investors: Devaluation can create economic uncertainty, making it difficult for businesses to plan and invest confidently. This uncertainty might lead to a cautious approach in terms of expansion and capital expenditure. Naira devaluation can create uncertainty for investors, which can lead to a decrease in foreign investment. This is because devaluation can erode investor confidence and make it difficult to predict the future value of investments **(**Chuku & Nwokoye, 2017).

Possible Capital Flight: Devaluation can also result to capital flight, as investors may seek to move their money out of the country to avoid losses. This can further strain the country's foreign reserves and make it difficult to finance the country's debt obligations (Chuku & Nwokoye, 2017).

Potential for Economic Recession: Naira devaluation can also increase the risk of an economic recession. This is because devaluation can increase borrowing costs, lead to higher inflation, and reduced investor confidence, which can then lead to a contraction in economic activity. According to a report by the National Bureau of Statistics, Nigeria experienced an economic recession following the devaluation of the naira in 2016 (Owoye & Omisakin,2015).

Negative Impact on Debt Servicing: On the country's ability to service its external debt, Naira devaluation can also have a negative impact because devaluation can increase the cost of debt servicing, particularly for those borrowing in foreign currency. According to a report by the International Monetary Fund, Nigeria's external debt has increased significantly in recent years, and devaluation could exacerbate the country's debt burden. Debt burden,if a significant portion of the government's debt is denominated in foreign currencies, devaluation can increase the cost of repaying external debt in domestic currency terms. This might strain the government's finances and impact its ability to allocate resources to development projects (Amassoma& Odubo,2018)

Policymakers need to carefully weigh these drawbacks against the potential benefits before making decisions regarding devaluation.

Naira Devaluation Challenges for SMEs

Onifade, Adegbite and Adegbite (2020) Currency devaluation refers to a deliberate reduction in the value of a country's currency relative to other currencies, often driven by economic factors such as trade imbalances, inflation, and foreign exchange reserves. In the context of Nigeria and its Naira currency, SMEs face several challenges when the Naira is devalued. This include:

Increased Import Costs: SMEs relying on imported raw materials or components experience higher costs when paying for these inputs in foreign currency. This can lead to reduced profit margins and pricing challenges in the domestic market.

Inflationary Pressures: Currency devaluation can contribute to inflation by raising the cost of imported goods and services. This impacts SMEs as it affects consumer purchasing power and leads to reduced demand for their products or services.

Access to Finance: SMEs often struggle to access affordable financing even under stable economic conditions. In times of currency devaluation, lenders may be more cautious about providing loans due to increased economic uncertainty, making it harder for SMEs to secure the capital they need to operate and grow.

Exchange Rate Risk: SMEs engaged in international trade are exposed to exchange rate fluctuations, which can lead to unpredictable costs and revenue volatility. Managing currency risk becomes more challenging when the Naira is devalued.

Market Competitiveness: SMEs may find it difficult to compete with larger corporations that have more resources to absorb the impact of currency devaluation. This can hinder SMEs' growth potential and market expansion efforts.

Operational Disruptions: Currency devaluation can lead to disruptions in supply chains, particularly for SMEs reliant on imported inputs. Delayed shipments, increased lead times, and higher costs can hamper their operational efficiency.

Export Opportunities and Challenges: While devaluation can make domestically produced goods more competitive in international markets, SMEs might lack the capacity to take advantage of export opportunities due to factors like quality standards compliance and lack of access to global distribution networks.

Finally, Nigerian small and medium scale enterprise owners also face regulatory challenges such as multiple taxes, bureaucratic bottlenecks, and corruption. These challenges make it difficult for entrepreneurs to start and operate their businesses, and they discourage foreign investment in the Nigerian economy (Onifade, Adegbite & Adegbite, 2020).

Addressing the challenges

Addressing the challenges posed by naira devaluation on Small and Medium-sized Enterprises (SMEs) requires a multifaceted approach. Here are some possible solutions that SMEs and policymakers could consider for further exploration:

Export Diversification: SMEs can diversify their export markets to reduce reliance on a single currency. This strategy can help mitigate the negative impact of naira devaluation on their export revenues. Exploring new markets and adapting products to meet varying international demand can enhance resilience.

Import Substitution: To counter the higher costs of imported inputs, SMEs could focus on substituting imported inputs with domestically produced ones. This approach can reduce exposure to exchange rate fluctuations and enhance the stability of supply chains.

Hedging Strategies: SMEs can use financial instruments such as forward contracts or options to hedge against exchange rate risk. These strategies can help SMEs lock in favorable exchange rates for future transactions, reducing uncertainty.

Productivity Enhancement: Improving operational efficiency and productivity can help SMEs reduce costs, making them more resilient to external shocks like currency devaluation. Investments in technology, training, and process optimization are essential.

Access to Finance: Enhanced access to financing, especially during periods of economic uncertainty, can enable SMEs to weather the challenges of currency devaluation. Financial institutions and governments can implement initiatives to provide easier access to credit for SMEs.

Export Promotion Programs: Governments can support SMEs by offering export promotion programs, technical assistance, and incentives. These initiatives can help SMEs explore new markets and adapt their products to meet international standards.

Strengthening Local Supply Chains: Policymakers can encourage the development of robust local supply chains to reduce SMEs' reliance on imported inputs. This involves fostering collaboration between SMEs and local suppliers.

Currency Risk Education: SMEs should be educated about the risks associated with currency devaluation and the various strategies they can adopt to manage these risks. This could involve workshops, seminars, and information dissemination.

In conclusion, while naira devaluation presents challenges to SMEs, it also sparks opportunities for growth and resilience. By adopting a proactive approach, implementing sound risk management practices, and leveraging available support mechanisms, SMEs can navigate the complexities of currency devaluation and emerge stronger in the competitive global market. Collaborative efforts between SMEs, governments, and financial institutions are essential to realizing this potential (OECD,2020).

Roles of Government and Central Bank in Managing the Devaluation Process

Government Role: The government can play a vital role in managing the devaluation process by implementing policies that can enhance the country's economic competitiveness. These policies may include tax incentives, subsidies, and tariff reductions on imported goods, which can help to stimulate domestic production and exports. The government can also negotiate favorable trade agreements with other countries to increase exports and reduce the country's reliance on imports. Government needs to address potential inflationary pressures resulting from devaluation and can adjust trade policies to complement the devaluation strategy. This may involve providing incentives for export-oriented industries, imposing tariffs on certain imports, and negotiating trade agreements to enhance export opportunities. fintech and tech industries (GEM, 2021).

To address these challenges, government has implemented policies to improve the ease of doing business in Nigeria, such as reducing the time and cost of registering a business (World Bank, 2021). In addition, the government has established institutions such as the Bank of Industry (BOI) and the Small and Medium Enterprises Development Agency of Nigeria (SMEDAN) to provide financial and non-financial support to MSMEs (BOI, 2022; SMEDAN, 2022).

Central Bank Role: The central bank is responsible for managing the country's monetary policy, including the exchange rate of the country's currency. They can intervene in the foreign exchange market by buying or selling foreign currency to influence the value of the domestic currency. This intervention can help to stabilize the exchange rate and prevent excessive fluctuations in the currency's value. The central bank can use its monetary policy tools to manage inflation expectations and stabilize prices in the aftermath of devaluation (Lane & Milesi-Ferretti,2003). The central bank manages foreign exchange reserves to ensure stability and support the devaluation process. Adequate reserves can help mitigate speculative attacks on the currency and provide a buffer against sudden shocks (Vegh, & Vuletin,2014).

Additionally, the central bank can adjust the country's interest rates to influence the demand for the domestic currency. If the central bank increases interest rates, it can make the domestic currency more attractive to foreign investors, increasing demand and the currency's value.

Theoretical Review
J-Curve Theory.
Krueger, A. O. (1983) The theory posits that the improved export competitiveness resulting from the devaluation could benefit export-oriented SMEs. They might experience an increase in

demand for their goods and services from foreign markets; leading to potential growth opportunities. The theory also suggests that in the short term, the trade balance of a country worsens after currency devaluation due to the immediate increase in the cost of imports. However, over time, as export volumes rise and import volumes fall in response to the changed relative prices, the trade balance improves, forming a "J" shape when plotted on a graph.

J-Curve Theoryand SMEs
The J-Curve Theory is particularly relevant to SMEs engaged in international trade. Initially, currency devaluation could lead to challenges for SMEs that rely on imported inputs, as the cost of production increases. However, as the theory suggests, over time, these SMEs might adapt by seeking alternative local suppliers or adjusting their supply chains to mitigate the impact of higher import costs (Krueger,1983).

Conclusion and Recommendations

Based on the literature one may conclude that Naira devaluation can have positive effects on various aspects of the economy, including the volume of imports, financial performance, and development of indigenous entrepreneurial businesses. A devalued naira typically leads to an increase in the cost of imported goods, which in turn can reduce the volume of imports. However, this can also lead to inflation, making it difficult for businesses to operate and for consumers to afford essential goods. On the financial performance front, devaluation can lead to a decline in the value of assets denominated in the local currency. This can be particularly challenging for businesses that have significant debt obligations in foreign currency, as their debt burden may increase with devaluation. Moreover, devaluation can also increase the cost of borrowing for businesses, making it more challenging to access credit and expand their operations. While naira devaluation introduces challenges for SMEs, it also provides an opportunity for them to innovate, optimize their operations, and explore new avenues for growth. With strategic planning, adaptation, and the right support from both the private and public sectors, SMEs can navigate the complexities of currency devaluation and emerge stronger in the global economic landscape.

Recommendations

To navigate the challenges posed by naira devaluation, SMEs and policymakers can consider the following recommendations: A comprehensive approach that combines short-term support with long-term capacity building is necessary to help SMEs navigate the challenges and opportunities associated with naira devaluation. Additionally, involving SME representatives and expertsin the policy-making process can ensure that the recommendations effectively address their needs. Governments and relevant institutions should provide support through export promotion programs, market intelligence, and financial incentives. SMEs should also diversify their export destinations to reduce reliance on a single market. This will help them capitalize on favorable exchange rates in different countries and mitigate the impact of currency fluctuations.

To foster the development of indigenous small and medium-scale enterprises, governments should focus on policies and initiatives that promote overall economic growth. This can be achieved by implementing measures to improve infrastructure, streamline regulatory frameworks, and provide access to finance and technology. By creating a conducive business environment, governments can stimulate economic growth, which, in turn, supports the development and expansion of SMEs.

Contribution to knowledge

By comparing various sectors and regions, the study provides insights for policymakers and SME stakeholders on how to promote sustainable growth amidst currency devaluation.

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