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# Cash Reserve Ratio and Credit to Micro-, Small and Medium-Sized Enterprises in Developing Economies.

## Analysis of Transmission Channels Using Nigerian Data

***Anthony Orji*[1], *Christian E. Ugwu*[2], *Jonathan E. Ogbuabor*[3], *Onyinye I. Anthony-Orji*[4], *Lynda C. Nwufo*[5]**

[1-5] *University of Nigeria, Department of Economics, Nsukka 400001, Nigeria*

[1] *anthony.orji@unn.edu.n*

[2] *ugwuchristian68@yahoo.com*

[3] *jonathan.ogbuabor@unn.edu.ng*

[4] *onyinye.anthony-orji@unn.edu.ng (corresponding author)*

[5] *lynda.nwufo@unn.edu.ng*

***Abstract***

*This study examines the channels of transmission through which cash reserve ratio impacts on credit to micro-, small and medium-sized enterprises (MSMEs). A vector error correction model was used to capture the objective. Quarterly data ranging from 2001 to 2017 were also utilized in the analysis. The study found that cash reserve ratio indirectly impacts credit to MSMEs through liquidity ratio and lending interest rate as its channels of transmission. It is worthy to note that, as liquidity ratio has a positive significant impact on credit to MSMEs, lending interest rate has a negative but significant impact on credit to MSMEs. To boost economic productivity in developing economies, the study therefore recommends that the monetary authorities reduce the cash reserve ratio in order to increase commercial banks' liquidity. As the commercial banks' liquidity rises, they should also reduce their lending interest rate to increase access to credit by MSMEs. Again, the government should appropriate and monitor the judicious disbursement of interest-free loans/credit to MSMEs through banks, especially development banks.*

***Keywords:*** *cash reserve ratio; credit; channels of transmission; micro-, small and medium-sized enterprises*

***JEL:*** *E51, G21, L26*

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## INTRODUCTION

Globally, there is a growing recognition of the important role that micro-, small and medium-sized enterprises (MSMEs) play in economic development [Nwosu E.O. et al. 2020; Orji A. et al., 2019]. They play a crucial role through several dimensions, apart from creating employment opportunities. They not only contribute significantly to improving the living standards of the larger population, but also create a platform for local capital formation, innovation and competition in Third World countries.

According to the Nigeria Bureau of Statistics, the 2013 National MSME Survey, which was conducted in all the 36 States of the Federation and the Federal Capital Territory, Abuja, revealed that the total number of MSMEs as at 2013 was about 37,067,416 (micro, 36,994,578; small, 68,168; and medium, 4,670). In addition, the total number of persons employed by the MSME sector as at December, 2013 was about 59,741,211, representing 84.02% of the total labor force in Nigeria and contributing 48.47% to the Nation's Gross Domestic Product in nominal terms.

However, amongst the six main challenges confronting the operations of MSMEs in Nigeria as revealed by the survey are access to finance and poor infrastructure, inconsistency in government policies, poor support (business development services), access to market, multiple taxation, and obsolete technology. The most challenging of all is access to credit [Nwosu E.O., Orji A., 2016]. Thus, this paper investigates the channel of transmission of cash reserve requirement in widening access to credit for MSMEs.

The Central Bank of Nigeria (CBN) Monetary Policy Circular No. 22 of 1996 defines a small or medium business enterprise as any manufacturing or service enterprise whose business turnover does not exceed ₦500,000 (including land and working capital) and whose annual turnover does not exceed ₦5 million. In the 1990 budget, the Federal Government of Nigeria also defined small/medium-sized enterprises, for the purpose of commercial bank loans, as enterprises with annual turnover not exceeding ₦500,000, and for merchant bank loans, as enterprises with capital investments not exceeding ₦2 million excluding cost of land, with between 11 and 100 people employed. Large scale industries are those with investments of over ₦200 million, excluding land but including working capital, and a workforce of over 300 people. According to Lawrence E. Imoughele and Mohammed Ismaila, the definition and criteria for classification of an enterprise as small, medium or large varies from one country to another, depending on whether it is a developed or developing country [Imoughele L.E., Ismaila M., 2014]. What constitutes an SME is a matter that each country decides individually as there is no universally accepted definition of what they are, as shown by the Central Bank of Nigeria's communiqué No. 69 (2010) of the special monetary policy committee which acknowledged the existence of several definitions of MSMEs. What is termed a large scale business in a developing country may be a small business to a developed one.

The Nigerian government has put in place several measures to promote the growth and development of MSMEs in terms of funds availability. The government has also collaborated with bilateral and multilateral agencies and non-governmental organizations (NGOs) in supporting MSMEs in Nigeria. The Federal Government of Nigeria negotiated and obtained the World Bank SME I loan scheme to the tune of US$42 million in 1984. After the adoption of the Structural Adjustment Program (SAP) in mid-1986, the government again obtained the World Bank SME II loan scheme of US$270 million for the development of MSMEs. However, the loan was reduced to US$142 million in 1992. The scheme was said to have generated jobs for over 40,000 people at the end of disbursement in 1996 [CBN, 2000].

The loan was managed by the Central Bank of Nigeria and disbursed through a number of participating banks comprising of commercial, merchant and development banks. Despite the laudable schemes and institutions established like Small Scale Industries Credit Scheme, Peoples Bank Scheme, Community Banks Scheme, Nigerian Industrial Development