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Effect Of Monetary Policy Instruments On Debt Financing Of Selected Private Companies In Nigeria

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ABSTRACT
The issue of whether corporate debt financing responds to monetary policy shocks has continued to dominate scholarly debate in the economics and finance literature. This study contributes to this debate by analyzing the effect of monetary policy instruments on debt financing of private companies in Nigeria using a dynamic random effect framework. The analysis is based on balanced panel data consisting of 21 private companies that are listed in the Nigerian stock exchange from 2011 to 2022. Contrary to the interest rate and bank credit channels of monetary policy transmission process, we provide evidence that corporate debt financing is largely driven by own past effects and does not respond to changes in monetary policy shocks. More specifically, our results indicate that none of the three monetary policy instruments (money supply, monetary policy rate, and treasury bills rate) exerts a significant impact on non-current liabilities of private companies. Based on these results, we conclude that monetary policy instruments are not among the macroeconomic variables driving corporate debt financing in Nigeria.
Keywords: Monetary policy instruments, money supply, monetary policy rate, treasury bills rate, debt financing.

INTRODUCTION

Corporate debt financing refers to the extent to which private firms rely on debt instruments such as loans and bonds to fund their capital expenditure. It is corporate borrowing from external sources such as banks, non-bank financial intermediaries and private individuals through the financial market (Nyamita, 2014). Firms rely on debt financing for several reasons. First, debt is the cheapest source of external finance and serves as a tool for reducing the information gap between managers and shareholders (Myers, 1984; Myers & Majluf, 1984). Secondly, the use of debt can enhance firm profitability and value. Thirdly, the use of debt reduces the agency problem between managers and shareholders by reducing the tendency of expropriation of firm resources by managers (Valipour & Moradbeygi, 2011; Jensen, 1986).

Traditionally, studies on corporate debt financing have focused mainly on optimal debt level and its determinants. While optimal debt level refers to the debt level that maximizes corporate value, its determinants generally include firm-specific factors, industry characteristics and macroeconomic conditions. However, while there is vast empirical literature on both firm-specific and industry-related determinants of optimal debt level, there is little empirical evidence on macroeconomic factors, especially in the context of developing countries.

Among the macroeconomic factors affecting corporate debt financing are monetary policy shocks. Monetary policy is the deliberate use of monetary instruments such as money supply, interest rate, and bank reserves to influence real economic variables towards a predetermined objectives including full employment and inclusive economic growth. Theoretically, changes in monetary variables corporate debt financing through various channels such as interest rate and bank credit. (Anwar & Nguyen, 2018;

Mishkin, 1996; Mohanty & Turner, 2008). Interest rate channel emphasizes the role of interest rates in business spending and investment decisions, while credit channel describes the role of monetary policy in banks' lending and deposit decisions as well as firms' balance sheet behaviours (Mishkin, 1996).

This study investigates the impact of monetary policy instruments such as money supply, monetary policy rate, and treasury bills rate on corporate debt financing in Nigeria. Money supply is the total amount of money in an economy at any given time, monetary policy rate refers to the benchmark interest rate that governs other interest rates, while treasury bills rate is the interest rate at which government treasury bills are exchanged in the money market.

Statement of the Problem

The issue of whether corporate debt financing responds to monetary policy shocks continues to be topic of great concern in economics and finance literature. Theoretically, monetary policy affects real economic variables through various channels such as interest rate, exchange rate, and bank credit channels. However, while several empirical studies have attempted to provide evidence on the existence of these channels, there is little empirical evidence particularly linking changes in corporate debt to monetary policy shocks.

This study therefore contributes to the on-going debate by investigating the impact of monetary policy instruments on corporate debt financing in Nigeria. More specifically, the study seeks to provide empirical evidence on the relative effects of money supply, monetary policy rate and treasury bills rate on corporate debt financing for listed private companies. The study is significant as it uses a dynamic panel regression framework that effectively controls some unobserved firm-specific effects (such as management capacity and organizational culture) that drive both corporate debt policy and its relationship with monetary policy shocks. While there is ample empirical evidence suggesting that these unobserved factors play a significant role in strategic management decisions, it is surprising that they are largely not incorporated in the econometric models used in previous empirical studies.

Research Questions

1. To what extent does money supply affect corporate debt financing some selected private companies in Nigeria?
2. To what extent does monetary policy rate affect corporate debt financing of some selected private companies in Nigeria?
3. To what extent does treasury bills rate affect corporate debt financing of some selected private companies in Nigeria?

Objective of the Study

The main objective of this study to investigate the effects of monetary policy instruments on corporate financing debt financing in Nigeria focusing on listed nonfinancial companies across different sectors from 2011 to 2022. Other specific objectives of the study are to:

1. determine the extent to which money supply affects corporate debt financing of some selected private companies in Nigeria;
2. examine the extent to which monetary policy rate affects corporate debt financing of some selected private companies in Nigeria; and
3. estimate the extent to which treasury bills rate affects corporate debt financing of some selected private companies in Nigeria.

Research Hypotheses

H_{01}: Money supply has no significant effect on corporate debt financing of some selected private companies in Nigeria.

H_{02}: monetary policy rate has no significant effect on corporate debt financing of selected private companies in Nigeria.

H_{03}: Treasury bills rate has no significant effect on corporate debt financing of selected private companies in Nigeria.

LITERATURE REVIEW

Conceptual Review

Corporate Debt Financing

The concept of corporate debt financing has received much attention in corporate finance literature. Debt financing is a source of corporate external financing that relates to the use of debt instruments to raise new capital for investment purposes. It is corporate borrowing from banks, non-bank financial intermediaries and/or the public through the financial market (Nyamita, 2014). According to Onchong'a (2016), debt financing fills the gap between insufficient financial resources and acquisition of new assets. According to Liu et al. (2023), sources of corporate debt financing include bank loans, corporate bonds, inter-enterprise loans, and commercial credit and its advantages include agency cost reduction, positive signaling effect in the stock market, and tax-shield effect. However, a major disadvantage of debt financing is that it can increase the firm's financial risk or bankruptcy risk (Liu et al., 2023).

Debt financing can also be described in terms of maturity of debt instruments. From this perspective, debt financing can be classified as short-term and long-term debts. Short-term debts are debt instruments maturing within one year. They include bank loans, trade credit, and bank overdraft and constitute the current liabilities of the firm. According to Chen et al. (2019), short-term debts are used mainly to finance liquid assets. On the other hand, long-term debts, which constitute non-current liabilities, include corporate bonds and deferred tax liabilities. They are typically used to finance fixed assets (Chen et al., 2019).

Literature suggests that there are several internal and external factors influencing corporate external financing. Internal factors are firm-specific characteristics that are both observable and latent. Observable firm characteristics include firm size, liquidity level, growth opportunities, profitability, cost of debt, and cost of equity, while unobservable factors include organizational culture, leadership philosophy, and management style. On the other hand, external factors include industry factors such as competition, and industry classification, and macroeconomic factors such as GDP, financial market conditions, as well as fiscal and monetary policies. In this study, we explore the impact of monetary policy as a determinant of corporate debt financing, focusing on three policy instruments: namely, money supply, monetary policy rate, and treasury bills rate.

The Concept of Monetary Policy

Monetary policy is the deliberate manipulation of money supply and interest rate by the central bank to influence the pace and direction of real economic activities. The main objective is to control inflation without comprising employment and output (Friedman, 2000). According to Disyatat (2008), monetary policy implementation process comprises three main aspects: namely, the selection of a policy signal, the choice of operational target, and the design and utilization of various instruments. While the short-term money market rate can function as both policy signal and operational target, the main instruments often used to achieve the operational target include open market operations, reserve requirements, standing facilities, and the rate of remuneration on reserves (Disyatat, 2008).

Monetary policy can be classified as direct or indirect. Direct monetary policy links policy instruments such as credit ceilings, credit rationing, and statutory liquidity ratios directly to the policy objectives, while indirect monetary policy operates through the market through instruments such as interest rates and reserve requirement (Lindgren, 1991).

Literature suggests that monetary policy influences real economic activities through several channels including interest rate and credit channels (Anwar & Nguyen, 2018; Mishkin, 1996; Mohanty & Turner, 2008). Interest rate channel emphasizes the role of interest rates in household and business spending decisions. A change in the monetary policy rate would trigger a change in bank lending and deposit rates, which would in turn affect private borrowing and investment decisions, leading to a change in aggregate

demand and output. On the other hand, credit channel, which is anchored on asymmetric information (adverse selection and moral hazard) in the credit market, describes the role of monetary policy in banks' lending and deposit decisions as well as firms' balance sheet behaviours (Mishkin, 1996). A tightening monetary policy by the central bank implies a sale of government securities or treasury bills in the money market and the associated decline in bank reserves. This limits banks' ability to extend credit to households and private firms, leading to a fall in aggregate demand, investment and output. Hence, the credit channel links changes in capital structure of private firms to monetary policy shocks.

Empirical Review

There is a vast empirical literature on the determinants of corporate financing decisions. However, despite the well-established implications of monetary policy on firm-level performance, there is limited empirical evidence on the likely effects of monetary policy instruments on corporate financing decisions, particularly in developing countries.

Ayodele (2014) investigates the nexus between monetary policy and commercial bank credit in Nigeria using the vector error correction model. They find that while the relationship between monetary policy instruments and bank credit has a long-run dimension, money supply, liquidity ratio, interest rate, and exchange rate all exert a significant effect on the commercial banks' loan and advances extended to private firms. In other words, changes in monetary policy variables affect the capital structure of private firms.

Białek-Jaworska and Nehrebecka (2015) examine the determinants of corporate financing decisions in Poland in the context of monetary policy instruments using the system GMM method. Focusing on the period from 1995 to 2012, their empirical analysis proves that the effect of monetary policy on corporate debt financing is generally low.

Cloyne et al. (2018) evaluate the impact of monetary policy on corporate finance and investment for UK and US firms. Their finding, which is consistent with the balance sheet channel of monetary policy transmission, indicates that monetary policy shocks significantly affect the investment and borrowing behaviours of private firms. More specifically, they find that corporate borrowing decreases significantly in response to monetary policy tightening, especially for younger firms with no dividend payment history.

Bauer and Granziera (2018) employ the panel VAR model to explore the linkage between monetary policy shock and private-sector leverage for eighteen (18) advanced countries using quarterly data from 1975Q1 to 2014Q4. They find that an unexpected monetary policy tightening causes borrowing costs to increase, thereby deleveraging the private sector in the long run. Their empirical findings also suggest that the ultimate effect of monetary policy tightening on financial crisis depends on the extent of private sector leverage.

Bräuning et al. (2020) investigates the role of corporate debt in the monetary policy transmission process. More specifically, they seek to address the question of whether private companies adjust their debt maturities in response to monetary policy shocks. Their analysis reveals, amongst others, the tendency for private firms to adjust the composition and maturity of their bond issuance to benefit from the changes in policy-induced Treasury term spread.

Holm-Hadulla and Thürwächter (2021) examine the monetary policy transmission mechanism in euro area countries in the context of private sector loans and corporate debt securities. Using monthly data from January 2002 to May 2019, they find among other things that monetary tightening raises the cost of borrowing relative to corporate bonds. While the resultant increase in the overall cost of borrowing is less pronounced in countries with a high share of bond financing, the increase in cost of borrowing is supported by a shift in the corporate debt composition towards bank credit in countries with a low share of bond financing.

Lhuissier and Szczerbowicz (2022) employ the vector autoregressive model (VAR) to analyze the effects of both conventional and unconventional monetary policy measures on the financial structure of private companies in the United States from 1990 to 2018. They find that conventional and unconventional policy measures have differential impacts on corporate financial structure. More specifically, their analysis

shows that conventional policy easing increases corporate loans and reduces corporate bond financing, while unconventional policy easing increases corporate bonds but has no effect on corporate loans.

In Korea, Cho and Im (2023) study the time dimension of the effects of monetary policy uncertainty on corporate capital structure focusing on the period from 2000 to 2019. They provide evidence on the asymmetrical impacts of monetary policy uncertainty on corporate capital structure, which they attribute to the differences in corporate business strategies and debt maturities. More specifically, their empirical analysis shows that the impact of monetary policy uncertainty is more significant in the short run and less significant in the long run.

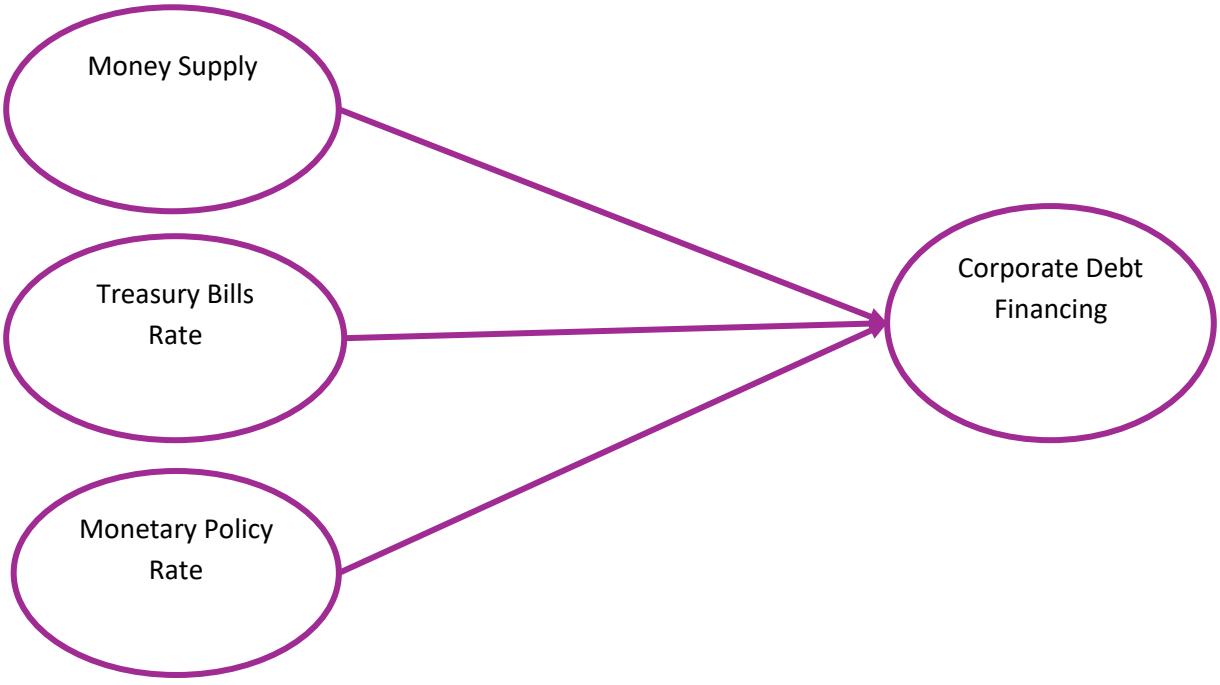
Theoretical Framework

The relationship between monetary policy instruments and corporate debt financing can be analyzed in the context of Baker and Wurgler's (2002) market timing theory. This theory, which is consistent with both interest rate and credit channels of monetary policy transmission mechanism, links capital structure of a firm to the underlying macroeconomic and financial market conditions that influence the firm's cost of capital. According to the market timing hypothesis, firms issue equity capital when the cost of equity is low, but relies on debt financing when the cost of equity is high (Ahmadimousaabad et al., 2013; Huang & Ritter, 2005). Accordingly, firms increase their borrowing in response to an expansionary monetary policy that reduces interest rate or cost of borrowing, and issue more equity in response to a tightening policy that increases interest rate. Hence, the market timing theory underscores the tendency of firms to adjust their financing model in response to monetary policy shocks.

METHODOLOGY

Research Design

Consistent with our research objectives and theoretical framework, this study adopts a unidirectional or one-way causal design, which allows corporate debt financing to depend on monetary policy variables as follows:



However, our design would be implemented under a panel regression framework since the study focuses on debt financing across private companies over a specified period.

Sample and Data

We use firm-level data and monetary policy variables. Our sample comprises 21 selected listed nonfinancial companies (see Table 1) from 2011 to 2022. Judgmental sampling method is used for sample selection. While monetary policy data are sourced from the CBN statistical bulletin, firm-level data are obtained from the audited financial statements of the individual companies downloaded from their official websites and the Nigerian exchange. All data are analyzed using EViews software.

Table 1: Selected companies

S/NO	COMPANY	SECTOR
1	NB	CONSUMER GOODS
2	NESTLE	CONSUMER GOODS
3	UNILEVER	CONSUMER GOODS
4	DANGOTE SUGAR	CONSUMER GOODS
5	GUINNESS NIGERIA	CONSUMER GOODS
6	PZ	CONSUMER GOODS
7	CHAMPIONS BREWERIES	CONSUMER GOODS
8	NASCON	CONSUMER GOODS
9	CADBURY	CONSUMER GOODS
10	VTTA FOAM	CONSUMER GOODS
11	HONEY WELL	CONSUMER GOODS
12	OANDO	OIL AND GAS
13	JULIUS BERGER	CONSTRUCTION/REAL ESTATE
14	UPDC	CONSTRUCTION/REAL ESTATE
15	DANGOTE CEMENT	INDUSTRIAL GOODS
16	LAFARGE	INDUSTRIAL GOODS
17	OKOMU OIL	AGRICULTURE
18	ACADEMY	SERVICES
19	UNIVERSITY PRESS	SERVICES
20	MAY & BAKER	HEALTHCARE
21	MORRISON	HEALTHCARE

Variables and Measures

- **Debt Financing**: This is proxied by non-current liabilities. Theoretically, corporate debt financing is influenced by both firm specific factors and factors in the external environment (such as industry and macroeconomic factors).
- **Monetary Policy**: Three measures are used: namely, broad money supply (M_3), monetary policy rate and treasury bills rate. These measures are expected to exert a highly significant impact on corporate debt financing since monetary policy measures are among the macroeconomic factors that affect corporate investment and financial policies.
- **Firm Size**: This is measured in terms of total asset. It serves as a control variable since larger firms have more access to debt financing than smaller firms due to low information asymmetry and high visibility effect.

Model and Methods

We use a dynamic panel regression model to analyze the effects of monetary policy variables on corporate debt financing. This framework, not only captures the main relationship of interest, but also controls some latent organizational factors (such as organizational culture, leadership capacity) that may be present in the model that links corporate financing to monetary policy.

Our dynamic fixed effect model (in logarithmic form) for the relationship between monetary policy instruments and corporate financial leverage is specified as follows:

$$LNCL_{it} = \beta_0 + \phi_i + \beta_1 LNCL_{it-1} + \beta_2 LMS_{it} + \beta_3 LMPR_{it} + \beta_4 LTBR_{it} + \epsilon_{it}$$

Where NCL= non-current liability, MS = broad money supply, MPR = monetary policy rate, TBR = treasury bills rate, and L = logarithm. Also, ϕ_i is the time-invariant heterogeneity parameter, which captures latent organizational factors such as organizational culture and management capacity that vary across firms. The lagged dependent variable, NCL_{it-1} is included in the model to capture the persistence in non-current liability and account for any endogeneity or feedback effect in the model. The assumption is that firms determine their current and future debt levels based on their previous debt performance.

There are two main estimation approaches under the panel regression framework: namely, fixed effect and random effect approaches. The fixed effect approach is applicable when ϕ_i is expected to correlate with other explanatory variables in the model, while the random effect approach is applicable when ϕ_i is purely a random variable and hence does not have any close association with other factors in the model. To determine the best estimation approach for our model, we employ the widely used specification test suggested by Hausman (1978). The test assumption is that ϕ_i does not correlate with both government expenditure and taxation, which is consistent with the random effect theory. Hence, the significance of ϕ_i would lead to the rejection of the random effect approach in favour of the fixed effect approach

Test of Hypotheses

Table 3 displays the panel regression results for the effects of money supply, monetary policy rate, and treasury bills rate on non-current liabilities of the sampled companies. Both the fixed effect and random effect results are provided. Panel A contains the results of the individual coefficients, while Panel B contains the goodness of it and post estimation diagnostic tests.

Table 3: Panel Regression Results; parenthesis contains p-values.

Variable	Fixed Effect	Random Effect
Panel A: Model Estimates		
C	2.2511	0.0718
	(0.0000)	(0.8642)
LNCL(-1)	0.5535	0.9436
	(0.0000)	(0.0000)
LMS	0.0591	0.0742
	(0.2314)	(0.1333)
LMPR	0.8220	0.3154
	(0.0351)	(0.4080)
LTBR	-0.2116	-0.1002
	(0.0280)	(0.2887)
Panel B: Model Diagnostics		
R-squared	0.9316	0.9091
Adjusted R-squared	0.9227	0.9073
F-statistic	105.07	512.74
	(0.0000)	(0.0000)
Durbin-Watson stat	1.8760	2.1002
Hausman	–	0.0000
		(0.9999)

From Panel B, the F-ratio (p-value =0.0000) shows that both fixed effect and random effect results models are highly statistically significant, while the goodness of fit statistic shows that former slightly outperforms the latter. The adjusted R-square shows that the fixed model explains approximately 92% of the variations in corporate financial leverage, while the random effect model explains approximately 90%. However, the Hausman test (p-value = 0.9999) is not statistically significant, thereby failing to reject the test assumption that there is no correlation between the heterogeneity parameter and other explanatory factors in their model. This implies that the random effect model outperforms the fixed effect model in capturing the relationship between monetary policy variables and corporate debt financing in Nigeria. In other words, latent organizational factors such as organizational culture and management capacity do not moderate the specified relationship of interest. Hence, our findings show that monetary policy shocks influence the debt structure of private listed companies in the same way, irrespective of their industry and firm-specific differences.

From the random effect results in Panel A, the coefficient on LNCL (-1) is estimated at 0.9436 with a zero p-value, indicating that corporate financial leverage is highly persistent and significantly depends on its previous level. This shows that holding other factors constant, a 1% increase in non-current liabilities in the current period would, on average, lead to about 0.9% increase in non-current liabilities in the next period. Hence, there is strong evidence that private firms tend to set their target debt ratios based on their historical debt performance.

Turning to the main relationships of interest, the coefficient on LMS ($\beta_2 = 0.0742$, p-value = 0.1333) is positive but not statistically significant, leading to the non-rejection of hypothesis 1. This shows that changes in money supply exert no significant effect on corporate debt financing. Similarly, the coefficients on LMPR ($\beta_3 = 0.3154$, p-value = 0.4080) and LTBR ($\beta_4 = -0.1002$, p-value = 0.2887) are not statistically significant, leading to the non-rejection of hypotheses 2 and 3. Hence, there is no evidence that changes in both monetary policy rate and treasury bills rate do not affect corporate debt financing in Nigeria.

DISCUSSION OF FINDINGS

Money Supply and Corporate Debt Financing

Our first objective addresses the issue of whether monetary policy shocks affect real economic activities through the credit channel. The credit channel of monetary policy transmission implies a direct relationship between money supply and corporate debt financing. Hence, we expected, *apriori*, that money supply shocks exert a positive and highly significant effect on debt financing of private companies in Nigeria.

Contrary to our expectation *apriori*, we find that money supply has no significant effect on corporate debt financing. While the coefficient on LMS has the expected positive sign, it is small and lacks statistical significance. This finding contradicts the credit view of the monetary policy transmission process and shows that changes in money supply do not affect corporate debt financing in Nigeria. In other words, bank credit is not an effective channel through which monetary policy shocks affect real economic variables in Nigeria. This finding, which tends to disagree with several previous empirical studies including Ayodele (2014), Cloyne et al. (2018), and Cho and Im (2023), therefore reinforces the view that firms are less likely to access higher bank credit even when there is a significant increase in money supply due to high asymmetric information (adverse selection and moral hazard) in the credit market, especially in developing countries (Mishkin, 1996; Stigliz & Weiss, 1980).

Monetary Policy Rate and Corporate Debt Financing

Our second objective addresses the issue of whether monetary policy shocks affect real economic activities through the interest rate channel. The interest rate channel of monetary policy transmission implies a direct relationship between policy rate and corporate financing decision. Hence, we expected,

apriori, that monetary policy rate exerts a positive and highly significant effect on debt financing of private companies in Nigeria.

Contrary to our expectation, *apriori*, we find that monetary policy rate has no direct effect on corporate debt financing. The coefficient LMPR (p-value = 0.4080) is not statistically significant, showing that corporate debt financing model does not respond to changes in monetary policy rate. This evidence which tends to agree with Białek-Jaworska and Nehrebecka (2015) but clearly contradicts the market timing theory as well as several past studies including Ayodele (2014), Bauer and Granziera (2018), and Cho and Im (2023). Hence, there is evidence that interest rate is not an effective monetary policy transmission channel in Nigeria.

Treasury Bills Rate and Corporate Debt Financing

Our third objective addresses the issue of whether open market operations affect corporate debt financing. The interest rate channel of monetary policy transmission implies a direct relationship between open market operations (treasury bills rate) and corporate financing decision. Hence, we expected, *apriori*, that treasury bills rate exerts a significant effect on debt financing of private companies in Nigeria.

Contrary to our expectation, *apriori*, we find that treasury bills rate has no direct effect on corporate debt financing. The coefficient LTBR (p-value = 0.2887) is not statistically significant, showing that corporate debt financing model does not respond to changes in treasury bills rate. This evidence which tends to agree with Białek-Jaworska and Nehrebecka (2015) but clearly contradicts the market timing theory as well as several past studies including Ayodele (2014), Bauer and Granziera (2018), and Cho and Im (2023). Hence, there is evidence that open market operations do not influence corporate financing and investment decisions in Nigeria.

CONCLUSION

This study employs the random effect model to examine the effectiveness of interest rate and bank credit channels of monetary policy transmission in Nigeria. More specifically, the study investigates the impact of monetary policy instruments (money supply, monetary policy rate and treasury bills rate) on corporate debt financing for a sample of 21 listed companies across different sectors from 2011 to 2022. The main findings can be summarized as follows:

There is evidence that latent organizational factors such as organizational culture and leadership capacity play an insignificant role in the corporate debt financing model. This implies that the relationship between monetary policy instruments and corporate debt financing in Nigeria can be framed as a random effect process.

There is evidence that corporate debt financing is largely driven by own effects and does not respond to changes in monetary policy shocks. Accordingly, none of the three monetary policy instruments: namely, money supply, monetary policy rate, and treasury bills rate, exerts a significant impact on corporate debt financing. Hence, in Nigeria, both interest rate and bank credit do not play a significant role in the monetary policy transmission process.

Overall, our results suggest that monetary instruments are not among the macroeconomic drivers of corporate debt financing in Nigeria.

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