INFLATION AND THE PERFORMANCE OF SMALLAND MEDIUM ENTERPRISES IN NIGERIA: CHALLENGES AND POLICY IMPLICATIONS. AN EXPLORATORY REVIEW

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Abstract

Small and medium enterprises (SMEs) are central to Nigeria's economic growth, accounting for a significant share of employment and gross domestic product (GDP). However, their performance is increasingly threatened by macroeconomic instability, particularly inflation. This study investigates the impact of inflation on the performance of SMEs in Nigeria using a qualitative approach grounded in literature, statistical reports, and empirical studies. Findings reveal that inflation exerts both negative and positive effects on SME operations. While mild inflation can incentivize production, persistent high inflation undermines profitability, access to finance, and long-term sustainability. This paper underscores the need for effective inflation management through coordinated monetary and fiscal policies, affordable credit facilities, and strengthened institutional support. These measures are crucial for enabling SMEs to thrive in an unstable economic environment and for sustaining inclusive national growth.

Introduction

Small and medium enterprises drive growth and development in any economy. Most economies, especially emerging ones depend on then since they make up most companies, providing jobs and boost global economic growth (world bank, 2022). They are vital to global economic development architecture and processes (Manasseh etal, 2019) and are garnering more attention as the drivers of economic growth and development especially in poor nations, SMEs in developing economics account for 90% of enterprises globally, 40% of GDP, and more than 50% of employment, according to the WorldBank (2022).SMEs make up the majority of enterprises in Nigeria, producing over 70% of jobs and contributing

over 45% to the GDP. Over 80% of Nigeria employment and 49.78% of GDP come from SMEs, according to the SMEDAN/NBS MSME Survey (2017) (PWC, 2020).Eniola (2014) stated that SMEs employs 70% of the country's work force; notwithstanding crude oil extraction. Any economy's growth depends on the SMEs. It drives Industrialization, modernization, rural-urban development, and gainful employment, increasing per capital Income, promoting equitable Income distribution and Improving citizens' welfare and quality of life. Various government, national and internationalorganizations are increasingly concerned about engaging the survival of SMEs to guarantee economic growth and development.

Despite their significance, SME in Nigeria face numerous challenges, many of which are linked to the country volatile macroeconomic environment. Nigeria economy is heavily dependent on oil experts making it susceptible to fluctuation in global oil prices.The dependency has led to macroeconomic instability characterized by high inflation rates, interest rates, exchanges volatility etc. These factors among others have a profound impact on the performance of SMEswhich oftenlack the resources and resilience to navigate such uncertainties.

Small and Medium Enterprises Development Agency of Nigeria (SMEDAN) in 2021 reports that most small and medium enterprises businesses in Nigeria die before their fifth anniversary. Certain factors in Nigeria business environment have been identified to affect the performance of the SMEs and contribute to the high failure rate.Inflation has been a growing problem in Nigeria for quite some time. When interest rates are high, investors are scared off, and the currency falls in value, which makes importing basic materials more expensive and difficult(CBN, 2022). Economic growth and price stability are the two primary goals of macroeconomic policies, according to a large number of economists, central bankers, law makers, and credits administrators(Bresser-Pereira, 2019). Incremental price makes market economies difficult to manage in many developing countries (Wang, 2016). Inflation at non-significant levels benefits borrowers at the expense of creditors and is bad for those living on fixed incomes.Financial issues like hyper-inflation and deflation, high-interest rates, and rising currency rates have an impact on SME performance. Financial ability and access to equity or debt financing limit SME's ability to meet investment, financing, and transaction demands, Watambwa and Shilongo (2021). High lending rates in Nigeria have also hampered SMEs' growth, which raises production costs. Nnenna et al (2020) noted that poor government budget implementation and raw material assessment have continued to hurt Nigerian SMEs. Unfortunately, little is known about how macroeconomic factors affect Nigeria's industrial sector.

Existing research on the effects of macroeconomic variables on the performance of SMEs has not resolved disagreements over the kind and extent of these effects. Ogundele et al (2020) and Rokas (2012) stated that macroeconomic factors do not significantly impact the performance of SMEs. However, Orugbu et al (2017) and Cheptot (2014) came to the opposite conclusion. This is the problem identified in this study that made the researcher to focus more on the impact of inflation rate on the performance of small and medium enterprises in Nigeria.

Objectives of the Study

The main objectives of this study are to examine the effect of inflation rate on the

performance of SMEs in Nigeria, while the specific objectives include;

1. Examine how inflation rates affect Nigerian SMEs performance.
2. To ascertains the impact of inflation rates on SMEs output in Nigeria.

Literature Review and Conceptual Review

Small and Medium Enterprises (SMEs)

There is no universally acceptable definition of SMEs in the literature, perhaps due to the fact that different countries utilize different criteria and definitions. A number of criteria are used to identify small and medium sized enterprises (SMEs), including the number of employees, total capital invested, plant capacity, sales turnover, and profits margin (Dababneh &Taken in Manasseh et al, 2019). Similarly, defining SMEs on a global scale is a challenge for the World Bank. The World Bank Research Group (2019) notes that national standard differs significantly. Micro, small or medium sized businesses are defined using the same standard criteria by the International Finance Cooperation (IFC) and the Multilateral Investment Guarantee Agency (MIGA), according to the World Bank Research Group (2019),A proper definition of SMEs is important to distinguish between the different categories of the production units in terms of factors like, number of employees, the value of fixed assets, production capacity, basic characteristics of the inputs, level of technology used,capital employed, management characteristics etc.

In Nigeria, the CBN puts the employment level of the small-scale business at less than 50 and medium scale business at less than 100. In terms of asset based, small scale has less than N1 Million,while medium scale has less than N150 million naira (IFC, 2002). Classification inUSA, Britain and Canada defined SMEs in terms of annual turnover and the number of paid employees whereas it is conceptualized in Japan as an industry paid up capital and the numbers of employees.

The Federal Ministry of Industries defines a medium scale enterprise as any company with operating assets less than N200 million and employing less than 300 persons. A small-scale enterprise, on the other hand, is one that has total assets of less than N50 million, with less than 100 employees. Annual turnover will not be given consideration in the definition of an SME. The National Economic Reconstruction Fund (NERFUND) defines a Small-Scale Enterprises as one whose total assets are less than N10 million, but makes no reference either to its annual turnover or the number of employees. The small and medium Industry Equity Investment Scheme (SMIEIS), defined an SME as any enterprise with a maximum asset base of N50 million, excluding land and working capital and with the number of employees not less than 10 and not more than 300. This definition did not distinguish between a medium scale enterprise (Sanusi, 2003).

SMEDAN (2007) adopted a classification and definition for National Policy of MSMES.

S/N	Size Category	Employment	ASSETS ('N' million Excluding Land and Building)
1	Micro Enterprises	Less than 10	Less than 5 million
2	Small Enterprises	10 – 49	10- less than 100 million
3	Medium Enterprises	50 -199	100- less than 1billion

Source: SMEDAN National Policy on MSME, 2015.

- Micro are those enterprises whose total assets (excluding land and Building) are above N1 million but not exceeding N10 million with a total work force of not exceeding 10 employees.
- Small are those enterprises whose total assets (excluding land and building) are above N10 million but not exceeding N100 million with a total workforce of above 10, but not exceeding 49 employees.
- Medium are those enterprises with total assets (excluding land and building) above N100 million but not exceeding N1 Billion with a total workforce of between 50 – 199 employees.

Inflation and the Performance of SMEs in Nigeria.

The rate of Inflation measures the annual percentage Increases in Prices; the most usual measure is that of retail prices. The government Publishes an Index of consumer Prices each month, and the rate of Inflation is the percentage Increase in that Index over the previous 12 months.

Olusola, etal,(2002) defined Inflation as a situation where there is an excessive demand for goods and services in the economy. Inflation occurs when the demand for goods and services surpasses the available supply (Achua, etal. 2020). The reason may be attributed to excessive spending by both the private sector and the government, resulting in a deficit or temporary reduction in productivity. Price Increasesmight also occuras consequences of rising production costs. Failure to control imported raw material price increases will lead to inflation.

According to Hossain (2018), while high Inflation is bad for an economy because of its adverse effect on economic performance, zero Inflation is equally harmful because it will lead to eventual stagnation of the economy sinceits presence at a mild level is needed for economic growth. The problem of Inflation is not confined to national boundaries neither is it restricted to emerging market economies of the World; it is also an over-arching challenge in the developed market economies, and since it is by no means a new challenge or Phenomenon, over the years, it control has become the Unquestioned mantra of economic policy makers Worldwide. Melberg (2016) the term Inflation describes a general and persistent increase in the prices of goods and services in an economy. Inflation rate is measured as the percentage change in the price Index (consumer Price Index, Wholesale Price Index, Producer Price Index, etc.).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 earners purchasing power is also reduced. Inflation in a country; either low or medium levels can have 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.

However, Inflation affects Nigeria SMEs growth in numerous ways, and individuals with fixed incomes and firms that are into product which demand is highly elastic bear its weight (Omotosho, 2019). These people can't purchase as much when price rise. Savings are discouraged, and economic development is reduced since investment requires savings. Due to the increasedprices, they must charge to pay their costs, businesses cannot foresee demand for their products, making it difficult to determine what, where, and for whom to manufacture in the future. It also raises concern about future pricing, interest rates, and currency rates, which Increase trade partner risks and discourage commerce. Inflation makes the nominal value unclear, making Investment planning harder (Austin and Okezie, 2019).

Methodology

This study adopts both a quantitative and qualitative research approach were contemporary literature such as books, journals, online publications, CBN statistical bulletin and quarterly reports, Newspaper and empirical studies of previous researchers were reviewed in an attempt in gauging the efforts of government through its agencies like the central bank of Nigeria and Small and Medium Enterprises Development Agency of Nigeria in addressing the various challenges hindering the SMEs' in achieving its potential.

Theoretical Review

There are few theories directly underlining the macro-economicvariables with respect to the SMEs Sector. These theories have been reviewed ranging from cause-and-effect theory and contingency theory.But the theory found adequate for this study is the cause-and-effect theory.

Cause and Effect Theory.

The theory of cause and effect (also known as feedback loops) was originally proposed by Braun and Le Chatelier in the 18th Century in ground breaking studies about how systems constantly establish a new equilibrium in response to stimuli.Cause and effect theory explain that, no event happens by chance but happens as a result of a cause. By applying this to the subject matter, it can be explained that small and medium scale enterprises growth and performers is cause by the macro-economicvariables. The stability of the variables in a long run ensures efficient growth of the sector while continuous fluctuation of these variables could either make or mar the growth of the sector. According to Anghelache et al (2016) Cause and effect links between macroeconomics variables and growth provide useful information for policy makers in the government and private agencies on the systematic relationship that reveals the influences of certain factors on growth. When these variables are not stable, it is therefore becoming the responsibility of the government to ensure that macroeconomics policies are implemented to manage and control these variables so as to spur growth in all sectors of the economy. Small and medium scale enterprise is crucial to the economic development of a nation; however, to sustain the benefits derived from this sub-sector, macroeconomic variables must be stable. This

theory was also employed by Kebede and Simesh (2015).

Contingency Theory

The need for small and medium sized enterprises (SMEs) to comprehend and adapt to macroeconomic dynamics in order to improve performance is best shown by continuity – Contingency theory. The theory was developed by Lawrence and Lorsch in 1967. According to contingency theory hypothesis, there is no optimal method for running a business. There will be a difference in the environmental requirements of company owners and management. The element outside managements control determines the problems solution (s) (Mohammed etal, 2021). When an organizations internal characteristicaligns with its external environment, it will better able to adapt, according to the theory. They think that companies may be saved by being adaptive to their environments. Uncertainly and change, they argued, impact internal organizational characteristics. To improve operational performance, SMEs need to know how the macro-economic climate affects them. They can therefore better anticipate macroeconomic events and how they will affect business operations, which will ultimately lead to improved performance.According to Mohammed et al. (2021), performance might be enhanced if one's actions are tailored to the specific environment and circumstances

Empirical Review

Ebinum et al (2025) investigated the effect of inflationary trends on the growth of Small and Medium Enterprises (SMEs) in Nigeria, with particular emphasis on the period spanning from 1990 to 2024. Inflation was proxiedusing four key indices:Consumer Price Index(CPI),Producer Price Index(PPI),CoreInflationRate(CIR),andWholesalePriceIndex(WPI),whileSMEgrowthwas measured through their contribution to Nigeria's Gross Domestic Product (SMECGDP). The study adopted an ex-post facto research design, utilizing annual secondary time series data obtained from the Central Bank of Nigeria (CBN) Statistical Bulletin and National Bureau of Statistics (NBS) annual reports. Given the macroeconomic nature of the variables and their potentialmixedstationarityproperties,theAutoregressiveDistributedLag(ARDL)boundstesting methodology was employed using E-Views 9.0 to assess both short-run dynamics and long-run equilibriumrelationships.Theresultsrevealedthatnoneoftheinflationaryindicators—CPI,PPI, CIR,orWPI—exertedstatisticallysignificanteffectsonSMEgrowth,eitherintheshortrunorthe long run. These findings suggest that while inflation may influence the broader economic environment,itdoesnotindependentlyserveasaprimarydriverorinhibitorofSMEperformance in Nigeria. The insignificance of these variables calls attention to the role of other non-price macroeconomic and structural factors—such as infrastructural challenges, access to finance, regulatory inconsistencies, and institutional inefficiencies—which may have more pronounced impacts on SME development. The study concludes that inflation-targeted policies alone may be insufficienttodrivemeaningfulgrowthintheSMEsector.Itrecommendsthatpolicymakersfocus more on comprehensive and SME-specific strategies aimed at enhancing resilience, innovation, andproductivity.Thisresearchcontributestotheexpandingliteratureoninflation-SMEdynamics and offers methodological insight into ARDL modeling in the context of emerging economies.

Nwosu (2025) examined the effect of inflation and exchange rates on the financial

performance of selected quoted manufacturing companies in Nigeria. The financial performance of manufacturing companies in Nigeria has been increasingly unstable, marked by fluctuating profitability, declining returns, and rising costs. This instability is largely attributed to persistent inflation and exchange rate volatility, both of which have intensified in recent years. The study examines the effect of inflation and exchange rates, on the financial performance of selected quoted manufacturing companies in Nigeria, using Tobin's Q as a proxy for firm performance. The study adopts ex-post factor research design and covered 43 quoted manufacturing firms in Nigeria. Utilizing panel data from 2014 to 2023 which was extracted from published annual reports of Statistical Bulletin of the Central Bank of Nigeria, National Bureau of Statistics and Nigerian Stock Exchange and applied regression analysis through the least squares' method. The study found that both inflation and exchange rates have negative and significant effect on financial performance (Tobin's Q) of selected quoted manufacturing firms in Nigeria 5% significant level. The study concludes that inflation and exchange rates negatively influence financial performance (Tobin's Q) of selected quoted manufacturing firms in Nigeria. The study therefore, recommend that manufacturing companies in Nigeria should strengthen their resilience to rising inflation-related production costs by enhancing operational efficiency through energy-efficient technologies and waste reduction. The study also recommends that manufacturing companies in Nigeria should implement strong foreign exchange risk management strategies, such as hedging with forward contracts or options, to protect against exchange rate volatility.

Olaiya et al (2025) This study was carried out to examine the influence of insecurity and inflation on the performance of small and medium-scale enterprises (SMEs) in Nigeria. The study specifically examined the influence of insecurity, inflation and interest rate on SMEs. The variable of interest, which is the performance of SMEs, was measured with SMEs' contributions to real gross domestic products, while the independent variable was proxied with the global insecurity index, inflation rate, and interest rate. The study employed secondary annual time series data, which spanned from 1999 to 2023. The data used were extracted from the CBN Statistical Bulletin 2023 edition. Preliminary tests were conducted using the Augmented Dickey-Fuller to determine the level of integration of the variables of interest. Consequent upon the findings of the above tests, the study employed an auto-regressive distributed lag as the method to estimate the specified model. A residual post-diagnostic test was also conducted. Findings from the study indicated that the influence of insecurity on the performance of SMEs on GDP is negative with a coefficient of -1,303.885 and significant with a probability value of 0.0000. Also, interest rate exerted a negative (with a coefficient of -415.51) and significant influence on the performance of SMEs to GDP with a probability value of 0.000. Similarly, the inflation rate has a negative (with a coefficient of-142.57) and significant influence on SMEGDP with a probability value of 0.0069; thus, all the explanatory variables with negative co-efficient had a significant and negative on SMEs' contributions to real gross domestic products in Nigeria. The study concluded that insecurity and inflation have a significant but negative influence on the performance of SMEs in Nigeria. The study, therefore, recommended that governments both at the federal and state levels should design proactive and practical policies and measures to reduce the level of insecurity in Nigeria so as to guarantee safe and

more secure environment for the SMEs to thrive and contribute significantly to Nigeria's economic growth.

Boniface (2025) This study examines the relationship between three significant external factors, inflation, innovation, and market dynamics and the performance of SMEs in Southeast Nigeria.A sample of 359 SME ownersandmanagerswaschosenusingTaroYamane'stechnique,withan emphasisonSMEsregisteredwiththeSmall and Medium Enterprises Development Agency of Nigeria (SMEDAN) in the states of Abia, Anambra, Ebonyi, Enugu, and Imo.The studyused amulti-stage sampling approach and a survey design.Structured questionnaireswere used to collect the data, and multiple regression analysis and descriptive statistics were used for analysis. The SWOT and PESTEL analytical frameworks were used to gain a deeper understanding.The results show that market dynamics, innovation, and inflation have a considerable impact on SME success in the Southeast, with good explanatory power($R2 = 0.921$, 0.927, and 0.923, respectively; $p < 0.001$).According to the study's findings, external environmental factors are essential to the sustainability and success of SMEs.It suggests that authorities invest in ICT infrastructure, improve financial accessibility, and give economic stability first priority.To be competitive in a changing economic climate, SMEs are urged to embrace innovation, keep an eye on environmental trends, and implement flexible tactics. For Southeast Nigeria's SME sector to become more robust and enabling, several steps are crucial.

Mgbomene, et al. (2025) examined inflation and growth of SMEs in Nigeria:Apre and post fuel subsidy period analysis.This study set out to achieve thespecificobjectivesofinvestigatingtherelationship between inflation rate,exchangerate,interestrate, averagefuelpumppriceandSMEsoutput inNigeriabeforeandafterfuelsubsidyremovalperiods.Thedatawerecollectedmonthlyfrom January, 2022to December, 2024.ThemonthofMay2023was observed as the structural break period in the analysis. The Structural break analysis was conducted using the Chow breakpoint test and the result revealedthattherewasstructuralbreakinSMEsoutputatthespecifiedbreakpoint(May, 2023)asaresultoftheinflationeffectresultingfromfuel subsidy removal.The Chow forecast estimates further revealed that inflation rate and fuel price exerted positive effects on SMEs output before and after fuel subsidy removal periods while exchange rate and interest rate had a significantly negative effect on SMEs output before and after fuel subsidyremoval.Thestudyconcludedthatinflation effectoffuelsubsidyremovalwasnotsevereonSMEsinNigeriabecausetheyhavemonopolistic tendencies which make them transfer the increasing cost of production on to consumers hence hedging against inflationary trends. The only strain experienced by SMEs was from exchange rate fluctuations and rise in capital acquisition (interest rate).The study recommended interest rate reduction for SMEs, foreign exchange provision for export trades and stable fuel price to ease SMEs operation in Nigeria.

In another study conducted by Lawal and Akanbi (2020) examine the relationship between inflation rate and performance of small and medium enterprises in Nigeria using ARDL approach.Time series analysis data were collected on contribution of wholesale and retail trade outputs to GDP spanning 38 years (1981-2018). The study employed both descriptive and inferential (using econometric approaches tools) in analyzing the data. As regards the

econometric analysis, Autoregressive Distribution Lag (ARDL), regression model was employed to examine the long-run relationship. The results of the estimated ARDL model showed that inflation rate have negatively and positively significantly long effects on performance of small and medium enterprises (PSME). The study recommended that government should reduce borrowing and lending charges to enhance the performance of small and medium enterprises in Nigeria.

Conclusion and Recommendations

This study investigated the impact of inflation rate on the performance of small and medium enterprises. The finding shows that inflation rate has negatively and positively significant long-run effects on the performance of small and medium enterprises as collaborated by Okeke, etal (2020) andLawal and Akanbi (2020) in their empirical studies. Based on the research findings the following recommendations were made; that there is a need for efficient management of inflation rate in such a way to stimulate the economic growth. That government and policy makers should try more in regulating the interest rate and other credit facilities, making sure that they are accessible and affordable to all SMEs in Nigeria. The study further recommended that government should reduce borrowing and lending charges to enhance the performance of small and medium enterprises in Nigeria.

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