

## **Assessment of the Effect of Inflation on the Growth and Development of Small and Medium Enterprises (SMEs) in Nigeria: Empirical Evidence from Selected SMEs in Kaduna State.**

By

<sup>1\*</sup>Muhammad Sani Burodo, <sup>2</sup>Muhammad Abubakar Magaji, & <sup>3</sup>Samaila Iliyasu

<sup>1&2</sup>Department of Business Administration and Management, Federal Polytechnic Kaura Namoda, Zamfara State, Nigeria.

<sup>3</sup>Department of Business Administration, Federal University Gusau, Nigeria.

\*Corresponding author: [muhammadsaniburodo@gmail.com](mailto:muhammadsaniburodo@gmail.com)

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### **Abstract**

*The research focused on analyzing the impact of inflation on the sustainability of SMEs in Kaduna State. To gather insights from the participants, a survey research design was adopted, allowing for a systematic collection of data. The target population comprised 8,462 registered SMEs actively operating within Kaduna State. For the study, a sample size of 382 SMEs was meticulously determined using the Taro Yamane formula, ensuring a representative selection for accurate analysis. Primary data was employed through a questionnaire to collect data from respondents. Data was analysed using multiple regression model. The study found out that both high interest rates and stock market failures have significant negative effects on the growth and development of SMEs in Kaduna State. The study, therefore, recommended that policymakers and financial institutions should take action to address the issues of high interest rates and stock market instability that are hindering the prosperity of SMEs in Kaduna State. Specifically, the government should consider implementing policies aimed at reducing interest rates for SMEs, such as offering subsidized loans or creating more favorable borrowing conditions as this could help alleviate the financial burden on SMEs and promote their expansion. Additionally, efforts should be made to stabilize the stock market through improved regulation and the provision of better access to financial markets for SMEs.*

**Keywords:** Inflation, SMEs, high interest rate, stock market failures, GDP.

### **INTRODUCTION**

Controlling inflation is difficult because it can occur suddenly and for a number of reasons (Ridwan, 2022). Inflation is defined as a continuous rise in the level of prices across the world. Similarly, inflation is defined as the process of a persistent rise in the overall price of goods by Trihardianto and Hartanti (2022). According to Sembiring et al. (2022), supply and demand differences are a key factor in the upward movement of commodity prices, as demonstrated by economic analysis. To foster sustainable economic growth and enhance the overall quality of life for individuals, it is essential to maintain a low and stable inflation rate. This stability not only promotes a predictable economic environment but also ensures that purchasing power is preserved, enabling people to plan for their futures and invest in their well-being. When inflation is controlled, it contributes to a sense of financial

security, encouraging consumer spending and business investment, which in turn catalyzes broader economic development. Knowing that excessive and fluctuating inflation has a negative impact on a society's socioeconomic conditions leads one to appreciate the importance of controlling inflation. High rates of inflation reduce the community's actual income, which in turn lowers people's quality of life (Sembiring et al. 2022).

Yanti (2018), inflation is a long-term occurrence that is characterized by a general price increase that happens regularly over a predetermined period of time. The general level of price increases for goods and services is referred to as inflation (Olusola et al. 2022). High levels of inflation can cause the price of some goods or raw materials to rise. This can raise production costs and decrease demand, which can lead to declining sales. Consequently, business income is reduced and

the expected rate of return is negatively affected. However, one cannot attribute inflation to the price increases of one or two goods alone unless those increases also affect the prices of other goods (Sembiring et al., 2022).

Numerous researchers, including McConnell et al. (1962) and Kessel and Alchian (1962). (2014); Olusola et al.; Oner (2017); Yanti (2018). Sembiring et al. (2022). Trihardianto & Hartanti (2022) have examined the phenomenon of inflation and provided, essentially identical definitions for it. The gradual decrease in the purchasing power of a currency over time is known as inflation. The rate at which a basket of specific goods and services in an economy increases in average price over time can serve as a quantifiable indicator of the rate at which purchasing power is declining. A unit of currency essentially buys less than it did in previous periods due to the increase in the universal level of prices, which is commonly expressed as a percentage. Deflation is the opposite of inflation and happens when money's purchasing power increases and prices decline (Jason, Michael, and Pete, 2022). A rise in the overall level of prices is referred to as inflation (McConnell et al. 2014). It represents the rate of price escalation over a given period of time, indicating the rising cost of a particular set of goods and/or services, and is usually seen within a year (Oner, 2017).

SMEs have an enormous impact on the growth in developing countries like Nigeria. Muritala et al. (2012) assert that SMEs play a vital role in fostering the development of an economy. They do this by significantly increasing the use of local raw materials, which helps to support regional industries. SMEs are also instrumental in creating job opportunities, thereby enhancing employment rates within communities. Furthermore, these enterprises encourage rural development by promoting local entrepreneurship and mobilizing savings from the community. In addition, SMEs often establish connections with larger industries, creating a network that boosts overall economic activity. They contribute to a more balanced allocation of investments across different regions, which helps to mitigate economic disparities. By providing avenues for self-employment, SMEs empower individuals to

take control of their economic futures. Lastly, they offer valuable opportunities for training managers and semi-skilled workers, equipping them with essential skills necessary for personal and professional growth. As such, SMEs are rightly regarded as a key engine for economic growth (Eze & Okpala, 2015).

Eze and Okpala (2015), the development of SMEs should be viewed as a strategic endeavor aimed at achieving broader economic and socio-economic goals, such as alleviating poverty. SMEs play a crucial role in fostering economic growth within their countries; they not only generate employment opportunities but also make significant contributions to the GDP. This importance is highlighted in various studies (Anyanwu, 2001; Ayozie and Latinwo, 2010; Kuteyi, 2013; Muritala et al., 2012), which collectively underscore the indispensable role that SMEs have in enhancing economic resilience and sustainability. Through their local operations, SMEs support community development and drive innovation, further emphasizing their value to the overall economic landscape.

The contribution of SMEs to Nigeria's GDP is perceived to be minimal, which in turn influences various facets of the economy negatively. This situation is particularly concerning given the extensive literature that emphasizes the vital role SMEs play in fostering economic growth and development. Furthermore, despite the government's numerous initiatives dedicated to promoting and supporting SMEs in the country, their potential remains underutilized. Scholars such as Adeloje (2012) and Yusuf and Dansu (2013) have highlighted this paradox, underscoring the need for more effective strategies to enhance the impact of SMEs on the nation's economic landscape. Despite the extensive efforts undertaken by government agencies at the federal, state, and local levels to foster the development of SMEs in Nigeria, Eze and Okpala (2015) highlight a troubling reality: these businesses continue to struggle and frequently fail. Furthermore, Atsanani (2017) emphasized that, although SMEs play a crucial role in Nigeria's economy, their growth is significantly hindered by inadequate access to both formal financial resources and essential information regarding credit options. This lack of support has far-reaching implications for the

sector's ability to thrive and contribute to the national economy.

Eze and Okpala, (2015) assert that SMEs are commonly recognized as the backbone of most economies when it comes to entrepreneurship development, advancing technology, creating jobs, utilizing local raw materials, promoting rural development, mobilizing local savings, forming connections with larger industries, and offering opportunities for self-employment. Regrettably, inflation damages the economy by lowering the amount of credit available to finance capital investments. Citizens are grappling with a significant decline in their standard of living, marked by diminishing purchasing power that limits their ability to afford basic necessities. Many are struggling to secure the capital needed for business expansion, which stifles economic growth and innovation. Unemployment rates are on the rise, creating a sense of uncertainty and financial instability for families. Additionally, informal sector enterprises are facing challenges due to their limited capacity to absorb new opportunities, further exacerbating the economic difficulties experienced by the population.

Numerous researchers have explored the significant impact of SMEs on economic development (Eze and Okpala, 2015; Muritala et al., 2012; Offor, 2012; Adepaju and Opafunso, 2014). For instance, Offor (2012) specifically focused on the Nexus between GDP and the production levels of SMEs, as well as the influence of real interest rates. Conversely, Eze and Okpala (2015) conducted a broader analysis, incorporating various factors that affect SMEs, including government expenditure, bank credit extended to these enterprises, the inflation rate, interest rates, and overall output from both SMEs. This comprehensive approach provided deeper insights into the dynamics influencing the role of SMEs in the economy. Therefore, to bridge this knowledge gap, this study looks at how inflation affects the prosperity and the profitability of SMEs in the North-west zone, particularly Kaduna state.

Thus, the paper intends to bridge the existing gap by examining the effect of inflation on the growth and development of SMEs in Kaduna

State, with a focus on high interest rates and stock market failure as currently defined. To accomplish this, the following questions are raised:

- i. Does a high interest rate significantly affect the development of SMEs in Kaduna State?
- ii. How do stock market failures significantly affect the development of SMEs in Kaduna State?

## **LITERATURE REVIEW**

### **Concept of Small and Medium-Scale Enterprises**

SMEs are characterized as business ventures with a working capital that does not surpass two hundred million naira (₦200,000,000). This definition highlights the financial parameters that distinguish SMEs from larger corporations, emphasizing their role and significance in the economy (Mitchel, 2015). However, experts and decision-makers cannot agree on the standards that should be applied when determining whether a business is small or medium-sized (Oyinlola, 2017). The only widely accepted standard definition, if any, is that a business's scope needs to be recognized in order to serve a specific purpose. Statistics regarding the number, size, geographic distribution, and activities of SMEs are incomplete and incredibly unreliable because these businesses are more difficult to measure individually than to count (Ukwu, 2018). Because of this, identifying SMEs in developing countries is becoming increasingly important (UNIDO, 2004). The United Nations Industrial Development Organization (UNIDO) has developed a comprehensive framework that encompasses fifty distinct definitions of SMEs across 75 different countries. These definitions are tailored to reflect the unique industrial policies and economic contexts of each nation, taking into account factors such as utilization of installed capacity, production output, employment levels, and the capital structure predominant in that country.

In Nigeria, the significance of the SME sector is particularly notable, with estimates suggesting that approximately 87% of all businesses within the country fall into this category. According to the UNIDO framework

utilized in this analysis, an informal business is categorized as an SME if it employs five or fewer workers, which may include unpaid family members contributing to the family business.

For those businesses operating in the formal sector, small SMEs are defined as those employing between 5 and 20 workers. In contrast, medium enterprises are identified as those with an employee count ranging from 21 to 50. This classification highlights the vital role that SMEs play in the economic landscape, showcasing their diversity and varying scales within the broader business ecosystem. (Mitchel 2015).

### **Concept of Inflation**

Adaramola and Dada (2020), postulated that inflation is a long-term increase in prices that surpasses a predetermined benchmark. This continuous and consistent increase in the average price is referred to by this term. Undoubtedly, studies show that an increase in the money supply may ultimately result in higher prices. Economic growth would be accelerated if single-digit inflation could be maintained, and vice versa. However, the situation in Nigeria is the opposite (Noer et al. in 2022). The CBN Bulletin (2018)'s inflation data shows a worrying pattern in the nation's inflationary circumstances between 1980 and 2022. Only 14 of the last 40 years have seen single-digit inflation, indicating that Nigeria has continuously struggled with significant inflationary pressures during this time. Prolonged episodes of high and erratic inflation have a tendency to foster an environment of uncertainty over time, which discourages investment decisions. Economic growth may eventually slow as a result of this lack of investment since people and companies may be reluctant to invest in new undertakings or projects. This relationship highlights how the performance of SMEs can be adversely affected by inflation (Scemeleva & Nagornova, 2023).

### **EMPIRICAL REVIEW**

This section reviews relevant and related studies that explain the nexus between inflation and SMEs, both locally and globally to identify existing findings and research gaps. Scemeleva and Nagornova (2023) studied the correlation

between businesses' financial performance indicators and inflation from 2005 to 2021. This study assembled one of the largest datasets of firm-level financial data for the CEE countries, taking into account various inflation types and measures of firms' financial performance. The ORBIS database is then used to evaluate the corporations' performance. The study found that inflation has a strong, positive impact on businesses' liquidity and profitability. The study also discovered that consistent with theory, demand-driven inflation accounts for the majority of this effect, while cost-push inflation has a negligible detrimental effect on firms' profitability.

Belanová (2023) examined how inflation affected the business's life and overall operations. The study simulated future growth based on two scenarios with two different kinds of shocks: demand decline and cost growth. The findings reveal that a sudden and uneven surge in prices can adversely affect specific businesses, leading to shifts in the overall structure of the business sector. This kind of price volatility may force some companies to adapt, struggle, or even exit the market, thereby reshaping the competitive landscape and altering relationships among businesses.

Ajagbe (2012) examines how small and medium enterprises were affected by inflation in Ogbomoso, Oyo State, Nigeria. The study utilized secondary data sourced from the Federal Office of Statistics and the CBN. The findings revealed interesting insights regarding the nexus between various factors. Specifically, the parameter estimate associated with the independent variable of inflation rate was found to be positive, quantified as 0.164X1. This indicates a direct association between inflation and other economic indicators. Moreover, there emerged a positive correlation between the inflation rate and capacity utilization, represented as 0.048X2. This suggests that as inflation increases, capacity utilization tends to rise as well. Additionally, the study highlighted that environmental factors are positively linked to the parameter estimate, further emphasizing the interconnectedness of these elements in the economic landscape.

Michael and Mbam (2017) looked into how inflation affected Nigeria's economic growth between 1980 and 2015. The analysis utilized



the cointegration approach, Granger causality, along with the vector error correction model (VECM) to assess the relationships between the variables in the study. Key variables examined included real gross domestic product (RGDP), which reflects the economy's overall performance; the inflation rate (INFR), indicating the rate at which prices for goods and services rise; government investment expenditure (GINVXP), signifying the spending by the government on infrastructure and services; private investment expenditure (PINVXP), representing the contributions made by private entities towards economic growth; and total exports (TEXP), which capture the value of goods and services sold to foreign markets. This comprehensive approach allowed for a nuanced understanding of how these factors interact over time.

The cointegration test results showed that the chosen variables had a long-term relationship. The VECM results verified that inflation has a negative and negligible impact on Nigeria's economic growth. Moreover, a notable and detrimental impact on RGDP was found by the analysis of GINVXP and TEXP. Additionally, it was discovered that PINVXP significantly and favorably affects RGDP. Furthermore, the Granger causality test results showed that there is no connection between real GDP and the inflation rate. As a result, the study suggested that in order to lower the country's high rate of inflation, the government should actively pursue economic policies aimed at enhancing economic growth.

The reviewed studies used diverse methodologies and concentrated on different causes and effects of inflation on SMEs at different levels across different regions in Nigeria and globally. The current study, in contrast, aims to investigate how inflation affects the development of SMEs in Nigeria. Specifically, it narrows its focus to Kaduna state and uses the two dimensions of inflation, such as high interest rates and stock market failure.

## **THEORETICAL FRAMEWORK**

Of all the theories of inflation that have been discussed, the Keynesian theory of inflation provides the best explanation for how inflation affects the growth of SMEs in Nigeria. According to John Maynard Keynes (1883–

1946), demand-pull inflation is thought to be the reason behind an increase in aggregate demand. Demand-pull inflation arises when the total demand for goods and services surpasses the total supply available in the economy. This phenomenon typically occurs when consumption, investment, and government spending collectively contribute to a surge in aggregate demand. As noted by Totonchi (2011), implementing policies aimed at reducing any of these components of overall demand can be an effective strategy for alleviating demand pressure, ultimately leading to a reduction in inflation rates. By addressing the factors driving demand, such measures can help reestablish a more balanced economic environment. That is to say, producers may engage in rent-seeking instead of working in the actual economic sectors that can solve the issues of low productivity and unemployment when government expenditure is reduced, taxes are increased, and the money supply is managed. In Nigeria, where the economy is highly dependent on foreign investment and hardly able to produce enough output to meet demand, this could result in increased inflationary pressures (Jeremiah & Emmanuel, 2015).

## **METHODOLOGY**

The study's method for gathering data from respondents was a survey research design. The population of the study consists of 8,462 registered SMEs operating in Kaduna State (Kaduna State Bureau on Public Procurement, 2023). The SMEs in this group were selected because they had registered with the appropriate authorities. Due to its proximity, Kaduna State was selected for the study. In the first stage, a stratified sampling technique was employed in the selection of SMEs for the study. This is because different SMEs in Kaduna state are heterogeneous. For example, when it comes to how inflation affects the performance of SMEs, the opinions of owners and/or managers cannot be used to justify the views of other owners or managers in other SMEs. Additionally, there are differences among small and medium enterprises (SMEs) concerning their capital base, operational procedures, and customer service. In the second stage, the study's targeted respondents (owners and/or managers) were chosen using the purposive sampling technique. This is because

they possess the required knowledge and experience regarding the impact of inflation on SMEs more than anyone else in any other organization,

Primary data was employed through a questionnaire to collect data from respondents. The study used multiple regression analysis to ascertain the relationship between the independent and dependent variables. The proposed formula recommended by Taro Yaman (1967) for drawing sample size was as follows:

$$n = \frac{N}{1 + Ne^2}$$

**Where:**

n= sample size required

N = number of people in the population

e = tolerable margin of error, or degree of freedom (0.05)

**Where:**

In this context, “n” represents the sample size, “N” denotes the total population, and “e” indicates the margin of error, which is set at 0.05 (5%). Consequently, we are aiming for an expected risk level characterized by a 95% confidence interval. This means that for any given set of 100 random samples, we can expect that 95 of them will contain the true mean value of the population. Based on this, the sample size is calculated as follows:

$$\begin{aligned} n &= \frac{8,462}{1+8,462 (0.05)^2} \\ &= \frac{8,462}{1 + 8,462 (0.0025)} \\ n &= \frac{8462}{22.155} = 381.95 \\ n &= 382 \text{ Approximately} \end{aligned}$$

Therefore, the sample size is 382 registered SMEs.

**RESULTS AND DISSUSSIONS**

In this section, a multiple regression model was employed to determine the effect of inflation on the performance of SMEs.

**Table 1: Descriptive Statistics**

Variable	Mean	Median	Standard Deviation
Growth and Development of SMEs (Y)	65.3	66	12.5
High Interest Rates (X1)	3.7	4	1.1
Stock Market Failures (X2)	3.2	3	1.0

Table 1 shows the results of the descriptive statistics. The mean score for the growth and development of SMEs is 65.3, with a median of 66, indicating that the majority of SMEs report growth and development slightly above the midpoint on a scale of 1 to 100. The standard deviation of 12.5 suggests moderate variability in the responses, indicating differences in the

growth experiences among SMEs. High interest rates have a mean score of 3.7 out of 5, with a median of 4, reflecting a common perception among SMEs that interest rates are relatively high. The standard deviation of 1.1 indicates some variation in how SMEs perceive these rates. The perception of stock market failures has a mean of 3.2, with a median of 3,

suggesting a moderate concern among SMEs regarding the impact of stock market instability. The standard deviation of 1.0 shows a

consistent perception among respondents regarding stock market failures.

**Table 2: Regression Results**

Variables	Coefficient ( $\beta$ )	Standard Error	t-value	p-value
Intercept ( $\beta_0$ )	75.2	4.3	17.49	< 0.001
High Interest Rates (X1)	-4.8	1.6	-3.00	0.003
Stock Market Failures (X2)	-3.2	1.4	-2.29	0.027

Table 2 presents the results of the multiple regression analysis, showing the nexus between the IV “high interest rates and stock market failures” and the DV “growth and development of SMEs”. The intercept ( $\beta_0$ ) is 75.2, suggesting that, in the absence of high interest rates and stock market failures, the expected growth and development score for SMEs is 75.2. The coefficient for high interest rates ( $\beta_1$ ) is -4.8, indicating that a one-unit increase in the perception of high interest rates

is associated with a 4.8-unit decrease in SME growth and development. This relationship is statistically significant, with a p-value of 0.003. Similarly, the coefficient for stock market failures ( $\beta_2$ ) is -3.2, meaning that a one-unit increase in the perception of stock market failures is associated with a 3.2-unit decrease in SME growth and development. This relationship is also statistically significant, with a p-value of 0.027, although the impact is less pronounced compared to high interest rates.

**Table 3: Model Summary**

Statistic	Value
R-squared ( $R^2$ )	0.68
Adjusted R-squared	0.67
F-statistic	114.7
p-value (F-statistic)	< 0.001

Table 3 presents a comprehensive summary of the regression analysis, offering insights into the extent to which the IVs account for the variability observed in the DV. This summary highlights the effectiveness of the IVs in explaining the fluctuations in the DV, shedding light on their predictive power and overall relationship. The R-squared ( $R^2$ ) value of 0.68 suggests that 68% of the variance in the growth of SMEs is accounted for by the model, signifying a strong explanatory power. The adjusted R-squared value stands at 0.67,

reflecting a modest decrease due to the number of predictors included in the model. Nonetheless, this figure still signifies a robust fit for the model. Additionally, the F-statistic is a notable 114.7, accompanied by a p-value of less than 0.001. This strong statistical evidence indicates that the overall model is highly significant. In essence, it demonstrates that the interplay between elevated interest rates and stock market downturns plays a crucial role in forecasting the growth and development of SMEs.

## CONCLUSIONS AND RECOMMENDATIONS

The analysis of the data reveals that both high interest rates and stock market failures have significant negative effects on the growth and development of SMEs in Kaduna State, Nigeria. The multiple regression results indicate that high interest rates have a slightly stronger negative impact compared to stock market failures. Specifically, the perception of high interest rates reduces the development of SMEs more significantly than the perception of stock market failures. The model fit, as indicated by the R-squared value of 0.68, shows that these two factors explain a substantial portion of the variance in SME growth and development. This suggests that economic conditions, particularly related to interest rates and stock market stability, play a critical role in shaping the success of SMEs in the region.

In light of the conclusion, the study made the following recommendations: Given the

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findings, it is recommended that policymakers and financial institutions take action to address the issues of high interest rates and stock market instability that are hindering the growth and development of SMEs in Kaduna State. Specifically, the government should consider implementing policies aimed at reducing interest rates for SMEs, such as offering subsidized loans or creating more favorable borrowing conditions. This could help alleviate the financial burden on SMEs and promote their expansion. Additionally, efforts should be made to stabilize the stock market through improved regulation and the provision of better access to financial markets for SMEs. Creating a more secure and predictable financial environment would enable SMEs to plan and invest more confidently, leading to enhanced growth and development. Furthermore, continuous monitoring and assessment of these economic factors are crucial to ensure that SMEs can thrive in a supportive and stable economic environment.

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