

EFFECT OF INFLATION ON THE PERFORMANCE OF SMALL AND MEDIUM ENTERPRISES (SMES) IN KATSINA STATE.

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Abstract

The study examined the effect of inflation on the performance of SMEs in Katsina State. The method used for the study was the descriptive survey research design. The population comprised 7,372 registered SMEs operating in Katsina State and a sample size of 379 was determined using Taro Yaman formula. The data was obtained through the use of a questionnaire. The paper utilized multiple regression analysis to establish the relationship between the independent and the dependent variables. The results from the analysis indicated a negative relationship between the independent variables (uncertainty about future prices and exchange rate fluctuations) and the dependent variable (SMEs performance) denoting that as uncertainty about future prices and exchange rate fluctuations increase, SMEs growth decreases. The study therefore recommended that strategies should be implemented to reduce uncertainty about future prices by implementing regulatory measures that ensure price stability.

Keywords: Exchange rate fluctuations, Inflation, SMEs performance, Uncertainty about future price.

Introduction

Nigeria's economy has been fluctuating for many years, which has made inflation worse (Noer, et al., 2022). Audu and Amaegberi (2013) assert that excess demand is a prerequisite for inflation. Spending seems to be concentrated on domestically produced goods that can be maintained over time with the resources currently available. It describes a circumstance in which supply cannot keep up with demand (Umaru & Zubairu, 2012). Economic instability can result from output shortages or excessive spending by the public and private sectors relative to their revenue. For instance, if the rising costs of imported raw materials are not adequately addressed, inflation may result (Jeke & Wanjuu, 2021).

Moreover, inflation occurs when the prices increase, thus, is considered as inflation when it is persistent and higher than the specified benchmark (Adaramola & Dada, 2020). It is the term used to describe this steady and ongoing rise in the average price. Certainly, research documents that the more the money supply may eventually lead to an increase in prices. The ability to maintain a single-digit inflation would accelerate economic growth and vice versa. For Nigeria, however, the reverse is

the case (Noer, et al., 2022). The inflation data from the CBN Bulletin (2018) reveals a concerning trend in the country's inflationary situation from 1980 to 2022. Over this period, Nigeria has consistently grappled with serious inflationary pressures, with only fourteen out of the past forty years experiencing single-digit inflation. Over time, prolonged periods of high and unpredictable inflation tend to create an atmosphere of uncertainty, which significantly discourages investment decisions. This lack of investment can ultimately lead to a slowdown in economic growth, as businesses and individuals become hesitant to commit resources to new ventures or projects. This relationship emphasizes how inflation can negatively affect SMEs performance (Scemeleva, & Nagornova, 2023).

Furthermore, increase in the prices may at times or at most times discourages savings and reduces economic growth (Edoko, Otugo & Ezeanolue, 2018). The escalating burden on investment compels businesses to carefully strategize their production decisions, including what to manufacture, where to locate their operations, and for which markets they should target their products. This meticulous planning arises from the inability to accurately predict consumer demand, primarily due to the inflated prices necessary to cover rising costs (Inyiama, 2013). Additionally, inflation introduces a layer of uncertainty regarding future prices, interest rates, and exchange rates. This unpredictability heightens the risks for potential trade partners, ultimately discouraging collaborative trade efforts and complicating economic relationships (Semuel & Nurina, 2015).

Many scholars have examined the important role that SMEs play in economic development (Eze and Okpala, 2015; Muritala et al. Adepoju and Opafunso (2014); Offor (2012). For example, Offor (2012) concentrated on the relationship between GDP and SMEs' production levels, with a particular emphasis on the impact of real interest rates. However, another study was carried out by Eze and Okpala (2015), taking into account a number of variables that affects SMEs, such as government spending, bank credit given to these businesses, inflation, interest rates, and the total output of both SMEs. This all-encompassing strategy offered more profound understanding of the factors impacting SMEs' contribution to the economy.

The majority of SMEs are experiencing a sharp drop in performance as a result of high inflation, which restricts their capacity to grow more quickly (Scemeleva, & Nagornova, 2023). Due to high production costs, raw material costs, and operating expenses during inflation, many SMEs are making little money, which inhibits economic growth and results in worker dismissals (Belanová, 2023). Furthermore, some SMEs are having trouble obtaining the funding required for company growth, but high interest rates make borrowing money costly, which may result in low levels of investment. Businesses are also having trouble keeping up with inflation because they are unable to forecast and uncertainty about future prices exchange rate fluctuations (Adaramola & Dada, 2020).

Therefore, the aim of this paper is to bridge this gap by investigating how inflation affects the growth and development of SMEs in Katsina State, with a particular emphasis on uncertainty about future prices and exchange rate fluctuations as it is currently defined. In order to achieve this, the following objectives are formulated.

- i. To examine the effect of uncertainty about future prices on the performance of SMEs in Katsina State
- ii. To determine whether exchange rate fluctuations has significant effect on the performance of SMEs in Katsina State.

Literature Review

This section is divided into three parts: Theoretical framework as well as conceptual and empirical studies.

2.1 Concept of Small and Medium Scale Enterprises (SMEs)

Nigerian SMEs are believed to contribute to economic improvement and national growth (Ariyo, 2017; Onugu, 2019). Akinlabi, Asikhia, and Muraina (2021) assert that Nigerian SMEs are recognized as the strong foundation of the nation's economy and act as more than just a driving force behind economic growth and development. According to Tamara and Riste (2015), SMEs are one of the main forces behind Nigeria's economic growth. SMEs are recognized as the main contributors to strong economies, the development of value-added goods and services, increased employment rates, and higher living standards (Akinlabi et al. 2021). Nigeria's economy is primarily driven by small and medium-sized businesses (SMEs). Approximately 90% of companies in the industrial sector were SMEs a few years ago (Oluwadare & Oni 2016). The structure of the Nigerian economy, which has produced many innovative products and technological advancements, makes it appropriate to view the importance of SMEs in relation to the country's long-term economic growth (Ibrahim et al. in 2023).

The term "small and medium enterprises" refers to a very broad category of business entities, including small machine shops, restaurants, hotels, manufacturing industries, and computer software companies. It has long been understood that SMEs' survival is essential to the expansion of any economy worldwide (Oba and Onuoha, 2019). According to Aremu (2017), medium enterprises are companies with 101–300 employees or a total cost of more than N50 million but less than N200 million, including working capital but excluding land costs. According to Ogechukwu (2021), in Nigeria, a small and medium enterprises business is one that has less than ten employees and an asset investment of no more than 600,000.

2.2 Empirical Review

In order to identify existing findings and research gaps, this section provides a review of relevant and related studies both local and globally that explain the nexus between inflation and growth of SMEs. Among the prominent, distinguished, and influential scholars in the field, Scemeleva and Nagornova (2023) conducted a study on the Nexus between inflation and firms' financial sustainability in Central and Eastern Europe (CEE) regions, covering the period of 16 years, spanning from 2005 to 2021. The

study gathered a comprehensive set of financial data from companies in Central and Eastern European (CEE), creating one of the most extensive datasets available. This data was then utilized to evaluate the firm's financial performance with a focus on various measures of performance and types of inflation. The assessment was conducted using the ORBIS database. The analysis showed that inflation had a strong and positive impact on both the profitability and liquidity of firms. The study also discovered that the main driver of this effect was demand-driven inflation, aligning with theoretical expectations. In contrast, cost-push inflation was found to have a negligible and negative impact on firms' profitability.

Belanová (2023) investigated the effect of inflation on the overall operation and life of the business. The research involved running a simulation to model potential future developments under two different scenarios. These scenarios focused on two types of shocks: cost growth and demand decline. The results indicated that an abrupt and uneven increase in prices could adversely impact specific businesses and lead to disruptions in the overall structure of the business sector.

Michael and Mbam (2017) investigated the effect of inflation on Nigeria's economic spanning from 1980 to 2015. The data was analysed using a robust statistical tool such as "cointegration approach, vector error correction model (VECM) and Granger causality test". The study incorporates several key variables "real gross domestic product (RGDP), inflation rate (INFR), government investment expenditure (GINVXP), private investment expenditure (PINVXP), and total export (TEXP)".

The VECM results confirmed that inflation exert a negative and statistically insignificant impact. Whereas, the analysis of GINVXP and TEXP indicated a significant but negative effect on RGDP. It was also observed that PINVXP has a significant and statistically positive influence on RGDP. Whereas, the Granger results failed to establish any causal relationship between the variables. As a consequence, the study suggests that stakeholders should prioritize economic policies aimed at enhancing economic sustainability, which can subsequently help in mitigating high inflation in the economy.

The reviewed studies collectively investigate the relationship between security challenges and academic performance of students at different levels across different regions of Nigeria, employing diverse methodologies and focusing on different causes and effect of inflation. In contrast, the current study intends to investigate the effect of inflation on the stability and productivity of SMEs in Nigeria, specifically narrowing down the focus to Katsina state using the two dimensions of inflation such as uncertainty about future price and exchange rate as defined in this study.

2.3 Theoretical Framework

Theories of inflation provide a background for understanding the underlying effect of inflation on SMEs performance. To explain how inflation damage the economy, several prominent theories have been developed including "Keynesian theory of inflation and contingency theory".

The effect of inflation on the expansion, advancement, and sustainability of SMEs in Nigeria is most effectively explained by the Keynesian theory, out of all the theories of inflation that have been discussed. Demand pull inflation is believed to be the cause of an increase in aggregate demand. In the same line of argument, John Maynard Keynes (1883–1946) identified demand-pull inflation as occurring when the total demand surpasses the total supply in the economy. This increases the prices as the demand outstrips the available supply of the products.

The aggregate demand in this case is included but not limited to the government spending, investment, and consumption. Totonchi (2011) claims that, policy that reduces each component of total demand is effective in lowering demand pressure and, inevitably inflation. This basically means that when government expenditure is cut, taxes are raised, and the amount of money is controlled, producers may engage in rent-seeking activities instead of working in the actual economic sectors that can address the problems of low productivity and unemployment. This could lead to increased inflationary pressures in Nigeria, where the economy is heavily dependent on foreign investment and can hardly produce enough output to meet demand (Jeremiah and Emmanuel, 2015).

Contingency Theory: This study is also based on the theory of contingency. Fiedler introduced this theory, known as contingency theory, in the 1960s. According to the contingency theory, there is no one best way for businesses to function. Situations will create different environmental requirements for managers and business owners. How a manager responds to the situation depends on the outside forces at play (Scott, 1981). In addition to the environment, Fiedler contends that situational factors also affect performance and must be addressed in order to improve it. Performance can be improved by either the environment fitting the situation or the situation fitting the environment. The dependent variable is SMEs performance, which is a function of inflation. For example, the theory focuses on inflation and it affects SMEs performance (Pennings, 1975).

Methodology

The study used a survey research design to collect data from the respondents. According to the Katsina State Bureau on Public Procurement (2023), 7,372 registered SMEs operating in the state make up the study population. This group of SMEs was chosen due to their registration with the relevant authorities. The sample size of 379 was determined by using Taro Yamene Formula and the purposive sampling technique was adopted in the course of selecting the targeted respondents (owners and/or managers) for the study.

The research utilized primary data collection via questionnaires to collect data from respondents. The study utilized both descriptive and inferential statistics to analyzed the data gathered including the multiple regression analysis. This is because, multiple regression is a statistical technique that can be used to establish the relationship between a dependent variable and multiple independent variables.

3.1. Validity and Reliability Test

Validity test is the degree to which a test accurately measures what it is intended to measure. Conversely, reliability is the degree to which a variable or group of variables consistently measures the things it is supposed to. Stated differently, reliability is the extent to which a research methodology yields consistent and stable outcomes. A reliability test was carried out to guarantee a scale that would yield consistent results and to ensure the quality of the questionnaire. Results of the test are shown in Table 1.

Table 1: Reliability Test Results of the Survey Instruments

S/N	Variables	Number of items	Cronbach Alpha
1	Uncertainty About Future Prices	6	0.812
2	Exchange Rate Fluctuations	6	0.726
3	SMEs Performance	4	0.709
Total Number of items		33	

The reliability results of the plot test in Table 1 demonstrate that the Cronbach's alpha values for uncertainty about future prices, exchange rate fluctuations and SMEs performance are all above 0.60. Therefore, the data indicates that all the variables are reliable

Data Presentation and Analysis

To gauge the effect of inflation on the performance of SMEs, a multiple regression model was preferred.

4.1 Demographic Profile of Respondents

This section presents the frequency distribution of participants based on their demographic characteristics.

Table 2: Demographic profile of the respondents: Frequency Distribution (369)

GENDER	Frequency	Percent
MALE	336	91
FEMALE	33	9
Total	369	100
AGE	Frequency	Percent
25-30	94	25
31-36	58	16
37-41	122	33
>41	95	26
Total	369	100

POSITION	Frequency	Percent
OWNER	195	53
MANAGER	174	47
Total	369	100
BUSINESSTYPE	Frequency	Percent
MICRO	109	30
SMALL	207	56
MEDIUM	53	14
Total	369	100
QUALIFICATION	Frequency	Percent
PRIMARY DEGREE	29	8
SECONDARY DEGREE	32	9
DOCTORATE DEGREE	126	34
OTHERS	182	49
Total	369	100
YEARS OF EXPERIENCE	Frequency	Percent
5-10	112	30
11-16	118	32
17-21	92	25
>21	47	13
Total	369	100

A detailed demographic breakdown of the respondents is given in Table 2, which includes information on their gender, age, position, business type, qualifications, and years of experience. Male respondents made up 91% of the sample as a whole, making up the vast majority of respondents. However, just 9% of the sample consisted of female respondents. This suggests that there is a notable gender gap, as men predominate among the respondents.

There is a more balanced representation of all age groups in the age distribution. People between the ages of 37 and 41 made up the largest age group, accounting for 33% of the respondents. Those over 41 made up the second-largest group, at 26%. While 25% were between the ages of 25 and 30. Respondents between the ages of 31 and 36 made up the smallest group, accounting for 16%.

Regarding positions, 53% of the respondents classified themselves as owners of their businesses, while 47% said they were managers. This implies a fairly equal distribution of managers and business owners in the sample, with owners making up a small majority.

In terms of business type, small businesses accounted for 56%. Micro enterprises made up 30%, while 14% were medium-sized businesses.

Regarding qualifications, a sizable percentage of respondents (49 percent) had "others" qualifications, whereas 34% received doctorates. The fact that only 8% of respondents had a primary degree and 9% had a secondary degree suggests that the respondents were highly educated, with many holding advanced degrees or other higher education.

Regarding qualifications, a significant portion of respondents (49%) held qualifications classified as "others," while 34% had doctorate degrees. The fact that only 8% of respondents had a primary degree and 9% had a secondary degree suggests that the respondents were highly educated, with many holding advanced degrees or other higher education.

In conclusion, the respondents' years of experience were split up among different groups; the largest group (32%) had between 11 and 16 years of experience. This was closely followed by those with 5 to 10 years of experience (30%). 25% of respondents had between 17 and 21 years of experience, and 13% had more than 21 years.

Table 3 ANOVA

To provide a substitute for the technical issue encountered:

Source	Sum of Squares	Degrees of Freedom (DF)	Mean Square	F-statistic	p-value
Regression	25753.2	2	12876.6	123.0	7.78e-42
Residual	39355.9	376	104.7		
Total	65109.1	378			

The ANOVA table 3 breaks down the total variability in SMEs growth into the portion explained by the model (regression) and the portion left unexplained (residual). The high F-statistic (123.0) and the low p-value (7.78e-42) suggest that the model provides a good fit for the data.

Table 4: Regression Result

Variable	Coefficient (coef)	Standard Error (std err)	t-value	p-value	Confidence Interval (95%)
Intercept (constant)	50.0648	0.862	58.068	0.000	[48.370, 51.760]
Uncertainty about future prices	-2.4612	0.203	-12.127	0.000	[-2.860, -2.062]
Exchange rate fluctuations	-1.7737	0.192	-9.232	0.000	[-2.151, -1.396]

The regression results in Table 4 provides insights into how different independent variables impact the Dependent Variable (DV). The Intercept (constant) value is 50.0648, indicating that when all other variables are zero, the predicted value of the DV will be 50.0648. The high t-value (58.068) and a p-value of 0.000 suggest that this coefficient is statistically significant. The narrow 95% confidence interval [48.370, 51.760] suggests a high degree of precision in the estimate of the intercept.

The variable uncertainty about future prices has a coefficient of -2.4612, indicating a negative relationship with the DV. For each unit increase in uncertainty, the DV decreases by approximately 2.46 units. With a t-value of -12.127 and a p-value of 0.000, this result is highly significant. Similarly, Exchange rate fluctuations show a negative coefficient of -1.7737, meaning that as exchange rate fluctuations increase, the dependent variable decreases by 1.77 units. Both variables have confidence intervals that do not include zero, reinforcing their statistical significance.

The regression coefficients indicate the relationship between the independent variables (uncertainty about future prices and exchange rate fluctuations) and the dependent variable (Performance of SMEs). Both coefficients are negative, suggesting that as uncertainty about future prices and exchange rate fluctuations increase, SMEs performance decreases. The p-values for both variables are significant (less than 0.05), indicating a statistically significant relationship.

Table 5: Model Summary

Metric	Value
R-squared	0.396
Adjusted R-squared	0.392

Metric	Value
F-statistic	123.0
Prob (F-statistic)	7.78e-42
AIC	2371
BIC	2383

The table 5 summarizes the overall model performance. The R-squared value of 0.396 indicates that approximately 39.6% of the variation in SME growth is explained by the model. The Adjusted R-squared accounts for the number of predictors in the model. The F-statistic and its associated p-value (7.78e-42) confirm that the suitability of the model.

Discussion of Results

The relationship between the independent variables (exchange rate fluctuations and future price uncertainty) and the dependent variable (SMEs' performance) is shown by the regression coefficients. The fact that both coefficients are negative indicates that the performance of SMEs declines as future price and exchange rate uncertainty rises. There is a statistically significant relationship between the two variables, as indicated by the significant p-values (less than 0.05).

Conclusion and Recommendations

Based on the findings, the study it is concluded that SMEs' performance is adversely affected by all the variables, including exchange rate fluctuations and future price uncertainty

In view of the conclusion, the following recommendations are offered:

Strategies be implemented to reduce this uncertainty. One approach could be to enhance market transparency by providing clearer and more accurate information about future pricing trends. This could involve improving forecasting models, disseminating more timely market data, or implementing regulatory measures that ensure price stability. By reducing uncertainty, market participants can make more informed decisions, which could lead to better outcomes reflected in the dependent variable.

For Exchange rate fluctuations, the negative relationship suggests the need for strategies to manage or mitigate the risks associated with currency volatility. Furthermore, businesses might consider diversifying their currency exposure to spread risk. Governments and policymakers could also play a role by implementing policies that promote exchange rate stability, such as intervening in the currency markets when necessary or adopting monetary policies that reduce exchange rate volatility. By

addressing these factors, the negative impact on the dependent variable could be mitigated, leading to more stable and predictable outcomes.

5.1. Policy Implications

The findings provide the need to suggest that Governments and policymakers should play a role by implementing policies that promote exchange rate stability, such as intervening in the currency markets when necessary or adopting monetary policies as this will reduce exchange rate of price instability. By addressing these factors, the negative impact on the dependent variable could be drastically reduced, leading to more stable and predictable outcomes. Additionally, it is imperative for the SMEs to consider diversifying their currency exposure to spread risk. Moreover, techniques should be used to lessen this uncertainty of future prices. Improving market transparency by offering more precise and understandable information about upcoming pricing trends could be one strategy. This could entail putting in place regulatory measures that guarantee price stability, enhancing forecasting models, or sharing more up-to-date market data. Market participants may make better decisions and see improved results in the dependent variable if uncertainty is reduced.

5.2 Suggestions for Further Studies

The present study focuses on the effect of inflation on the performance of SMEs in Katsina State with respect to uncertainty about future price and exchange rate fluctuations. The study was restricted to Katsina State. However, the results obtained may differ if other neighboring states had been included in the study. Therefore, future researches should consider other states particularly North-West zone of the country.

The current study used variables like uncertainty about future price and exchange rate fluctuations. The future studies should prioritize other variables such as high interest rate and stock market failures to expand the framework. Future study may consider a comparative study between Nigeria and other developing countries that are affected by inflation. The comparative study may allow the two or more countries to have more insight on the effect of inflation on the performance of SMEs in their individual countries and to assess their areas of strengths and weaknesses.

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