

Effect of Economic Business Environment on the Performance of Small and Medium Enterprises (Smes) in Katsina State, Nigeria

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ABSTRACT

This study examines the effect of economic business environment on performance of small and medium enterprises in Katsina state. The study investigates the effect of exchange rate and unemployment rate on the profitability performance of small and medium enterprises SMEs. Primary data collected from 500 SMEs owners and managers; the study employs Partial Least Squares Structural Equation Modeling PLS-SEM to examine the relationships between these economic variables and SME performance. The measurement model demonstrates acceptable reliability and validity across all constructs with Cronbach's Alpha values. The structural model results reveal that both exchange rate and unemployment rate have statistically significant negative effects on SMEs profitability performance. The model explains the variance in SMEs performance with both predictors demonstrating small but meaningful effect sizes. These findings underscore the critical importance of macroeconomic stability for SMEs survival and growth in Nigeria's business environment. Based on the study findings, it was concluded that economic business environment negatively affects performance of small and medium enterprises in katsina state. the study further recommends among others that government and other monetary regulatory authorities should device means to improve the exchange rate power of Naira through import dependence reduction, export promotion incentives, exchange rate stabilization policies and foreign currency planning. Government at all level should also introduce policies aimed at facilitating favorable economic conditions directed towards reducing unemployment rate. This can be achieved through labour market stimulation policies, skills development initiatives, SMEs hiring incentives and local demand stimulation.

Keywords: Economic Business Environment; Exchange Rate; Unemployment Rate; Profitability; SMEs Performance.

1. INTRODUCTION

1.1 Background to the Study

Small and medium businesses (SMEs) are important to the economic development of many countries. They serve as main engines of community prosperity by generating employment and providing chances for financial progression to locals. SMEs refer to prevalent forms of businesses required for the development of economy in both developed and developing nations, according to Qureshi et al. (2022). Globally, the majority of businesses are small and medium enterprises (SMEs), which are essential for promoting social mobility and generating seven out of ten employment opportunities (World Bank, 2022). In Katsina State, SMEs dominate trading, agro-processing, manufacturing, and services, serving as key sources of livelihood. However, persistent macroeconomic instability continues to constrain their performance and profitability. The performance of SMEs, particularly in terms of profitability, remains a major concern in this study. Profitability is a key indicator of SME performance which is the ability of organization to maintain itself over time, carry out activities strategically to produce financial result, reach target level of market share and profitability (Adam & Alarifi, 2021; Gerald, Obianuju & Chukwunonso, 2020). Therefore, the study performance metric is Profitability since it shows if a business is making enough money to pay its expenses, make growth investments, and stay competitive.

Economic business environment can be defined as the aspects that affect how products and services are produced, consumed and distributed within community or economy (Yakubu et al. 2023). Economic factors that might affect the actions, decisions, results of organizations, companies and individuals are referred to as economic business environment. These factors include unemployment rates, exchange rates, inflation, interest rates and rates of economic improvement. They also include things like market trends, investment levels, and consumer spending. This study therefore examines how economic business environment affect the performance of small and medium sized businesses (SMEs) in Katsina State.

1.2 Statement of the Problem

Many economies around the world have benefited greatly from the growth, development, and industrialization of small and medium enterprises (Fitriasari, 2020). Since Nigeria attained independence, these businesses have played a significant role in promoting economic development (Adewale and Umoru, 2021). However, a number of obstacles, such as their own attitudes and practices, environmental factors, governmental instability, and frequent policy changes, have caused Nigerian SMEs to underperform (Aderibigbe, 2017). Despite the effort to create an enabling economic environment through friendly economic policies, SMEs in Nigeria are still struggling to survive, hence the researcher wants to find out why it is so.

Previous studies by Yakubu et al (2023); Ammar Yaser et al. (2021); Nnenna et al. (2020); Kwarbai et al. (2020); Mohammed & Suleiman, (2022); Nkwini & Akinola, (2023) investigated

the impact of economic factors on Small and Medium Enterprise (SME) performance has produced varied outcomes. These studies, conducted across different populations, geographical areas, and time periods, may have limited applicability to the current Nigerian SMEs landscape due to region-specific economic conditions. To address this gap, the present study will focus on Katsina State.

Again, previous studies have examined the connection between economic factors and SME performance. For instance, Henry, Osahon, and Osazevbaru (2021) investigated the effects of exchange rate on the performance of Nigeria's informal sector; however, they did not take unemployment rate into account. Bekeris (2012) investigate effects of unemployment on profitability of SMEs solely. This study seeks to bridge this gap by analyzing how exchange rates and unemployment rate affect SME performance in Katsina State.

Therefore, this study aims to add to the body of existing knowledge by empirically examining the effect of these economic environmental factors on SME performance in Katsina State, specifically using exchange rate and unemployment as defined in this study.

1.3 Research Questions

This study will be guided by the following research questions:

- i. To what extent does exchange rate affect the performance of SMEs in Katsina State?
- ii. To what extent does unemployment rate affect the performance of SMEs in Katsina State?

1.4 Objectives of the Study

The main objective of the study is to investigate the effect of economic business environment on performance of SMEs in Katsina State, Nigeria. Specific objectives of the study are to:

- i. Examine the effect of exchange rate on the performance of SMEs in Katsina State.
- ii. Evaluate the effect of unemployment rate on the performance of SMEs in Katsina State.

1.5 Research Hypotheses

The following research hypotheses are

- i. **H0₁:** Exchange rate has no significant effect on the performance of SMEs in Katsina State.
- ii. **H0₂:** Unemployment rate has no significant effect on the performance of SMEs in Katsina State

2. LITERATURE REVIEW

2.1 Conceptual Review

Economic business environment issues comprise inflation, interest rates, currency rates, and economic growth. These elements have an impact on how companies function and make choices. For example, interest rates affect an economy's supply and price of imported commodities in addition to the expenses of exporting goods (Obiwuru et al, 2011). Laws, regulations, wages, interest rates, tax rates, and government acts are a few examples of economic factors that have an impact on the economy (Hans, 2018). These elements affect the value of future investments even though they have nothing to do with business. According to Egger and Merlo (2019), economic business environment include macroeconomic metrics like GDP, inflation, and interest rates as well as outside environmental factors that influence how the economy functions and how well businesses operate. This definition emphasizes how crucial macroeconomic indicators are in determining economic outcomes. In this study, business economic environment is referred as the external environmental factors that affect the functioning of the economy and the performance of firms, including macroeconomic indicators such as exchange rate and unemployment rates.

Exchange rate, also referred to as the international exchange rate, illustrates the relative value of one currency to another. It shows the speed at which one currency can be converted into another. The amount of inflation in a country is one of the factors that might affect exchange rates. Adam (2021) defines an exchange rate as the value of one nation's currency relative to the currency of another nation or economic zone. The study defines exchange rate as the rate at which one currency can be exchanged for another between nations or economic zones.

The unemployment rate is defined by classical economics as the excess supply of labor over the demand for labor, which results from changes in real wages. By dividing the total number of jobless people by the total number of people in the labor force, one can determine the prevalence of unemployment. The number of persons in an economy who are unemployed can be thought of as a percentage of the labor supply (Jhingan, 2003), which will eventually have an impact on the banks' financial performance. A higher unemployment rate is a sign of people's diminished purchasing power, which reduces economic activity and lowers financial performance (Horobet, Radulescu, Belascu, & Dita, 2021). In this study, unemployment rate is the perception of how unemployed individuals affect the aggregate demand of SMEs goods or services.

SMEs Performance is a metric of their success in attaining their objectives. It is defined as an organisation's ability to generate activity and valuable outcomes (Adam et al., 2020). Scholars hold varying perspectives on SME performance measurement. Ghazali (2021) elaborated that SMEs must establish benchmarks and evaluate their strategies, values, and practices against high-performing entities to measure performance. Fu et al. (2021) maintained that performance measurement assesses how well SMEs are functioning. In this study, profitability is the ability to

generate more revenue than expenses, indicating how efficiently a company uses its resources to make money.

2.2 Empirical Review

2.2.1 Exchange Rate and SMEs Performance

Odey and Agunobi (2023) examine how exchange rates affect performance of manufacturing sector in Nigeria, comparing it to other African countries and Asian economies like China and Japan. Using secondary data from CBN Statistical Bulletin 2021, the analysis takes ex post facto technique. The study employs manufacturing sector output (GDPmfg) as the dependent variable and exchange rate, inflation, and real interest rate as independent variables. It covers 41 data from 1981 to 2021. According to linear regression analysis, the GDP of the manufacturing sector is barely affected by the exchange rate, suggesting that output is not much impacted. However, the study concentrate on manufacturing sector alone and neglect other sectors therefore, this research aims to fill this gap by studying a larger sample that cut across different sectors.

Oguche (2024) examines on how exchange rate affects the performance of SMEs in Kogi State Nigeria. The research employed a descriptive methodology mostly used questionnaires to gather data. A 78% response rate was obtained from the distribution of 384 questionnaires to an infinite population, 298 of which were filled out and returned. The study used simple linear regression to test three hypotheses and descriptive statistics, notably mean and standard deviation. The results showed a strong correlation between Kogi state's SME sales and currency rates. However, the study sample size is too short and grossly inadequate to have a fair finding. The research will address this gap by studying a larger sample.

2.2.2 Unemployment Rate and SMEs Performance

Bekeris (2012) examines how Lithuanian SMEs' profitability is affected by unemployment. The purpose of the study was to assess how macroeconomic factors affect the profitability of SMEs. The model with the macroeconomic elements influencing a SME's profitability was presented in the paper. These components include the number of people and businesses in a nation, exports and imports, foreign direct investment, GDP, unemployment, inflation, taxes paid, average salary, and a variety of other macroeconomic indicators. Additionally, the study examines the dynamics of corporate profitability in Lithuania and demonstrates the relationship between macro factors and corporate profitability. According to the study's findings, profitability is most affected by unemployment. However, the study lacks information on the method of data collection from participants. Consequently, this research will employ primary data collection techniques.

Mokuolu and Oluwaleye (2023) examine how Nigerian unemployment might be decreased by small and medium-sized enterprises (SMEs). The investigation was conducted using secondary time series data. Descriptive statistics correlation analysis, ARDL co-integration, the

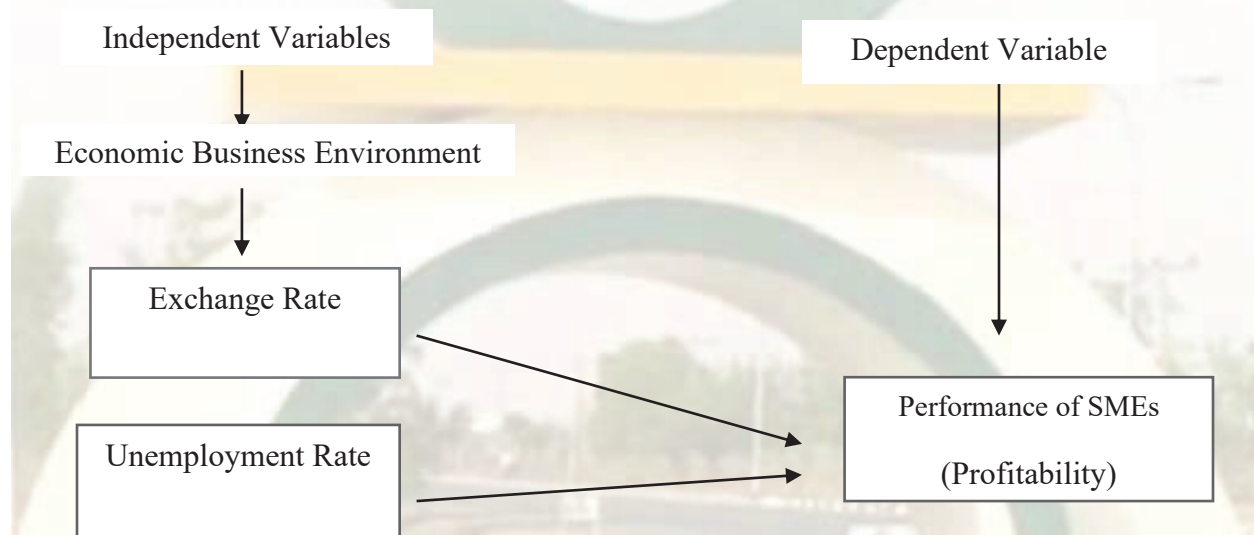
parsimonious error correction model, and additional post-estimation tests were among the estimation techniques employed in the study's analysis. The study's findings showed that SMEs' contributions to exports have a favorable but negligible effect on Nigeria's unemployment rate. The report recommends that the government should provide a favorable climate for SMEs, that DMBs provide loans to SMEs on fair conditions, and that the government provide incentives for SMEs. Nevertheless, the study utilizes secondary data and the findings may not be generalized therefore, the study will address the gap by utilizing primary source.

2.3 Theoretical review

2.3.1 Contingency Theory

Lawrence and Lorsch's seminal study of (1967) propounded that anything that is impossible to foresee or anticipate with precision is a contingency factor. Unexpected events or circumstances beyond our control are considered contingencies. This theory implies that SME performance is contingent on how well the enterprise adapts to its economic environment, when macroeconomic conditions deteriorate such as exchange rate depreciation, high unemployment SMEs with limited resources and flexibility face greater challenges in adapting and result in profitability decrease. The theoretical perspective supports the hypothesis that economic business environment, exchange rate and unemployment negatively affect SME performance, especially SMEs in developing economies with limited access to hedging instruments and financial resources.

Figure: Conceptual framework



Source:Current survey (2026)

The conceptual model displays the relationship between the independent and dependent variables. The figure shows specifically the relationship between exchange rate and

unemployment on performance of small and medium enterprises specifically profitability of SMEs in Katsina State.

3. METHODOLOGY

This study employs a research design using cross sectional survey data. The study focuses on SMEs in Katsina State with data collected from SME owners and managers. The targeted population comprises all registered SMEs operating in Katsina State. According to the Small & Medium Enterprises Development Agency of Nigeria (SMEDAN 2025) Katsina state there are 44,102 registered SMEs operating in Katsina State making up the study's population. In selecting business owners and managers who have full knowledge about their business operations and economic condition affecting them a purposive sampling approach was employed with SMEs selected from various sectors including retail, manufacturing, agriculture, and services. The study used primary data through the use of structured questionnaire with items measured on 5-point Likert scale ranging from 1 = Strongly Disagree, 5 = Strongly Agree. The questionnaire captured exchange rate, unemployment rate and SMEs performance. The total number of questionnaires distributed was 515 but 500 were valid and returned which make the totality of 500 SMEs owners and managers who completed the survey questionnaire. The method suggested by Taro Yamane was used to choose the study's sample. Taro Yamanen's 1967 formula used to determine the sample size 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 N is the population, e is the degree of freedom (e=0.05), and n is the sample size. Consequently, the projected risk level is 95 percent confidence level, which indicates that the genuine population means value is present in 95 out of 100 samples. This is used to determine the sample size, which is done as follows:

$$\begin{aligned} n &= \frac{44,102}{1 + 44,102 (0.05)^2} \\ &= \frac{44,102}{1 + 44,102 (0.0025)} \end{aligned}$$

$$n = \frac{44,102}{111.26} = 396.39$$

n= 396.39 Approximately 396 SMEs

Therefore, the study's sample was 396 registered SMEs. Three hundred and ninety six (396) was the minimum sample size required for this study. Israel (2013) suggested increasing the minimum sample size by 10% to 30%. The minimum sample size will therefore be increased by 30%. A total of 515 copies of the questionnaire were distributed among the SMEs owners and managers respondents after adding 119 respondents, or 30% of the sample size.

Partial Least Squares Structural Equation Modeling (PLS-SEM) was utilized in this study to analyze the data. PLS-SEM is appropriate in this study for a number of reasons, provides measurement model assessment for both reliability and validity as well as structural model testing path coefficients and model fit. It can also handle small and medium sample size effectively. Reliability measure is evaluated through Cronbach's Alpha threshold: > 0.70 and Composite Reliability threshold: > 0.70 while measure Validity is evaluated through Average Variance Extracted AVE, threshold: > 0.50 for convergent validity and through construct correlations and HTMT ratios for discriminant validity. Structural Model Testing comprised estimating path coefficients and assessing model fit, Path coefficients represent the standardized relationships between constructs. Statistical significance is determined through bootstrap resampling of 5,000 resamples to generate confidence intervals and t-statistics. Model fit is assessed through R^2 coefficient of determination and Q^2 predictive relevance.

4. RESULTS AND DISCUSSION

The results of data carried out to ascertain how the economic business environment affects the performance of small and medium businesses in Katsina state are presented in this section. Descriptive and correlational analysis, diagnostic and post-estimation tests, regression analyses, findings discussion, and hypothesis testing are all included.

Table 1: Descriptive Statistics of Constructs

Construct	Mean	StdDev	Min	Max	N
Exchange Rate	2.162	0.643	1.000	4.000	500
Unemployment	2.872	0.886	1.000	5.000	500
Performance	3.093	0.623	1.000	5.000	500

Descriptive statistics for the three constructs are shown in Table 1. With a mean of 2.16 SD = 0.64, the exchange rate is thought to have a moderate impact on business performance. The unemployment rate indicates a bigger perceived impact of unemployment on business operations, with a higher mean of 2.87 SD = 0.89. The performance of SMEs indicates moderate levels of profitability with a mean of 3.09 SD = 0.62.

Table 2: Reliability Assessment (Cronbach's Alpha and Composite Reliability)

Construct	Cronbach's Alpha	Composite Reliability	Assessment
Exchange Rate	0.851	0.894	Acceptable
Unemployment	0.918	0.939	Excellent
Performance	0.854	0.892	Acceptable

Table 2 displays Cronbach's Alpha and Composite Reliability (CR) values. The Cronbach's Alpha scores for each construct range from 0.851 to 0.918, all of which are over the 0.70 criterion, indicating acceptable internal consistency dependability. The composite reliability values, which range from 0.894 to 0.939 and are all greater than the 0.70 criterion, show that the measuring items accurately assess the corresponding constructs.

Table 3: Convergent Validity Assessment (Average Variance Extracted)

Construct	AVE	$\sqrt{\text{AVE}}$	Assessment
Exchange Rate	0.627	0.792	Acceptable
Unemployment	0.753	0.868	Excellent
Performance	0.579	0.761	Acceptable

Values from Average Variance Extracted (AVE) are shown in Table 3. All constructs have AVE values between 0.627 and 0.753, exceeding the 0.50 threshold for convergent validity. This demonstrates that each construct, on average, accounts for over half of the variation in its assessment items, hence validating convergent validity.

Table 4: Construct Correlations (Discriminant Validity Assessment)

	Exchange Rate	Unemployment	Performance
Exchange Rate	1.000	0.011	-0.308
Unemployment	0.011	1.000	-0.292
Performance	-0.308	-0.292	1.000

Table 4 uses concept correlations to evaluate discriminant validity. Discriminant validity is confirmed by the correlations between constructs being significantly smaller than the square roots of AVE values. The exchange rate and unemployment assess different conceptions, as seen by their nearly zero connection ($r = 0.011$). In line with theoretical predictions, it displays both somewhat negative correlations with Performance ($r = -0.308$ and $r = -0.292$, respectively).

Table 5: Outer Loadings (Item to Construct Correlations)

Construct	Item	Outer Loading	Assessment
Exchange Rate	EXC1	0.764	Strong
	EXC2	0.794	Strong
	EXC3	0.776	Strong
	EXC4	0.820	Strong
	EXC5	0.805	Strong
Unemployment	UNM1	0.866	Strong
	UNM2	0.871	Strong
	UNM3	0.875	Strong
	UNM4	0.881	Strong
	UNM5	0.846	Strong

Performance	PER1	0.760	Strong
	PER2	0.768	Strong
	PER3	0.764	Strong
	PER4	0.751	Strong
	PER5	0.759	Strong
	PER6	0.763	Strong

The outer loadings item used to create correlations for every measurement item is shown in Table 5. Every item has a loading over the 0.70 cutoff, suggesting that it is a reliable indication of its corresponding construct. The range of exchange rate items is 0.764 to 0.820; the range of unemployment items is 0.846 to 0.881; and the range of performance elements is 0.751 to 0.768.

4.2 Structural Model Results

Table 6: Path Coefficients and Hypothesis Testing Results (*) $p < 0.001$**

Hypothesis	Path	Coefficient	SE	t-stat	p-value	95% CI	Decision
H1	EXC → PERF	-0.305	0.041	-7.50	<0.001	[-0.386, -0.224]	Supported ***
H2	UNM → PERF	-0.288	0.041	-7.09	<0.001	[-0.369, -0.207]	Supported ***

The t-statistics, p-values, path coefficients, and standard errors for the two proposed correlations are shown in Table 6. The evidence supports both hypotheses.

H1 Exchange Rate to Performance: The path coefficient is $\beta = -0.305$ SE = 0.041, and the p-value is less than 0.001 and the t-statistic is -7.50. Higher exchange rates and naira depreciation are linked to decrease SMEs' profitability, according to this negative coefficient. There is strong evidence for H1 because the link is very statistically significant ($p < 0.001$).

H2 Unemployment to Performance: The t-statistic is -7.09, the path coefficient is $\beta = -0.288$ SE = 0.041, and the p-value is less than 0.001. According to this negative coefficient, SMEs' profitability is negatively correlated with increasing unemployment rates. There is strong evidence for H2 because the link is very statistically significant ($p < 0.001$).

Table 7: Model Fit and Predictive Relevance Indices

Model Index	Fit Value	Interpretation	Model Index	Fit Value	Interpretation
R ²	0.178	17.81% of variance explained	R ²	0.178	17.81% of variance explained
Adjusted R ²	0.175	Adjusted for predictors and sample size	Adjusted R ²	0.175	Adjusted for predictors and sample size

The structural model accounts for 17.81% of the variation in SME performance, or $R^2 = 0.178$. This shows that unemployment and exchange rates together explain around 18% of the variation in SMEs' profitability, with the remaining 82% coming from unaccounted-for factors including business size, market conditions, and management caliber.

Indicating that the model is not overfitting the data, the adjusted $R^2 = 0.175$, which takes into consideration the number of predictors and sample size, is extremely near to the unadjusted R^2 . A positive and significant predictive relevance $Q^2 = 0.171$ suggests that the model has sufficient predictive relevance. A Q^2 value around R^2 indicates that the model does a good job of generalizing to new data that was not used for model estimate.

Table 8: Effect Sizes (Cohen's f^2)

Predictor	f^2	Effect Size Classification
Exchange Rate	0.113	Small
Unemployment	0.101	Small

Cohen's f^2 effect sizes are shown for each predictor in Table 8. The little effect of unemployment is $f^2 = 0.101$, while the tiny effect of the exchange rate is $f^2 = 0.113$. Despite being categorized as tiny by Cohen's standards (0.02 = small, 0.15 = medium, 0.40 = big), these effect sizes have significance when considering the performance of SMEs, where a variety of factors impact profitability.

4.3 Discussion of Findings

Economic business factors have a significant impact on the profitability of SMEs in Katsina State, as confirmed by the results, which provide strong empirical support for both hypotheses. The negative path coefficients for both unemployment ($\beta = -0.288$) and exchange rate ($\beta = -0.305$) are consistent with existing empirical literature and theoretical expectations.

The fact that the exchange rate had a strong impact than unemployment indicates that exchange rate volatility might be a bigger problem for SMEs in Katsina State than unemployment. This result is in line with Nigeria's economic situation, where a large number of SMEs rely on imported technology, equipment, and raw materials, rendering them susceptible to changes in exchange rates. This study offers quantitative proof of the detrimental effects of the naira's depreciation against major foreign currencies, especially the US dollar, on the profitability of SMEs, which has been a recurring problem for Nigerian companies.

Even though it is marginally less than the exchange rate, the impact of unemployment on SMEs' performance is nevertheless enormous and highly significant. The results show that high unemployment actually lowers aggregate demand for goods and services, which has a direct impact on SMEs' earnings. Profitability is directly impacted by demand reduction brought on by

unemployment in Katsina State, where a large number of SMEs cater to small markets with a restricted geographic reach.

The findings are consistent with contingency theory, which holds that the alignment of organizational traits with external circumstances determines how well an organization performs. SMEs with limited resources and flexibility may find it difficult to adjust to a challenging macroeconomic climate, as indicated by the negative correlations found between macroeconomic parameters and SME performance. This theoretical realization has significant ramifications for comprehending SMEs in emerging nations.

The findings support the previous research on economic business environment by offering empirical evidence that external macroeconomic factors are major predictors of SMEs profitability, which adds to the larger body of literature on SMEs' performance determinants. The findings emphasize the vital significance of macroeconomic surveillance and strategic planning in reaction to trends in the unemployment rate and exchange rate. Managers of SMEs should think about diversifying their revenue streams, keeping sufficient cash reserves to withstand economic downturns, and, when practical, putting exchange rate risk hedging measures into practice. Supervisors must to keep an eye on labor market conditions and modify their hiring and pay policies accordingly. To promote the success of SMEs, macroeconomic stabilization policies are necessary, as the findings further empirically demonstrate. In particular, by implementing suitable monetary and fiscal policies, authorities should give exchange rate stability top priority. This study finding is in line with the findings of Odey and Agunobi (2023) Ayobami (2019); which support the effect of exchange rate on SMEs performance. Similarly Bekeris (2012); Dewi et al. (2019); Mohd and Siddiqui (2020) studies support the findings of this study.

5. CONCLUSION AND RECOMMENDATIONS

The study was conducted to examine the effect of economic business environment on performance of small and medium scale enterprises in Katsina State. Based on the study findings and test of hypotheses, it was concluded that economic business environment negatively affects performance of small and medium enterprises in Katsina state. This implies that an increase in exchange rate and unemployment rate will lead to lower performance. This is possible, because increase in exchange rate results in price increase which negatively affects the cost of input materials for SMEs. Based on its conclusion, the study recommends among others that government and other monetary regulatory authorities should device means to improve the exchange rate power of Naira. This can be achieved through import dependence reduction, export promotion incentives, exchange rate stabilization policies and foreign currency planning. Government at all level should introduce initiatives aimed at facilitating favorable economic conditions directed towards reducing unemployment rate. This can be achieved through labour market stimulation policies, skills development initiatives, SMEs hiring incentives and local demand stimulation. Although the study considers only two macroeconomic variables the

exchange rate and the unemployment rate, ignoring other significant variables further researchers can consider other economic variables like inflation, interest rates, and political stability.

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