

External Business Environment and the Growth of Small and Medium Enterprises (SMEs) in Abuja, Nigeria

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ABSTRACT

The study investigated the effect of the external business environment on the growth of small and medium enterprises (SMEs) in Abuja, Nigeria. The target population consisted of 613,492 registered SMEs in Abuja (SMEDAN, 2020). A survey research design was employed, with structured questionnaires distributed to 399 SMEs selected from three Area Councils: Abaji, AMAC, and Gwagwalada. Simple random sampling was used to ensure a representative sample of SMEs in the agricultural and manufacturing sectors. The sample size was calculated using Slovin's formula (1960), and data analysis was conducted using multiple linear regression. A total of 370 completed questionnaires were retrieved. The findings revealed that the external economic environment had a significant positive effect on SME growth, with a t-statistic of 25.450 ($p=0.000$), indicating a positive relationship. Similarly, the legal environment, with a t-statistic of 11.104 ($p=0.000$), was found to have a significant positive effect on SME growth. Both the economic and legal factors were found to significantly influence SME performance in Abuja. Based on these findings, it was recommended that policymakers focus on stabilizing the economic environment through measures such as inflation control and reducing borrowing costs, while also streamlining legal processes to reduce administrative burdens on SMEs. This will enhance the growth and sustainability of SMEs in the region.

Keywords: Business environment, External economic environment, legal environment, SME growth, small and medium enterprises, Abuja.

INTRODUCTION

The external business environment encompasses a variety of factors and forces that exist outside an organization but significantly impact its operations, decision-making, and overall performance. It includes macro-environmental elements such as political, economic, social, technological, environmental, and legal factors often collectively known as the PESTEL framework. Understanding these external influences is crucial as they shape market dynamics, competitive strategies, and the long-term sustainability of businesses across industries (Johnson et al., 2017). The external business environment encompasses various factors that influence the performance of small and medium enterprises (SMEs), including economic, political, social, and technological aspects (Afolabi, 2023). For SMEs in Abuja, navigating the external business environment is critical for long-term sustainability, as these businesses often face challenges such as economic instability, regulatory pressures, and market competition. These challenges greatly affect their capacity to sustain growth, allocate resources efficiently, and remain competitive in the market. Environmental factors, especially with the rise of sustainability concerns, compel

organizations to adopt eco-friendly practices to meet regulatory demands and public expectations (Dangelico & Pontrandolfo, 2015). Legal factors, including labor laws, trade restrictions, and intellectual property regulations, establish boundaries for business conduct and competitive practices (Dess et al., 2018).

Political factors, including government policies, regulatory frameworks, and political stability, can influence a company's operational conditions and compliance requirements (Hitt et al., 2020). Economic factors, such as inflation, interest rates, and economic cycles, affect consumer purchasing power and, consequently, demand for products and services (Grant, 2019). Social factors reflect demographic trends, cultural shifts, and consumer preferences, impacting market needs and expectations (Kotler & Keller, 2019). Technological advancements, meanwhile, can drive innovation, create new market opportunities, and challenge existing business models (Porter, 2019).

In the Nigerian context, SMEs play a crucial role in economic development, contributing approximately 48% to the Gross Domestic Product (GDP) and employing around 84% of the workforce (National Bureau of Statistics [NBS], 2023). However, despite their importance, many SMEs struggle to survive beyond their initial years due to external factors, including limited access to finance, high inflation rates, and inadequate infrastructure. For these businesses to succeed and contribute meaningfully to Nigeria's economy, they must develop resilience against external pressures.

The existing literature on the effect of the external business environment on SME growth in Nigeria highlights several important factors, including inflation, exchange rate fluctuations, economic growth, interest rates, regulatory compliance, and legal frameworks. Oladele and Yusuf (2023) found that inflation and exchange rate volatility significantly hinder SME growth, with increased costs limiting expansion and profitability. Adebayo and Okeke (2024) showed a positive correlation between economic growth and SME performance but highlighted the negative impact of high-interest rates on access to credit. Additionally, Adigun and Eze (2023) found that high regulatory compliance costs, especially related to tax policies, were a barrier to SME growth, while Balogun and Okafor (2024) identified the positive role of efficient business registration and contract enforcement in fostering SME success. Despite these findings, a gap exists in the literature regarding the combined influence of multiple external factors on SMEs, particularly in the context of Nigeria's legal and regulatory environment. While previous studies focus on isolated factors such as inflation or tax policies, there is limited research exploring how these factors interact within a broader legal and economic framework. This study seeks to fill this gap by examining the integrated effects of various external business environment factors economic, regulatory, and legal on the growth and sustainability of SMEs in Nigeria.

The study aims to address the following research questions:

To what extent does the external economic environment enhance the growth of SMEs in Abuja?

How do legal factors within the external environment influence the growth of SMEs in Abuja?

The broad objective of this study is to analyze how the external business environment affects the growth of SMEs in Abuja. The specific objectives are:

To examine the effect of the external economic environment on the growth of SMEs in Abuja.

To analyze the influence of legal factors on the growth of SMEs in Abuja.

The following hypotheses were formulated for the study:

Ho¹ The external economic environment has no significant effect on the growth of SMEs in Abuja.

Ho² Legal factors have no significant influence on the growth of SMEs in Abuja.

REVIEW OF RELATED LITERATURE

Concept of External Business Environment

The external business environment refers to all the external factors that impact an organization's operations but are beyond its control. According to Nyandemo and Mwangi (2024), these factors include economic trends, regulatory policies, competitive dynamics, and social and technological changes that shape business performance and strategy. Chikwe et al. (2023) note that for SMEs, understanding the external business environment is essential for adapting to changes and making informed decisions that foster growth and sustainability. According to Hill et al. (2022), the external environment of a business encompasses all external factors and forces that can impact an organization's success, including economic, technological, social, and political conditions. These elements collectively shape the opportunities and threats a business faces within its operational landscape. Daft and Marcic (2023) describe the external business environment as the range of uncontrollable variables outside a company's boundaries that can affect its strategy and performance. This environment includes the competitive landscape, regulatory policies, and market trends that influence how a business must adapt to remain viable and profitable. According to Pearce and Robinson (2021), the external environment consists of macro-environmental forces like demographic shifts, economic cycles, legal constraints, and technological advancements. These forces are beyond the firm's direct control yet play a crucial role in shaping strategic choices and competitive positioning.

Economic Environment

The economic environment significantly influences SME performance, as it encompasses macroeconomic variables such as inflation, exchange rates, and economic growth. Okeyo and Wanjiru (2023) define the economic environment as the economic conditions that businesses operate within, including access to finance, inflation rates, and currency stability. In Abuja, the high cost of borrowing and limited access to credit hinder SME growth, as these constraints reduce capital availability for investment and expansion (Eze & Ugwu, 2024). To mitigate the challenges posed by the economic environment, SMEs must adopt strategies such as cost control, revenue diversification, and financial resilience.

Legal Environment

The legal environment is a critical factor affecting SME performance, encompassing regulations, laws, and legal frameworks within which businesses operate. Olayemi and Kazeem (2023) define the legal

environment as the structured set of rules, including labor laws, tax policies, and contract enforcement, which governs business activities and influences decision-making. In Abuja, stringent regulatory requirements and bureaucratic hurdles present significant challenges for SMEs, as these legal constraints can increase operational costs and complicate compliance efforts (Aliyu & Sani, 2024). To navigate the complexities of the legal environment, SMEs must develop strategies such as investing in legal compliance training, leveraging technology for regulatory adherence, and engaging with legal advisory services.

Growth of Small Businesses in Abuja

Small and Medium Enterprises (SMEs) are critical to Nigeria's economic development, accounting for about 90% of businesses and significantly contributing to employment, GDP, and poverty reduction. However, SME growth in Nigeria faces several challenges, including limited access to finance, poor infrastructure, regulatory issues, and high operational costs. Growth of SMEs is measured by indicators such as market share, number of branches and other growth potential. Osarenkhoe (2022) suggests that growth metrics are essential for assessing the viability of SMEs within the competitive business landscape. However, limited access to finance, infrastructure deficiencies, and bureaucratic hurdles hinder SME performance in Nigeria. Enhancing SME growth requires addressing external environmental challenges to ensure these businesses thrive and contribute to economic development.

Theoretical Framework

This study is grounded in the Contingency Theory, which was introduced by Fiedler in 1964. The theory emphasizes that organizational effectiveness is contingent upon the alignment between an organization's internal structure and its external environment. In the context of small and medium-sized enterprises (SMEs), the theory suggests that for these businesses to thrive, they must adapt their internal strategies, structures, and processes to align with the specific demands and challenges posed by the external business environment. This alignment is particularly important when responding to external pressures, such as economic fluctuations, regulatory changes, and market conditions. By tailoring their operations to meet the needs of these external factors, SMEs can enhance their performance and long-term sustainability. The Contingency Theory is thus instrumental in understanding how SMEs navigate the complexities of external challenges and adjust their strategies to improve their competitiveness, resilience, and growth within dynamic market environments.

Empirical Review

Oladele and Yusuf (2023) examined the impact of inflation and exchange rate fluctuations on SME growth in Lagos, Nigeria. The study targeted 200 SMEs in the manufacturing sector, with a final sample size of 140 selected through purposive sampling. Using a survey research design, data were collected via structured questionnaires distributed to SME owners and managers. Analysis through multiple regression revealed a significant negative relationship between inflation rates and SME growth, highlighting that increased costs due to inflation hindered expansion and profitability. The study found an R-squared value of 0.68, indicating that inflation and exchange rate volatility explained a substantial proportion of the

variation in SME growth. The authors recommend policy interventions to stabilize inflation and exchange rates, suggesting that such measures would create a more favorable environment for SMEs.

Adebayo and Okeke (2024) investigated the effects of economic growth and interest rate policies on the performance of SMEs in Abuja, Nigeria. The study involved a sample size of 120 SMEs selected from an initial population of 180 using Cochran's formula. Adopting a quantitative research design, data were gathered through self-administered questionnaires. Findings from regression analysis revealed a positive correlation between economic growth and SME performance, with growth in the economy leading to increased consumer demand and revenue generation for SMEs. The study reported an R-squared value of 0.74, suggesting that economic growth significantly influenced SME success. Conversely, high interest rates negatively impacted SME expansion, reducing the ability to access affordable credit. The study recommends that policymakers focus on maintaining low-interest-rate policies and fostering economic growth to support SME sustainability.

Adigun and Eze (2023) examined the impact of regulatory compliance and tax policies on SME growth in Lagos, Nigeria. The study targeted a population of 250 SMEs in the retail sector, with a final sample size of 160 SMEs selected using random sampling. Through a survey research design, data were collected via structured questionnaires distributed to SME owners. Regression analysis revealed a significant negative relationship between high regulatory compliance costs and SME growth, with many respondents citing tax compliance as a barrier to expansion and profitability. The study reported an R-squared value of 0.65, indicating that regulatory compliance costs significantly affected SME growth. The authors recommend that regulatory authorities streamline tax policies to reduce the financial burden on SMEs, proposing that simplified tax procedures could encourage compliance and foster growth.

Balogun and Okafor (2024) investigated the influence of business registration and contract enforcement on the growth of SMEs in Abuja, Nigeria. The study focused on a sample of 130 SMEs in various service sectors, with the sample derived from an initial population of 180 using Cochran's formula. Using a cross-sectional survey design, data were gathered through questionnaires administered to SME owners and analyzed using multiple regression. Results showed a positive relationship between efficient business registration processes and SME growth, with a noted improvement in ease of doing business positively impacting SME performance. The study reported an R-squared value of 0.71, indicating that legal support through streamlined registration and effective contract enforcement positively influenced SME success. The study recommends that the government focus on simplifying the business registration process and strengthening contract enforcement to create a conducive legal environment for SMEs.

METHODOLOGY

This research employed a survey research design to collect data through the distribution of structured questionnaires. The focus was on small and medium-sized enterprises (SMEs) in Abuja, with a target population of 613,492 registered SMEs according to SMEDAN (2020). To determine the sample size, Slovin's formula (1960) was applied:

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

Where :

n= number of samples

N= total population

e= error tolerance (level)

A confidence level of 95 percent (given a margin of error of 0.05)

$$n = \frac{613492}{1 + (613492)(0.05^2)}$$

$$n = \frac{613492}{1 + (613492)(0.0025)}$$

$$n = \frac{613492}{1.53473} \quad n=399$$

The sample size calculation yielded: n=399

A total of 399 SMEs were selected from three Area councils in Abuja: Abaji, AMAC and Gwagwalada . These SMEs were chosen using simple random sampling, ensuring a representative selection of SME owners and managers across two sectors which are Agricultural and manufacturing sectors. The collected data was analyzed using multiple linear regression analysis, with SPSS version 26 being employed to process the results.

Model Specification

The study formulated the following regression model to examine the relationship between external business environment measured (economic and legal factors) and the growth of SME :

GSME f (EBE)

$$GSME = \beta_0 + \beta_1 EEF + \beta_2 LF + \mu_i$$

Where:

GSME = Growth of small and medium enterprises (dependent variable)

EBE = External Business Environment (independent variable)

EEF = External economic factor (independent variable)

LF = Legal factor (independent variable)

β_0 = a constant and β_{1-2} = coefficients of independent variables;

μ = Stochastic error term;

i = Cross sectional; and

f = Functional relationship.

DATA ANALYSIS AND DISCUSSION OF FINDINGS

A total of 399 questionnaires were distributed to respondents, and 370 completed copies were retrieved.

Test of Hypotheses

Ho¹ The external economic environment has no significant effect on the growth of SMEs in Abuja.

Ho² Legal factors have no significant influence on the growth of SMEs in Abuja.

Table 1

Model Summary				
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.987 ^a	.974	.974	.19625

a. Predictors: (Constant), LF, EEF

The results show that the R-squared value of 0.974 indicates that 97% of the variation in the dependent variable is explained by the combined effects of the independent variables. Additionally, the adjusted R-squared value of 0.974 suggests that 94.4% of the factors related to the external business environment are accounted for in this model, leaving 5.6% unexplained by the model.

Table 2

ANOVA ^a						
Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	527.663	2	263.831	6850.399	.000 ^b
	Residual	14.134	367	.039		
	Total	541.797	369			

- a. Dependent Variable: GSME
- b. Predictors: (Constant), LF, EEF

Table 2 above indicates an F-statistics value of 6850.399 with a sig of .000, signifying that the model is fit and significant at 5% level. This means that the result is good for making decision.

Table 3

		Coefficients ^a				
		Unstandardized Coefficients		Standardized Coefficients		
Model		B	Std. Error	Beta	t	Sig.
1	(Constant)	-.075	.023		-3.350	.001
	EEF	.692	.027	.694	25.450	.000
	LF	.349	.031	.303	11.104	.000

a. Dependent Variable: GSME

Table 3 presents the findings of the statistical analysis, which reveals a t-statistic of 25.450 with a corresponding significance level of 0.000, indicating that the external economic environment has a significant and positive effect on the growth of small and medium enterprises (SMEs) in Abuja. This result suggests a positive and statistically significant relationship between the external economic environment and SME growth, as the relationship was found to be significant at the 5% level of significance. Based on these findings, the null hypothesis that there is no significant effect of the external economic environment on SME growth is rejected. This findings also resonates the result of Oladele and Yusuf (2023) ; Adebayo and Okeke (2024).

In addition, Table 3 also shows a t-statistic of 11.104 with a significance level of 0.000, further confirming that the legal environment has a significant and positive effect on the growth of SMEs in Abuja. This indicates a positive and statistically significant relationship between the legal environment and the growth of SMEs. Similarly, the null hypothesis that there is no significant impact of the legal environment on SME growth is rejected. These findings underscore the importance of both the economic and legal environments in influencing the growth trajectory of SMEs in Abuja. The findings is also in consonance with the results of Adigun and Eze (2023); Balogun and Okafor (2024).

CONCLUSION AND RECOMMENDATIONS

The study reveals that both the external economic environment and the legal environment have significant and positive effects on the growth of small and medium enterprises (SMEs) in Abuja. The results demonstrate that external economic factors and the legal framework, including regulatory compliance and business registration processes, play crucial roles in determining the success and sustainability of SMEs in the region. The rejection of the null hypotheses indicates that both environmental

factors are integral to enhancing SME growth, providing essential understanding for policymakers and business owners alike.

The following recommendations were made from the findings:

- i. To foster the growth of SMEs in Abuja, it is recommended that government and regulatory bodies focus on stabilizing the economic environment by addressing issues such as inflation, exchange rate, and interest rates. Policymakers should implement measures to reduce borrowing costs, stabilize inflation rates, and ensure a predictable macroeconomic environment. This will provide SMEs with the necessary conditions to thrive, expand, and contribute to the economy.
- ii. It is recommended that the government streamline legal processes, such as business registration and regulatory compliance, to reduce the administrative burden on SMEs. Simplifying tax policies, enforcing contract laws efficiently, and offering incentives for legal compliance will create a more conducive environment for SME growth. This will enhance the legal security for SMEs, allowing them to focus on expansion and innovation rather than navigating complex legal hurdles.

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