

# BUSINESS ENVIRONMENT AND THE FINANCIAL PERFORMANCE OF SMALL AND MEDIUM ENTERPRISES: A STUDY OF LAGOS STATE, NIGERIA

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## Abstract

*The financial outcome of an enterprise is perceived to have some relationships with its operational environment. This study analysed the business environment as a correlate of financial performance of small and medium enterprises (SMEs), as to contribute to environment-enterprise policy mechanisms and regulatory framework, industry and management practices. Relevant definitional criteria and World Bank's model were adopted to sample 228 SMEs from 456 via judgmental and convenience techniques. Multifactor business-environment questionnaire (MBEQ) was used to elicit responses from SMEs in a field survey. Enterprise type, activity, product line and financial performance were examined. Results showed dominance of sole proprietorship and services SMEs, multi-product lines, and highly positively correlated financial performance and business environment. Consequently, improved SME-friendly business environment was recommended.*

**Keywords:** Business Environment, Small and Medium Enterprises, Financial Performance, Correlational Analysis

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## 1 Introduction

In the past decade, the World Bank has promoted the improvement of business environments as a key strategy for development. This has resulted in a significant amount of investment in collecting firm-level investment climate surveys across countries, and led to the key finding that the effects of business environments are heterogeneous and depend crucially on industry, initial conditions and complementary institutions (Lixin, 2010). Elements of the business environment, such as labour flexibility, low entry and exit barriers, and a reasonable protection from the “grabbing hands” of the government, seem to matter a great deal for most economies. Such other elements as infrastructure and contracting institutions (courts and access to finance), hinge on the initial status and the size of the market (Lixin, 2010). Profit making, sustainable liquidity and attainment of maturity status are among the objectives of a business enterprise. In pursuit of these objectives, the enterprise allocates scarce resources to competing ends. In the process, it provides employment, produces goods or renders services, purchases goods and services and, thus, contribute to the growth of the society and economy at large (Obiwuru *et al.*, 2011). Unamaka (1995) observes that in most Nigerian small-scale settings, the effectiveness of this process is greatly determined by the availability of and access to personnel, finance, machinery, raw material and possibility of making

goods and services available to the market. Obviously, optimal financial performance is a necessary driver of this process.

Small and Medium Enterprises Development Agency of Nigeria (SMEDAN) in 2008, reports that most small and medium scale businesses in Nigeria die before their fifth anniversary. Certain factors in the business environment have been identified to affect the performance of the SMEs and contribute to the high failure rate. These include legal-regulatory pressures and limited access to external finance (Lixin, 2010); government policies and infrastructure (Akinbogun, 2008; World Bank, 2000; Akpala, 1998; Ekpeyong, 1997; Fadahunsi, 1997 and Utomi, 1997), heavy tax and regulatory burdens, near non-existent power supply and inappropriate state policies (SMEDAN, 2005). Inappropriate state policies, heavy tax and regulatory burdens, near non-existent power supply and limited access to credit facilities seem to characterise the Nigerian business environment at various levels. As a result, the enterprises incur huge operating costs in meeting tax and regulatory burdens, and providing alternative sources of power. Those that are unable to afford such alternative sources of power depend on the epileptic infrastructural facilities of government. This contributes to the eventual collapse of many SMEs in Nigeria (SMEDAN, 2005). Udechukwu (2003) observes that this discourages entrepreneurship, results in absence of a strong and virile SME sector and, thus, creates industrial gap. For

the medium and large enterprises, the additional costs incurred to provide alternative sources of power erode the competitiveness of locally manufactured goods. This makes them less attractive to potential foreign investors who may wish to invest in the Nigerian manufacturing ventures (SMEDAN, 2005). These reduce profit potentials of the enterprises, even with increases as recorded in annual turnover.

This study is intended to examine the business environment of Lagos State as a correlate of financial performance of SMEs. The study considers annual turnover and profitability for metrics of financial performance of the SMEs. They are among the criteria for classifying a firm as micro, small, medium or large (CBN, SMEDAN, NASSI, NASME), and as in the literature (Babalola, 2012; Stewart, 2010; Chong, 2008; Doyle, 1994; Robinson, 1982). Moreover, performance-driven sustained increases in turnover or sales value is usually expected to translate to profitability which is a common measure of entrepreneurial success and enterprise performance as in Suleiman (2007). This study is structured into five sections. Section two, review of related literature, follows this introduction. Methodology is discussed in section three, analysis of data and discussion of results are done in section four, and section five summarises and concludes the study and proffers recommendations.

## 2 Literature review

This study anchors on Thompson's (1967) Contingency Theory and its variants. Zeithaml *et al.*, (1988) explain that the management literature offers a variety of contingency frameworks. The theory postulates that the optimal course of management action is dependent upon the internal and external situations. However, this study emphasises the external environment of the enterprise. The contingency theory has its roots in Cyert's and March's (1963) "Behavioural Theory of the Firm", Simon's (1957) "Administrative Behaviour", the "General systems theory" and the "Open System" perspectives by Katz and Kahn (1966), Anderson (1957), Boulding (1956) and Von (1951). These earlier constructs explore the "Goal and System Resource" approaches to firm performance evaluation. Simon's (1957) and March and Cyert's (1963) work stream holds the view that organisations are problem-facing and problem-solving entities. Therefore, they develop rational decision processes to cope with the complex and uncertain dimensions of the business environment to achieve a satisfactory level of performance. The open system perspective sees the complex organisation as a set of interdependent parts that, taken together, constitute a whole which, in turn, is interdependent with some larger environment. Interaction between elements within the organisation and between the organisation and the environment can

lead to the system reaching the same final state from different initial conditions by a variety of strategies.

The goal approach emphasises measuring performance in terms of such financial indices as profits, revenues, returns on investment, returns on sales and returns on equity. Thus, the approach measures the extent to which an organisation attains these financial goals. The system resource approach assesses the ability of an organisation obtaining its resources. The most common system resource measures used by the SMEs include number of employees, annual turnover, market share [growth] and revenue per employee (Orser *et al.*, 2000; Mohr and Spokeman, 1994; Robinson and Sexton 1994). The goal approach has been criticized on the ground that profits and other financial measures are subject to manipulations and misinterpretations. Therefore, combining the two approaches (goal and system) helps owner-managers to gain a wider perspective on measuring and comparing their performance, especially the extent of effectiveness and efficiency in utilising resources, competitiveness and readiness to face the growing external pressure (Chong, 2008).

Several studies that have attempted to analyse the effects of environmental factors on the performance of firms (Norzalita and Norjaya, 2010; Nwokah (2008), Jaworski and Kohli (1993) and Narver and Slater (1990). Some have established moderating influences on enterprise variables (e.g., Han *et al.*, 1998; Greenley, 1995 and Jaworski and Kohli, 1993). Norzalita and Norjaya (2010) investigated the role of the external environment among SMEs in the agro-food sector in Malaysia. The study found that technology turbulence and competitive intensity did not moderate the relationship between market orientation and business performance. Golden *et al.* (1995) examined the influence of the external environment on business performance in transition economies. Considering demand changes, product obsolescence, competitive pressures and technology, the study found moderating influences on that market-orientation performance of the enterprises.

Dollar *et al.* (2005) used World Bank data to study the effects of business environment on firm performance in Bangladesh, China, Ethiopia and Pakistan. For the firm, they considered total factor productivity (TFP), wages, profits, growth rates of output, employment and fixed assets. Infrastructure (e.g. custom efficiency, power loss, and the number of days to install phones), the share of firms with overdraft access [finance], and the frequency of inspection visits per year by relevant government agencies were the environmental factors. The study found infrastructure to be the most important factor. It induces lower transportation and transaction costs, increases TFP and outputs, returns to capital, investment and leads to higher wages. Similarly, Fernandez (2008), reports that infrastructure (measured by electricity supply) enhances firm performance in Bangladesh. However, based on his

check on investment climate data for India and China, Lixin (2010) explains that the positive relationship between investment and business environment in general and infrastructure in particular does not have to hold everywhere. After all, the strategy of Indian firms to adapt to bad electricity system by purchasing their own power generators increases investment. With generators, Indian firms still have lower capital-labour ratio than China, which possesses a better infrastructure. Hallward-Driemeier et al. (2006) examined the effect of physical infrastructure at city-level on firm performance in China, and found that the proxies of physical infrastructure considered in their study are not significantly associated with firm performance.

The differing views of Lixin (2010) and Dollar et al. (2006) may find explanation from the considerations of infrastructure variables. Firms can provide alternatives to government electricity and telephone lines with relative ease but not other variables like roads and security of lives and property.

The above studies suggest that the effects of physical infrastructure, as an indicator of business environment, seem to differ by countries. Li (1997), notes that China is richer and has invested more in physical infrastructure than most of the countries that feature positive infrastructure effects. Lixin (2010) suggests that decreasing marginal return to infrastructure could be a possible reason for the particularly strong positive association between infrastructure and firm performance in countries with a worse stock of infrastructure.

Kayanula and Quartey (2000) studied the policy, legal-regulatory and institutional capacity for promoting SMEs in Ghana and Malawi. Other aspects of the environment are access to finance and technology. For the SMEs, they considered turnover, employment and contribution to poverty alleviation. The study found access to finance, inappropriate technology, laws and regulation to be among the constraints that impede development of the SME sector. Similarly, Ayyagari et al. (2005) examined the effects of government policy and regulation, legal-regulatory mechanism, and external finance on SME sector in 76 countries. Considering the sector's share of total labour force and gross domestic product, they found the business environment to predict large SME sector in Manufacturing. They also found a weak association between high exit costs and employment rigidities and, thus, established stronger support for the hypothesis that a large SME sector is due to a competitive environment that encourages entry of new innovative firms. Other studies have shown that legal system and institutions exert significant effects on SMEs (Long, 2010; Lu and Tao, 2009; Laeven and Woodruff (2008); McMillan and Woodruff, 2002, 1999). Some studies have examined regulation in relation to firm performance in developing and developed economies (START Adhvaryu et al., 2010; Harrison, 2010; Lixin, 2010; Amin, 2009a, b;

Hallward-Driemeier et al., 2006; Klapper, Laeven and Rajan, 2006). Adhvaryu et al. (2010), Dong and Lixin (2009) and Hallward-Driemeier et al. (2006) submit that flexible labour regulation allows for labour flexibility, enhances firm size and facilitates better performance.

Studies have also shown that deregulation eases entry of new firms, induces competition and engenders level play field for the enterprises. For instance, while Ciccone and Papaioannou (2007) found high entry rates, Long and Zhang (2009) established cluster effects, access to finance, competition, export and productivity, in addition to high entry rates. Yakovlev and Zhuravskaya (2007) analysed cross-sectional firm data on firm entry and small business density in Russia, and found significant positive effects. Similarly, Kaplan, Piedra and Seira (2007) found that entry deregulation increases new firm start-ups in the targeted industries in Mexico. With World Business Environment Survey (WBES) data for 21 transitional countries in the East Europe and Central Asia region, Clarke and Lixin (2004) found that privatisation and competition reduce corruption. Li and Lixin (2002) note that the relevance of incentives for effective deregulation policies has also been manifested in the telecommunication deregulation movement in the 1980s and 1990s, during which national carriers were privatised, new competitors licensed, and new services allowed. With a country-level panel data set from 1990 to 2001, complemented by operator-level data on privatisation and competition, Li and Lixin (2004) found that new entry improves both factor allocation and productivity, and that privatization complements new entry in deepening network penetration and restraining increases in service prices.

This, particularly, has been the experience in Nigeria from 2004 after the telecommunication sector was deregulated in 2001; the national carrier, the Nigeria Telecommunications (NITEL) was commercialised, new competitors were licensed which ushered in new services. As at 2014, average service prices have reduced by approximately 99.6 percent of the 2001 to 2003 service prices. This has spanned positive multiplier effects to various categories of business enterprises in Nigeria.

Johnson et al. (2002) studied the importance of property rights and external finance to small firms in Poland, Romania, Russia, Slovakia and Ukraine. Property rights variables included extralegal payments for licences, government protection and services, and courts enforcement of contracts. They found strong correlation between firms' profits reinvested and property rights, but otherwise for access to finance. McMillan and Woodruff (2002) showed that the importance of institutions like court and finance increases as the economy achieves more stages of development. Cull and Lixin (2005) used data on a large sample of Chinese firms for the period 2000-2002 on a regression analysis model. They considered

informal payment to government officials as proportion of sales revenue, the propensity of government officials helping instead of hindering firms, proportion of firms' disputes resolved through courts, and the likelihood of a court upholding firms' legal rights in commercial disputes. Their results confirm McMillan and Woodruff's (2002) proposition, in addition to external finance variables being statistically significant with high explanatory power. Demircuc-Kunt and Vojishav (1998) used a sample of 30 developed and developing countries and country-level data to show that protection of property rights increases availability of external finance. Lixin (2010) emphasises the importance of a reliable court system to enforce contracts, and the need for external finance over retained profits as large scale production ensues and expansion becomes a strategic option. Lixin (2010) further explain the transmission process of well protected property rights to be information disclosure about firm performance and adequate uses of fund. In response, banks are more likely to extend credit facilities, shareholders are more willing to invest, and abuse of company funds is more likely to be detected and punished. Essentially, this study recognises the relevance of such external finance to the enterprises of current research interest.

Corruption is one other visible factor of SME-unfriendly business environment. Some recent micro studies under the auspices of the World Bank have found both tax and corruption to exert negative effects on SMEs (Cai et al., 2011; Djankov et al., 2009; Fisman and Svensson, 2007).

Some studies have attempted to analyse the business environment in relation to aspects of enterprises in Nigeria. Abimbola and Agboola (2011) used reports of government agencies and other stakeholders in the field to examine some policy programmes of government with a view to understanding the relevance of states in enterprise development initiatives in Nigeria. The study found that most of programmes were moribund either due to discontinuation by succeeding governments or lack of adequate human and material resources for their operations. It also observed skewed spread in few cases which hampered the success of the programmes. Balogun and Alimi (1988) examined loan delinquency among small farmers in developing countries, with specific focus on Small-Farmer Credit Programme in Lagos State. They found default rates in loans to small farmers in Lagos State in 1985 and 1986 to be in the range of 55 and 90 per cent respectively. Similarly, Obamuyi (2007) used nine commercial banks and one hundred and fifteen SMEs that secured loans from banks, and employed exploratory survey approach to study loan delinquency among SMEs in Ondo State of Nigeria, and the lending practices of banks towards the SMEs. He found poor credit worthiness, lack of collateral security, poor-project package and the constraint imposed on banks' capital by regulations to be among the several factors responsible for banks'

attitude of restricted loan portfolio to the SMEs. Loan delinquency rate was low among the SMEs in the State due to banks' disapproval of loan applications of those SMEs believed to have high probabilities of default.

Perhaps, Obamuyi's (2007) finding contradicts Balogun's and Alimi's (1988) for two obvious reasons. First, Obamuyi's study cut across sectors while Balogun's and Alimi's was sector-specific - small farmers. Second, loan source in Balogun's and Alimi's study was government-sponsored small-farmer credit programme while private sector commercial banks were the loan sources in Obamuyi's study. However, both studies did not show how the external finances correlated with the financial performance of the SMEs.

Obokoh (2008) employed selective and purposive survey approach 500 manufacturing firms to investigate the effects of the 1986 trade liberalization policy in Nigeria on SMEs in Lagos State. With tenets of the trade liberalisation policy, labour availability, infrastructure, technology, competition, access to finance, turnover, profit, production level and market coverage as relevant variables, he found that the policies had no effects on most manufacturing SMEs. He found improper planning and the absence of favourable investment climate to be the reason. Suleiman (2007) used primary data generated through Infrastructural Evaluation Questionnaire (IEQ) and documentary evidence from SMEs' records to examine the correlation between expenditure on infrastructural development and performance of SMEs in Kaduna State, Nigeria. Major infrastructural variables are information technology, electric power supply, transportation, water, roads, industrial estates, industrial waste collection and management, and industrial clinic/hospital. SME variable is level of profitability. The study found that infrastructure expenditure has a negative correlation with profitability. Consequently, the study established that inadequacy of these infrastructural components are among the major barriers to SMEs' viability.

### **3 Constraints to entrepreneurship and performance of SME sector in Nigeria**

Various institutions, agencies and authors have highlighted and discussed constraints to the SME sector in Nigeria (Nigeria's Vision 2020 National Technical Working Group (NTWG) on SMEs, 2009; Ogechukwu, 2006; Archibong, 1997; Ekpeyong & Nyong, 1992; Aftab and Rahim, 1989; World Bank, 1989). NTWG on SMEs (2009) categorised the constraints into exogenous factors - government policies, legal-regulatory frameworks, inadequate institutional support, poor infrastructure and inadequate external finance - and endogenous factors - weak corporate governance, poor business partnership, low human capital development, low level of

technology adoption and insufficient innovation. These vary across Nigerian cities and regions, with differing relative ease of doing business in specific environments. For instance, based on certain indicators that show the relative ease or difficulty in

starting or doing a business, the World Bank in its ‘Doing Business’ surveys (2012, 2014), showed the positions of Lagos State among 37 cities/regions in Nigeria (see Table 1).

**Table 1.** Starting a business in Lagos State relative to 37 cities/regions in Nigeria

Business Aspect	Measurement Indicator	Rank	Top City
Starting a Business	Procedures (stages), Time (days), Cost (%of Income per capita).	8 (2012), 4 (2014)	Abuja, FCT
Obtaining/Dealing with Construction Permits	Procedures (stages), Time (days), Cost (% of income per capita).	35 (2012), 36 (2014)	Jigawa
Registering Property	Procedures (stages), Time (days), Cost (% of Income per capita or property value)	27 (2012), 31 (2014)	Gombe (2012) Zamfara(2014)
Enforcing Contracts	Procedures (stages), Time (days), Cost (% of income per capita or claim value).	15 (2012), 28 (2014)	Katsina

Source: World Bank (2012, 2014)

The summary of ‘Doing Business’ 2012 and 2014 data for Nigeria show that Lagos ranks 8<sup>th</sup> & 4<sup>th</sup>, 35<sup>th</sup> & 36<sup>th</sup>, 27<sup>th</sup> & 31<sup>st</sup>, and 15<sup>th</sup> & 28<sup>th</sup> among 37 cities/regions in Nigeria in terms of starting a business, dealing with construction permits, registering property and enforcing contracts respectively. The firsts are: Starting a business (Abuja, FCT), Dealing with construction permit (Jigawa), Registering property (Gombe, Zamfara) and Enforcing contracts (Katsina). These indicate that Lagos has not fared well in terms of regulatory business environment. This is expected to relate, one way or the other, with financial outcomes the SME sector in the State.

#### 4 Methodology

This study employed a composite of survey and exploratory designs to elicit information from the respondents, and process numeric data. The survey design was appropriate for effective information gathering from respondents whose response behaviours are not subject to the researcher’s

influence. The design was used to determine the target population from which a sample of 228 SMEs was selected. The exploratory design was used to process responses into numeric data based on pre-assigned codes. The data were analysed in section four. The responses and data were analysed on the basis of demographic information, enterprise characteristics, environmental factors and SMEs’ financial performance. That provided the basis for conclusion and recommendations.

Target population was all SMEs operating within the enterprise nerve centre of Nigeria, Lagos State and its environs. But based on the outcome of a pre-survey exercise, the sampling frame was limited to 456 of the SMEs listed in the 2014 edition of Lagos Business Directory (LBD) which satisfied annual turnover criteria as defined by relevant institutions, agencies and trade associations in Nigeria. With the World Bank’s (2009) scientific model for sample size determination, a sample of 228 (50%) SMEs was selected for the study.

$$n = \left( \frac{1}{N} + \frac{N-1}{N} \frac{1}{PQ} \left( \frac{k}{Z_{(1-\alpha)/2}} \right)^2 \right)^{-1}$$

where N = population size, P = population proportion, Q = 1 – P, k = desired level of precision,  $Z_{(1-\alpha)/2}$  = the value of the normal standard coordinate for a desired level of confidence, 1 –  $\alpha$ .

Through telephone numbers in the LBD, 350 SMEs were initially contacted and intimated of the research intent, with follow-ups via emails, where possible. Then, judgmental and convenience sampling techniques were used to select 228 SMEs as sample for the study. Subsequently, a structured survey instrument, Multifactor Environment-Enterprise Questionnaire (MEEQ), was used to elicit information

from the respondents. The questionnaire has A, B, C and D sections. Section A elicited demographic information of the respondents. Section B elicited enterprise characteristics information used to classify the participating SMEs into small and medium categories and business activity types. Section C sought responses to survey statements on the 10 factors of the business environment considered in this study - legal-regulatory framework (LGF), policy and political aspects (POP), infrastructure (INF), external source of finance (ESF), technology (TEC), competition (COM), taxes and other fees (TOF),

social-cultural factors (SCF), labour availability and costs (LAC) and corruption (COR). The factors were adapted mainly from key elements of the business environment identified for Committee of Donor Agencies for Small Enterprise Development by White (2004), those used in business environment rankings methodology by The Economist Intelligence Unit (2006), World Bank's Enterprise Survey (2009, 2011) and World Bank/IFC's (2012) Business Environment and Enterprise Performance Surveys indicator descriptions. Section D sought responses to statements on financial performance of the SMEs - annual turnover (TOV) and profitability (PRT). Statements in sections C and D were close-ended with exhaustive response pattern, and pre-coded after the Likert-type scale as follows: Always (4), In Most Cases (3), Sometimes (2), On Rare Occasions (1), and Never (0). This made it possible to process numerical data from the responses. The questionnaire was validated through scrutiny and evaluation by experts in the field. Reliability of the instrument was established via Cronbach's alpha coefficients of 0.8711 and 0.8176 computed from pilot test responses to sections C and D, respectively. Most copies of the questionnaire were administered on the business premises of the

respondents, and few copies via emails. The responses were processed into numerical data using the pre-code scale 0 – 4. The process yielded data used for the descriptive statistics and correlational analysis.

#### 4 Results and discussion

Table 2 shows that out of 228 copies of the questionnaire administered to SMEs, 190 (83%) were dully completed and returned while 38 (8%) were not dully completed/returned. The Table also shows that 138 (73%) of the respondents are male and 52 (27%) are female. This indicates that more male than female respondents participated in the survey. Further, this shows that since majority of the respondents (127 or 67%) are owners or partners (see Table 4), there are more males than females in the SME sector. That is, more of the SMEs in the State are operated by male entrepreneurs. The table equally shows that majority of the SMEs in the sample population filled out the questionnaire copies, and that the survey had a high response rate. Consequently, responses of the respondents were collated for analysis from the 190 copies of the questionnaire that were duly filled out and returned.

**Table 2.** Response rate and gender of respondents

Response Rate	Frequency	%	Gender	Frequency	%
Returned dully completed	190	83	Male	138	73
Not returned/unduly completed	38	17	Female	52	27
<b>Total</b>	<b>228</b>	<b>100</b>	<b>Total</b>	<b>190</b>	<b>100</b>

*Source: Field Survey, 2013*

**Table 3.** Age and educational levels of respondents

Age Range	Frequency	%	Level of Education	Frequency	%
21-30	31	16	M. Phil/PhD	2	1
31-40	61	32	MA/MSc	21	11
41-50	73	38	HND/BA/BSc	99	52
51-60	22	12	NCE/ND	50	26
61 or above	3	2	O/Level	18	10
<b>Total</b>	<b>190</b>	<b>100</b>	<b>Total</b>	<b>190</b>	<b>100</b>

*Source: Field Survey, 2013*

Age distribution and educational levels of the respondents, as shown in Table 3, reveal that 31 (16%) of the respondents were in the age range of 21 – 30 years, 61 (32%) were 31 – 40 years, 73 (38%) were 41 – 50 years, 22 (12%) were 51 – 60 years and only 3 (2%) of the respondents were 61 or more years. This indicates that while majority of the respondents were between 21 and 50 years of age, most were in the 31 – 40 and 41 – 50 years age brackets. This shows that matured young people engage in enterprise activities, and that all the respondents are within 15+ years

definition of economically active persons for Nigeria (see Population Reference Bureau, [www.prb.org/DataFinder/Topic/Rankings.aspx?ind=23](http://www.prb.org/DataFinder/Topic/Rankings.aspx?ind=23)). Educational levels of the respondents show 2 (1%) hold higher degree up to M.Phil/PhD, 21 (11%) hold Master's degree, 99 (52%) higher qualifications up to HND/BA/BSc, 50 (26%) hold NCE/ND qualifications and 18 (10%) of the respondents are O/Level holders. The distribution shows that the respondents are matured and have educational exposures that are adequate to give reliable information.

**Table 4.** Status/position and interest of respondents

Status/Position	Frequency	%	Interest	Frequency	%
MD/CEO	98	52	Owner	97	16
Top Level Manager	36	19	Partner	30	33
Middle Level Manager	33	17	Employee	63	-
Lower Level Manager	23	12	-	-	-
<b>Total</b>	<b>190</b>	<b>100</b>	<b>Total</b>	<b>190</b>	<b>100</b>

Status and interest of the respondents, as shown in Table 4, reveal that 98 (52%) are MDs/CEOs, 36 (19%) are top level managers, 33 (17%) are middle level managers and 23 (12%) are lower level managers. Respondents' interest in the enterprise shows that 97 (51%) are owners, 30 (16%) are partners and 63 (33%) are employees. Therefore, 127

(67%) of the respondents own the business enterprises either as sole owners or owner-partners while 63 (33%) were employees. Thus, while 98 (52%) were at the 'board' level, 92 (48%) were at the 'management' level. The status or position is deemed to have earned the respondents sufficient exposure and experience to enable them volunteer reliable information.

**Table 5.** Years of respondents in the enterprise

Year Range	Frequency	%
1-3	22	12
4-6	43	23
7-9	50	26
10 or more	75	39
<b>Total</b>	<b>190</b>	<b>100</b>

Source: Field Survey, 2013

Table 5 shows that 22 (12%) of the respondents have spent 1 to 3 years in their firms, 43 (23%) respondents have been in the enterprise for 4 to 6 years, 50 (26%) respondents have been with their respective business outfits for 7 to 9 years and 75 (39%) of the respondents have been in their respective

firms for 10 or more years. Thus, 168 (88%) of the respondents have been in the business environment for periods of 4 or more years. These periods are deemed sufficient to acquire enterprise-environment experience to give reliable information.

**Table 6.** Status of Enterprise and Ownership Type

Status	Frequency	%	Ownership Type	Frequency	%
Entity	103	54	Sole Proprietorship	90	47
Non-entity	87	46	Partnership	24	13
-	-	-	Limited Liability	76	40
<b>Total</b>	<b>190</b>	<b>100</b>	<b>Total</b>	<b>190</b>	<b>100</b>

Source: Field Survey, 2013

On enterprise characteristics of the SMEs, As shown in Table 6, 103 (54%) of the SMEs surveyed are legal entities while 87 (46%) are non-entities. The ownership type shows that 90 (47%) of the SMES are sole proprietorships, 24 (13%) are partnerships and 76 (40%) are limited liabilities. These indicate that

majority of SMEs considered from the LBD are legal entities, and that more are sole proprietorship type of business enterprises. These also suggest the extent of regulatory coverage in the State's business environment.

**Table 7.** Activity and product/service line

Activity	Frequency	%	Product/Service Line	Frequency	%
Manufacturing	33	17	One	23	12
Construction	34	18	Two	53	28
Processing	22	12	Three or more	114	60
Services	98	52	-	-	-
Others	3	1	-	-	-
<b>Total</b>	<b>190</b>	<b>100</b>	<b>Total</b>	<b>190</b>	<b>100</b>

Source: Field Survey, 2013

The activity type and product or service line, as shown in Table 7, reveal that 33 (17%) of the firms surveyed engage in manufacturing activity, 34 (18%) are into construction works, 22 (11%) are in processing industry, 98 (52%) of the SMEs are into service activity, and 3 (2%) are into other or ungrouped activities. The table also shows that the

business focus of 23 (12%) of the SMEs is on one product/service line, 53 (28%) of the firms have their enterprise thrust on two product/service lines and 114 (60%) firms engage in three or more product/service lines. These show that majority of the enterprises surveyed are in services sub-sector of the SME sector, and engage in multi-product or service lines.

**Table 8.** Years in operation and number of employees by the enterprises

Age (years)	Frequency	%	Employees	Frequency	%
1 – 3	14	8	5-19	5-19	61
4 – 6	40	21	120-99	120-99	39
7 – 9	48	25	-	-	-
10 or more	88	46	-	-	-
<b>Total</b>	<b>190</b>	<b>100</b>	<b>Total</b>	<b>190</b>	<b>100</b>

Source: Field Survey, 2013

As shown in Table 8, categorization of the enterprises by years in operation shows that 14 (8%) of the firms have been in business for 1 to 3 years, 40 (21%) have been operating for 4 to 6 years, 48 (25%) have been existing for 7 to 9 years and 88 (46%) of the SMEs have operated for 10 or more years. The table also shows that 116 (61%) of the firms surveyed have 5 to 19 employees and 74 (39%) employ 20 to 99 paid workers. These satisfy the employee-based

definition criterion for SMEs by CBN, NASME and World Bank/IFC. This provides further evidence that most of the firms surveyed are small-scale enterprises. It is evident from the table that majority of the enterprises surveyed (176 or 92%) had been operating in the State's business environment for at least 4 years. Therefore, the operators are deemed to have sufficient enterprise-environment experience to give reliable information.

**Table 9.** Current asset value and annual turnover/sales value

Asset Value	Frequency	%	Turnover/Sales Value	Frequency	%
₦1 Million or Less	32	17	₦1 Million or Less	51	27
₦10 Million or Less	67	35	₦40 Million or Less	75	39
₦50 Million or Less	54	28	₦100 Million or Less	43	23
₦150 Million or Less	37	20	₦150 Million or Less	21	11
<b>Total</b>	<b>190</b>	<b>100</b>	<b>Total</b>	<b>190</b>	<b>100</b>

Source: Field Survey, 2013

As shown in Table 9, classification of the surveyed firms by current asset value reveals that 32 (17%) have asset value of ₦1 million or less, 67 (35%) have asset value of ₦10 million or less, 54 (28%) of the entities have ₦50 million or less as value in asset, and 37 (20%) of the SMEs have asset value in the neighbourhood of ₦150 million. These are consistent with asset-based definitions of SMEs by Central Bank of Nigeria (CBN), National Economic Reconstruction Fund (NERFUND), National Association of Small and Medium Enterprises (NASME) and National Association of Small Scale Industrialists (NASSI). This shows that 153 (80%) of the SMEs surveyed have current asset values of ₦1 million to ₦50 million, and further provides the

evidence that most of firms are small enterprises. Responses by the respondents on annual turnover/sales value of their firms reveal that 51 (27%) of the enterprises record maximum of ₦1 million, 75 (39%) of the businesses record ₦40 million maximum, 43 (23%) firms have maximum sales value of ₦100 million and 21 (11%) recorded annual turnover/sales value of ₦150 million maximum. These are also consistent with SMEs sales value-criterion by CBN, NASSI and NASME, and further show that majority of the SMEs (169 or 89%) are small enterprises.



**Table 10.** Descriptive statistics – business environment factors

	LGF	POP	INF	ESF	TEC	COM	TOF	SCF	LAC	COR
Mean	1.3232	1.2674	2.7695	1.4716	1.6226	1.9947	1.8547	0.8937	1.8242	1.5726
Median	1.2000	1.2000	2.6000	1.4000	1.6000	1.8000	1.6000	0.4000	1.8000	1.4000
Maximum	3.8000	3.0000	4.0000	4.0000	4.0000	4.0000	4.0000	4.0000	3.8000	4.0000
Minimum	0.0000	0.0000	0.4000	0.0000	0.0000	0.6000	0.0000	0.0000	0.0000	0.0000
Std. Dev.	0.9257	0.6756	0.9229	0.7874	1.0022	0.7841	0.8425	1.1094	0.6925	1.0219
Jarque-Bera Probability	12.3408 0.0021	11.6097 0.0030	8.0041 0.0183	26.4966 0.0000	6.2445 0.0441	10.7238 0.0047	9.3026 0.0095	47.1610 0.0000	5.5640 0.0619	16.0683 0.0003
Obs.	190	190	190	190	190	190	190	190	190	190

Source: Computed from data processed from the responses of entrepreneur SME operators

The descriptive statistics in Table 10 were computed from the numeric data processed from the field survey responses. The statistics are used to examine the distribution and consistency of the responses of the respondents. The mean value of the data-responses to the environmental factors ranges from 0.8937 to 2.7695, with standard deviation that ranges from 0.6756 to 1.1094. The mean and median

values are approximately equal for the variables. These indicate that the processed data were approximately normally distributed. The Jarque-Bera statistic with associated probability further substantiates this. Low standard deviations of the data set indicate consistency of responses by the respondents.

**Table 11.** Correlation analysis

Partial Correlation Coefficients: Business Environment Factors											
	LGF	POP	TOF	TEC	INF	ESF	COM	SCF	LAC	COR	
LGR	1.0000										
POP	0.6493	1.0000									
TOF	0.5661	0.4085	1.0000								
TEC	0.7159	0.7228	0.3958	1.0000							
INF	0.5467	0.3818	0.6004	0.4167	1.0000						
ESF	0.5125	0.4914	0.3338	0.4972	0.2759	1.0000					
COM	0.5187	0.3379	0.5587	0.3301	0.5370	0.3212	1.0000				
SCF	0.6414	0.3451	0.6339	0.4000	0.4307	0.4354	0.5908	1.0000			
LAC	0.6364	0.5769	0.4921	0.6512	0.4899	0.3931	0.4352	0.4656	1.0000		
COR	0.5806	0.3764	0.6714	0.4157	0.5063	0.4201	0.6591	0.6978	0.4354	1.0000	
Cross-Partial and Aggregate Correlation Coefficients: Business Environment-Enterprise Variables											
	LGF	POP	TOF	TEC	INF	ESF	COM	SCF	LAC	COR	BUEV
TOV	0.5735	0.5019	0.3522	0.5845	0.3198	0.4982	0.3709	0.3850	0.4517	0.3549	0.5801
PRT	0.5453	0.3982	0.3531	0.5505	0.3607	0.5200	0.3335	0.3807	0.3943	0.4046	0.5774
<b>ENTFP</b>	0.6562	0.6044	0.4905	0.7254	0.5616	0.5945	0.4901	0.4368	0.6299	0.5013	<b>0.7591</b>

Source: Computed from data processed from the responses of the SMEs in the survey

Note: **BUEV** is Business Environment; **ENTFP** is Enterprise Financial Performance

The correlation coefficients in Table 11 were also computed from the numeric data processed from the responses elicited in field survey. While the partial correlation coefficients were used to check for multicollinearity problem among the environmental factors considered in the study, the cross-partial correlation coefficients measured the strength and direction of the relationship between the metrics of the

financial performance (TOV and PRT) of the SMEs and the respective factors of the business environment. Since none of the partial coefficients exceeds the threshold of 0.80 when squared (Kennedy, 2008), the environmental factors are not highly linearly correlated. That is, no two factors measured the same phenomenon and each has been treated on its individual independent merit.

It is evident from Table 11 that LGF, POP, TEC, ESF and LAC showed moderately high interactions with TOV while TOF, INF, COM, SCF and COR exhibited low positive interactions. But in totality, the factors of the business environment (BUEV) showed highly moderate positive correlation with turn over value (TOV) as evidenced by 0.8501 coefficient. On the other hand, only three of the environmental factors, LGF, TEC and ESF exhibited moderately high positive correlations with profitability (PRT) of the firms. The other factors showed weak positive correlations with PRT. However, the factors jointly (i.e., BUEV) correlated moderately highly positively with profitability (PRT) of the SME sector as indicated by 0.5774 coefficient.

On the aggregate, the high correlation coefficient in bold format, **0.7591**, indicates the strength of the correlation between the financial performance of the SMEs and business environment. Therefore, on the basis of the survey and outcome of this analysis, it is evident that financial performance of the SMEs correlates highly positively with dynamics of Lagos State business environment.

## 5 Conclusion and recommendations

From annual turnover and profitability perspectives, this study has examined the elements of Lagos State business environment as correlates of financial performance of SMEs in the State. Analysis was based on a set of 10 factors of the business environment and two enterprise financial performance indicators adapted from various similar studies. The median and mean values as well as the Jargue-Bera statistic in the descriptive statistics shown in Table 10 provided evidence of consistency in responses by the SMEs respondents who participated in the survey.

From the respondents' demographic and enterprise characteristics, it is evident that more male-owner SMEs operators participated in the survey. This suggested male-owner and employee SME-dominant sector in the State. Most of the enterprises surveyed are legal entities among which many have been operating for an upward of seven years. Evident in the survey outcomes are sole proprietorship and services subsector dominant SME sector with two or more product/service lines. The survey also showed predominance of small over medium scale enterprises in the State's business environment.

Each of the environmental factors in the study has been considered on its own individual independent merit as evidenced by the partial correlation coefficients. While some of the environmental factors showed moderately high interactions with the respective performance indices, others showed weak correlations though all in the same direction. Interestingly, virtually all the environmental factors showed moderately high positive correlation with aggregate enterprise financial performance. That underscored the importance of the business

environment in the financial sustenance of SME sector. On the aggregate, the financial performance of the firms showed high positive correlation with the business environment. Again, that showed the relevance of business environment to the SME sector, especially in terms of financial outcomes.

Based on the consistency of the responses and high degree of positive correlation coefficient, on the aggregate, this study concludes that financial performance of the SMEs correlate highly positively with dynamics of Lagos business environment. Consequently, the study recommends that SME-related policies should be reformed to make the State's business environment more attractive to female entrepreneurs who are at present outnumbered by their male counterparts as shown in the analysis of distribution of respondents by gender. Also, moderating influences of trade associations should target legal-regulatory framework and policy initiatives of relevant policy makers and agencies as they shape credit availability and technology adoption which, in turn, enhances sales growth and profitability. Tax incentives and other initiatives such as reducing costs of registration, licensing, permits and signage would go a long way to ameliorating the finance burdens of firms in the State and enhance the financial performance of the SME sector.

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