

# External Environmental Factors and Failure of Small and Medium Enterprises in Lagos Metropolis, Nigeria

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**Abstract:** - This study examines the relationship between external environmental factors and failure of SMEs in Lagos metropolis, using samples of failed SMEs in Lagos metropolis. Questionnaire was used to collect primary data from the sampled failed SMEs using snow ball method. The data was analyzed using both descriptive and inferential statistics. The outcome reveals that external environmental factors have significant impact on the failure of SMEs in Lagos metropolis, and financial inadequacy (FI) is the major contributing factor to the failure of SMEs in the Lagos metropolis; followed by market competition (MC), market demographics (MD), and inadequate infrastructure (II). In order to reduce SMEs failure and achieve significant positive contribution of SMEs sub-sector to the economic development of the state, the study recommends that government and relevant stakeholders should create an enabling business environment with financial support to SMEs, fair competition, sound market places and adequate infrastructures.

**Keywords:** SMEs, Failure, Environmental Factors, Inadequate Infrastructures, Market Demographics, Market Competition, Financial Inadequacy

## I. INTRODUCTION

SMEs sub-sector is an integral component of economic development and a key element in the fight against poverty and unemployment in both developed and developing economies. They are veritable vehicles in accelerating sustained growth and economic transformation in developed and developing economies. SMEs provide an effective means of stimulating indigenous enterprises, enhancing greater employment opportunities per unit of capital invested and aiding the development of local technology (World Bank, 1995). Consequently, the performance of SMEs sub-sector is closely associated with the performance of the nation.

The Nigeria Chamber of Commerce, Industry, Mines and Agriculture (NACCIMA, 2006) argues that small and medium businesses are the vehicle for rapid industrialization and development of any nation. They also account for 70% of national industrial employment if the threshold is set at 10 – 50 employees, and contribute 10% of manufacturing output (Ajayi, 2002). Anwatu (2006) opines that 75% of the private sector in Nigeria is dominated by SMEs, reiterating that the Organized Private Sector (OPS) is the engine of growth and creator of wealth and employment.

Lagos state is the major commercial center of Nigeria, with large concentration of SMEs, despite the increasing number of SMEs, SMEs in Nigeria have not performed creditably well;

hence, they have not played the expected role in the economic growth and development of the country. This may be because some of these SMEs close down while others that still exist are not doing well due to one reason or the other (Basil, 2005 & Fabayo, 2009). The rate at which businesses fail and fold up in Nigeria is alarming, as business failures have an adverse effect on the economy, resulting in losses of incomes, employment and other difficulties to the entrepreneur.

The success or failure of businesses depends on both internal and external business environment in which it operate, thus, the external environmental factors are those that are generally out of the control of the firm such as infrastructure, external sources of finance, the industry, technological changes, economical, and socio-cultural factors, including the external stakeholder such as competitors, creditors, customers, government. Akwani (2007) observes that there is an increased rate in business failure, as many new businesses rarely survived their first year in operation and many SMEs are closed down every year. The research on small business development has shown that the rate of failure in developing countries is higher than in the developed world (Arinaitwe, 2006). Therefore, the reason for the increased failure rate of SMEs in developing countries like Nigeria is worth investigating.

This study notes that in Nigeria and Lagos in particular, such research effort on failed SMEs has not yet been made, thus, this study investigates whether external environmental factors contribute to SMEs failure in Lagos metropolis, in order to achieve the stated objective of the study; the following formulated hypothesis is proposed for testing:

**Hypotheses:** External environmental factors do not play significant role in SMEs failure in Lagos metropolis.

This research work is organized into five sections: section one is this brief introduction, followed by the literature review, methodology, result and discussion and final section which is conclusions and recommendations.

## II. LITERATURE REVIEW

SMEs are expected to provide the driving force for the industrialization and overall development of the Nigerian economy (Akoja & Hasret, 2010), but their performance fall below expectation due to high rate of failure experience in the sector. A high failure rate is a huge negative for an economy,

especially a developing economy with limited capital such as Nigeria (Okpara & Wynn, 2007). This situation however subsists in Nigeria despite relevant government policies and programmes to aid enterprises. Sunday, (2008) observed that Nigerian business organizations are confronted with myriad of problems.

The theory of multiple origins or causes of business failure as a perspective for explaining small business failure emphasises problems such as small business management difficulty, internal organizational environment issues and external business environmental problems, as Barker III (2005) and Stanger (2010), confirm, this theory provides the theoretical validity for the conduct of this research. This study investigates whether; inefficiencies in infrastructure, market demographics, inadequate funding and market competition contribute to SMEs failure in Lagos metropolis.

Sunday (2008), states that the external difficulties facing SMEs in Nigeria include infrastructural problems. According to Alarape (2007) and Okpara and Wynn (2007) some of the obstacles to small business development in Africa include: poor location and poverty among others, the issue of poverty here relates to consumers' income. Poor external market conditions, including stiff competition, slow market growth, and small market size, have been found to be major factors associated with firm failure not only by entrepreneurs but also by venture capitalists (Zacharakis et al., 1999).

Maas and Herrington (2006) and Fatoki (2014) find that some of the primary reasons for the discontinuance of new businesses in South Africa include too much competition and a lack of customers. Basil (2005) in his study identifies many factors as the possible causes or contributing factors to the premature death of SMEs, which include: inability to procure the right plant and machinery, cut-throat competition, lack of official patronage of locally produced goods and services. Inadequate finance is a critical problem which has a huge impact on the growth of SMEs and even poses threat to their survival. Phaladi and Thwala (2008) and Bouazza et al. (2015) conclude that inability to access financial resources/ credit from banks and suppliers is a critical failure factor of SMEs. Maas and Herrington (2006) find that the primary reasons for the discontinuance of new businesses in South Africa are financial reasons. In Williams (1986) survey, 8% of 5,456 failed owners associate their failure with capital inefficiency. Respondents said it was hard for them to get access to external fund. It is clear that factors like interest rates, and the state of economy' would affect all ventures (Peacock, 2000).

From the above review and empirical examination of several studies made in the preceding sections indicates that there is vast literature on SMEs failure, there by placing this study within the framework of existing literature. But this study notes that the results of most of these researches conducted have not been all conclusive in terms of external environmental factors determining SMEs failure. This study also found that in Nigeria, such research effort on failed SMEs

has not yet been made. Therefore, this study aims at investigating the external environmental factors determining SMEs failure in Lagos metropolis through study of failed SMEs in order to fill this gap in the literature.

### III. METHODOLOGY

This research investigates the influence of external environmental factors on failure of SMEs in Lagos metropolis. The research is descriptive-explanatory in nature, and also focuses on studying the environmental causes of business failure in order to explain the relationship between external environmental factors and SMEs failure in Lagos metropolis. The study adopts survey research strategy using questionnaire technique to examine the external environmental determinants of failed SMEs in Lagos metropolis from 2000 to 2017. Lagos state were selected because it's the major commercial centers of Nigeria, and, according to recent survey of MSMEs in Nigeria, the large majority of SMEs in Nigeria are concentrated in Lagos metropolis, (NBS/SMEDAN, 2012).

The research uses primary data collected using questionnaire administered on the target respondents i.e. owners/managers of failed SMEs in Lagos metropolis. Multiple regression statistics was used to analyze the data collected. The study uses four selected external environmental factors (i.e. inefficiencies in infrastructure, market demographics, financial inadequacy and market competition) for analysis in order to investigate the role of these selected environmental factors in the failure of SMEs in Lagos metropolis. The study uses these factors as variable for analysis and each of these factors is measured with three indicators as defined below:

- a) *Inadequate Infrastructure (II)*:- Relates to indicators such as; poor access road, inadequate water supply, and inadequate power supply.
- b) *Market Demographics (MD)*:- Relate to indicators such as; size of the market, population, and consumer income.
- c) *Market Competition (MC)*:- Relates to indicators such as; non-patronage due to competitors, competitors employs better technology, and competitors have more access to advertisement facilities.
- d) *Financial Inadequacy (FI)*:- Relates to indicators such as; lack of access to external fund, high interest rate, and lack of collaterals.

The population of interest to this study is all SMEs situated in Lagos metropolis that failed from 2000 to 2017, and to best of our knowledge there is no statistics of failed SMEs in Lagos state, no survey conducted on failed SMEs and there is no study conducted on failed SMEs. Therefore since there is no existing database from which to clearly determine the population of failed SMEs in Lagos metropolis, the study deals with an infinite or unknown population. Since population of this study is unknown, therefore the sample size

was determined using a formula for determining sample size for unknown and large (infinite) population (Smith, 2013) as follows:

$$n = \frac{C^2 \times S(S)}{E^2}$$

We arrive at the 267 sample size using the 1.96 Z-score (95% confidence level), 50% standard deviation and 6% margin of error (sampling error).

Since there is no record of failed SMEs that will guide us in tracing and locating the owners or managers of failed SMEs, in order to make initial contact, the study created a database of failed SMEs containing business names and location addresses using NBS past (previous) and present (updated) records of existing SMEs in the state, that SME that appear in previous record and did not appear in the updated record is considered as failed SME, which guides us during questionnaire administration. The owners or managers were identified by “tracing and locating approach” using snowball method. This is done by visiting the physical location of the failed SMEs to acquire information about owners/ managers.

For the purpose of testing the hypothesis, the study uses multiple regression models. The independent variables are the four selected external environmental factors, while the

dependent variable is the SME failure represented by life duration/ survival time of the sampled failed SMEs which is identified with the abbreviation SMEF in the regression equation. Thus, the regression equation formulated for testing the hypothesis is as follows:

$$\text{SMEF} = \alpha + \beta_1 \text{II} + \beta_2 \text{MD} + \beta_3 \text{MC} + \beta_4 \text{FI} + \epsilon$$

Where: SMEF	=	SME Failure
II	=	Inadequate Infrastructures
MD	=	Market Demographics
MC	=	Market Competition
FI	=	Financial Inadequacy

#### IV. RESULT AND DISCUSSION

This section presents some descriptive data analysis, and the result of inferential data analysis and test of hypothesis of the research. A total of 267 questionnaires were administered and 171 were retrieved, which were used for analysis. The Table 4.1 summarise the outcome of the respondents' rating of indicators of the four selected external environmental factors that determined the failure of SMEs in Lagos Metropolis

**Table 4.1** Respondents' Rating: The Contributions of Indicators of the selected external environmental factors to their SMEs Failure in Lagos metropolis

Possible Determinants of SMEs' Failure	Ranking					Total Outcome
	1	2	3	4	5	
	Not at all	To a little extent	To an average extent	To a large extent	To a very large extent	
Inadequate Infrastructures						
Lack of good access road	83	36	29	12	11	171
Lack of adequate water supply	106	31	17	9	7	171
Lack of adequate power supply	16	19	35	37	64	171
Market Demographics						
Size of the market	28	42	51	31	19	171
Population	43	40	40	31	17	171
Consumers income	22	32	49	35	33	171
Market Competition						
Competitors enjoy better patronage by customers	15	45	46	42	23	171
Competitors employ better technology	46	47	48	13	17	171
Competitors have more access to advertisement facilities	41	52	48	18	12	171
Financial Inadequacy						
Lack of access to external funds	6	20	40	52	53	171
High interest rate	10	25	40	45	51	171
Lack of collaterals	13	44	40	39	35	171

Source: field survey, 2018.

The descriptive analysis of indicators of inadequate infrastructures as shown in Table 4.1 indicates that most of the respondents rated the contribution of first two indicators i.e. lack of good road and water supply as not at all, but the majority of the respondents rated lack of adequate power supply as contributing to very large extent to the failure of SMEs in Lagos metropolis, which make lack of power supply as the major contributing factor under inadequate infrastructures. This finding agrees with the study of Charles (2006) where 50% of the respondents of his study indicated power shortage as the major cause of business failure. Under market demographics; the respondent indicates that population is not a serious problem, while size of the market and consumer income contributed to an average extent to the failure of their SMEs, but size of the market is the major contributing factor. The findings on market size is in line with works of Williams et al (2005) who agree that few customers and markets are the major factors influencing firm failure.

Tables 4.1 also indicate that the majority of the respondents rated all the three indicators of market competition as contributing between to a little and an average extent to the failure of their SMEs. Similarly, Egeln et al. (2010) agree that causes of business failure include problem with demand. Under financial inadequacy all the three indicators make similar contributions to the SMEs failure in Lagos metropolis, as most of the respondents rated the contributions all the indicators between to an average and very large extent, though the result indicated that lack of access to external fund is the most contributing factor to SMEs failure in Lagos metropolis. Kambwale, et al. (2015) and Iffat et al. (2015) reported that lack of financial support is among the major causes of SMEs failure.

### Hypothesis Testing

External environmental factors do not play significant role in SMEs failure in Lagos metropolis. For the purpose of testing this hypothesis, four predictor variables were used and the multiple regression was ran on SPSS. The result from the analysis is presented in Table 4.2;

**Table 4.2** Regression Result on the Role of Selected External Environmental Factors on SMEs Failure in Lagos Metropolis

R		0.760		
R Square		0.545		
Adjusted R Square		0.364		
F Statistics		4.560		
ANOVA Sign		0.010		
Variables	II	MD	MC	FI
B-Coefficient	-1.514	1.927	-2.306	-2.668
Sign	0.106	0.043	0.041	0.025
Beta	-0.148	0.201	-0.234	-0.281

Source: field survey, 2018, IBM SPSS Statistics, Version 21.

From the statistical results in the Table 4.2, the R value of 0.760 indicates that our model is well fitted. Therefore the  $R^2$  of 0.545 indicates that 54.5% of the variations in the life duration of SMEs in Lagos metropolis is explained or accounted for by the variation in “inadequate infrastructures, market demographics, market competition and financial inadequacy”. The F statistics show a positive value of 4.560 which also indicates that external environmental factors have significant impact on the life duration of SMEs in Lagos metropolis.

The B-coefficient on II, MC and FI are all negative showing an inverse relationship with survival time of SMEs in the metropolis, this indicates that for every extra unit increase in hazard rate of II, MC and FI we expect 1.514, 2.306 and 2.668 years reduction in survival time of SMEs respectively, holding all other variables constant. The B-coefficient for MD is positive showing a direct relationship with survival time of SMEs, indicating that for every extra unit of “market demographics” increase, the survival time of SMEs is expected to increase by 1.927 years holding all other variables constant. Table 4.2 also shows that, MC and FI have significance value of 4.1% and 2.5% respectively which is less than 5% alpha, indicating that they make significant contributions to the failure of SMEs in Lagos metropolis, while the contributions of II to the SMEs failure in the metropolis is insignificant with 10.6%, but MD make significant impact on the survival of SMEs in the metropolis with 4.3% significant value.

However, the joint or collective significant value of all the external environmental factors in the model is 1% which is less than 5% alpha. We therefore infer that external environmental factors make significant contribution in the failure of SMEs in Lagos metropolis, and consequently reject the hypothesis that “external environmental factors do not play significant role in SMEs failure in Lagos metropolis”.

The beta values in this study indicate the hazard rate contributed by the selected external environmental to the SMEs failure in Lagos metropolis, the beta coefficients of -0.148, -0.234 and -0.281 for II, MC and FI respectively, indicate a negative relationship between life duration (survival time) of SMEs, on one hand, and II, MC and FI on the other. These findings revealed that FI is the most contributing factor to the SMEs failure in Lagos metropolis, followed by MC, then II. This agree with the study of Zahra (2011) which indicate that one of the four main causes of business failure in Iranian context is lack of financial support from banks and financial institutions, and Phaladi and Thwala (2008) who conclude that inability to get credit from banks and suppliers is a critical failure factor of SMEs. Maas and Herrington (2006) find that the primary reasons for the discontinuance of new businesses in South Africa are financial problems such as lack of access to credit and high interest rate.



## V. CONCLUSION

In view of the findings that emerged after data analysis and the test of hypotheses, as well as evidence that emerged from the review of empirical studies in the existing literature. The study concludes that external environmental factors contribute to the failure of SMEs in Lagos metropolis, and different environmental factors make different contributions to SMEs failure. Among the selected environmental factors in this study, financial inadequacy (FI) is the major cause of SMEs failure in Lagos metropolis.

## VI. RECOMMENDATIONS

In view of the findings that emerged from this study, and the conclusions drawn, the study recommends that in order to reduce SMEs failure and achieve significant positive contribution of SMEs sector to economic development of Lagos state and Nigeria in general; government and relevant stakeholders should create an enabling business environment by provision of power which will ease the operational problems experienced by SMEs in the metropolis.

The problem of small market size and lack of access to market under market demographics can be minimised through government intervention by provision of market places, patronizing locally made products and purchases from local producers for exportation. The study also recommends provision of simple and affordable credit facilities to SMEs via microfinance institutions as well as grants from the government, relevant stakeholders and donor agencies such as NGOs will reduce the financial problems face by SMEs owners.

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