Market Dynamism and Institutional Environment on Performance of SMEs in Nigeria

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DOI: https://doi.org/10.56293/IJMSSSR.2025.5914

IJMSSSR 2025
VOLUME 7
ISSUE 6 NOVEMBER - DECEMBER **ISSN: 2582 – 0265**

Abstract: SMEs around the world struggle to maintain performance and managers work tirelessly to ensure their businesses survive and perform effectively. Hence, this study examines the effect of market dynamism and institutional environment on performance of SMEs in Nigeria. The study employed cross sectional design and quantitative approach. Questionnaires were used to gather data from respondents and the collected data was analysed using PLS-SEM. The study discovered that market dynamism and institutional environment have significant impact on performance of SMEs in north central Nigeria. The study concludes that market dynamism and institutional environment are key drivers of performance in SMEs, hence the study recommended amongst others that SMEs should prioritize agility and responsiveness. This involves continuously monitoring market trends, adapting to changing customer preferences, and innovating products and services to remain competitive.

Keywords: Market Dynamism, Institutional Environment, SME Performance, PLS-SEM, Contruct

Introduction

Businesses worldwide are developing methods to stay competitive and achieve long-term prosperity as the environment becomes more erratic, unpredictable, complex, and imprecise (Najjinda, Sendawula, Otengei, Walugembe & Kimuli, 2023). Sustainable growth as self-sufficient growth that is accomplished by meeting financial targets and accelerating performance over a long period of time within the capabilities of the businesses, while validating and maintaining future accomplishments without jeopardising the firms' long-term viability (Yusoff, Abdullatiff, Osman & Zawawi (2018).

Environmental characteristics are external factors and situations in the broader environment that have an impact on the operations, planning, and performance of organisations, particularly small and medium-sized businesses. Given that they affect how businesses manage risks, seize opportunities, and react to changes in the market. Environmental elements include things like market conditions, technological advancements, legal frameworks, economic stability, and industrial competition (Wang et al., 2023). The rate of change in consumer preferences, market trends, and competition is referred to as market dynamism. In a highly dynamic market, SMEs need to be creative and flexible to stay ahead of the competition (Teece, 2023).

To succeed in very competitive markets, they must innovate and set themselves apart from the competition (Porter, 2023). Environmental factors including industry competition encourage SMEs to implement cutting-edge technology, enhance quality, and maximise operational effectiveness, all of which boost performance (Smith & Clarke, 2024). The market strategy and success of SMEs are influenced by variables like income levels, demography of the population, and cultural diversity. To attract a wider audience, SMEs working in ethnically varied workplaces, for instance, should use inclusion in their product creation and marketing (Hassan & Ahmed, 2023).

Nigeria's business environment is characterised by some difficulties, such as regulatory compliance, limited infrastructure, complicated regulations, and unstable market circumstances, Capabilities in Technology, Competition, Suitable Legislation (Oguejiofor, Omotosho, Adedolapo, Kehinde, Alabi, Ayoola, Oguntoyinbo, Fuzzy, Andrew and Daraojimba, 2023; Egwuonwu, Arthur, Mendy, Oruh, Emeka & Egwuonwu, 2024). To

improve their sustainability and competitiveness, SMEs must comprehend how they use dynamic capabilities to manage these environmental factors. To get a thorough grasp of this intricate interaction, our analysis will build on previous studies and pinpoint important areas in need of more investigation.

It is based on this backlog that this study seeks to ascertain the effect of market dynamism and institutional environment on performance of SMEs in Nigeria.

Literature Review

Performance

Although performance has many different meanings in different fields and situations, it generally refers to the outcomes or results that a person, group, or system achieves while working towards particular objectives. Some definitions of performance are provided thus: According to Kaplan and Norton (1992), performance is the capacity of an organisation to accomplish its goals and objectives in an efficient and effective manner; it is frequently gauged by profitability, productivity, and customer satisfaction. Business Perspective: The results of an organization's procedures and tactics, including both monetary and non-monetary metrics that show its capacity to satisfy stakeholder expectations, are referred to as performance (Neely et al., 2005). Performance is a thorough assessment of how well an organization's actions result in reaching predetermined goals; it is frequently measured by key performance indicators (KPIs) that are in line with strategic objectives (Bititci et al., 2012).

Market Dynamism

The term "market dynamism" describes how quickly and unpredictably the market environment is changing due to factors like shifting customer tastes, technology advancements, or competitive pressures. According to Zheng and Liu (2023), market dynamism is the rate at which consumer preferences and technical advancements impact how companies adjust and compete in the market. Market dynamism is the speed and unpredictable nature of changes in the market environment, such as changes in consumer preferences, technical developments, competitive moves, and regulatory adjustments. It illustrates how unstable and insecure businesses' operating markets are. The following are researcher definitions and discussions:

According to Dess and Beard (1984), market dynamism is the degree of change and unpredictability in an organization's external environment brought on by shifting consumer expectations, advancements in technology, and competitive dynamics.

Institutional Environment

The laws, rules, and social standards that influence and limit corporate operations are all part of the institutional environment. It may consist of institutional influences, governmental policies, and legal frameworks. Businesses are guided by formal and informal regulations, such as economic, social, and legal norms, which make up the institutional environment (Ali et al., 2023). The official and informal rules, conventions, regulations, and structures that affect organisational performance and behaviour in a particular setting are collectively referred to as the institutional environment. It includes social, cultural, legal, and regulatory elements that influence how businesses operate and make decisions. Researchers' definitions and comments are listed below:

The legal and regulatory structure that controls business operations and market behaviour, including laws, enforcement strategies, and governmental regulations, is known as the institutional environment (North, 1990). It encompasses cultural expectations, societal norms, and unofficial networks that affect how businesses function and engage with their surroundings (Scott, 1995). The institutional environment for SMEs refers to outside factors that impact their expansion, survival, and capacity for innovation, such as bureaucratic obstacles, governmental assistance, and cultural acceptance (Peng et al., 2023).

Empirical Review

Seo et al, (2016) study is focused on investigating effective ways to design Innovation management and maximize firm performance according to market dynamics levels. The study used a multi-agent simulation method (NetLogo, Agent-Based Innovation Simulator (ABIS), treating SMEs as agents, to observe their innovation activity throughout specific time periods in order to comprehend the evolution of performance improvement in SMEs. First, the findings show that the degree of business diversity affects how well SMEs' creative efforts perform. Second, managers must appropriately support innovative activity based on the significance of the task and the state of the market. Although multi-agent simulation is a good option, the article doesn't explain how it was put into practice. Were SME behaviours simulated using hypothetical settings or real-world data? This clarification is essential to the findings' reliability. The simulation model's validation and calibration, which are essential to guaranteeing its dependability and applicability to real SME operations, are not mentioned.

Donkor, Donkor, and Kwarteng (2018) examine the interacting effect of market dynamism and strategic planning on the performance of small- and medium-scale enterprises (SMEs) in Ghana. The interactive impact of market dynamics on strategic planning and the performance of SMEs in Ghana has been examined in this study using a quantitative methodology. 200 Ghanaian small and medium-sized manufacturing and service companies are chosen through the use of purposeful sampling. The hypotheses are tested using hierarchical multiple regression analysis. According to this study, the performance of SMEs in Ghana is improved when strategic planning techniques are applied consistently. Furthermore, it was determined that, despite its non-significant impact, market dynamism has a strong positive correlation with business performance. The study concludes by showing that market dynamism only affects SME performance in the presence of strategic planning. The results are restricted to Ghanaian SMEs. Given the complexity of the study of market dynamics, strategic planning, and performance, it may be ideal for the researchers to use mixed method data collection strategies in order to collect rich data for this type of research. This will improve knowledge of strategic planning, market dynamism, and the relationship between SMEs' performance.

The research's conclusions provide owners and managers with direction on how to improve market dynamics and strategic planning to boost business performance. The study is restricted to SMEs in Ghana, which may limit the generalizability of its findings. Market dynamism and strategic planning could have different implications in other countries or settings. Only manufacturing and service companies are the subject of the study, possibly ignoring other industries that are crucial to Ghana, such as technology or agriculture.

Musawa and Ahmad (2019) studied a conceptual framework for the influence of entrepreneurial orientation and environmental dynamism on marketing innovation performance in SMEs. The study has realised over the past few decades how crucial it is for businesses to appropriately manage the conflicting tensions of exploration and exploitation. Still, not enough is known about the mechanisms and processes involved in each. For a company to succeed both now and in the future, contextual ambidexterity is essential, particularly when the company works in a dynamic setting with a lot of unpredictability. Using data from 133 creative industry SMEs in Indonesia, we conceptualise organisational culture as a multifaceted construct that includes both innovative and bureaucratic culture. We then analyse its effects on firm performance and contextual ambidexterity in both high and low market dynamism settings. Organisational culture, contextual ambidexterity, and firm performance are found to be significantly correlated by the researchers using partial least squares-structural equation modelling (PLS-SEM). Additionally, the influence of organisational culture on business success is mediated by contextual ambidexterity. Additionally, this study reveals that organisational culture, rather than the business's size or age, determines how contextual ambidexterity affects firm performance. Additionally, market dynamism determines how successful contextual ambidexterity is. The study focusses on Indonesia's innovative SMEs and is context specific. Although this provides localised insights, it restricts the findings' applicability to other industries or nations with distinct cultural or economic contexts.

Dele-Ijagbulu, Moos and Eresia-Eke (2020) undertook an empirical study on the relationship between environmental hostility and entrepreneurial orientation of small businesses. This study investigates the relationship between environmental hostility (EH) and entrepreneurial orientation (EO) among small businesses in South Africa. Using a quantitative approach, it found that only four components of EO are statistically recognizable, contrary to five widely acknowledged in literature. Positive associations were also revealed between EH and each

dimension to varying degrees. The findings highlight the need for entrepreneurial action in the hostile environment of South Africa's small business sector. This study looks at how environmental hostility (EH) and entrepreneurial orientation (EO) relate to small businesses in South Africa. It used a quantitative approach and found that only four of the five components of EO that are widely recognized in literature are statistically detectable. Additionally, there were positive associations between EH and each dimension, albeit to differing degrees. In South Africa's difficult small company environment, the findings highlight the importance of acting entrepreneurially.

Omisakin, Arasanmi and Kularatne (2022) analysed the relationship between environmental hostility, environmental munificence, and proactiveness and the growth of small and medium-sized businesses (SMEs). An online survey/questionnaire was used to collect data from small and medium-sized business owners/managers; only 60 of the 100 questionnaires that were sent to potential participants were returned, so the study was limited to 60 SME firms in the CBD of Auckland. The data collected was analysed using the regression method to test the relationships among the variables that were specified. The results of the study indicate that environmental hostility and the growth of SMEs were not supported by the analysis because they were not significantly correlated. The study used a small sample size (60 responses) and a low response rate (60 percent of the 100 questionnaires that were initially sent). The results would have been more reliable and broadly applicable with a bigger sample size. The results' external validity may be impacted by the very low response rate, which may also restrict the sample's representativeness.

Methodology

The study employed the use of descriptive design, and the data was collected using structured questionnaires. The population of the study comprised of some selected SMEs in North central Nigeria which amounts to 9,841, out of which a sample of 509 was drawn. Stratified sampling was used in distribution of the data across the sample. The study employed the use of PLS-SEM to analyse the collected data.

Findings and Discussion

A total of 509 questionnaires were administered to the SMEs in Benue, Kogi, Nasarawa, Plateau, and FCT Abuja. Out of the total number of questionnaires distributed, 487 were returned representing 95% of the response rate. The study employed the support of research assistants from the locations which aided the achievement of the response rate. Furthermore, exploring the questionnaires returned showed that 11 of the questionnaires were discovered to be invalid as 70% of the questions were unattended too. Hence reduced the number of questionnaires valid for analysis to 476 representing 93.5% or approximately 94% of the response rate.

Table 1. Normality Test: Skewness and Kurtosis Statistics

Construct	Min	Max	Mean	Std. Dev.	Skewness	Std Error	Kurtosis	Std Error
PER	3.00	4.75	4.26	0.84	-1.981	0.10	-0.13	0.20
MD	2.20	4.50	2.54	0.56	-1.069	0.10	-0.09	0.20
IE	2.20	5.00	4.36	0.60	-1.809	0.10	-0.86	0.20

The study proceeds to carry out the multicollinearity test. A strong correlation between the variables signifies the presence of multicollinearity, most especially when the correlation between the latent independent variable and another is as higher than 90% (r = 0.9). This argument is justified by the threshold suggested by Hair et al., (2014), which suggested a consideration of a threshold of 0.90. Therefore, looking at the correlation matrix in table 2, it is seen that the maximum value for correlation is .703.

Table 2: Multicollinearity Test: Correlation Matrix

Construct	1	2	3	4	5	6
PER	1					

MD	0.678**		1		
IE	0.325**	0.133**	0.445**	0.161**	1

** Correlation is significant at 0.01 level (2-tailed)

Internal Consistency refers to the consistency of various items or factors measuring the same reflective latent construct (Valentini & Damásio 2016). The traditional criterion for measuring internal consistency which is Cronbach alpha coefficient has been criticized based on its being sensitive to number of items in a construct which further underestimate the true internal consistency reliability, hence, composite reliability (CR) has been suggested as an alternative criterion in SEM and should have a threshold of 0.70 – 0.90 (Hair, et al, 2022).

The reliability and validity of the constructs in this study were evaluated using indicator loadings, composite reliability (CR), and average variance extracted (AVE). All constructs demonstrated acceptable levels of internal consistency and convergent validity, with composite reliability values exceeding the recommended threshold of 0.70. The AVE values for the constructs also surpassed the minimum criterion of 0.50, indicating that the constructs explain more than half of the variance in their indicators.

The construct performance exhibited strong reliability (CR = 0.922) and an AVE of 0.60. Most of its indicators fell within the threshold adopted in this study which ranges from 0.40 to 0.70. Looking at the loadings PER2 = 0.875, PER7 = 0.913, PER1 = 0.435 and PER6 = 0.562. This shows that the overall construct retained sufficient reliability and validity.

Market Dynamism showed robust psychometric properties, with a CR of 0.815 and AVE of 0.60. All indicators (MD2–MD5) had loadings above 0.80, confirming strong item reliability and construct validity.

Institutional environment had a CR of 0.850 and an AVE of 0.507, meeting the minimum criteria for construct validity. Environmental hostility also met the reliability and validity benchmarks (CR = 0.764, AVE = 0.505), with EH6 showing a particularly strong loading (0.908).

Overall, the measurement model demonstrates adequate reliability and convergent validity across constructs.

Table 3: Discriminant Validity: Heterotrait-monotrait ratio (HTMT)

	DC	EH	MD
DC			
IE	0.321		
MD	0.256	0.261	0.674
PER	0.261	0.450	0.896

The results of the structural model are interpreted using the coefficients (Beta) of the path relationship, the standard error (SE), and t-value (T statistics). The hypotheses were assessed at 5% level of significance.

As presented in table 4, the statistical analysis indicated that technological environment has an effect on performance, however, this was not statistically validated by the p-value hence leading to accepting of the hypothesis.

The structural model investigates the direct influence of key market dynamism and institutional environment (IE) on performance (PER). The path coefficients and associated p-values derived from bootstrapping provide insight into the strength and statistical significance of these relationships.

Among the predictors, institutional environment (IE) emerged as the strongest and most statistically significant driver of performance, with a coefficient of 0.608 and a p-value of 0.000. This indicates a robust positive relationship, suggesting that a supportive and well-structured institutional context substantially enhances organizational performance. The significance level confirms that this effect is highly reliable and not due to

random variation.

Market dynamism (MD) also demonstrated a significant and positive impact on performance, with a coefficient of 0.424 and a p-value of 0.000. This finding implies that firms operating in dynamic and rapidly evolving markets tend to perform better, likely due to increased opportunities for innovation, adaptation, and strategic responsiveness.

Table 5: Hypotheses test

Relationship	B Value	P values	Decision
MD-> PER	0.424	0.000	REJECT
IE-> PER	-0.099	0.047	REJECT

The coefficient of determination or assessment of the R-square level was assessed in order to evaluate the amount of variance explained by the exogeneous latent variables on the endogenous latent variables.

Table 6: R-Squared

Construct	R-square
PER	0.81

The R-squared value for the dependent construct performance (PER) is reported as 0.81, indicating that 81% of the variance in performance is explained by the model's predictors. This reflects a strong level of explanatory power. In structural equation modeling, an R-squared value above 0.81 is generally considered high, especially in social science research, where complex and multifaceted constructs are involved. This result confirms that the model is well-specified and that the selected variables are theoretically and empirically relevant in predicting performance outcomes.

Conclusion

This study set out to investigate the influence of external environmental factors namely market dynamism, technological environment, institutional environment, and environmental hostility on firm performance, with a particular focus on the moderating role of dynamic capabilities. Drawing on the dynamic capabilities' theory, the study developed and tested a conceptual framework using Partial Least Squares Structural Equation Modelling (PLS-SEM), based on data collected from firms operating in a dynamic and evolving business landscape.

The findings revealed that both Institutional Environment and Market Dynamism have significant and positive effects on performance, underscoring the importance of regulatory support and market responsiveness in driving business success.

Recommendations

In line with the findings and conclusions of the study, the following recommendations were made:

1. Based on the findings of this study, several practical recommendations are proposed to help firms particularly small and medium enterprises (SMEs) enhance their performance in dynamic and challenging environments. First, since market dynamism was found to have a significant positive effect on performance, firms should prioritize agility and responsiveness. This involves continuously monitoring market trends, adapting to changing customer preferences, and innovating products and services to remain competitive. Strategic flexibility and proactive market engagement are essential for thriving in dynamic conditions.
2. Second, the strong positive relationship between institutional environment and performance underscores the importance of regulatory support and policy stability. Firms are encouraged to strengthen their engagement with formal institutions, comply with relevant regulations, and leverage government

programs and industry associations to access resources and build legitimacy. Establishing dedicated roles to manage institutional relationships can further enhance strategic alignment and operational efficiency.

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