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## The Impact Of The Nigerian Economic Environment On Company Performance: A Particular Reference To 20 Most Capitalised Companies In Nigeria.

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### **Abstract**

There is a theoretical agreement that the environments within which businesses operate have great bearing on their performance. This research shows the empirical standing of this theoretical convergence with respect to the 20 most capitalized companies in Nigeria. Using the Ordinary Least Square and simple multiple correlation methods, we show the impact of the Nigerian business environment on the performance of these companies. Collectively, the variables of the environment have significant and positive impact on the companies' performance. Government expenditure and inflation have positive impact while exchange rate and interest rate have negative impact but on the whole there was a positive and significant impact. Amongst the recommendations are that Government should pay more attention to capital expenditure on vital sectors like infrastructures and education while maintaining fiscal stability. The private sector should partner with Government in infrastructural investment instead of each company providing its own infrastructures.

**Keywords:** Nigerian Business Environment, Company Performance, Nigeria.

### **Introduction**

The environment of going concerns, like the habitats of animals, contributes to their development. Like the natural environments of living beings, the environment of a business can either enhance or stifle its growth and development. The nature and extent of the impact of the environment on any one company depends on the internal configuration of such a company. Researchers have categorized the environment into three components, the preparedness of any one company being referred to as the internal environment. These are the macro environment, the industry environment and the internal environment. It has also been shown that the internal environment affect performance most followed by the

industry environment and lastly, the macro environment.

Nigeria started as a company, the Royal Niger Company, became a protectorate and finally a Republic. As a Republic there were businesses that were run by the government. The government was doing business and also providing enabling environment for businesses. With time it became obvious that the Government was not a good entrepreneur and that it was better to concentrate in providing an enabling environment while private organizations are allowed to run the businesses. This led to the wave of privatization that is still ongoing. The interplay of government and business first as a direct participant and later as a provider of an enabling environment suggests the importance of the

environment in the prospects of businesses. It would appear that due to the developing nature of the Nigerian business environment, it is likely to occupy a critical position in the performance of businesses. Using simple Ordinary Least Square (OLS) regression and multiple correlations, the role of the Nigerian business environment on the performance of companies in Nigeria is explored.

### **Literature Review**

The theories that are most relevant to our research are discussed. We concentrate on two of these theories. These are the systems theory and the Corporate Social Responsibility theory. This is followed by a review of related studies.

### **The Systems Theory**

Nwachukwu (2006: p9) defines a system as “a set of interrelated and interdependent parts arranged in a manner that produces a united whole” while Kuhn (1974) considers a system as “any pattern whose elements are related in sufficiently regular way to justify attention”. Laszlo and Krippner (1997) view a system as a boundary maintaining entity with complex interacting components that sustain relationships. With the social Sciences these boundaries do not only become weak but keep changing as behaviours change.

The systems theory holds that an organization is a system that needs to work harmoniously not only within itself but that it is a system within a collection of other systems and, therefore, needs to work also in congruence with the other systems around it. What happens in the larger system is capable of affecting the

organization either positively or negatively. Boulding (1956), the economist torched on the systems theory but termed it ‘The General Empirical Theory’ slightly different from Bertalanffy’s (1968) ‘General Systems Theory’. The system theory, therefore, has its origin in Biology with the work of Bertalanffy. The theory started with two major assumptions that were later adjusted to the contrary. These are, one that a system could be broken into its component parts and each part analysed separately, two that the different sections of a system can be added linearly to get an understanding of the total system. These assumptions were later adjusted to the effect that a system is not a summation of its component parts which is linear, but a non-linear aggregation of the interactions of these component parts

All researchers concur on the usefulness of the Systems Theory. The theory is not only interdisciplinary but integrative in nature. As Laszlo and Krippner (1997: 6-7) put it “Systems theory promises to offer a powerful conceptual approach for grasping the interrelation of human beings and the associated cognitive structures and processes specific to them in both society and nature”. It is “concerned with the holistic and integrative exploration of phenomena and events”. The term conveys “a complex of interacting components together with the relationships among them that permit the identification of a boundary-maintaining entity or process” The General Systems theory aims at looking at the entire world as a composite of co-existing, interacting and interrelating elements. This is not to undermine or downplay the value of studying units, subsystems or even

systems within a larger context (a reductionist approach) as is done in specialization, but to place all disciplines within proper perspective of the whole. As captured by Laszlo and Krippner (1997: ), "the General systems approach encourages the development of a global, more unitary consciousness, teamwork, collaboration, learning for life and exposure to the universal storehouse of accumulated knowledge and wisdom". Boulding (1956) as cited in Walonick (1993: 10) had earlier indicated this by stating that the general systems theory "aims to provide a framework or structure on which to hang the flesh and blood of particular subject matters in an orderly and coherent corpus of knowledge"

In 1974, Kuhn extended the theory to include the fact that the knowledge of a part of a system facilitates the knowledge of another part. A system can either be controlled (cybernetic) or uncontrolled. A controlled system sensed information (Detector), applies rules to take decision on what is sensed (Selector), and makes some transaction or communication between the system (Effector). According to Kuhn (1974), the aim of decision (communication and transaction) between systems is to achieve equilibrium. A system can either be a closed system in which case interactions occur only between elements within the system and not with any system outside it, or an open system where interactions occur both within the system and outside it. Closed systems tend towards negative entropy with the likelihood of decaying due to the absence of exchanges with outside systems.

Kuhn (1974) also gave insights into how systems could be studied. They could be studied by cross-sectional method where the interactions between two systems are examined or by developmental approach by which changes that take place in a system over a period of time are looked at. A system can be evaluated holistically by looking at its functioning in totality or by a reductionist manner where subsystems within the system are studied. Lastly a functionalist approach could be used where an upward examination of the interactions of the system with a larger system is carried out.

### **The Corporate Social Responsibility (CSR) Theory**

Corporate Social Responsibility has many perspectives, It involves both the behavior of organizations to meet societal expectations (Carrol, 1979) and those voluntary undertakings aimed at improving the environment in which corporations operate so that they can function in a better environment which may even supersede societal expectations (Vogel, 2006). In fact Kinderman (2012) and Brammer et al (2014) believe that CSR is sharpened and grounded in voluntary behaviours of corporations intended to improve the environment of doing business. Little wonder the European Commission in Brammer et al (2014) looked at an institutional perspective of CSR focusing on "the determinants of whether and in what forms corporations take on social responsibilities". They define Social Responsibility as "a concept whereby companies integrate social and environmental issues in their business operations and in their interactions with their stakeholders on a voluntary basis".

This voluntarism appears to explain why despite many researches indicating no or even negative link between Corporate Social performance and profits, more corporations still engage in CSR.

Matten and Moon (2008) showed that companies that engage in CSR both in Japan and Western Europe indicated high levels of success. Campbell (2007:1) revealed some of the conditions under which companies are likely to embark on CSR to include “public and private regulations, the presence of non-governmental and other independent organizations that monitor corporate behavior, institutionalized norms regarding appropriate behavior, associated behavior among corporations themselves, and organized dialogues among Corporations and their stakeholders” Researches on the relationship between CSR and the financial performance of companies have shown divergent results. While some showed CSR leading to enhanced financial performance (Rowley & Berman, 2000; McWilliams & Siegel, 2000; Walsh et al, 2003, Matten & Moon, 2008 and Gunu, 2008), others showed that it was the financial conditions of organizations that determine their Corporate Social Performance (Friedman, 1970).

In fact Friedman (1970) started with an opposing view of CSR. He sees the concept as capable of subverting the principal objective of corporation which is to make profit. He holds that “the business of business is business”. Friedman & Friedman in Gunu (2008: 3) state that there is one and only one social responsibility of business: to use its resources and energy in activities designed to increase its profits, so long as

it stays within the rules of the game and engages in open and free competition without deception or fraud”. They believe that social issues should be left for Government which is set up for that particular purpose. With the increasing adoption of Private Public Partnership (PPP) arrangements in many countries, this view appears to be losing grounds. The issues are how far and under what conditions should Corporations be more socially responsible (Campbell, 2007; Gunu, 2008; and Agbaeze & Onwuka, 2014). This variation in CSR issues and practices was shown by Adapa (2013) with Islamic Banking in Kuala Lumpur, Malasia between local and foreign banks.

Other researchers have argued that the Corporation being a creation of the State has been given the right to exploit resources and make profit. For this privilege and power, there has to be a balancing responsibility. CSR should, therefore, be viewed as a pure business venture considering the impact of Corporations both on the environment, working conditions, employment, incomes, and politics (Brammer et al, 2012; Radin & Calkins, 2006; Jermier et al, 2006; and Crouch, 2004). As Multi-National Corporations (MNCs), CSR should not be optional in view of the enormous resources they command. In fact it should be institutionalized so that it is practiced wherever the Corporation has a presence (Fransen, 2012; Maren, 2012; and Campbell, 2007)

### **Empirical Review**

A lot of researches have been carried out on the impact of the environment on various sectors of the Nigerian economy, but in a disaggregated manner. Each



research normally takes a particular aspect of the environment and examines its impact on a sector of the economy. Eze and Ogiji (2013) considered the impact of Fiscal policy on manufacturing output of Nigerian companies. They showed a long term relationship between government expenditure on one hand and manufacturing output and capacity utilization on the other hand. The impact was positive and significant. Kwaghe (2011) pointed to the fact that power failure increases the cost of production of small and medium scale enterprises in Abuja, Nigeria. Adelegan (2011) looked at infrastructural deficiency and investment in the manufacturing firms in Nigeria. Gado and Nmadu (2011) similarly showed that electricity as an infrastructural resource significantly determines the performance of textile companies in the North West zone of Nigeria. This research aggregates various environmental issues and assesses the impact of the aggregate on the performance of companies. The impact of the energy sector on the competitiveness of the Nigerian economy was underscored by Adenikinju (2008) while Iarossi and Clarke (2011) showed that energy supply was considered as the number one challenge amongst businesses in Nigeria

Adebayo (2005) studied the relationship between environmental factors and business strategy finding a good reason to recommend the establishment of a separate 'strategy and corporate affairs unit' charged with the responsibility of monitoring the environment so as to properly align company activities with the former. He considered all the environmental factors of economic, technological, socio-cultural and politico-legal without any empirical linkage. We concentrate

on the economic environment and employ parametric analysis for empirical linkage. Other researchers have either linked two or more environmental factors with one another (Idris, 2008) or explore the relationship between one or more environmental variable(s) with the general performance of an economy (Gunu, 2008; Enu & Havi, 2014; and Gado & Ezie, 2014)

Walonick (1993) agrees that "although there is now a consensus on the importance of the environment, there is still much disagreement about which features of the environment are most important". With the interrelationship between businesses especially in this age of increasing use of sub-contracting, the environment of business affect all organizations. Akinyele et al (2014) found out that inter-industry marketing relationship significantly affect the development of company production capabilities.

Shah and Yadav (2014: 37) studied the impact of the Cultural environment on international business performance and came to the conclusion that "as important as culture is, it is probably less important than economic, political and legal systems in explaining differential economic growth between nations, We should not overemphasise their importance in economic spheres". Taking a cue from this finding, we concentrate on the economic environment to learn more about its impact on the performance of 20 most capitalized companies in Nigerian.

### **Conceptual Framing**

Traditionally, the external business environment was viewed as uncontrollable so that organizations

seeking success had to devise means of coping with this environment (Wheelen and Hungers, 1995). This view is still useful today with the added knowledge that organizations can proactively shape their environment through their collective behavior. The usefulness of the external environment is in the fact that companies should be conversant with their environment by periodically scanning or analyzing it to identify both driving forces and threatening factors. This prepares them to garner their internal factors (within their control) to take advantage of the driving forces and also to shield themselves from the threatening factors. This exercise has been described by the acronym SWOT (Strength, Weaknesses, Opportunities, and threats) analysis or strategic group mapping (Thompson and Strickland, 2004).

Taking a look at the business environment is, therefore, like considering the cost of a building before embarking on it lest after starting one finds that the cost is too much and the building is not completed. People pass by such building and mock the owner for starting something he could not complete. It is also like a country going to war with another country and making a good assessment of its war capabilities against those of the enemy whether there is chance of winning the war (Luke 14: 28-31). Even before starting the business, a painstaking, time consuming and mind-involving business plan utilizes variables in the environment to determine the prospects of the business and assure investors of the safety of their moneys in the venture. Environmental factors such as income, employment, cost of capital, inflation, exchange rates,

technology, legal provisions, industry demand and nature of competition need to be captured in the business plan (Hisrich, Peters, and Shepherd, 2008)

All the environmental variables could be broken into four groups of Economic, Technological, Politico-legal and Socio-cultural, with each group having myriads of individual variables (Porter, 1980). The focus of this paper is on the economic variables which comprise of Gross Domestic Product (GDP), Interest rates, Government expenditure, Inflation rate, unemployment, exchange rate, and foreign direct investment (FDI).

### **Research Methodology**

The Pearson's correlation is used to analyse the relationship between the performance of the companies and the economic variables. A multi-correlation is adopted to determine the correlation of individual independent variables (economic environmental variables) on the dependent variable (the performance of the companies as measured by their Earning per Share (EPS)). This is combined with the Ordinary Least Square (OLS) regression method to determine the degree of dependence of company performance on each of the environmental variables.

E-views version 7 is used both for the analyses and for determining the significance of the correlation at 95% degree of confidence. This level of significance is chosen because it is considered adequate for the Social Sciences (Frankfort-Nashmiahs & Nashmiahs, 1996 and Asika, 2000). Though correlation coefficient ordinarily does not suggest causation, when

squared it becomes a coefficient of determination which indicates causation between variables (FrankfortNashmiahs & Nashmiahs, 1996). The regression coefficients suggest the level of determination. The yearly EPS (dependent variable) of individual companies were extracted from their annual reports and the average for the 20 most capitalized companies computed using EXCEL. The yearly average was then used as proxy for performance (Maimako, 2014).

The environment (independent variable) was represented by four variables which are Interest Rate, Exchange Rate, Government Expenditure, and Foreign Direct Investment. The data of both dependent and independent variables are presented in *Appendix 1*.

### Results Of Analysis

The regression results in Table I indicate a robust model going by the high F-Statistics of 20.88 and a probability of 0.0025 (2.5%). A corresponding R-Squared of 0.9435 (94.35%) indicates

that the model has a 94.35% power of predicting the dependent variable. Also a Durbin-Watson Statistic of 1.72 (approximately 2) means that there is little or no autocorrelation within the variables themselves. Even when we penalize our model on the assumption that non-contributory variables were probably added, our adjusted R Squared is still very good (89.83%).

Taking a look at the statistics of our regressors, our a priori expectations were met. Exchange rate and interest rates have negative coefficients showing that increase in their values impact negatively on the performance (EPS) of the companies. Government Expenditure and inflation had positive signs meaning that there is more purchasing power and more demand with increase in Government expenditure. Performing better with more inflation means that the inflation is not cost induced and that demand does not respond to price increases for want of alternatives. The resultant effect is that companies make more profit leading to increase in EPS.

Table I: OLS Regression Statistics

Dependent Variable: EPS

Method: Least Squares

T Date: 01/30/15 Time: 13:16

T Sample: 2004 2013

Included observations: 10

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	5.436410	4.492901	1.210000	0.2804
EXCHANGE	-0.027702	0.027654	-1.001740	0.3625
GOVTEXP	8.02E-07	1.22E-07	6.592008	0.0012
INFLATION	0.037500	0.086826	0.431892	0.6838

INTEREST -0.070813 0.256926 -0.275618 0.7939

		Mean dependent	
R-squared	0.943526	var	4.066000
Adjusted R-squared	0.898347	S.D. dependent var	2.526593
S.E. of regression	0.805557	Akaike info criterion	2.712288
Sum squared resid	3.244612	Schwarz criterion	2.863580
Log likelihood	-8.561438	Hannan-Quinn criter.	2.546320
F-statistic	20.88402	Durbin-Watson stat	1.724672
Prob(F-statistic)	0.002546		

Source: Author's Computation using E=Views Version 7

Table II: Pearson's Correlation Statistics

	EPS	EXCHANGE	GOVTEXP	INFLATION	INTEREST
EPS	1.000000	0.508725	0.963282	-0.289664	-0.349022
EXCHANGE	0.508725	1.000000	0.621585	0.069557	0.109251
GOVTEXP	0.963282	0.621585	1.000000	-0.298466	-0.301495
INFLATION	-0.289664	0.069557	-0.298466	1.000000	0.431300
INTEREST	-0.349022	0.109251	-0.301495	0.431300	1.000000

Our regression results show that Government expenditure has the highest impact (800%) on company performance followed by interest rates (7.08%) and inflation rates (3.75%). Exchange rates have the least impact of 2.77%.

However, all the variables except government expenditure were individually not significant in determining the performance of the companies. Government expenditure was significant at 5%. All the variables



combined were also significant at 5% in determining the dependent variable (EPS).

The results of our correlation in Table II agrees with the regression result in Table I. Government expenditure has the highest 96.32% (almost perfect correlation) followed by exchange rate (50.87%) then interest rate (34.90%) and lastly inflation (28.96%).

### **Discussions And Policy Implications**

Nine of the 20 companies in our sample are banks while the remaining 11 are made up of 10 manufacturing companies and 1 oil company (Appendix II). While interest rates may have more impact on the 9 Banks, exchange rate and inflation may affect the manufacturing companies most. Government expenditure is likely to affect all the companies uniformly.

Government expenditure affects the state of infrastructures like roads, water, security, power, transportation and communication which have positive impact on the performance of companies. The improved state of these infrastructures makes for increase in the volume and efficiency of output. It also affects purchasing power and by extension demand as employment is increased. For the banks, increased government expenditure means more money circulating through various accounts thereby generating Commission on Turnover (COT) and other administrative charges.

The policy implications include the need for efficient management of exchange, inflation and interest rates in such a way as to stimulate the economy to grow. The

positive coefficient of inflation in our model suggests that high inflation, though a disincentive to savings, may not be undesirable as it could encourage companies to make profit by either investing more or by earning more from existing investments as demand may be inelastic on account of the psychological underpinning of high prices being associated with quality in a country like Nigeria.

The need for high, well structured and effective government spending to stimulate the economy is echoed by the work of Ajayi (2011) who showed that the main cause for the collapse of the Nigerian manufacturing sector was the unsatisfactory implementation of the budget particularly in the area of infrastructural development. This was also supported by Charles (2012) whose work suggests that money supply, which has a direct link with the level of government expenditure, has a positive impact on manufacturing, industry being an important component of Nigeria's GDP (UNIDO, 2011).

The effective management of interest, inflation and interest rates is also underscored by the result of this research. Since both the regression and correlation results show a good connection between interest rates, exchange rates and inflation rates, the relative stability of these variables over time, in addition to their levels, is crucial. This explains the fact that while some researchers have shown non effect of these variables on performance (Omitogun & Ayinla, 2007; and Dickson, 2010), others, including this research, have shown tremendous impact (Eze & Ogiji; Rasheed, 2010; Charles, 2012, Sikiru & Umaru, 2011).

This seeming divergent results suggest that the levels, as well as the fluctuations, in these variables affect company performance, and by extension, economic performance. Thus the Nigerian government should not only strive to achieve macroeconomic stability but attain appropriate levels of these fiscal variables.

Another possible reason for divergent results of the connection between government expenditure and performance is the discriminating nature of the impacts of capital expenditure and recurrent. Increase in the recurrent portion of government expenditure has been shown to have little or no impact on economic performance (Aladejare, 2013).

The sectoral distribution of even the capital expenditure can colour the impact of such expenditure on company performance. Capital expenditure on education has been shown to impact positively on performance more than other sectors (Chude and Chude, 2013)

For the Companies, going by the theories of Social Responsibility and systems relationship, the issue of Private Public Partnership Agreement (PPPA) is recommended by which joint investment in infrastructural development can be undertaking. This will benefit the companies by providing better environment in which to operate. This is against the backdrop of the fact that a lot of researchers have shown that the Nigerian business environment, with infrastructures ranking very high, is an inhibiting factor (Adenikinju, 2008; Iarossi and Clarke; Kwaghe, 2011; and Obadan, 1998).

In consonance with the Systems theory Nigerian companies should not only ensure that they operate at optimum levels by developing and effectively deploying up-to-date resources but be conversant and properly tuned to the environment of business in Nigeria. Companies as subsystems within the larger economic environment must strive to attain harmony with the later. The effectiveness of the environment as a larger system affects the success of companies in this environment. Granted that the level of effect of the environment varies with the positioning of each company, the well being of the environment impinge generally on the performance of all companies within it.

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