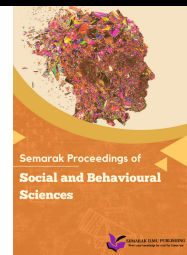




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# The Role of External Environment in the Business Outcomes of Malaysia's Micro-Entrepreneurs: A Conceptual Paper

Shuhymee Ahmad<sup>1,\*</sup>

<sup>1</sup> School of Business Management, College of Business, Universiti Utara Malaysia, 06010 Sintok, Kedah, Malaysia

### ABSTRACT

The uncertain external environment significantly influences the performance of small and medium enterprises (SMEs). Various studies highlight how different dimensions of environmental uncertainty impact SMEs' strategies and overall performance. Previous research has found the relationship between external environmental variables and business performance is complex and often inconsistent. This statement has been proven through several findings from past studies, which found an inconsistent relationship between external environmental variables and business performance. The relationship between external environmental factors (dynamic, hostile, and munificent) and the business performance of micro-businesses in Malaysia is complex and multifaceted. Research indicates that these environmental factors significantly influence micro-business performance, particularly in the context of strategic decision-making and resource allocation. The respondents consisted of micro-entrepreneurs running various business sectors in Malaysia. The respondents registered until June 2024 will be obtained from SME Corp. Malaysia. Micro-businesses operating in Malaysia will be randomly selected as respondents in this study. Researchers will use online and face-to-face approaches to receive information through the questionnaire developed. Correlation analysis and multiple regression will be used to test the three main hypotheses of the study. The findings from this study can be utilized by the government, entrepreneurs, other researchers, and stakeholders responsible for helping entrepreneurs in Malaysia.

**Keywords:** Business performance; external environment; micro-entrepreneurs

## 1. Introduction

Small and medium-sized enterprises (SMEs), particularly micro-entrepreneurs, are pivotal to economic growth and industrial development. They contribute significantly to job creation, innovation, and local economies, making them essential players in national economic strategies [1,2]. Micro-businesses play a crucial role in both developed and developing economies, significantly contributing to job creation, business establishments, and GDP. Their impact is particularly pronounced within the context of SMEs, which account for a substantial portion of economic activity [3]. Although micro-businesses contribute to the country's income, the contribution of individuals remains low. Issues related to the business performance of SME firms, especially in Malaysia, are often discussed and debated by academics and policymakers [4,5]. A study by SME Corp. Malaysia showed that more than 70% of SME firms operating in Malaysia are affected by the current uncertain

\* Corresponding author.

E-mail address: shuhymee@uum.edu.my

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economic environment [3]. Therefore, various policies have been implemented by the government to assist SMEs in Malaysia.

However, the transformation of the global business environment caused by the current economic and financial crisis and the latest impact of the COVID-19 pandemic has created various new problems and challenges for all SMEs worldwide, including in Malaysia. The COVID-19 pandemic represents one of the most profound crises recorded in historical context. It significantly disrupted the global business landscape [6]. The extended effects of the COVID-19 pandemic crisis have slowed down business activities worldwide, including in Malaysia [7].

A survey conducted by SME Corp. Malaysia found that SMEs, including micro-businesses in Malaysia, have suffered a direct impact from the global crisis. Due to these challenges and problems SMEs face, many researchers are interested in studying micro-businesses, especially their business performance, in developed and developing countries [8]. According to Yang [9], monitoring the performance of Small and Medium Enterprises (SMEs), including micro-businesses, is crucial due to their myriad challenges. Continuous assessment can help identify issues early and facilitate strategic adjustments to enhance resilience and success [4,5].

Many studies have been conducted to identify factors that can affect the performance of SME firms [8,10], especially micro-businesses in Malaysia. Yahaya and Nadarajah [8], Wiklund and Shepherd [11], Lumpkin and Dess [12], and Covin and Slevin [13] have proposed examining the influence of external factors on firms, which may also affect the performance of SME firms, particularly micro-businesses. Past studies have found that external environmental factors influence a firm's operation. Entrepreneurial firms that operate in an uncertain environment are always vulnerable to the risk of failure. Therefore, continuous research on the influence of the business environment, especially the dynamic, hostile, and munificence external environment, on entrepreneurial firms should be carried out to understand its impact on business performance [14,15].

In this regard, an empirical study should be conducted on the relationship between external environmental variables (dynamic, hostile, and munificence) and business performance. Specifically, this study aims to determine the relationship between the variables of dynamic, hostile, and munificence external environments and the business performance of micro-businesses in Malaysia.

## **2. Literature Review**

Environmental factors significantly influence the success or failure of entrepreneurial firms, as evidenced by various studies. These factors encompass macro-environmental elements such as political, economic, social, technological, environmental, and legal aspects, shaping entrepreneurial intentions and operational conditions [16,17]. According to Duncan [18], the environment refers to the physical and social factors that occur outside the organisation and are related to the decision-making process of an entrepreneur [19]. The external environment is the forces and institutions outside the organisation that can affect business performance [20]. Robbins and Coulter [20] categorise this external environment into two components: the specific environment, which includes economic, sociocultural, political or legal, demographic, technological, and global forces, and the general environment, which involves customers, suppliers, competitors, and public pressure. All these forces exert direct or indirect pressure on the firm, affecting business performance [21].

According to Guohe [22] and Donaldson [21], the effects or impacts of these forces can be categorised as dynamic, hostile, munificence, and complex. Past studies have examined the direct relationship between the external environment and performance. Based on the results and recommendations from previous studies, Augustie and Md Saad [14] and Rauch *et al.*, [19] have

agreed that the external environment can act as a contingency variable, directly impacting SME firms' business performance.

In this regard, Guohe [22], Davis [23], and Lumpkin and Dess [12] have agreed that dynamic, hostile, and munificence external environments are among the variables that need to be examined because all three have been widely accepted as dimensions of the external environment in most past studies.

## 2.1 Business Performance

Business performance is one of the key issues highlighted by stakeholders in a firm, including owners, investors, suppliers, and employees [24]. Strong performance is a key goal for every SME firm. According to Sagita *et al.*, [25], strong performance enables firms and society to reap benefits through the efficient use of resources, job creation, and wealth generation. Underperforming firms often face significant challenges that lead to uncompetitiveness and financial difficulties. Factors such as lack of entrepreneurial orientation, ineffective management, and external pressures contribute to their struggles. Research indicates that underperforming firms can persist due to non-performance factors like personal sunk costs and environmental complexity [26]. Therefore, it is important for firms to constantly monitor their performance due to changes in the business environment [27].

Performance measurement provides firms with information that allows them to take appropriate actions and adjust their strategic direction to secure their future. Given its significance, performance measurement has attracted considerable interest from researchers in both theoretical and practical fields [28]. Robbins and Coulter [20] have outlined several reasons organisations need to measure performance, such as identifying success, meeting customer needs, understanding processes, and determining where problems arise to take corrective actions. Additionally, performance measurement ensures decisions are based on facts and helps to track whether improvements are occurring [28].

## 2.2 Dynamic External Environment

According to Guohe [22], Dess and Beard [29], and Duncan [18], the main characteristics of a dynamic environment include unpredictable conditions and rapid rates of change, which introduce an element of uncertainty to a firm's operations in an industry. Miller and Friesen [31] define a dynamic environment as the rate of change and innovation in an industry and the degree of uncertainty or unpredictability in the actions of competitors and customers [32]. Lumpkin and Dess [33] describe a dynamic environment as one characterised by uncertain market conditions, complexity, and changes that affect firms' performance.

Empirical studies consistently demonstrate that entrepreneurial firms operating in dynamic environments positively influence business performance [33-35]. However, findings from past studies also show contrary results. For example, a study by Kreiser *et al.*, [6] found mixed results. The study found that the dynamic environment could influence a positive relationship with gross profit performance, but the relationship between sales level and sales growth is complex and often influenced by various internal and external factors [23]. While some studies suggest that external environmental dynamics do not significantly impact business performance, others highlight the nuanced interplay between sales metrics and firm capabilities [23]. In this regard, the researchers attempted to test the following hypothesis:

Hypothesis 1: The dynamic external environment has a significant relationship with business performance.

### 2.3 Hostile External Environment

The second external environment variable examined in this study is hostility [22]. According to Green *et al.*, [37], Covin *et al.*, [38], and Lumpkin and Dess [33], a hostile external environment is the opposite of a munificence environment, including in terms of its measurement. A hostile environment refers to the severity of competition due to a lack of resources [14,23,39,40], while a munificence environment helps firms with a level of resource readiness that can reduce the level of risk [36]. According to Augustie and Md Saad [14] and Lumpkin and Dess [33], a hostile environment describes unsupportive external pressures in the market or industry in which a firm operates.

Further, Miller and Friesen [41] describe a hostile environment as one characterised by competition for price, products, technology, strict legal restrictions, labour shortages, as well as raw materials and demographic patterns that are unfavourable to firms. Based on their preliminary study, Miller and Friesen [31] formulated that a fiercely hostile environment represents the level of threat faced by firms due to various aspects and the intense competition that causes fluctuations in the market or industry. Meanwhile, Covin and Slevin [39] refer to a hostile external environment as a situation where intense competition decreases a firm's chances of success. According to Davis [23], a fiercely hostile environment causes firms to become less competitive and always be in a very risky situation, which indirectly affects business performance.

Due to this situation, the factors of a hostile environment are frequently studied and discussed in the literature [12,14]. For example, a study by Becherer & Maurer [42] found that entrepreneurial firms are more successful when operating in a hostile environment. These findings are also supported by a study by Davis [23], which found that entrepreneurial orientation attitudes are positively related to the level of a hostile environment. However, not all previous studies have found that a hostile environment improves its relationship with business performance. According to Augustie and Md Saad [14], and Davis [23], some past studies found that a hostile environment can harm business performance due to the firm's limited resources. Therefore, the researchers have proposed the following hypothesis to be tested:

Hypothesis 2: The hostile external environment has a significant relationship with business performance.

### 2.4 Munificence External Environment

As discussed earlier, munificence external environments have characteristics that are at odds with hostile environments [22,33]. According to Covin *et al.*, [38], a munificence environment has characteristics such as high-profit margin rates, a low level of competition, a high level of customer loyalty, and the ability to tolerate poor decision-making by management. Due to these characteristics, most previous studies have found that the failure rate of firms operating in a munificence environment is low. Therefore, Dess and Beard [30] refer to a munificence environment as the ability of the environment to support and sustain the growth of a firm.

It was found that most past researchers agreed that a munificence environment is associated with the level of resource availability to firms [23,43,44,]. According to Castrogiovanni [45], a munificence environment can be classified into three main dimensions:

- i. Capacity – refers to the availability of resources in the environment to an entrepreneurial firm.
- ii. Growth or decline – refers to the rate of change in capacity.
- iii. Opportunity or threat – refers to the rate of capacity that the firm does not exploit.

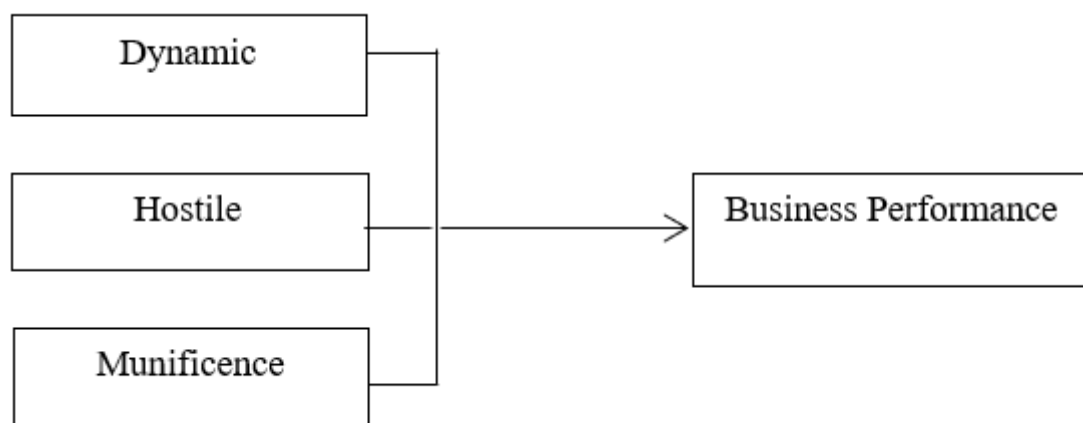
Based on these three dimensions, Chowdhury and Endres [46] and Castrogiovanni [45] summarise a munificence environment as one where the main resources needed by a firm or its competitors to operate are either diminishing or abundant. Meanwhile, Zahra [47] and Dess and Beard [30] refer to a munificence environment as the availability of resources and the existence of opportunities in such an environment [36,44]. According to Davis [23], resource availability in the environment gives firms an advantage to operate and positively impacts their performance.

It was found that the number of previous studies examining the influence of a munificence external environment was limited compared to studies on highly competitive environments [48]. However, most researchers have agreed that a munificence external environment has a strong influence on its relationship with business performance [15,23,43,44,48]. Therefore, this study aims to test the following hypothesis:

Hypothesis 3: The external environment of munificence has a significant relationship with business performance.

## 2.5 Conceptual Framework

Based on the literature review and the hypotheses developed, a conceptual framework of the study is illustrated in Figure 1.



**Fig. 1.** Conceptual framework

The model in this study presents the overall framework recommendations to be examined and analysed. Figure 1 illustrates the relationship between each external environment variable (independent variable) and business performance (dependent variable).

## 3. Methods

The respondents for this study consisted of all manufacturing (including agro-based) and manufacturing-related services firms operating in Malaysia and registered with the Small and Medium Enterprises Corporation of Malaysia [3]. The list of respondents registered until June 2024

will be obtained from SME Corp. Malaysia. The selection of respondents will be based on a simple random sampling technique. Both online and face-to-face approaches will be used to obtain information through the questionnaire developed. The measurement of dynamic external environment variables will be conducted using scales adapted from past researchers and scholars such as Green *et al.*, [37], Slevin and Covin [49] and Miller and Friesen [50]. A total of five items will be used to measure the dynamic external environment.

Next, the variables of the hostile and munificence external environments will be measured using six items developed by Green *et al.*, [37] and Slevin and Covin [49]. According to Green *et al.*, [37], since the hostile and munificence environments are two dimensions that are opposite to each other, the use of the same items is necessary to differentiate the situations of the two variables. Researchers need to refer to the mean score to determine the tendency of the external environment in which micro-businesses in Malaysia operate. A high mean score indicates a hostile environment, while a low mean score indicates a munificence environment. A 7-point Likert-type scale format will be used, ranging from 1 (strongly disagree) to 7 (strongly agree).

Business performance variables will be measured using eight subjective items that assess business growth and financial performance [51]. Past studies have shown that the approach of subjective financial measurement or self-reporting is reliable [52]. The items for business performance will be measured using a 7-point Likert scale ranging from 1 (very low) to 7 (very high), with scale number 4 indicating moderate performance for the business performance of an SME firm. Respondents will be asked to rank their firm's performance based on records from the last three years. According to Lumpkin [53], using a three-year average aims to reduce the influence of variations in the firm's annual financial results. This period is also sufficient to reflect the current position of the economic performance of an SME firm [52]. Correlation analysis and multiple regression will be used to test the three main hypotheses of the study.

#### 4. Conclusion

This empirical study seeks to find answers about the relationship between each external environment variable (dynamics, hostility, and munificence) and the performance of micro-businesses in Malaysia. Past studies have shown mixed outcomes. The diversity of findings may be due to the time, place, and method of the study, which varied according to the situation and over time. The impact of COVID-19 has also affected business performance in Malaysia and globally. In this regard, the findings from this study are expected to answer various questions about the influence of the external environment on the performance of entrepreneurial firms.

According to Guohe [22] and Petrovici [54], monitoring external environmental influences is crucial for entrepreneurs to maintain competitiveness amid evolving economic conditions. Various factors, including regional entrepreneurial climates, economic development levels, and socio-political dynamics, significantly impact enterprise performance. Furthermore, the findings of this study will assist the government and its agencies in providing assistance and advisory services to entrepreneurs. Through this study, micro-entrepreneurs will be able to focus on opportunities and threats when formulating strategic plans and controls for their businesses. These findings will also catalyse other studies that examine whether internal or external factors of entrepreneurial firms impact micro-businesses.

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