IMPLICATION OF SOCIO-ECONOMIC DEVELOPMENT THEORY AND NORTH'S INSTITUTIONAL THEORY ON THE MICRO, SMALL, AND MEDIUM ENTERPRISES (MSMEs) GROWTH IN LAGOS STATE, NIGERIA

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Abstract
This study provides an explanatory framework from socio-economic development theory for MSME growth in Lagos State, focusing on both formal and informal institutional factors. The study is grounded in North's Institutional Theory, which posits that the development of formal and informal institutions is crucial for socio-economic progress, with consequent effects on MSME development. The conceptual review examines MSMEs and their role in socio-economic development. It discusses various definitions and classifications of MSMEs, as well as the key institutional factors influencing their growth. A desk review approach was employed, involving an extensive review of academic literature, reports, and other credible sources. The study concludes that both formal and informal institutions significantly impact the development and sustainability of MSMEs in Lagos. A favourable socio-economic environment, driven by the positive interplay among these institutions, is essential for MSME growth and contributes to broader economic and social development. It therefore recommends that policymakers strengthen both formal and informal institutions to create a supportive environment for MSMEs. This includes improving legal and regulatory frameworks, addressing financial challenges, and fostering a collaborative socio-economic climate.

Key words: *Micro, Small, and Medium Enterprises (MSMEs), Socio-Economic Theory, North's Institutional Theory, MSMEs Development,*

Introduction

In Nigeria, as in most developed and developing countries, Micro, Small, and Medium-sized Enterprises (MSMEs) are the bedrock of the economy, as they are essential to economic growth, creating jobs, advancing local technology, diversifying output, fostering homegrown entrepreneurship, and integrating capability with large-scale industries. According to Moniepoint MFB's Survey report (2025), these capacities contribute 48% to national GDP, account for 96% of businesses, and 84% of employment. MSMEs play a crucial role in economic expansion, and a strong economy typically has a robust small-business sector. In a similar vein, the PricewaterhouseCoopers (PwC) MSMEs Survey report (2024) affirmed that Nigeria's Micro Enterprises (ME) accounted for 96.9%, while SMEs accounted for 3.1% of the total number of businesses in the country. However, Onugu (2005), as cited in Onyedikachi et al. (2022), argues that the growth and development of micro, small, and medium enterprises in Nigeria have been generally sluggish due to various challenges faced by this economic sector. These challenges include limited access to finance, insecurity, unfavourable government policies, and stagnation due to a lack of promotion. These factors emanated from MSMEs and their operating environments, threatening their very development. Therefore, it is worth studying the implications of the social-economic development theory through a theoretical lens.

Lagos, Nigeria's bustling economic hub, presents a unique context for examining the development of Micro, Small, and Medium-sized Enterprises (MSMEs), which are integral to the city's economic landscape. With a population of over 17 million (World Population Review, 2025), Lagos has a vibrant entrepreneurial culture that contributes significantly to job creation and GDP growth (World Bank, 2021). In the same vein, Olubiyi, in his study (2021), affirmed that Lagos State has a significant concentration of MSMEs, including micro and nano businesses, more than any other state in the country. The PwC survey report (2024) likewise confirmed that Lagos State accounts for 7.3 per cent of total MSMEs, a higher share, suggesting a concentration of MSME activities in these economically active regions, potentially driven by factors such as infrastructure, market access, and business ecosystems. However, despite their importance, the state government has not fully acknowledged the sector's role in economic development. For example, major economic hubs such as the Computer Village in Ikeja, the Ladipo Spare Parts Market in Oshodi, and Balogun Market on Lagos Island are predominantly composed of micro-businesses that drive substantial economic activity. Nevertheless, the state government has not provided the necessary policies and incentives, as affirmed by Olubiyi (2021), to formalise these businesses and build their capacity.

Social-economic development theories, which primarily focus on the intersection of economic, social, and institutional factors, offer valuable insights into the context within which MSMEs operate in Lagos. The success of MSMEs in Lagos is closely linked to explanatory frameworks from the institutional theory that examine how formal and informal institutions shape economic behaviour and performance. For example, Adegbite and Makinde (2019), ILO, and Chikeleze (2025) contend that public policy plays a crucial role in shaping the socio-economic development landscape for MSMEs. They further stressed that policy frameworks that prioritise investment in infrastructure, access to finance, and regulatory support are needed to foster a conducive environment for MSME development.

According to Narooz (2014), institutions can be regarded as relatively stable entities that may be subject to change by social actors. They consist of three main pillars: regulatory, normative, and cognitive-cultural, and these are present at both the micro and macro levels. Additionally, institutions can be categorised as formal or informal. On one end of the spectrum are formal institutions, which include explicit rules, constitutions, bylaws, and contracts that define the terms and limits of specific transactions or exchanges between parties (North, 1990; Scott, 1995, 2001). On the opposite end are informal institutions, which encompass "codes of conduct, norms of behaviour, and conventions.

The socio-economic development of institutional elements, such as formal rules and informal norms, creates a stable environment that reduces uncertainty, an essential factor for MSME growth. Formal institutions provide clear guidelines and legal frameworks, ensuring that MSMEs can operate within defined boundaries, while informal institutions, such as social norms and conventions, foster trust and cooperation, which are crucial for business relationships (Nimfa, Abdul Latiff & Wahab, 2021). Together, these institutional elements shape the environment in which MSMEs can thrive, innovate, and grow, providing both structure and social support. In light of these factors, policy implications are critical to strengthening the institutional framework supporting MSMEs in Lagos. Effective policies that streamline regulatory processes, improve access to finance, and promote entrepreneurial education can enable MSMEs to flourish and contribute meaningfully to Lagos's economy.

Yun (2017) believed that building a theoretical foundation is essential for the sustainable development of research on MSME achievement. As such, this study seeks a deeper understanding of MSME development and explores institutional theory to explain the outlook. Past studies reveal the role of institutional entrepreneurs in shaping organizational fields and industries (Tolbert & Zucker, 1996; Hardy & Maguire, 2008), and while studies have examined institutional factors and their impact on entrepreneurship broadly (Powell & DiMaggio, 1991; Baumol & Strom, 2007), the current study focuses on the implications of socio-economic development theory through the lens of institutional theory, specifically as it relates to the development of MSMEs in the Lagos metropolis.

Consequently, the specific objective of this study was to examine, through the lens of the institutional theory of entrepreneurship, the implications of the social economic development theory for the development of MSMEs in Lagos State. Specifically, the study was conducted to determine the implications of formal institutional elements of socio-economic development on the sustainability of small and medium-sized enterprises (MSMEs) in Lagos, and to evaluate the implications of informal institutional elements of socio-economic development on the development of small and medium-sized enterprises (MSMEs) in Lagos.

Literature Review

Theoretical Review

This section delves into the theoretical foundations and applications of the Institutional Theory in socio-economic development, with a specific focus on its implications for small and medium-sized enterprises (MSMEs)

Douglas North’s Institutional Theory (1990)

Douglas North, an influential economist and Nobel laureate, is best known for developing institutional theory, which emphasises the significance of institutions in shaping economic performance and development. Institutions are defined as the rules, norms, and organisations that structure human interaction, influencing the incentives and behaviour of individuals in an economy (North, 1990). North argued that institutions are fundamental to reducing uncertainty and transaction costs in economic exchanges, thereby promoting business activity and facilitating economic growth (North, 1994). By focusing on the historical evolution of institutions and their impact on economic outcomes, North's work bridges economic theory with historical analysis, emphasising the role of path dependence and the complexity of institutional change (North, 2005).

North’s celebrated definition of institutions provided him with the starting point to develop his theory. He defined them as follows: ‘Institutions are the rules of the game in a society, or, more formally, are the humanly devised constraints that shape human interaction” (North, 1990). Institutions are established to reduce the obstacles arising from imperfect and asymmetrical information. The obstacles institutions are meant to overcome are referred to as transaction costs. North distinguished two kinds of constraints: formal and informal. Together, these constraints comprise what he called the rules of the game. He describes formal rules as a set within a normative hierarchy, similar to those found in modern legal systems. His account of the origins of informal rules suggests that they originate in individuals' minds but reflect prevailing cultural conditions.

North’s theory of institutional change suggests that formal institutions are essentially a solidification of informal ones (North, 1990), with both evolving together through the actions of organisations, ranging from households and villages to networks, businesses, political parties, and governments. However, in North's framework, institutions are created by rational, unconstrained individuals, who are assumed to be "institutions are a set of rules, compliance procedures, and moral and ethical norms designed to regulate individuals' behaviour to maximise the wealth or utility of those in power."

Institutional theory focuses on factors that are central to the firm and to sustainable innovation. From the institutional theory of sustainable growth for small and medium-sized enterprises, opportunities with normative, coercive, and mimetic drivers to influence small and medium-sized enterprises to shape environmental, social or economic decision-making and to legitimise the vision of sustainable business practise (Shibin et al., 2020; Caldera, Desha & Dawes, 2019). Sustainable business practice is an aspiration for an increasing proportion of small and medium-sized enterprises worldwide, promising profitability, resilience, and positive social and environmental impacts (Caldera et al., 2019).

While traditional perspectives emphasise institutional rules, newer views highlight institutional entrepreneurship, such as the adoption of sustainable business models (Hadjimanolis, 2019) and the pursuit of opportunities (Laukkanen et al., 2013). Two key reasons behind the behaviour of enterprises within institutional theory are moral legitimacy and isomorphism. Companies seek legitimacy to meet the expectations of stakeholders and society (Ratten & Usmanij, 2020), and the pressure of institutional factors often leads to significant, isomorphic decisions regarding sustainability (Glover, Champion, Daniels & Dainty, 2014; Ahmad et al., 2020). Enterprises promote innovation by collaborating with various stakeholders within the institutional framework to support the sustainable growth of SMEs.

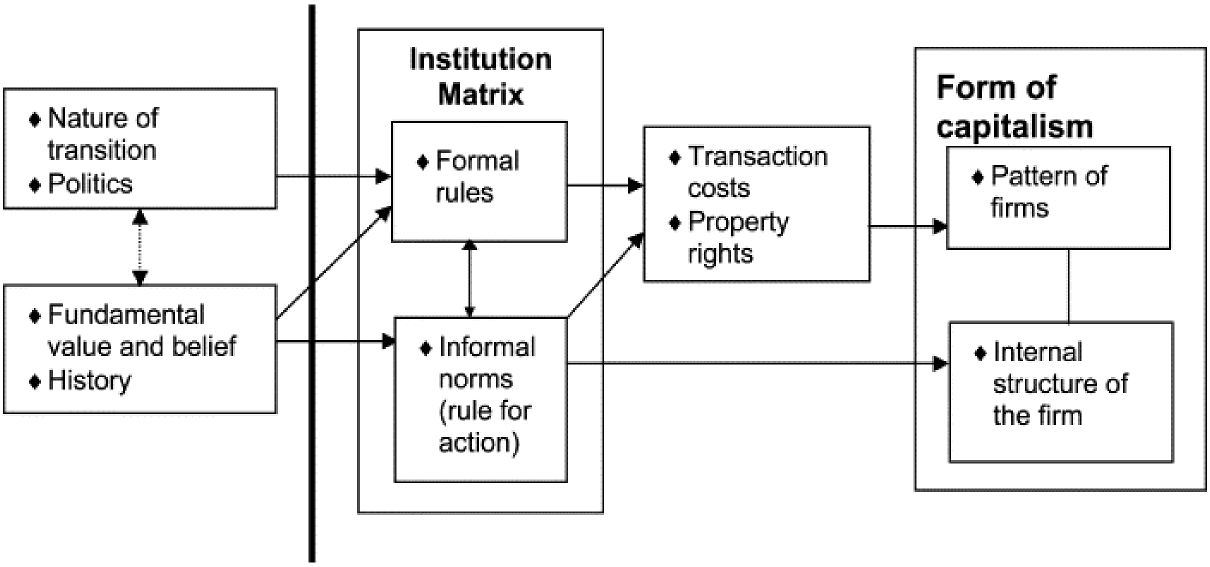


Figure 1: Conceptual framework from Douglass North's Pioneering Work in Institutional Theory.

Source: Douglass (1990).

Assumptions and Benefits

One of the key assumptions of North's institutional theory is that institutions are crucial for economic performance, as they provide the framework within which economic activities occur (North, 1990). He posits that effective institutions reduce transaction costs and create a conducive environment for investment, innovation, and economic activity (North, 1994). This focus on transaction costs underscores the importance of trust and social norms in facilitating interactions among economic agents. Furthermore, North's theory offers the advantage of explaining why some countries achieve sustained economic growth while others do not, attributing differences in economic outcomes to the quality and adaptability of institutions (Acemoglu, Johnson, & Robinson, 2001).

North's work also emphasises the evolutionary nature of institutions, suggesting that they are shaped by historical contexts and adapt over time (North, 1998). This perspective offers a nuanced understanding of development, highlighting that institutional changes often occur gradually and are influenced by a range of political, social, and economic factors. The recognition of path dependence, where historical decisions and events significantly shape future outcomes, provides valuable insights into the dynamics of institutional change and economic development (North, 2005).

Limitations

Despite its contributions, North's institutional theory has limitations. One notable criticism is that it can be overly deterministic, suggesting that institutions are the primary determinants of economic outcomes while underemphasizing other factors, such as technological change, culture, and individual agency (Williamson, 2000). Critics argue that this perspective can lead to neglect of how individual actions and crises can drive institutional change, resulting in a somewhat simplistic view of complex economic realities (Peters, 2000).

Additionally, while North's theory acknowledges that institutions evolve and can improve over time, it often does not adequately explain why some institutions become entrenched despite being inefficient or counterproductive (Acemoglu et al., 2005). This raises questions about the mechanisms of institutional change and the conditions under which institutions can adapt or reform. Lastly, the reliance on historical context in North's analysis can sometimes limit its applicability in contemporary settings, making it challenging to derive generalizable principles for economic policy (Bardhan, 2000).

In conclusion, Douglas North's institutional theory offers a profound understanding of the role of institutions in economic performance, highlighting their importance in shaping incentives, reducing uncertainty, and facilitating economic interactions.

However, its limitations highlight the complexity of institutional dynamics and the need to consider a broader range of factors that influence economic development.

Theoretical Implications

According to North's Institutional theory, the development of the following institutional elements for socio-economic development has the following implications on the development of SMEs:

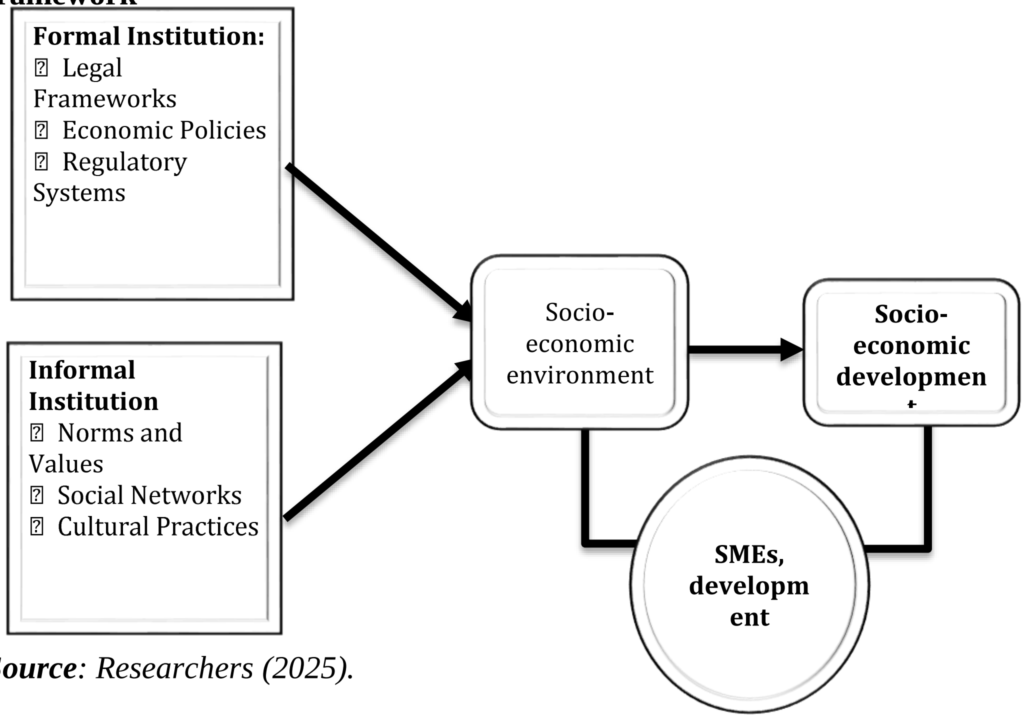
Implications of Formal Institutions on Socioeconomic Development and SMEs Development

Formal institutions, including codified laws, regulations, and policies, are fundamental to shaping the economic framework within which Small and Medium Enterprises (SMEs) operate. These institutions establish a structured environment that governs business activities, ensuring market predictability and stability. By providing clear rules and standards, formal institutions facilitate contract enforcement, protect property rights, and ensure access to essential resources, all of which are crucial for the growth and sustainability of SMEs (North, 1990). As these institutions embody society's collective problem-solving strategies, their effectiveness directly influences socioeconomic development. Efficient formal institutions create a supportive environment for SMEs, promoting innovation, competitiveness, and equitable growth, which are essential for a nation's broader socioeconomic progress (Scott, 1995; Witt & Redding, 2009).

Implications of Informal Institutions on Socioeconomic Development and SMEs Development

Informal institutions, encompassing cultural norms, social networks, and unwritten rules, significantly shape the socioeconomic environment and the development of Small and Medium Enterprises (SMEs). These institutions represent the shared values and collective understandings within a society, shaping behaviours and expectations that are not formally codified (North, 1990; Scott, 2005). Culture, as a key component of informal institutions, defines societal norms, ethical standards, and acceptable business practices, thereby influencing how SMEs operate and engage within their communities (Greif, 1994). The strength of informal institutions can either complement or undermine formal institutions, affecting SMEs' access to resources, trust-building, and market participation (Redding, 2005; Hofstede, 1980). In societies where informal institutions are well aligned with formal structures, SMEs are better equipped to thrive, thereby contributing positively to socioeconomic development. Conversely, when misalignments occur, SMEs may face challenges that limit their potential to drive economic growth and innovation (Powell, 1991; Inglehart & Baker, 2000).

Figure 2: Implication of socio-economic development on SMEs development framework



***Source**: Researchers (2025).*

The figure above demonstrates how the formal and informal institutions, the socio-economic environment, and, in turn, the sphere of operation of SMEs are interrelated. Formal institutional frameworks, such as legal, economic, and regulatory systems, define the structure and rules governing SMEs' interactions. They construct an orderly framework that benefits SMEs and offers more prospects for efficient growth. Informal institutions, on the other hand, comprise norms and values, social networks, and culture that serve as the blueprint for corporate behaviour and expectations. These aspects are vital to developing the social capital that drives trust, cooperation, and the broader business environment, which is most helpful to SMEs.

Hence, a favourable socio-economic climate enables SMEs to access resources, opportunities, and markets, thereby driving socio-economic development. SMEs are important for creating employment and driving socio-economic development, both of which are associated with growth and success. Thus, the framework emphasises that constructive, mutually complementary cooperation between formal and informal institutions will secure favourable socio-economic conditions for SMEs' development.

Methodology

This study utilised a desk review approach to examine the implications of socio-economic development theory for MSME development in Lagos State. A desk review (or document review) is a form of secondary research and evaluation that systematically analyses existing documents, reports, and data sets without field visits. It is used to quickly assess information gaps, verify data quality, or evaluate projects, serving as a critical preliminary step in planning. This approach is considered appropriate because it involves an extensive literature review that identifies, selects, and analyses grey literature, legal texts, institutional reports, academic journals, books, reports, and reputable online sources.

The desk review is commonly used for situational analysis, such as the subject the researchers studied, or validating data for accuracy and consistency. Unlike a full systematic literature review, a desk review is often more iterative, exploratory, and rapid, focusing on specific organisational needs. In order to achieve the study objectives, the following key steps were followed in conducting the Desk Review approach for this study: The researchers defined the study's scope by formulating and identifying three (3) specific research objectives that the review must accomplish. To accomplish the specific research objectives, the researchers obtained relevant documentation, including reports, academic journals, books, and reputable online sources.

Afterwards, the researchers analyse and synthesise the documents for quality, consistency, and findings, ensuring to take detailed notes. As such, the researchers summarise the information to provide a clear overview of the situation around the subject matter

Conclusion

The study concludes that the development and survival of MSMEs in Lagos State are heavily influenced by both formal and informal institutions within the socio-economic environment. Formal institutions, including legal, economic, and regulatory frameworks, provide a structured and predictable environment that allows MSMEs to operate efficiently and grow. On the other hand, informal institutions, such as social networks, cultural norms, and values, contribute to the social capital that fosters trust, cooperation, and a supportive business environment. The research highlights that a favourable, well-developed socio-economic climate, driven by positive interactions between formal and informal institutions, is crucial for the sustainable development of MSMEs. Such an environment enables MSMEs to access the resources, opportunities, and markets they need, thereby contributing to employment creation, economic growth, and overall socio-economic development.

Suggestions and Implications

Suggestions

In view of the conclusion made, the study suggested that:

i. Policymakers should focus on reinforcing both formal and informal institutions that support SMEs. This includes improving legal, economic, and regulatory systems to create a stable and predictable environment for businesses to thrive.
ii. The government should play an active role in addressing the financial challenges faced by SMEs, such as providing accessible credit facilities at reasonable rates.
iii. A collaborative approach is needed to ensure a favourable socio-economic climate that supports SME development.
iv. There should be continuous efforts to build the capacity of SME managers and staff through training programs that enhance their skills and knowledge.

Implication

The findings of this study highlight the critical roles of both formal and informal institutions in the development and survival of MSMEs in Lagos State. Hence, policymakers and stakeholders must prioritise the creation and maintenance of a stable socio-economic environment in which legal, economic, and regulatory frameworks are predictable and supportive. By doing so, MSMEs can operate within a structured environment that minimises uncertainties, thereby enhancing their ability to grow and contribute to the broader economy.

Additionally, the study contends that for MSMEs to reach their full potential, there must be a concerted effort to create a developed socio-economic climate that seamlessly integrates both formal and informal institutional support. This integration not only facilitates access to resources and markets but also enables MSMEs to navigate challenges and leverage opportunities more effectively. The broader implication for socio-economic development in Lagos State is that strengthening these institutional frameworks will not only support MSME growth but also drive employment creation, innovation, and economic dynamism, thereby sustaining economic growth and development.

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