

Ownership Structure and the Performance of Small and Medium Enterprises in Nigeria

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Abstract

This paper studies the effect of ownership structure on the performance of small and medium enterprises in Nigeria. The sample consists of three hundred and ninety nine (399) small and medium enterprises in Alimosho Local Government Area, Lagos State. The suggested hypotheses were established, using regression analysis, and analysis of variance (ANOVA). The observed outcomes offer indication that ownership structure has a significant effect on the performance of small and medium enterprise in Nigeria. Thus, it is recommended that ownership structure of Nigerian firms should be observed carefully by stakeholders as it affects their performance

Keywords: Small and Medium Enterprises, Ownership structure, Performance, Firms

1. Introduction

The role of Small and Medium Enterprises (SMEs) in any economy cannot be overlooked as they constitute a significant employer of labor as the active role of small and medium enterprises as a key element of development in developing countries has been acknowledged. As stated by Kuteyi (2013), small and medium enterprise stimulates economic growth as they generate employment and add to the gross domestic product (GDP). In the opinion of Ariyo, (2008); Ayozie and Latinwo (2010), and Muritala, Awolaja and Bako, (2012), there is the greater tendency of SMEs utilizing more labor-intensive equipment thereby minimizing unemployment especially in developing countries which therefore have a significant effect on employment creation. Emphasizing on the significance of SMEs on economic growth, SMEs generate prospects for revenue generation and circulation, and wealth accumulation (Ojo, 2003; World Bank, 2010; Babajide, 2012). SMEs develop the formation of a new group of small industrialists bringing about development, and wealth accumulation.

One major factor that affects the performance of SMEs is that of managerial skills and ownership structure and according to Gursoy and Aydogan, (2002) the concept of ownership structure can be well-defined along two scopes: ownership concentration and ownership mix. The earlier refers to the part of the major owner and is inclined by total risk and monitoring expenditures, while the latter is linked to the personality of the main shareholder (Griffith, Redding and Simpson, 2004). The link between ownership structure and performance of small and medium enterprise has been the topic of a significant and constant argument between researchers (Demsetz and Villalonga, 2001). There has been an extensive research on the association between ownership structure and business performance, but the findings relatively differ from each other (Pivovarsky, 2003; Farooque, Ziji, Dunstan, and Karim, 2007).

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In Nigeria, the Central Bank of Nigeria supports the Small and Medium Industries and Equity Investment Scheme (SMIEIS) in their definition of SMEs as an enterprise with a maximum asset base less than N200 million (equivalent of about \$1.43 million) excluding land and working capital, and with the number of staff employed not less than 10 (otherwise will be a cottage or micro-enterprise) and not more than 300 (Sanusi 2003; Udechukwu 2003; Akabueze 2002; SMIEIS 2002; and Sanusi 2004). And according to the Central bank of Nigeria, Small and Medium Enterprises (SMEs) are critical to the development of any economy as they possess great potentials for employment generation, improvement of local technology, output diversification, development of indigenous entrepreneurship and forward integration with large-scale industries.

In Nigeria, there has been gross under performance of the SMEs sub-sector and this has undermined its contribution to economic growth and development. The key issues affecting the SMEs in the country can be grouped into four namely: unfriendly business environment, poor funding, low managerial skills, and lack of access to modern technology (FSS 2020 SME Sector Report, 2007). This study focuses on the managerial skills as it relates to the ownership structure and SMEs performance. However, the study on the effect of ownership structure on SME performance in the Nigerian environment is rare, and the limited identified research on the subject matter has produced conflicting results (Adenikinju and Ayorinde, 2001). This identified problem has brought about a research gap in which the researcher tends to address. Thus, the central objective of this paper is to determine if ownership structure has any significant effect on the performance of small and medium enterprise (SMEs) in the Nigerian environment.

This paper is divided into five sections which includes the introduction as section one. Section two presents the literature review while section three is the research methodology, while section four contains the data analysis and interpretation. Section five concludes the paper with the relevant policy recommendations.

2. Literature Review

2.1 The Concept of Small & Medium Enterprises (SMEs)

According to International labor Organization (2005), there is no globally unified agreed definition of Small and Medium Enterprise (SMEs). The study indicated that there have been over 50 definitions was identified in 75 countries and each definition was made to suit specific criterion of enterprises and the stage of its industrial development of a particular country or state. In Nigeria, the definition of small and medium enterprise by the Small and Medium Industries and Equity Investment Scheme (SMIEIS) describes SME as an enterprise with a maximum asset base less than N200 million (equivalent of about \$1.43 million) excluding land and working capital, and with the number of staff employed not less than 10 (otherwise will be a cottage or micro-enterprise) and not more than 300 (Sanusi 2003; Udechukwu 2003; Akabueze 2002; SMIEIS 2002; & Sanusi 2004).

Even if there are variances in the definition of SMEs, it is generally agreed that SMEs play a significant role in economic development. Almost 10% of entire industrial production and 70% of manufacturing occupation are by SMEs (Osuagwu, 2001). SMEs similarly encourage business through the use of local resources. SMEs are commonly considered as crucial instrument which drives economic development and generate employment opportunities as well as rural development (Osuagwu, 2001). Finance is an essential instrument which promotes the channels of a business as well as enhances performance. No business can be successful or develop without adequate finance. There are different sources of finance to SMEs. The sources of finance could come from the Commercial Banks, and specialized banks like the micro-finance banks. Micro finance institutions such as cooperative societies and credit unions also finance SMEs. Some organizations also provides source of finance to SMEs through donation for expansion schemes (Carpenter, 2006). In spite of these various sources of finance, SMEs still lack sufficient financing. The finance sources highlighted are inadequate and not constantly accessible. Commercial banks do not assist SMEs because of the apparent hazard in giving loans (Carpenter, 2006). Just as small is attractive, so does it have its difficulties ranging from funding to marketing, raw materials, technology and infrastructural facilities.

Due to the risk and uncertainty surrounding small businesses, banks are hesitant to offer SMEs loans which there are no guarantee of recovering (Aigboje, 2006). Another challenge for SMEs is the market. Often, SMEs have no understanding of the market channels (Osuagwu, 2001).

Additionally, SMEs face the challenge of inadequate infrastructural facilities. There are quite no decent roads, no pipe borne water in several parts of the country, and no sufficient power supply to enhance business survival. Yet, the small and medium enterprises have continuously been doing business in this distressed condition (Ajonbadi, 2001). Finally, many of the small businesses are labor intensive. Some use obsolete machineries and equipment. Some are old-fashioned that hinge majorly on the amount of people involved for increased production (Carpenter, 2006).

2.2 Concept of Ownership Structure

Ownership structure could be defined as the means of control over a business enterprise and being able to dictate its functioning and operations. There are different types of ownership structure which can be grouped into managerial/insider ownership and foreign ownership. These includes sole proprietorship, partnership, limited partnership, limited liability company (LLC), corporation (profit & non-profit).

A sole proprietorship is a one-person business that is not registered with the corporate affairs commission. Sole proprietorship need not file any paper for registration. Sole proprietorship is not a distinct legal personality which implies that it is inseparable from its owner, and it cannot sue nor be sued. Similarly, partnership is simply a business owned by two or more people. Partners are each personally liable for the entire amount of any business debts and claims. Sole proprietorships and partnerships make sense in a business where personal liability isn't a big worry; for example, a small service enterprise in which you are unlikely to be sued and for which you won't be borrowing much money for inventory or other costs (Barako and Tower, 2006).

Limited Liability Company (LLC) or a corporation is a bit more complicated and costly. The main benefit of a Limited Liability Company or a corporation is that these ownership structures limit the owners' personal liability for business debts. What differentiate the limited liability company from other forms of ownership structure is that it is a separate legal entity, distinct from the people who owns controls and manages it. A nonprofit corporation is a corporation formed to carry out a charitable, educational, religious, literary, or scientific purpose. A nonprofit corporation can raise much-needed funds by soliciting public and private grants, and donations from individuals and companies (Barako and Tower, 2006).

2.2.1 Managerial/Insider Ownership

The significance of assigning an ownership structure to insider owners could be that they select to decrease the level of risk of the business so as to minimize their own level of personal risk. A key inference that could be deducted from this opinion is that insider ownership is a double edged sword that could affect the performance of the in either direction. Theoretically, the effect of managerial/insider ownership falls in two main premises; the Convergence-of-Interest and the Entrenchment hypotheses. The Convergence-of-Interest premise assumes that managers or insiders chase their personal interest at the cost of external stakeholders; a large proportion of shares to insider owners are consequently anticipated to inspire the mangers to chase interests that meet with that of the external shareholders (Mehran, 1995). The Entrenchment theory perceived that firms with a minimum insider ownership can still achieve better in the look of product market rivalry, but when the level of insider ownership becomes very high, this could provide them the chance to follow their selfish interest without the danger of job and salary loss (Lins, 2002; Lee and Ryu, 2003).

2.2.2 Foreign Ownership

Foreign ownership is assumed to exert a positive influence on firm performance in certain ways. The main way is through the establishment of SME by a foreign investor which is made achievable through globalization. This is expected to bring about active observation on the management which can bring about a positive effect on business performance; also, involving expatriates in business activities may conform to the global corporate governance system. The cost however is presumed to be very high (Reese and Weisback, 2001).

2.3 Empirical Evidence on the Relationship between Ownership Structure & Performance

Ownership structure is considered a significant issue that affects a company's performance. If ownership structure affects a company's performance, it is likely then to use the ownership structure to envisage firm performance.

There is resilient hypothetical and pragmatic evidence of an optimistic relationship between ownership structure and profitability (Zeitun and Tian, 2007). Demsetz and Villalonga (2001) studied the variables, ownership structure, and corporate performance with emphasis on insider ownership and concentrated ownership.

Their findings revealed that there was no significant relationship between concentrated ownership and firm performance; it further revealed that insider ownership has a negative relationship with firm performance. This implies that insider ownership has a significant relationship with firm performance; however, the relationship is in a negative direction.

Pivovarsky (2003) in his research titled ownership concentration and performance in Ukraine's privatized enterprises examined impact of concentrated ownership on performance and found out that there exist a significant positive relationship between concentrated ownership and firm performance. The study of Bai, Liu, Lu, Song, and Zhang, (2005) found out in their study titled an empirical study on corporate governance and market valuation in China that concentrated ownership and foreign ownership is positively related to firm value, while there is negative relationship between the largest shareholder and firm value. He further found out that insider ownership is not related to firm value. Farooque et al. (2007) in their study titled ownership structure and corporate performance: Evidence from Bangladesh discovered that ownership does not have significant impact on firm performance. However, he further discovered that performance has significant negative impact on ownership. Finally the study of Alonso-Bonis and res-Alonso (2007) studied ownership structure and performance in large Spanish companies: Empirical evidence in the context of an endogenous relation, and they found out that there was a positive systematic and significant relation between ownership concentration and firm performance as well as a positive and significant relation between insider and firm performance.

The results from Arosa et al. (2010) study of SMEs in Spain suggest that family ownership is related to higher firm performance depending on the role the family plays in the firm. If the family is a large shareholder with a board of directors or executive representation, family firm behavior differs from other concentrated ownership structures and seems to face different agency problems. They also noted the differences between family firms run by the first generation and those run by subsequent generations. The presence of independents on the board has a positive effect on performance when the firm is run by the first generation. However, when the firm is run by the second and subsequent generations, the presence of independents has no effect on performance. Pinto and Augusto (2014) analyzed the relationship between ownership concentration and corporate operational profitability in Portuguese SMEs.

They used a quadratic specification, which is validated for the companies under study and for the subsamples generated from the criteria of size, age, and nature of ownership. Their results showed that when they segment the sample by the nature of ownership, the empirical evidence shows that the relationship is valid only for family businesses, in line with the potential benefits associated with these companies. Bauweraerts and Colot (2014) investigated the relationship between governance structures and family firms' performance so as to determine if governance is a driver of value creation or a mechanism enabling family businesses to retain stakeholders' confidence. Their results showed that family governance practices are negatively linked with firm's performance while classic governance practices do not play a significant role. It suggests that the implementation of formal family governance mechanisms creates a superfluous cost that hampers performance. Our findings also demonstrate that family firms with the lowest levels of performance display the higher governance scores, thus suggesting that family firms try to improve the image perceived by stakeholders.

2.4 Theoretical Framework

2.4.1 Agency Theory

According to Sevenpillarsinstitute.org (n.d.) Agency Theory explains how to best organize relationships in which one party determines the work while another party does the work. In this relationship, the principal hires an agent to do the work, or to perform a task the principal is unable or unwilling to do. Agency theory assumes both the principal and the agent are motivated by self-interest. This assumption of self-interest dooms agency theory to inevitable inherent conflicts.

Thus, if both parties are motivated by self-interest, agents are likely to pursue self-interested objectives that deviate and even conflict with the goals of the principal. Yet, agents are supposed to act in the sole interest of their principals. To determine when an agent does (and does not) act in their principal's interest, the standard of "Agency Loss" has become commonly used. Agency loss is the difference between the best possible outcome for the principal and the consequences of the acts of the agent. And when an agent acts entirely in her own self-interest, against the interest of the principal, then agency loss becomes high. Furthermore, Sevenpillarsinstitute.org (n.d.) stated that research on agency theory shows that agency loss is minimized when two particular statements are true.

The first is that the principal and the agent share common interests. Essentially, this means that both the principal and the agent desire the same outcome. The second is that the principal is knowledgeable about the consequences of the agent's activities. In other words, the principal knows whether their agent's actions serve in the principal's best interest. If either of these statements is false, it follows that agency loss is therefore, likely to arise.

One objection to agency theory is that it "relies on an assumption of self-interested agents who seek to maximize personal economic wealth" (Bruce et al., 2005). According to Sevenpillarsinstitute.org (n.d.) the challenge is therefore, to get agents to either set aside their self-interest, or work in a way in which they may maximize their personal wealth while still maximizing the wealth of the principal. Thus, a standard of agency duty and action is necessary, not because agents are universally selfish, but because the potential for differences between the principal's and the agent's interests exists.

Pinto and Augusto (2014) stated that Agency theory has contributed to the understanding of the problems underlying the conflict within organizations. More specifically, agency theory states that the ownership structure is an important determinant of performance – causality of property for performance. Most study on the relationship between ownership structure and firm performance is entrenched in the agency theory (Farooque, Ziji, Dunstan, and Karim, 2007). The theory assumes essential pressure between shareholders and corporate managers (Jensen and Meckling, 1976). An elementary postulation of the agency theory, consequently, is that managers will act unscrupulously to advance their own concern before shareholders; and the elementary inference is that the worth of the firm cannot be exploited since managers have decisions which permit them to confiscate worth to themselves (Turnbull, 1997).

A group of rigorously self-centered actors implied in the agency theory suggests struggles of attention that must be decided through motivations, observing, or controlling action (Cohen and Holder-Webb, 2006), which involve added budget to the firm. Jensen and Meckling (1976) summarize these agency costs as being the cost of: observing management (the agent); connecting the agent to the principal (stockholder/residual applicant); and residual victims. The emphasis of corporate governance is to reduce these budgets and improve firm performance. It turns out to be vital that management is continually examined to guarantee it does not chase policies that are hostile to the success of the enterprise. This observing mission rests directly with the board whose structure mirrors the ownership structure of the firm.

Randøy, and Goel (2003) posited that the separation of ownership and control is the key condition giving rise to agency cost. And freed from the constraints of reducing agency costs, founding family firms can benefit by getting as much involvement from their founder, directors, and other insiders as possible. This implies that the firm can utilize the exceptional resources and capabilities that the founder(s) utilized to make the firm succeed in the first place. Studies by McConaughy et al. (2001) supports the contention that founding family control is key to reduced agency costs and higher firm performance (McConaughy et al., 1998). On the contrary, Randøy, and Goel (2003) opined that in a non-founder firm, a high level of board and inside ownership (including that of directors) creates conditions conducive to managerial entrenchment and self-aggrandizing behavior. As a result, it reduces outside owner's ability to monitor and control the behavior of the firm's leadership, which reduces the value of the firm, that is, the firm incurs high agency cost for lack of transparency. In this case, a high level of insider ownership is not functional, since the managers of the nonfamily firm have less incentive to use it to increase firm value by pursuing innovative entrepreneurial opportunities, rather, they may use it for entrenchment purposes.

Based on the above arguments and wide range empirical research on ownership structure and performance, and findings indicating the relationship between ownership structure and performance, we propose the following hypotheses:

H₀₁: Insider ownership structure has no significant effect on performance of small and medium enterprises in Nigeria.

H₀₂: Foreign ownership structure has no significant effect on small and medium enterprises in Nigeria.

3. Methodology

This study is a survey research design which is used in an attempt to gather data and provide test the hypotheses from the respondents. The use of survey research method is justified because it helps to determine whether or not there exist significant effects on the variables under study. This study applies a positivist philosophy to survey research design. Population can be defined as the total number of elements under consideration clearly defined. Population can be large, small, finite or infinite. The population under consideration in this study is five hundred (500) owners of small and medium enterprises small and medium enterprise in Alimosho local government area in Lagos State. This local government is selected because it is the largest local government in Lagos State comprising of more than one million people in the area.

Sample is a representation of the population which exhibits the critical characteristics of the population under consideration. It is a smaller group of element drawn through a definite procedure from a specified population. The sample size for this study is determined using the Taro Yamane formula which is

$$N = N/1 + Ne^2.$$

Where:

n = Sample size,

N = Population,

e = Error term =0.05

Thus, the sample size is $n = 500/1 + 500 \times 0.05^2 = 399$

The sample is therefore three hundred and ninety nine (399) owners of small and medium enterprises, which represents 79.8% of the total population under consideration. A non-probabilistic sampling technique is adopted in the process of selecting the sample of the study. This study adopted only primary data because its conclusion is based on responses from the respondents. These data are gathered by a means of questionnaire which are administered to the selected respondents. The data gathered are analyzed using statistical package for social sciences (SPSS V20). In testing for the effect of ownership structure on the performance of small and medium enterprises, the amount of variations in the dependent variable (performance) which can be associated with the changes in the value of the independent variable (Insider ownership and foreign ownership) was tested using regression analysis.

4. Results

4.1 Variables & Measures

4.1.1 Ownership Structure

This study initiated a five-point likert scale which ranged from strongly agree to strongly disagree to access questions on ownership structure. The results of the respondents rating on the five items are looked into, added up and averaged to generate the mean of ownership structure. Ownership structure is considered high if the index is equal to or greater than 5.0 while it is considered low if less than 5.0. The Cronbach alpha of the items is calculated to as 0.76 suggesting that the items are highly reliable.

4.1.2 Performance

A five-point point likert scale is also generated for performance. The scales ranged from strongly agree to strongly disagree. The result of the items are added and averaged to determine the mean index. Organizational performance is considered high if the index is equal to or greater than 5.0 while it is considered low if less than 5.0. The Cronbach alpha of the items is calculated to be 0.81 suggesting that the items are highly reliable.

4.2 Hypotheses testing

H₀₁: Insider ownership structure has no significant effect on performance of small and medium enterprises in Nigeria.

Variables Entered/Removed^a

Model	Variables Entered	Variables Removed	Method
1	insider ownership ^b	.	Enter

- a. Dependent Variable: performance
- b. All requested variables entered.

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.798 ^a	.637	.636	.37289

- a. Predictors: (Constant), insider ownership

ANOVA^a

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	96.823	1	96.823	696.328	.000b
	Residual	55.202	397	.139		
	Total	152.025	398			

- a. Dependent Variable: performance
- b. Predictors: (Constant), insider ownership

Coefficients^a

Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.
		B	Std. Error	Beta		
1	(Constant)	1.547	.060		25.783	.000
	insider ownership	.424	.016	.798	26.388	.000

- a. Dependent Variable: performance

The significant effect of insider ownership structure on performance of small and medium enterprises in Nigeria was analyzed using Regression analysis as well as Analysis of Variance (ANOVA). Preliminary analyses were conducted to ensure no violation of the assumptions of normality, linearity, multi-collinearity and homoscedasticity. After entry of insider ownership and performance scale, the total variance explained by the model as a whole was 79.8%, F = 696.328, <.005. It can be explained that insider ownership affects small and medium enterprises up to 79.8% which therefore means that there are other variables up to 20.2% which affects SMEs performance. It can therefore be said that the insider ownership structure have a strong positive significant effect on SMEs performance in Nigeria. Thus, hypothesis which states that insider ownership structure has no significant effect on performance of small and medium enterprises in Nigeria is therefore rejected.

H₀₂: Foreign ownership structure has no significant effect on small and medium enterprises in Nigeria.

Variables Entered/Removed^a

Model	Variables Entered	Variables Removed	Method
1	foreign ownership ^b	.	Enter

a. Dependent Variable: performance

b. All requested variables entered.

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.798 ^a	.637	.636	.37289

a. Predictors: (Constant), foreign ownership

ANOVA^a

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	96.823	1	96.823	696.328	.000 ^b
	Residual	55.202	397	.139		
	Total	152.025	398			

a. Dependent Variable: performance

b. Predictors: (Constant), foreign ownership

Coefficients^a

Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.
		B	Std. Error	Beta		
1	(Constant)	1.547	.060		25.783	.000
	foreign ownership	.424	.016	.798	26.388	.000

a. Dependent Variable: performance

The effect of foreign ownership structure on small & medium enterprises in Nigeria was tested using regression analysis. Preliminary analyses were performed to ensure no violation of the assumptions of normality, linearity & homoscedasticity. The result indicated that the decision parameter 79.8%, $F = 696.328 < .005$. This indicates that the result is statistically significant at $< .005$. It also explains that foreign ownership structure accounts for 79.8% of the total variation that can be explained and 20.2% which cannot be explained. This means that there are other factors which affect SMEs performance apart from foreign ownership structure that are not considered in this study. Following this assertion, H₀₂ which says foreign ownership structure has no significant effect on small and medium enterprises in Nigeria is rejected while accepting the alternate hypothesis.

5. Conclusion and Policy Recommendations

This paper is focused on establishing whether a significant effect subsists between ownership structure and SME performance in Nigeria. The findings in this paper indicated that: (1) Insider ownership structure has a statistical significant effect on the performance of small and medium enterprise in Nigeria; and (2) Foreign ownership structure has a statistical significant effect on performance of small and medium enterprises in Nigeria. The findings further reveals that in general, ownership structure has a significant effect on Small and medium enterprises in Nigeria. This implies that the type of ownership whether one man business, partnership or limited liability company will affect the performance level of the business. This research opposes the study of Bai, Liu, Lu, Song, & Zhang, (2005) who found out that insider ownership is not related to firm value, and that of Farooque et al. (2007) who discovered that ownership does not have significant impact on firm performance.

As the research confirms a significant effect of ownership structure on business performance, ownership of Nigerian businesses needs to be therefore observed carefully by shareholders and stakeholders. This research, however, calls for additional studies into predominantly the significant sectors which are vital for economic development in Nigeria.

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