The Effects of Firm Strategic Factors on Manufacturing Companies' Performance: Evidence from Nigeria

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Abstract

The effects of firms' strategic factors on strategic choices and performance differentials in Nigerian manufacturing sectors have not been systematically investigated. Against the backdrop of declining manufacturing performance in Nigeria, this paper examined the effects of selected firm strategic factors on the returns on invested capital in Nigeria's manufacturing sector. The study sample consisted of 30 quoted manufacturing firms spread over eight industrial sectors. Data was collected from these 30 firms over a five year period (i.e. 2003 to 2007 and analyzed using a panel regression model. A key finding of the study is firm strategic factors in the study i.e. size, age and capital intensity were heterogeneous and related differently to the performance parameter - return on invested capital. Size had a positive effect on returns on invested capital while age and capital intensity had negative effects. The study concluded that firm strategic factors influenced returns on invested capital differently for manufacturing firms. It was therefore recommended that emphasis on resources and capabilities should be sustained to boost the strategic performance of Nigerian manufacturing sectors.

Keywords: Firm Strategic Factors, Manufacturing Companies, Performance, Nigeria

INTRODUCTION

Strategy has been linked to firms (Penrose, 1959; Schmalensee, 1985; Barney, 1986) and industries (Porter, 1981) performance (Prevos, 2005). Which of market structure approach or the Resource Based View (Hansen &Wernerfelt, 1989) of strategy serves as a better guide for strategizing remained in the realm of speculation. According to Grant (1991), in an unstable context, strategy should be crafted based on assessments of internal factors, since tastes, preferences of customers, and competitors' choices are fluid. Also, Prahalad& Hamel (1990) opined that core competences when well harnessed underlie firms 'competitive advantages.

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Indeed, many hitherto unknown and small Asian firms have phenomenally grown into serious competitors even overtaking leading western world's companies relying by building and accumulating resource into capabilities, to core-competences (Utomi, 1998).

According to Barney & Wright (1997), when firms in competition have the same quality of resources and capabilities, they are deemed to operate at strategy parity, but firms which own and protect distinctive competences against imitation by rivals emerge as market leaders and expand market opportunities extensively. The survival and reasonably high performance of key Nigerian manufacturing firms despite experienced difficulties in operating contexts such as steady rise in production costs, unremitting competition from abroad through unchecked importation of manufactured products, public policy inconsistencies towards manufacturing and multiple taxes leveled by various tiers of government on manufacturing concerns (Odah, 2010); the poor status of Nigeria's manufacturing (average 5% of GDP 2001-2010) and massive market size available ordinarily should attract more scholars and practitioners attention to the resource based view in Nigeria. The main objective of this study was to examine the effects of age, and size; and capital intensity (which are respective proxies of organizational and financial resources and capabilities (Ural &Acaravci, 2006)) on the performance of some Nigerian manufacturing firms. It is an exploratory attempt to fill the void existing in the absence of empirical studies validating the resource based stream of strategy research. This holds significance as the effective promotion of the resource based way of thinking among managers and strategists in the manufacturing sectors can aid desired unlocking of the potentials of the sector, a midstream area of economic activity linked to the dominant value chains in the country.

LITERATURE REVIEW

Resources are the firm's building blocks (Penrose, 1959) and functional and cross functional routines i.e. capabilities (Barney & Wright, 1997; Bharadwaj, 2000; Barney, 2001; Berman, Down & Hills, 2002; Hills & Jones, 2008) are their specialized combinations. Firms' strategy crafting options either is based on resources and capabilities or on customers' preferences, technological innovativeness and emerging new markets dependence (Voss & Voss, 2000). Barney (1986) and Prahalad& Hamel (1990) noted respectively that strategy process was effective if greater details were given to how firms can fully utilize resources and capabilities through creation and sustenance of a firm-environment fit. A strategic factor is strategic because when employed, it has future performance implications (Ural &Acaravci, 2006). For instance, a manufacturing capability developed through intensive research spending by a firm or bought from a research center is a strategic factor since it could redefine the market or reconfigure relationship within the firm and the aligning of the firm with its environment as well as spur new competitive advantage. Barney & Wright (1997) argued that strategic parity is achievable when firms in competition have all got the same kinds of resources and capabilities. It is distinctive competences which are well protected from imitation or copying by rivals that position the firm firmly in market leadership positions to explore and exploit more market opportunities.

Capabilities generally refer to routines, identity, norms and values, learning, or vocabulary, that come into existence when individuals possess tacit knowledge (Collis, 1996, Grant, 1996, Spender, 1996, and Teece *et al*., 1997). The essence of strategic factors is that they are the basis for creation of competitive advantages, strategy as well as performance. Firms that don't understand and hone specific strategic factors, using same in tapping benefits from their environments could confront threats triggering their downwards spirals.

Theoretical & Empirical Framework

This study's theoretical foundation firstly is the Barney's (2002) VRIO-valuable, rarity, inimitability and organization-framework of the RBV, and secondly, the 'performance' claims of strategy (Prevos, 2005). The resource based view holds that a firm owning valuable, rare and non-substitutable resources and capabilities could strategically build sustainable competitive advantage. The strategic advantage a firm has is sustainable relative to its characteristics such as valuable, scarcity, protected and non-substitutability to maintain favourable competitive equilibrium (Barney, 2002). Therefore, the basis of competitive superiority includes the rarity, value and inimitability or non-substitutable of firms resources and capabilities. Specific firm attributes are related to performance (Barney, 2002). According to Miller & Cardinal (1994), the strategy process results in improved performance of firm (see also Mintzberg 1996; Hart 1992; Hamel 1996; Hills, Jones & Garvin 2004; Rogers, Miller & Judge, 1999; Hill, Jones & Galvin, 2004). This is the foundation of the 'performance claim' proposition that successful organizations will 'anticipate' and 'address environmental turbulence' through strategic planning (Miller & Cardinal, 1994; Rogers, Miller & Judge, 1999). According to Evans (1991), flexibility in strategically planning decision options for firms' adaptation to the environment changes is a preparatory or an ex-ante state.

In his pioneering RBV empirical study, Schmalensee (1985) found industry and firm effects were 9 per cent and 44 per cent respectively. Hansen &Wernerfelt (1989) measured the relative effects of firms and industry effect, concluding that firm effects were superior. Rumelt (1991) decomposed the 80 per cent error term in Schmalensee's (1985) and found low year effects, insignificant corporate effects and low corporate/industry interaction effects. Rumelt's (1991) inspired studies by Powel (1996); Roquebert, Philips & Westfall (1996); McMahan & Porter (1997); Mauri& Michaels (1998); and, Brush, Bromiley & Hendrickx (1999). Mauri& Michaels (1998) found variances in heterogeneity in marketing and R&D strategies. However, variances in ROA (returns on assets) i.e. dependent variable were36.9 per cent to 6.2 per cent and 25.4 per cent to 5.8 per cent for firm- and industry-effects respectively over 5-years and 15-years periods. Chatterjee &Wernerfelt (1991) established that successful diversification depends on availability of surplus productive resources. Henderson & Cock-burns (1994) examined the impacts of 'component competence' and 'architectural competence' on the productivity of research and development departments of pharmaceutical firms. Makadok's (1999) studied the impacts of differential levels of economies of scale on the ability of market mutual funds to increase their market shares to validate the resource based view of the firm. King, Fowler &

Zeithaml (2001) studied 17 organizations spread over two industries and reached the conclusion linking competency characteristics of firms and performance.

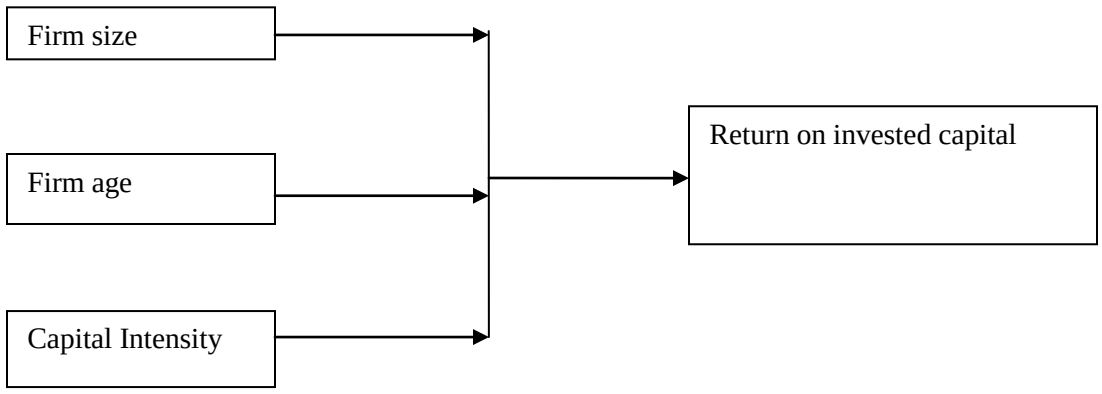
Berman, Down & Hill (2002) attempts validating the RBV in an examination of tacit knowledge at team-level. Hawawinni, Subramanian & Verdin (2001) studying the effects of outliers to verify the resource based view concluded that this significantly had impacts. Prahalad& Hamel (1990) established that small Asian firms by leveraging 'niches' using core competences successfully out-performed leading industrial giants in the electrical and electronics sector. Ural & Acaravci's (2006) used proxies for resources and capabilities which are size and age for organizational capability; and, capital intensity for financial capability allows for quantification of variables that were obtainable in the context within which this study has done for Nigeria. They showed in their study how these variables were capable of facilitating competitive advantages of Turkish manufacturing firms, enhancing their local and global market shares, and this is what we adopted to carryout this study in Nigeria. This study also benefits from Olumide's (2010) work where firm experience (i.e. age) was studied as a determinant of growth in Nigeria's Food, Beverages and Tobacco Industry.

Analytical Framework

It is assumed here that each of the firm specific strategic factors influence strategy choices (RBV) which in turn determines performance (performance claim). Resources and capability indicators: value, rarity and non-substitutability are based on managerial past strategies which imply that firms with better strategies are developing foundations for future capabilities. Resources and capabilities also explain the nature of extant strategies of firms (Hills & Jones, 2008). The study adopted the model used by Ural &Acaravci (2006) wherein respective firm specific proxies i.e. size, age, and capital intensity are evaluated as related to performance differentials among the subjects. A firm with an appropriate size and age has the required level of capital utilization that would be deemed organizationally capable and financially capable respectively. Figure 1 is the simple model of what the study depicts.

FIGURE 1

Analytical Framework



Source: Authors (2016)

METHODOLOGY

Research Design

The study is a descriptive design involving analysis of secondary data obtained from financial statements of listed manufacturing companies in Nigeria. The data set had both cross sectional and time series dimensions i.e. a cross section of heterogeneous manufacturing companies, for each data was collected for five years period (2003-2007).

Population of the study

The 110 manufacturing firms listed in the Nigerian Stock Exchange Market fact-book whose principal operations involved manufacturing comprised the population of the study.

Sample size & sampling procedure

A multistage randomized sampling technique was used in the study. All manufacturing sectors as classified by the NSE (Nigerian Stock Exchange) formed the basis for the first stage of randomization and eight of the sixteen existing sectors were initially selected. Next was the random selection of 30 firms from the complete list of all the firms that were captured in the eight selected sectors with the aid of the random number table. The sampling procedure ideally allowed for representation of all the sectors in the manufacturing industries in Nigeria. The study's sample size was in excess of 10 per cent bearing in mind the uniformity of their characterization as manufacturing concerns.

Study Variables

Dependent variable: The returns on invested capital (ROIC) was proxy for performance and independent variable of the study. This ratio was computed using values obtained from the financial statements of the sampled firms as shown in equation 1.

$$ROIC = {}^{NOPAT}/_{TA} \quad (1)$$

Where NOPAT is the net operating profit after tax and TA is total assets.

Independent variables: Firm size (S), age (A) and capital intensity (C) were the independent variables of the study representing: size and age for organizational capability; capital intensity for financial resources and capability respectively. The values of natural logarithm of total assets were used to overcome the skewed characteristics. Index values for age were obtained by deducting each successive year in the study from year of incorporation and averaged using study period (five years). Capital intensity was computed as ratio of plant and equipment and total turnover. These were performed for purposes of aggregating the independent variables prior to further analysis (Ural & Acaravci, 2006).

DATA ANALYSIS

Diagnostic testing for Panel Analysis

The dataset was first confirmed as balanced, that is the cross sectional dimension was matched by the time series dimension. The i = 30 firms and the t = 5 giving a balanced 150 observations. Once dataset was confirmed suitable for panel analysis, the effects of stationarity and heteroscedasticity were obviated. However fixed effect was determined first and with λ_i= 0.73 (see table 1) indicated the appropriateness of OLS (ordinary least square) model for analysis of the result. Hausman specification test was obviated.The basic linear regression model was modified to suit the panel nature of this study i.e. combining cross sectional and time series analysis. The basic model is as follows:

$$y_{it} = \beta_i x_{it} + \alpha_i + \varepsilon_{it} \quad (2)$$

Where$y$ is dependent variable; αsignifies the constant term; $\varepsilon$is the disturbance or error term; β are unknown coefficients that vary with individual and group observations, and time; $x$is the explanatory variables; i = 1, 2….N represents the cross section units or space dimension and t = 1, 2…..T represents the spread or time. For this study, the general equation modified is as follows:

$$ROIC = \beta_0 + \beta_1 S_{it} + \beta_2 Ci_{it} + \beta_3 A_{it} + \varepsilon_{it} \quad (3)$$

Where the firm strategic factors each is symbolized as *S, Ci,* and *A* respectively and *ROIC is* the dependent variable. i = 1, 2, 3... 30 and t = 1, 2, ..., 5 i.e. 2003-2007. Equation 3 converted reflected the firm strategic factors or independent variables thus:

$$ROIC_{it} = \beta_0 + \beta_1 (Firmsize)_{it} + \beta_2 (CapitalIntensity)_{it} + \beta_3 (FirmAge)_{it} + \varepsilon_{it} \quad (4)$$

Each β represents a population parameter and it measures the elasticity of the dependent variable with respect to the related independent variable *ceteris paribus* (all other things being equal). The regression function for the study contains five parameters each of which measured the degree of change in returns to invested capital or ROIC along with degree of changes in related firm strategic factors. The following four parameters: β_1, β_2, *and* $\beta_3$were used to estimate elasticity of ROIC for each variable. β_0 was used to estimate the overall intercept of the expression, i.e. the estimable conditional mean. More specifically, the parameter β_1 is the elasticity of ROIC with respect to firm size; β_2 is the elasticity of ROIC with respect to capital intensity; and $\beta_3$is elasticity

of ROIC with respect to firm age. Unanticipated effects of the panel quality of the data set of the study are encapsulated in error terms which accommodate time and width dimensions with the double subscripts and α_i which denotes the specific effects of the variables on the intercept.

FINDINGS AND DISCUSSION

The result of panel data analyses is presented as table 1.

TABLE 1
Results of panel analyses for three models

VARIABLES	(1) Fixed Effect	(2) Random effect	(3) OLS
Size	0.156*	0.0521***	0.0521***
	(0.0838)	(0.0188)	(0.0188)
Capital Intensity	-0.210***	-0.151***	-0.151***
	(0.0652)	(0.0370)	(0.0370)
Age	0.403	-0.169*	-0.169*
	(0.561)	(0.102)	(0.102)
Constant	-1.429	0.0697	0.0697
	(0.889)	(0.201)	(0.201)
Observations	149	149	149
R-squared	0.094	0.0670	0.126
F-statistic	4.00***		6.97***
Chi-squared		20.90***	
λ_i	0.73		
Number of firm	30	30	30

Standard errors in parentheses
*** p<0.01, ** p<0.05, * p<0.1
Source: Authors (2016)

Table 1 shows that a positive and significant relationship exists between size and ROIC. Approximately 11.7 9 per cent of the variation in firm performance is attributable to the size variable. Although 34.17 per cent of the variation in returns was found to arise from the capital intensity variable, the relationship between these variables was negative. Also, a negative relationship was found for firm age and returns on invested capital. The 38.25 per cent of the variation in returns attributes to age. Despite negative coefficients for age and firm capital intensities to ROIC, the relationships fell within acceptance regions. The ρ value for size as a determinant of performance was less than 1 per cent. For capital intensity, ρ value was found

also less than 1 per cent and for firm age ρ <10 per cent (approximately). The OLS model explained 12.6 per cent of the variation in the returns on invested capital of firms included in the study. It is therefore the best of the three models shown in table 1. The generally high unexplained value is assumed arises from the parsimonious non-inclusion of variables representing macro-environment factors such as energy, the state of infrastructures, public policy and governance issues, competition from foreign products etc.in the model despite their significance in the Nigerian contexts as deficits. Based on foregoing findings therefore:

> *H_{oa}: there is no significant relationship between firms' size and returns on invested capital of Nigeria's manufacturing firms was rejected (ρ = 0.005 i.e. within acceptance region);*
> *H_{ob}: there is no significant relationship between firms' capital intensity and returns on invested capital of Nigeria's manufacturing firms was rejected (ρ = 0.001);*
> *H_{oc}: there is no significant relationship between firms' age and returns on invested capital of Nigeria's manufacturing firms was rejected (ρ = 0.096).*

Firm size is therefore a determinant of returns on invested capital. Not only is difference in firm size as measured in this study found to be related to returns on invested capital, it is also a positive determinant of returns on invested capital. As sizes of the firms vary among the sampled firms, ROIC changed though marginally. Secondly, as rate of capital leveraging varies for the studied firms, the performance of the firms changed too however negatively i.e. as capital intensity increase in the sample, ROIC decline. Lastly age though a significant determinant of changes in rates of returns to capital investment was found to be inversely related to the dependent variable.

DISCUSSION OF FINDINGS

Similar to Ural &Acaravci (2006) findings, this study established that the returns on invested capital was influenced by the varied firms' sizes. Therefore, larger sized firms represent greater resources and capabilities than their small-sized counterparts. This matters in the creation of additional values for the shareholders. On the other hand, small-sized firms obtained lower returns on investments. Size therefore is an equivalent of market power. Larger firms generate more products and are able to cascade their average cost curves through spread of fixed costs components that allows flexibility for profit making. Such increases in profitability allow firms seek more advantages employing quality improvement strategies, greater after sales services, customers' care and research and development leading to innovations and premium offerings. This finding is in support of the niche orientation of small firms in third world or transition economies of Asia now operating at the global scenes in the electrical electronic sectors (Prahalad& Hamel, 1993; Utomi, 1998).

The findings counters size as underlying cluttering to sunk costs and overheads related operational inefficiency. High value of assets such as capital equipment is therefore proved as necessary to lower unit costs of production. In capabilities and resources terms, firm of large sizes encompasses human, organisational, financial, and branding and market power advantages. Internal strategic factors that are valuable, rare and non-substitutable are more in large-sized firms than in small firms (Barney, 2001). Secondly, as firms' age, this study shows that their returns on related invested capital become lower. Older firms are shown to perform less than younger ones, suggesting that passage of time is a risk factor accounting for lower returns. Aging causes obsolescence and is degenerative (Drucker, 1987). Younger firms are less prone to the cementation of rigidity, inefficiency associated with bad corporate governance fixation and other rent seeking behaviours (Loderer & Waelchli, 2009).

Lastly, the negative capital intensity-ROIC relationship is a departure from Ural & Acaravci's (2006) finding for Turkey firms. However, it supports Onaolapo & Kajola's (2010) study where it was established that a negative relationship existed between capital structure and firm performance in Nigeria for listed non-financial sector firms using panel data analysis. The work therefore confirms that firms with significant financial resources must follow through with financial management capability to perform positively. Sound policies and practices guiding financial decision making are required for optimality.

CONCLUSION AND RECOMMENDATIONS

In view of adverse market structure and macro-economic environment of Nigeria which is reflected in parlous infrastructure, energy crises, insecurity of lives and properties and government policy instability, manufacturing firms in Nigeria are found based on this study relying more on their sizes, age, and capital nature being resources and capabilities proxies to achieve different rates of profitability. This suggests that despite the difficult operating contexts, manufacturing outfits can hone their specialized abilities i.e. internal strategic factors raising their profit rates and achieving for stakeholders the respective expectations from the managements. Firms are therefore strongly encouraged to foster conditions that ensure full utilization of resources and capabilities. There is always enough room for improvement within the ambits of the resources and capabilities that a firm has. Strategies and policies must be made more reliant on the internal factors that are to be well analysed and evaluated to form a realistic opinion about their value, rarity and non-substitutability, while efforts must be made to enhance the qualities of firms' strategic factors.

Government on its part should encourage manufacturing business growth through directly intervening in the infrastructural and overall macro-environmental deficits to enhance real sector competitiveness. Attention should be paid to management development on the benefits inherent in internal environmental scanning as the bedrock for strategy formulation in Nigerian businesses. This is not to suggest that firms should fail to identify and harness opportunities in the macro-context.

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