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## Impact of Human Capital on the Performance of Small and Medium Enterprises in South West, Nigeria

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### **Abstract:**

*This study examined the Impact of Human Capital on the Performance of Small and Medium Enterprises (SMEs) in South West Nigeria. The specific objective assessed the effect of human capital practice on the innovativeness of SMEs in South West, Nigeria. Data were collected from the primary source using structured questionnaire. Stratified random sampling was employed to select a sample of three hundred and ninety-three (393) SMEs from a population of twenty three thousand two hundred and ninety (23,290) SMEs in the Nigerian South West states comprising Lagos, Oyo, Ogun, Osun, Ondo and Ekiti. The population was divided into small and medium enterprises after which selection from each stratum was done using simple random sampling. Analysis of the data was carried using linear regression to test the strength of relationship between the variables. Findings from the study revealed that human capital index ( $B=0.277$ ,  $T = 13.306$  and  $R^2 = 0.323$ ) was positive and significantly affect SMEs innovativeness. The study concluded that human capital has positive and significant impact on SMEs performance.*

**Keywords:** Human capital, impact, innovativeness, performance, small and medium enterprises

### **1. Introduction**

Small and Medium Enterprises occupy a very important place in any economy. They are the driving force of business growth, innovation and competitiveness. The SMEs sector plays a decisive role in job creation and generally is a factor of economic development and social stability. The sector also provides training ground for future entrepreneurs in different fields, aids in the process of redistribution of income and provides intermediate semi-processed goods for use by large scale firms. Small and medium enterprises have also been found to play a leading role by virtue of their contributions to domestic capital formation and technological development (Ojokuku, Sajuyigbe and Ogunwoye 2014).

Studies by Ndesaulwa (2016) and Katarzyna (2016) indicate that the global economy has shifted from industry-based economy to knowledge-based economy due to the fast evolution of business environment characterized by rapid technological advancements, increasing pace of globalization and hyper-competition, the shorter product life-cycle, the changing customers preferences, expectations and awareness. Orugun, Nafiu and Aduku (2017) assert that business firms, regardless of their sizes must be strategically positioned to cope with the dynamism to enable them remain at competitive advantage.

To succeed and remain viable, organizations must respond with the implementation of strategies which incorporate creativity and innovativeness. This implies that organization should embark on creating new product or improve on the existing one, ensuring its process, organizational and marketing activities are innovative. Osman (2014) submits that the existence of innovative and competitive SMEs is crucial for the prosperity and future growth of nations. Human resource input plays a significant role in enhancing firm's competitiveness and long term sustainability. It is imperative on organizations to leverage on their workforce. Therefore, organizations now focus on strategies for improving employees' productivity to derive improved value for their firms through the implementation of comprehensive human capital development programmes.

In order to achieve business goals and for long-term survival and sustainability, organizations need to heavily invest resources to ensure that the workforce is embedded with knowledge, skills and competencies needed to function effectively in an environment that is not only ever changing but also complex.

#### *1.1. Statement of the Problem*

Despite the economic significance of Small and Medium Enterprises in Nigeria, they have not played the expected role in the economic growth and development of the country. Today small and medium enterprises struggle to survive under tough competition in the internal and external business environments.

The calls for innovative actions, notwithstanding, the level of innovation in Nigeria is considered still low. Nigeria SMEs and other organizations place less emphasis on innovation for global competitiveness. This claim is supported by the Global Innovation Index (GII) 2018 and 2019 reports produced by the World Economic Forum (WEF). In 2018, out of one hundred and twenty-six (126) countries examined, Nigeria ranks 119th and in 2019, ranks 114th out of 129 countries. Switzerland ranked as the most innovative in the world ahead of Sweden, United States of America, Netherland and the United Kingdom, Nigeria was missing among the innovation achievers but six countries which had been named in this category emerged from Africa namely; South Africa, Tunisia, Morocco, Kenya, Egypt and Rwanda.

The inclinations of SMEs in Nigeria towards investment in Information and Communication Technology (ICT) and Research and Development (R & D) is low and this reflection on their effectiveness. SMEs human capital development practices and competences should promote innovation for SMEs sustainability (Chudboy, Kamariah, Ndaliman, Jaward & Maqsood, 2015).

Therefore improving SMEs performance through the innovation of products and services has become a critical issue for Nigerian SMEs. Considering the above, this study fills the gaps by considering the extent to which human capital affect SMEs innovativeness in South West, Nigeria.

## 2. Literature Review

### 2.1. Human Capital

Human capital means to the processes that deal with training, education and other professional programmes aimed at increasing the levels of knowledge, skills, abilities, values and societal assets of an employee which will lead to the employee's satisfaction and performance (Ukenna, Ijeoma, Anionwu and Olise, 2010). Wright, Coff and Moliterno (2014) stated that human capital is an important input for organizations especially for employees' continuous improvement mainly on knowledge, skills and abilities. It also refers to knowledge, skills, competencies and attributes implanted in individuals that assist in the conception of personal, social and economic well-being. In the same vein, Subramaniam and Youndt (2005) refers to human capital as all the knowledge, possessed by the employees, which include their individual values and attitudes, experiences and know-how. Human capital is the capital that resides in the members of the organization and generates value to the company. Brooking (1996), calls this component 'human assets' including elements such as collective skills, creative abilities, problem-solving competencies and leadership. Human capital represents the personal investment people make to develop themselves that results in positive contributions to the economic development of the nation and organizational productivity (Ogunyomi and Bruning, 2015).

In order to be competitive and adaptable to the volatile business environment, firms desire certain qualities of human capital (Jordan, Gonzalez and Loureiro, 2013). According to Cania, (2014) and Genc, (2014) the workforce requires human capital to be creative, bright and skillful, experts in their roles and functions as well as contributor of new ideas and knowledge. In the same view, Al-Azzam, Irtaimah, and Al-Quraan, (2016) posit that most organizations, if not all, have realized the need for the best talent to drive and sustain optimal levels of performance in markets that are complicated and competitive. Business leaders must retain and align business organization strategy with their internal resources and capabilities mainly by engaging high-potential and high-performing employees in its processes to achieve the implementation of its strategic vision, mission and objectives (Al-Azzam *et al.*, 2016).

Knowledgeable employees possessing high problem-solving skills are crucial in making effective decision especially for firms involved in advanced technology (Ugheoke, Isa and Noor, 2014). As noted by Hsu and Wang (2012), as employees gather specific information, skills and knowledge, these will improve the efficiency and effectiveness in communication, hence lessen the mistakes in decision-making and result in enhanced quality and high-firm performance. In a related study Ahmed, Fiaz and Shoaih (2015) state that knowledge acquisition, conversion, application and protection are crucial for organizational performance.

Two aspects of human capital are 'explicit knowledge' and 'tacit knowledge' (Andres, Asongu and Amavilah, 2014). They stated that explicit knowledge is the knowledge, skills, abilities or competencies of a person acquired from education, experience and specific skills and these are germane for the selection of an employee. Explicit knowledge can be expressed verbally, put in writing and captured in drawings (Andres *et al.*, 2014). However, explicit knowledge is easily copied by competitors given the characteristics of a knowledge-based economy and high-tech environment, which make education skills and experience diminish in value quickly (Andres *et al.*, 2014). Analysts submit that although explicit knowledge is necessary for firms, it is insufficient for obtaining the potential gains from human capital.

Tacit knowledge is unstated and tied to the senses, movement skills, physical experiences, intuition or inherent rules of thumb. Nonaka and Krogh, (2009) assert that tastiness is crucial in knowledge sharing. In the view of a Pai and Chang (2014), knowledge sharing is a process through which employees mutually exchange and jointly create new knowledge. Studies by Gbolani, Ashi, Shirkowhi and Noruzy (2013) and Sylva (2016) attest to knowledge sharing as providing firm with the capability to solve problems quickly and enhance reaction to new information. New knowledge is created during the transformation process from tacit to explicit knowledge (Andres *et al.* 2014) where, according to Nawaz, Hassan and Shaikat (2014), tacit knowledge is transformed into words or number in order to disseminate the tacit knowledge.

Many studies (Khaliq, Shaari, Isa and Ageel, 2011; Ogbo, Ezeobi and Ituma, 2013) agree that knowledge sharing is crucial to advance innovation capability. In line with this agreement, Ahmed, Fiaz and Shocub, (2015) said that the willingness of employees to contribute and exchange knowledge within groups and organizations may yield more new ideas and new business opportunities hence promote innovation. Hence, tacit knowledge makes it difficult for competitors to learn and imitate new knowledge development (Nonaka, Kodana, Hirise and Kohlbacher, 2014). Knowledge capability

becomes unique, rare, and difficult for competitors to duplicate and thus, leads to sustained high level of innovation capability (Supeno, Sudharma, Aisjah and Laksmana, 2015). This becomes so efficient it becomes a source of advantage or firm capability that other people cannot replicate (Genc, 2014). According to Teece (2014) the vibrant capacity in people can be developed through the introduction of new knowledge and skills and continuous improvement of human resources through training and development programmes.

In relating to strategy implementation, and based on the firms human capital, managers make decisions and take actions assigning tasks to employees that are designed to implement the firm's strategy (Greer, Lusch and Hitt, 2016). According to Burma (2014) tasks are allocated according to skills. In short, managers leverage the firm's human resources to connect the firms' capabilities in ways that are calculated to implement the organization's strategy. According to the behavioural perspective of human resource management Jackson, (2013) notes that effective strategy implementation involves understanding the essential employee role behaviours needed for implementation and then designing or espousing management traditions that can be used to shape a firm's human capital. Its stock include methods for creating centre of attention, selecting, developing, motivating and retaining capacity that create value for the firm's customers leading to the attainment of competitive advantage (Vomberg, Homburg and Bornemann, 2015).

## 2.2. Human Capital Theory

Human capital theory proponent was Schultz (1961). Its extensive development was carried out by Becker (1964). Schultz (1961, p. 140) submits that human capital consisted of the 'knowledge, skills and abilities of the people employed in an organization'. Schultz (1961) notes that with knowledge and skills are form of capital and that this capital is a product of deliberate enterprise growth achievable through education and training.

Becker (1964) argues that investments in education and training will improve productivity noting that it is the type of training that determines who will pay for training, that is the employee or the firm. The concept views workers as potential resource that managers use to achieve competitive advantage for their companies. Human capital theory considers people an asset. Thus, organizations must invest in people's education and training as this will generate an increase in human productivity leading to a positive rate of return and hence organizational performance. The theory proposes that sustainable competitive advantage is attainable when organization has a pool of human resource that cannot be imitated or substituted by its rivals (Fombrum and Shanley, 1990)

## 2.3. Empirical Review

Ugheoke, Isa & Noor (2014) examined the impact of strategic human resource management on tangible firm performance. The study employed cross sectional approach to collect data from a sample of 250 SMEs in Lagos, Nigeria. Finding shows that strategic human resource management (SHRM) has significant positive influence on tangible performance. Also Ologunde, Monday and James-Unam (2015) examined the effect of strategic human resource management on the level of competitiveness of 120 Small and Medium Enterprises using the Nigerian hospitality industry as a reference. The findings indicated that strategic human resource management practice had a positive relationship with the firm's market share and a significant effect on profitability. Similarly, Ojokuku and Sajuyigbe (2015) identified human capital as one of the most potent tools for the attainment of performance by SMEs in Nigeria. Using a survey, method and sample of 80 randomly selected SMEs operators, the study sought to establish a like between human capital and SMEs performance. The result showed that human capital development variables (on-the-job training, level of formal education, level of participation in seminars, conferences and workshops, and level of participations in trade fairs including exhibitions) significantly affect SMEs performance.

Samal (2014) also examined the impact of Human capital management on the innovativeness of research centre: The case of scientific research centres in Algeria; and concluded that innovation depends in intangible assets especially human capital.

## 2.4. Objective of the Study

The main objective of the study is to examine the Impact of Human Capital on the Performance of SMEs in South West Nigeria. The specific objective is to examine the effect of human capital on innovativeness of SMEs in South West Nigeria.

## 2.5. Research Question

To what extent does Human capital affect innovativeness of SMEs in South West Nigeria?

### 2.5.1. Hypothesis of the Study

- $H_{01}$ : Human capital does not significantly affect innovativeness of SMEs in South West Nigeria.

### 2.5.2. Scope of the Study

The scope of this study relates to SMEs in the manufacturing and services sectors. These two were chosen for their largest representation of SMEs establishments and significant contributions to Nigeria's economy. The geographical scope cover SMEs in South West, Nigeria made up of Lagos, Ogun, Oyo, Osun, Ondo and Ekiti state.

### 2.5.3. Significance of the Study

The relevance of this study lies in the fact that in Nigeria, over ninety percent of businesses are micro, small and medium enterprises according to reports by Small and Medium Enterprises Development Agency in collaboration with

National Bureau of Statistics (2017). Therefore, they must remain competitive in a market that is dynamic since they represent a significant force to the economy. This study gives a clear proof of the need for small and medium enterprises to strategize to counter environmental challenges and increased competition through innovative activities and the monitoring of a key factor affecting their performance. At the practical level the study offers SMEs operations tools and techniques for developing and maintaining human capital with necessary skills, and competence for the improved performance and survival.

#### 2.5.4. Limitation of the Study

The sample was not a representative of all the SMEs in Nigeria because it is limited only to two sectors (Manufacturing and services). Therefore, the results cannot be generalized to firms that do not belong to those sectors.

### 3. Methodology

The study adopted a quantitative research method using a field survey. The population of this study comprised of all registered SMEs in the south west, Nigeria based on the official statistical report of Small and Medium Enterprises Development Agency in collaboration with National Bureau of Statistics (2017).

The population consisted of all SMEs which have their primary business activities in the manufacturing and services sectors with a total of 22,720 small and 570 medium enterprises. 393 SMEs operators were selected as sample using stratified sampling technique. Structured questionnaire using a 5-point Likert scale was adopted in collecting data from the participants who were mainly SMEs Managers/Chief Executives Officers and the instrument was subjected to a test and re-test process to establish its reliability. The validity of the instrument was established by giving the instrument to experts for scrutinizing and evaluation.

Cronbach's/alpha was used to test for reliability. The result of the reliability test was 0.81 thus indicating that the instrument is reliable. Both descriptive and inferential statistical techniques were used to analyze the data. In order to test the hypothesis of this study, linear regression analysis was employed.

### 4. Results and Discussion

Statements	WMS	Rank
Our employees are highly skilled	4.70	1st
Our employees are widely considered the best in our industry	4.42	6th
Our employees are creative and bright	4.44	5th
Our employees are experts in their particular jobs and functions	4.55	2nd
Our employees develop new ideas and knowledge	4.40	7th
Our employees undergo training, seminars, workshops regularly	4.54	3rd
Employees skills are upgraded through acquisition of academic and professional qualification	4.34	9th
Our employees are motivated to share new ideas	4.45	4th
Most of our employees are aware of the plans which need to be implemented	4.40	7th

Table 1: Distribution of Respondents by Human Capital Practice

WMS = Weighted Mean Score

Source: Field Survey, 2019

#### 4.1. Interpretation: Responses on Human Capital Practice

Table 1 shows the distribution of respondents by effects of human capital on SME's innovativeness. Based on the result in the table 1, the belief that most of the employees are highly skilled was ranked highest among the effects of human capital on SME'S innovativeness with a Weighted mean score (WMS) of 4.70. Others in the rank order include the fact that employees are experts in their particular jobs and functions (WMS = 4.55), employees undergo training, seminars, workshops regularly (WMS = 4.54), employees are motivated to share new ideas (WMS = 4.45), employees are creative and bright (WMS = 4.44), employees are widely considered the best in our industry (WMS = 4.42), employees develop new ideas and knowledge (WMS = 4.40), employees are aware of the plans which need to be (WMS = 4.40) and employees' skills are upgraded through acquisition of academic and professional qualification (WMS = 4.34).

It must be mentioned that the mean score of the effect of human capital on SME'S innovativeness was found to be above average which indicates that human capital is a prerequisite factor for SMEs' innovativeness. This implies that each individual had some element of leadership trait which could help boost organizational innovativeness when they are well managed. The finding from this study agrees with some researchers (Orugun and Aduku, 2017) which shows that intellectual capital (human capital) plays a pivotal role in the pursuit and achievement of organizational performance and that the synergy among the three dimensions of intellectual capital is instrumental to this organizational performance. Similarly, Alzuod, Isa and Othman (2017) showed that dimensions of intellectual capital (human capital and customer capital) were found positively and significantly related to innovative performance. Also, Omerzel and Jurdana (2016) assert that the innovative capability of an organization depends on the intellectual capital (human capital) it possesses.

Statements	WMS	Rank
<b>Product/Service Innovation</b>		
We frequently update products/services delivery methods to increase productivity	4.49	1st
We have introduced many modifications to existing products/services	4.27	5th
Our organization constantly seeks for new products/services	4.40	2nd
We have introduced more new products/services than our competitors	4.35	4th
The new products/services we have introduced have caused significant changes in the industry.	4.39	3rd
<b>Process Innovation</b>		
We frequently update products/services delivery methods to increase productivity	4.55	1st
We frequently incorporate technologies to improve efficiency	4.39	5th
We frequently incorporate technologies to improve quality of our products/services	4.49	2nd
We make major investments to incorporate new computer techniques, equipment's and/or programmes	4.43	4th
We frequently train our staff in new technologies in this sector	4.45	3rd
<b>Marketing Innovation</b>		
We are dynamic in developing and using new sales channels	4.50	1st
We frequently introduce new techniques or channels for promoting our products/services	4.46	2nd
We frequently introduce new methods for pricing our products/services	4.38	4th
Our competitors use our marketing methods as a point of reference	4.43	3rd
The new marketing methods we have incorporated have been new to the sector	4.33	5th
<b>Organizational Innovation</b>		
We frequently introduce organizational changes to improve the division of responsibilities and decision-making	4.29	4th
we frequently introduce new methods of managing external relationships with other firms or public institutions	4.30	3rd
We often introduce new practices in work organization or firm procedures	4.33	2nd
The new organizational methods that we have incorporated have been pioneering in the sector	4.42	1st

*Table 2: Distribution of Respondents by Product/Service, Process, Marketing and Organisational Innovation activities*

*WMS = Weighted Mean Score*

*Source: Field Survey, 2019*

#### 4.2. Effects of Human Capital Innovative on SMEs Innovativeness

Table 2 shows the distribution of respondents by effects of human capital on SMEs performance metric.

##### 4.2.1. Interpretation: Product/Service Innovation

According to the result in the Table 2 above, the fact that organization frequently update products/services delivery methods to increase productivity was ranked highest among product/service innovation that enhance SMEs performance metrics with a Weighted mean score (WMS) of 4.49. Others in the rank order include the fact that organization constantly seeks for new products/services (WMS = 4.40), the new products/services introduced have caused significant changes in the industry (WMS = 4.39), introduction of more new products/services than rival/competitors (WMS = 4.35) and introduction of many modification to existing products/services (WMS = 4.27). The finding therefore indicates that every organization constantly adopts various product/service innovations to enhance their acceptance and invariably their sales as well as their income level. This finding is in with that of Rosli and Syansuriana (2013) which evaluated the impact of various innovation dimensions on SMEs performance and confirmed that product innovation and process innovation influenced firm performance significantly.

##### 4.2.2. Interpretation: Process Innovation

According to the result in the Table 2, the fact that organization frequently update products/services delivery methods to increase their performance was ranked highest among process innovations employed with a weighted mean score (WMS) of 4.55. Other process innovation strategies employed include the fact that most organizations frequently incorporate technologies to improve quality of our products/services (WMS = 4.49), frequently training of staff in new technologies (WMS = 4.45), organization making major investments to incorporate new computer techniques, equipment's and/or programmes (WMS = 4.43) and organization frequently incorporate technologies to improve efficiency (WMS = 4.39). The finding therefore indicates that organization frequently update products/services delivery methods to increase their sales and their income level. Similarly, in a survey of 350 SMEs in Mexico, Martinez, Vega and Vega (2016) assert that learning orientation, product process and management system innovation significantly affect performance.

#### 4.2.3. Interpretation: Marketing Innovation

According to the result in the Table 2, most of the organizations are dynamic in developing and using new sales channels was ranked highest among marketing innovation in enhancing SMEs' performance metrics with a weighted mean score (WMS) of 4.50. Others in the rank order shows that most of the organizations frequently introduce new techniques or channels for promoting our products/services (WMS = 4.46), competitors use our marketing methods as a point of reference (WMS = 4.43), organization frequently introduce new methods for pricing our products/services (WMS = 4.38) and the new marketing methods incorporated into the marketing scheme have been new to the sector (WMS = 4.33). The finding therefore indicates that dynamism in developing and using new sales channels in any organizations is an important ingredient in enhancing performance.

#### 4.2.4. Interpretation: Organizational Innovation

According to the result in the Table 2, it was revealed that new organizational methods that the organization have incorporated have been pioneering in the sector was ranked highest among organizational innovations employed by most SMEs with a weighted mean score (WMS) of 4.42.

Others in the rank order include the fact that most organizations often introduce new practices in work organization or firm procedures (WMS = 4.33), most organizations frequently introduce new methods of managing external relationships with other firms or public institutions (WMS = 4.30) and the fact that they frequently introduce organizational changes to improve the division of responsibilities and decision-making (WMS = 4.29). The finding therefore indicates that new organizational methods that the organization have incorporated have been pioneering in the sector is the most prominent among organizational innovations in order to boost their sales performance. The finding from this study agrees with Tajudeen, Musa and Musa (2012) finding in the study which investigated the effect of organizational culture, market orientation and innovativeness towards new product performance. The results indicated that organizational culture affect new product performance through innovativeness as mediating factor, but an entrepreneurial culture directly impacts new product performance.

#### 4.3. Hypothesis

- $H_{02}$ : Human capital does not significantly affect SMEs innovativeness

Variable	B- value (Coeff.)	Std. Error	T-value	Sig.
Constant	6.679	0.842	7.928	
Human capital	0.277	0.021	13.306***	0.000

Table 3: Result of Linear Regression Analysis Showing the Effect of Human Capital on SMEs Innovativeness

\*\*\*Significant at 1%; F Statistics = 177.049;  $R^2 = 0.323$  (32.3%)

Source: Survey, 2019

#### 4.4. Interpretation: Effect of Human capital on SMEs innovativeness

Table 3 presents the result of linear regression analysis showing the effect of human capital on SMEs innovativeness. It was revealed that human capital index (B = 0.277; T = 13.306) was positive and significantly related to SMEs' innovativeness. The relationship was positive which implies that any unit increase in the predictor variable will bring about an equivalent increase in the SMEs innovativeness. This development indicates the significance of human capital in determining SMEs innovativeness in any organization. The relationship was significant at 1% level. The F statistics for the relationship was found to be 177.049 while the  $R^2$  was found to be 0.323 (32.3%). The  $R^2$  value in this relationship indicates that human capital in this study accounted for 32.3% increase in the SMEs innovativeness. Since the relationship was significant, the null hypothesis is rejected while alternative hypothesis is accepted. This finding agrees with that of Alzuod, Isa and Othman (2017) which investigated the role of moderating effect of entrepreneurial orientation (EO) in relationship between intellectual capital and innovation performance among small and medium-sized enterprises (SMEs) in Jordan. The study revealed that dimensions of intellectual capital (human capital and customer capital) were found to affect innovative performance positively and significantly. However, it is contrary to that of some researchers (Costa, Dorrego and Fernandez- Jardon, 2013) who claimed that human capital does not have a significant and positive relationship with product innovation performance in Portuguese innovation SMEs. Moreover, the results also indicate that commitment to the product innovation process stands out as the only human capital factor that significantly affects product innovation performance.

### 5. Conclusion and Recommendations

The conclusion from the findings of this study is that human capital has positive and significant impact on SMEs performance. Therefore, this study postulates that for optimal performance, SMEs operators must pay attention to the employment of highly skilled, creative, bright and highly motivated workforce. Their knowledge skills and competences should be enhanced through training, seminars, workshops, and the acquisition of academics and professional qualifications. Human capital is a prerequisite for SMEs innovativeness.

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