# Control Environment and its Effect on the Organizational Performance of Medium Scale Enterprises in North-Central Nigeria

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## Abstract

The main aim of this study is to establish a relationship between control environment and organizational performance of medium scale enterprises in North-Central Nigeria. Medium Scale Enterprises play tremendous role in the reengineering of socio-economic landscape of the country creating employment and contributing to GDP. This study is quantitative in nature and adopts a census research design where a structured questionnaire was distributed to the identified population of 182 MSEs in North-Central Nigeria. The reliability of the research instrument was checked and found to have a Cronbach's Alpha value above 0.7. Exploratory factor analysis was also conducted to check the validity of the instrument, the result of the EFA showed satisfactory values for Kaiser-Meyer-Olkin measure of sampling adequacy, Bartletts Test of Sphericity, and Factor loadings. Simple regression analysis was used to measure the quantitative data which was analyzed using the statistical package SPSS V.20. The study findings indicated that control environment have a positive and significant effect on the organizational performance of MSEs in North-Central Nigeria. It was recommended that MSEs should optimize internal control environment by establishing and perfecting corporate governance structure.

**Keywords**: *Control environment, MSEs, and Organizational performance*

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**Background to the Study**
Everyone within an organization has some roles to play in the internal control system of the organization. The roles vary depending upon the level of responsibility and the nature of involvement by individuals. Managers and supervisory personnel are responsible for executing control policies and procedures at the detail level within their specific unit (Gilbert, 2006). This role expected of the management of any business concern is related to Control Environment which is a major component of Internal control system (COSSO, 1992).

In a developing economy like Nigeria Medium scale Enterprises play tremendous role in the reengineering of socio-economic landscape of the country. Medium scale Enterprises in Nigeria are structured across key sectors, including Agriculture, Mining and Quarrying, Building and Construction, Manufacturing, Solid Minerals, Hospitality, etc, and thus has strong linkages with the entire range of economic activities in the country (SMEDAN, 2014). They therefore play an important role in the development of a country by creating employment for rural and urban growing labor force and providing desirable sustainability and innovation in the economy as a whole. MSEs alongside small businesses contribute to over 55% of GDP and over 65% of total employment in high income countries .They account for over 60% of GDP and over 70% of total employment in low income countries, while they contribute about 70% of GDP and 95% of total employment in middle income countries (SMEDAN, 2014).

John (2011) asserts that organizational performance is measured by how efficient an enterprise uses the resources at its disposal in achieving its objectives. Performance is therefore seen as the measure of attainment achieved by an individual, team, organization or process.

This study however sought to contribute to the existing literature by empirically investigating the effect of Control environment on the organizational performance of Medium Scale Enterprise in North-Central Nigeria.

**Problem Statement**
In spite of the different measures taken by the government of Nigeria since 1960 to increase industrialization, both small and medium scale enterprises are still facing hard conditions due to ineffective internal control systems in some of these enterprises (Osotimehin, Jegede, Akinlabi & Olajide, 2012).

Employees of some Medium Scale enterprises in Nigeria are noted to deliberately abuse or disregard the system in carrying out their responsibilities. This is made possible by weaknesses in the control environment of such enterprises (Ajonbadi, Lawal, Badmus & Otokiti 2014). It was also noted by Siyanbola (2013) that disregard or abuse of internal control environment in business enterprises leads to low profitability, poor liquidity and distorted accounts.

**Objective/Research Hypothesis**

The main objective which this study sought to achieve is to examine the effect of control environment on the organizational performance of medium scale enterprises in North-Central Nigeria. In this regard the following hypothesis is therefore formulated:

$Ho_2$:    Control environment does not have a significant effect on the organizational performance of medium scale enterprises in North-Central Nigeria.

**Literature Review**

Internal control system is seen as a fundamental aspect of management stewardship responsibility that provides interested parties with reasonable assurance that the organization is effectively controlled and that the accounting data it receives on a timely basis are accurate and dependable. Developing a strong system of internal control environment provides this assurance (John, 2011). Internal control comprises five components; the control environment, the entity's risk assessment process, the information and communication systems, control activities and the monitoring of controls (COSSO, 1999).

According to Oseifuah and Gyekpe (2013), the control environment sets the tone of an organization, influencing the control consciousness of all its employees. Control environment is pervasive because it affects (either positively or negatively) the entire organization and all other elements in the framework. Ayom (2013) views control environment as the medium that spreads the organization's commitment to ethical and honest behaviour. He further stated that the different elements of control environment are management's philosophy and operating style; the way in which management assigns authority and responsibility; the way management organizes and develops employees; and the attention and direction provided by the governing board.

The definition of Medium scale businesses varies from country to country. Several definitions have been provided on the basis of varied criteria. Among the common criteria used are the number of employees, turnover, gross assets, investment level, and capital base. According to Oseifuah and Gyekpe (2013), the most common definitional basis used is employment, with varying levels of upper and lower size limits. According to Verovska (2012), small enterprises in the European Union have between 10 and 49 employees and an annual turnover not exceeding EUR 7 million or an annual balance sheet total not exceeding EUR 5 million. Medium-sized enterprises have fewer than 250 employees with an annual turnover not exceeding EUR 40 million or an annual balance sheet total not less than EUR 27 million. In the case of Sweden, all enterprises with fewer than 250 employees are categorized as medium size enterprises and those with fewer than 50 employees are categorized as small enterprises.

According to Yang (2010), the growing significance of Medium scale businesses in China's economy is difficult to ignore. This is due to the inherent advantages of flexibility and resilience, their easy start of business, and their potential to influence the growth of domestic demands. Yang (2010) stated that formally registered SMEs represent more

than 99.6 percent of all enterprises in China, accounting for 55.6 percent of GDP and 62.3 percent of imports and exports, and contributing 46.2 percent of tax revenues to the national economy in 2008.

The introduction of the National Policy on Micro, Small, and Medium Enterprises (MSMEs) in Nigeria has addressed the issue of definition as to what constitutes micro, small and medium enterprises. The definition adopts a classification based on dual criteria i.e. employment and assets (excluding land and buildings). Medium Scale Enterprises are therefore those enterprises with total assets (excluding land and building) of above Fifty Million Naira, but not exceeding Five Hundred Million Naira with a total workforce of between 50 and 199 employees (SMEDAN, 2013) as shown in Table 1.

**Table 1: Definition of MSME in Nigeria**

| Size Category | Employment | Assets (=N= Million) (excl. land and buildings) |
|---|---|---|
| Micro enterprises | Less than 10 | Less than 5 |
| Small enterprises | 10 to 49 | 5 to less than 50 |
| Medium enterprises | 50 to 199 | 50 to less than 500 |

**Source:** SMEDAN, 2007

According to the statistics provided by SMEDAN (2012), medium scale enterprises in industrialized countries like Nigeria are major contributors to private sector employment. Empirical studies have shown that small and medium sized businesses contribute to over 55% of GDP and over 65% of total employment in high income countries, they also account for over 60% of GDP and over 70% of total employment in low income countries, while they contribute about 70% of GDP and 95% of total employment in middle income countries.

**Control Environment Vs Organizational Performance**
According to John (2011) appropriate organizational performance measures are those which enable organizations to direct their actions towards achieving their strategic objectives. He emphasized that performance is measured by either subjective or objective criteria. Ayom (2013) believes that many firms' low performance is the result of poorly performing assets. John (2013) also stated that performance should be measured in terms of customer satisfaction. He argues that organizations should periodically critically look at their customers and know how best they are satisfying their needs. Engefu (2013) added that organizations should continuously improve on their services through innovations and great value. These researchers are therefore of the opinion that an effective internal control environment should bring about improved organizational performance.

Many definitions of internal control systems such as those provided by Menon and Williams (1994); Yusuf (1995); Pandey (1996); Reid and Ashelby (2002); Millichamp (2003); Whittington and Pany (2004); Tackett and Gregory (2006); and Messier (2012); views internal control system as covering the overall activities of an organization in all ramifications. These researchers are all in agreement however that Control Environment is a key component of internal control system and that it affects organizational performance.

**Theoretical Framework**
This study will be guided by "The Agency Theory" as initially put across by Barlie and Means (1932) and later expounded on by Jensen & Meckling (1976). The justification for the use of agency theory for this study is premised on the fact that the ownership structure of medium scale enterprises in Nigeria includes among others a partnership arrangement, private limited liability, co-operatives, and religious organizations. This ownership arrangement therefore, allows for a principal-agent relationship whereby the actual owners of the business may contract agents to manage the business on their behalf. According to the agency theory an organization consists of a nexus of contracts between the owners of economic resources (the principals) and managers (the agents) who are charged with using and controlling those resources (Jensen & Meckling, 1976). Agency theory emphasizes that agents have more information than principals and that this information asymmetry adversely affects the principals' ability to monitor whether or not their interests are being properly served by agents.

**Methodology**
This section is an exposition of the methods, techniques and instrument used in the conduct of this research. This study is quantitative in nature and adopts a census research design. This method is adopted for the study because it is well suited for gathering demographic data and the entire population in the case of this study is accessible. According to Ayom (2013), a census eliminates sampling errors and ensures that a desirable level of accuracy and precision is achieved. Quantitative data was collected in order to establish the relationship between the independent and dependent variables, so as to determine how control environment account for the performance of MSEs in the region. Related studies in the past such as those of Mawanda (2008), John (2011) and Ayom (2013) used a similar research design. The target population of this study is obtained from SMEDAN report of 2012. According to the report, there are a total of 182 registered medium size enterprises in the North-Central zone of Nigeria. This figure therefore constitutes the total population of this study.

Data was collected using a structured questionnaire, designed under a 5 point likert scale ranging from "Strongly disagree" to "Strongly agree". Primary data was sourced using these questionnaires that were distributed to medium scale enterprises that form the population of this research work. Simple regression analysis was used to analyze the data gathered after reliability and validity of the instrument had been checked using factor analysis. Descriptive statistics such as mean and standard deviation was used.

**Validity and Reliability of Instrument**

This study checked for construct and content validities by ensuring that all items in the questionnaire represent the constructs of the study. Validity test was conducted through factor analysis using SPSS version 20. The result showed an acceptable values of correlation, Kaiser-Meyer-Okin (KMO), Bartlett test of sterility (BTS), and factor loadings. The reliability of the instrument was tested to determine the Cronbach's alpha which was found to be above 0.7. Normality test was also conducted and the output of the skewers values reveals a range between -1.228 and -1.710, while that of kurtosis values ranges between 0.993 and 1.882 which is acceptable in social sciences research (Pallant, 2011). The overall result therefore shows that normality of the data set is evident.

**Hypothesis Testing**

Simple regression was also used to test the hypothesis after normality of the data was checked using various descriptive statistics and the data was found to be normal. Linearity, adequacy of sample and issues of Multi co-linearity were also checked and found to be within acceptable range.

The hypothesis of this study was tested using simple regression in other to determine the effect of control environment on the organizational performance of medium scale enterprises in North-Central Nigeria. The hypothesis states that:-

$H_{o2}$: Control environment does not have a significant effect on the Organizational Performance of MSEs in North-Central Nigeria.

The result of the simple regression test showed that control environment have a positive and significant effect on the organizational performance of MSEs in North-Central Nigeria. The $R^2$ value of this variable is 0.177, the β value is 0.421 and the P value is 0.000. This signifies that 17.7% of the variation in organizational performance of MSEs is accounted for by the independent variable control environment. Therefore considering the decision rule:

Reject $H_O$ if $p \leq 0.05$
Accept $H_O$ if $p > 0.05$

At 95% confidence level and 5% significant level the data signifies that control environment has a significant effect on the organizational performance of MSEs in North-Central Nigeria. The p-value of the model been $0.000 < 0.05$ signifying that the null hypothesis is rejected and the alternate hypothesis accepted.

**Discussion of Findings**

The hypothesis of this study states that Control environment does not have a significant effect on the Organizational Performance of MSEs in North-Central Nigeria. This null hypothesis is however rejected and the alternate hypothesis which indicates that control environment has a significant effect on the Organizational Performance of MSEs in North-Central Nigeria is accepted. This is because the result of the simple regression analysis reveals a $R^2$ value of 0.177 and a significant P-value of 0.000 indicating that there is

a positive and significant relationship between Control environment and Organizational performance of MSEs in the region. This implies that control environment explains organizational performance of MSEs by 17.7%. This findings is in agreement with the findings of Mawanda (2008); Engefu (2013); Nyakundi et al., (2014) and Verovska (2012). Verovska (2012), added that a good control environment help to ensure stability in the development of a business. The findings here support the theory of social control and the Institutional theory.

**Conclusion**

The result of simple regression analysis established that there is a strong positive relationship between control environment and organizational performance of MSEs in North-Central Nigeria. This conclusion was arrived at after a series of research activities which included the development of hypothesis, theoretical framework, a critical review of literature, development and distribution of questionnaires to medium scale enterprises in North-Central Nigeria, checking normality of the data set, checking reliability of the data using Cronbach's alpha which was found to be above 0.7, the conduct of exploratory factor analysis and final analysis of data conducted using simple regression analysis.

**Recommendation**

Control environment is an important component of ICS and it directly influences the operational effect of any enterprise's internal control. MSEs should optimize internal control environment by establishing and perfecting corporate governance structure. The independence and effectiveness of decision-making and business discussion of management should be improved. MSEs should also establish and perfect recruitment and selection mechanism, appoint people on the basis of merit, formulate reasonable award and punishment system, and thus stimulate work enthusiasm and creativity of staff.

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