
Managerial competence and financial performance of SMEs: the contingent role of stakeholder engagement

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Abstract: This paper examines the moderating role of stakeholder engagement on the relationship between managerial competence and financial performance. Using a survey-based approach, the study examined 423 small and medium scale firms operating in Ghana, a Sub-Saharan African country. The findings indicate that, stakeholder engagement does not assist managerial competence in having a positive impact on financial performance. However, both independent variables, acting separately, have a positive and significant relationship with financial performance. Hence, it was recommended that SMEs should invest more at employing competent managers or in training existing managers to become more competent as that alone, without the assistance of stakeholder engagement, can improve financial performance.

Keywords: managerial competence; stakeholder engagement; financial performance; small and medium-sized enterprises; SMEs; Ghana.

Reference to this paper should be made as follows: Ansong, A. (2017) 'Managerial competence and financial performance of SMEs: the contingent role of stakeholder engagement', *EuroMed J. Management*, Vol. 2, No. 1, pp.2–14.

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1 Introduction

Entrepreneurship literature suggests that managerial competence should promote the performance of small and medium-sized enterprises (SMEs) because this improves competitiveness, firm reputation and easier access to resources which have positive effects on financial performance (Ansong and Agyemang, 2016; Man et al., 2008; Colombo and Grilli, 2015). Resource-based theory is grounded in the idea that a firm's

internal environment, including its resources and capabilities, is more critical to the determination of strategic decision making than its external environment. It argues further that a firm's unique resources and capabilities provide the basis for a strategy that thoroughly exploits its core competencies relative to opportunities in the market (Prahalad and Hamel, 1990). The most important resources in business organisations are largely the intangible resources, such as the ideas, talents, and creative capacities of the workforce (Castells, 2001). Resource-based view studies have acknowledged the particular value of intangible resources, since they are the only kind of resources potentially capable of meeting the resource-based criteria of being valuable, rare, and costly to imitate (Michalisin et al., 2000).

The empirical evidence most often supports a positive relationship between managerial competence and financial performance (Chandler and Jansen, 1992; Mitchelmore and Rowley, 2010; Freel, 1999; Man et al., 2008). However, recent thinking suggests that these favourable results may be attributable to the contingent role of stakeholder engagement (Tehseen and Ramayah, 2015). Stakeholder engagement is concerned with how businesses integrate and understand stakeholders better in order to make better decisions and deliver superior service that will result in improved financial performance (Partridge et al., 2005).

The social capital theory has extended the idea of capital beyond its original meaning to include resources inherent in social relations which facilitate collective action. Social capital resources have been defined to include networks of associations working towards a common purpose. Also, resource dependency theory argues that the long-term survival and success of a firm is dependent on the firm's ability to link itself with its external environment (Pfeffer and Salancik, 1978). The theory concentrates on how firms acquire resources by building relationships with other stakeholders. Firms must constantly interact with their environment, either to purchase resources or to distribute finished products. They should, therefore, seek to gain control over their environment to create more stable flows of resources and lessen the effects of environmental uncertainty (Pfeffer and Salancik, 1978). It is becoming increasingly clear that managers with the right relational skills in dealing with stakeholders tend to develop collaborative relationships which reduce costs and enhances coordination in the supply chain of businesses (Man, 2001).

In addition, stakeholder engagement is pivotal to financial performance because stakeholders provide easier access to resources, build firm reputation and offer valuable information regarding trends in customers' tastes and preferences as well as their expected demands on firms in competitive markets (Tehseen and Ramayah, 2015). Sustainable competitive advantage can also be realised through these engagements since competitors would have to take longer period of time to develop and appropriate the benefits associated with such networks. Thus, entrepreneurs who learn to develop successful linkages with various stakeholders are more likely to enhance the financial performance of their businesses. The need for stakeholder engagement is more pronounced among SMEs in Ghana as this sector is composed of organisations operating largely in the trading and service sectors. Norman (1991) posits that firms that are into trading and provision of services tend to benefit more from stronger stakeholder engagements in view of the regular and personal interactions that occur between them and certain categories of stakeholders (e.g., customers).

This paper builds on and is related to three strands of the extant literature that examine:

- 1 the impact of managerial competence on firm performance
- 2 the effect of stakeholder engagement on firm performance
- 3 the contingent role of stakeholder engagement on the managerial competence-firm performance nexus.

It focuses mainly on expanding the frontiers of knowledge on the third strand. It argues that the relationship between managerial competence and financial performance is contingent upon effective stakeholder engagement and thus, set out to examine the moderating effect of stakeholder engagement on this nexus among SMEs in an emerging economy. The SME sector is an important source of employment creation and national revenue through taxation in Ghana (Kayanula and Quartey, 2000; Keskin, 2006; Abor and Quartey, 2010). Abor and Quartey (2010) provide evidence to the effect that SMEs contribute about 75% to Ghana's GDP and account for 85% of employment in the manufacturing sector. The economic and social contribution of this sector suggests that it is in the public interest for SMEs to thrive and become successful, hence, the need for empirical studies to interrogate all relevant variables that have influence on their performance. This current paper seeks to contribute to this drive.

The paper also contributes to our understanding on the stakeholder perspective of corporate governance by arguing that the link between managerial competence and firm performance is fortified by the involvement of other corporate stakeholders (Azoury et al., 2015). The remainder of the paper is structured as follows: the next section reviews literature and develops hypothesis. Ensuing is the methodology of the paper. It proceeds to the presentation and analysis of results. Finally, it concludes by making recommendations.

2 Literature review

This section presents the literature review on managerial competence, stakeholder engagement, and financial performance.

2.1 Managerial competence and stakeholder engagement

In today's competitive business environment, "where companies are expected to be accountable not only to shareholders for financial performance, but to stakeholders for their wider economic, environmental and societal impacts" [Wade, (2006), p.227], sustaining impressive financial performance depends on the competencies of management to relate responsibly with all stakeholders (Freeman, 1984; Donaldson and Preston, 1995; Wheeler and Sillanpää, 1997; Maak and Pless, 2006). This need has somewhat expanded the traditional functions of managers to include building networks with other parties interested in the affairs of business organisations. Maak and Pless (2006, p.103) posit that in the context of stakeholder theory, the purpose of management "can be understood as to build and cultivate sustainable and trustful relationships to different stakeholders inside and outside the organization and to coordinate their actions to achieve common objectives and business sustainability". In order to leverage the benefits related to social capital, it is imperative that managers develop good linkages with several stakeholders (Ghashghaeinejad and Hossein, 2016). Burt (1997, p.339), a

strong advocate of social capital theory, remarks: “knowing who, when, and how to coordinate is a function of the manager’s network of contacts with and beyond the firm”. It appears the competence of managers could be effectively judged by the extent to which they engage various stakeholders of firms which consequently could result in enhanced financial performance.

2.2 Stakeholder engagement and financial performance

Freeman (1984) is accredited with the introduction of the stakeholder concept. The author views a company’s stakeholders to consist of any group or individual who can affect or is affected by the achievement of a firm’s objectives. Stakeholders can be divided into primary stakeholders and secondary stakeholders. Primary stakeholders have interests that are directly linked to the fortunes of a company. They include shareholders and investors, employees, customers, suppliers, and residents of the communities where the company operates. Some theorists have also added individuals and groups that speak for the natural environment, non-human species, and future generations to this list (Wheeler and Sillanpää, 1997). Secondary stakeholders, on the other hand, have indirect influences on an organisation or are less directly affected by its activities. They include the media and pressure groups, and others that inhabit the business and social networks of the organisation (Svendsen et al., 2002). While there may be different kinds of stakeholders in SMEs due to the varying nature of these enterprises themselves, the identification of key stakeholders is, however, consistent. They are employees, customers, the environment and local community (Sen and Cowley, 2013). Therefore, this study focuses on how this group of stakeholders influences firm performance.

Post et al. (2002) posits that employees overtime develop distinctive competencies that become a source of competitive advantage. This advantage becomes more sustainable if these competencies emanates from team-work because that makes it more difficult for competitors to emulate. There is the need for management to develop good relationship with employees to ensure they work together for the betterment of firms. Employee engagement is about managing the relationship between employer and employees with the goal of attaining optimum level of productivity. A good relationship with employees is a unique social capital as it enhances firm reputation and performance. Clearly, firms with committed and hard-working employees are more likely to perform better than those that do not. Several empirical works have found positive relationship between employee engagement and organisational performance outcomes such as customer satisfaction and loyalty, productivity and profitability (Post et al., 2002; Ellis and Sorensen, 2007). These studies also indicate that firms with improved employee engagement are more likely to exceed the industry average in its revenue growth. Employee engagement is found to be higher in double-digit growth business organisations (Post et al., 2002; Ellis and Sorensen, 2007).

Customer engagement is founded on the assumption that firms consider customers as manageable strategic assets. Some researchers have contended that firms that adopt mechanisms for leveraging relationships with customers can be fundamental to sustaining a competitive advantage in the market (Hogan et al., 2002; Mithas et al., 2005). Rais and Goedegebuure (2009) opined that having a favourable customer engagement can assist a firm in product and service design, attract new customers and enhance loyalty which then leads to improved sales and financial performance. Several studies have been conducted to examine the effects of customer relationship on firm performance; ranging from the

negative impact of irresponsible firm activities to product recalls to demonstrate the importance of customer engagement on firm performance (Davidson and Worrell, 1992; Frooman, 1997). Most of the findings have been consistent with the fact that there is a direct and positive relationship between the quality of customer engagement and profitability (Heskett et al., 1994; Rust et al., 1995; Zahorik and Rust, 1992). Such a strong positive association has been widely accepted within the services marketing literature.

Empirical studies on green operations demonstrate that paying attention to environmental issues brings substantial financial gains to businesses. Companies with higher rating scores on environmental criteria tend to achieve stronger financial returns than the overall market, whereas companies with poor ratings tend to have weaker financial returns (Estampe et al., 2013; McCrea, 2010; Lee et al., 2012; Zacharia et al., 2009; Zhu et al., 2010). Most of these studies sought to connect the effects of environmental operations and practices on firms' stock market performance, market valuation, and competitive advantage (Hiroki and Keisuke, 2010; Klingenberg and Geurts, 2009). Reinhardt (1999) and Dao et al. (2011) suggest that firms that are concerned about the impact of their operation on the environment tend to innovatively develop green products and services that significantly improve firm-level financial performance and overall competitiveness. On the contrary, other authors are of the opinion that incorporating environmental variables into firms' activities often increase the cost of business operation because additional environmental standards and requirements have to be met. This in turn negatively influences firm-level financial performance (Porter and van der Linde, 1995; Reinhardt, 1999).

There have been different opinions on the effects of community engagement on the financial performance of business organisations (Berman et al., 1999). For instance, Porter (1980) maintains that community relation not linked to corporate social responsibility adds little value to firms whereas social responsibility activities forming part of community engagement are mostly done in an unfocused and piecemeal manner. However, some studies have argued that local communities have important roles to play due to their potential to prevent conflicts and maintain industrial harmony which ultimately lead to improved firm performance (Wood and Jones, 1995). Similarly, Post et al. (2002) posit that communities provide firms with the 'licenses to operate' and without their permission and cooperation their corporate objectives would not be achieved.

Overall, there is overwhelming evidence that firms that engage their stakeholders tend to report stronger financial performance (Orlitzky et al., 2003; Roman et al., 1999; Scholtens and Zhou, 2008; Choi and Wang, 2009). Some of the reasons are that this leads to easier access to critical resources and reduces risks and costs. The engagement also assists firms to identify and produce products and services that satisfy the exact needs of customers and reduce the risks and costs associated with legal suits for unfair and unethical business practices (Svendsen, 1998). Other scholars proffer that companies that take a stakeholder view do not recklessly pursue riskier investments which tend to derail financial performance (Orlitzky et al., 2003). Also, stakeholder-oriented companies tend to build good reputation that gives them leverage in new markets which ultimately results in better financial performance (Fauver and Fuerst, 2006).

2.3 Does stakeholder engagement moderate the effect of managerial competence on financial performance?

The development of the appropriate managerial competencies in managing competing stakeholder interests has emerged as one of the significant areas in management literature. Managerial competence in cultivating long-term relationships with stakeholders increases the set of value-creating exchanges with these groups that result in better financial performance (Hillman and Keim, 2001). Some of these value-creating exchanges could emanate from the fact that the business tend to gain access to resources, build their reputation as well as social capital (Tehseen and Ramayah, 2015). Barney and Hansen (1994) argued that in an institutional context, competencies in dealing with stakeholders generate substantial financial rewards. Hence, it is assumed that the positive effect of managerial competence on financial performance is strengthened through the effect of stakeholder engagement. Thus, the following hypothesis is examined:

H1 The relationship between managerial competence and financial performance is moderated by stakeholder engagement.

3 Research methodology

To test the hypothesis of this study, a sample consisting of owner-managers of all manufacturing and trading SMEs which had registered with the National Board for Small-Scale Industries (NBSSI) and the Association of Ghana Industries (AGI) in the Accra Metropolis as at September 2013 were used. The total number of SMEs in NBSSI's and AGI's registers by location in the Metropolis was 2,083. Based on the guidelines of Krejcie and Morgan (1970), to ensure a 5% margin error, 254 medium sized and 302 small-sized firms were randomly selected from 750 medium-sized and 1,400 small-sized firms, respectively. Regression analysis was employed to analyse the data. This study defines SMEs as enterprises with less than 100 employees, whereby a medium-sized enterprise employs between 11 and 99 people and a small firm employs between five and ten people. The sample selection was based on the criteria set by the Regional Project on Enterprise Development for SMEs in Ghana. The data was collected from October to December 2014 with the help of five research assistants.

3.1 Dependent variable

Following Sweeney (2009) and Man (2001), the study adopted the subjective approach of measuring financial performance consisting of profit and sales growth. According to Man (2001), the use of scales is a better alternative to measure SME performance than to use actual figures due to the unwillingness of SME owners/managers to disclose these sensitive figures.

3.2 Independent and moderating variables

Managerial competence was measured based on a 14-item scale consisting of information such as effective delegation, co-ordination, leadership, risk management, regulatory compliance, motivation, training, planning, supervising, networking and so on. Most of

the human capital variables for measuring managerial competence were adapted from Nakiyingi (2010). Stakeholder engagement was subjectively measured. It assessed issues consisting of stakeholders directly affected by organisation's operations; stakeholders who have an interest in or influence over the organisation's operations; stakeholders who have knowledge about the impact of the firm's operations; stakeholders who are part of the broader community who have influence over the operation of the firm; authorities or regulators who exercise control over the sector; authorities who control or issue licenses or permit to operate and so on.

3.3 Control variables

Control variables were also included to account for variables other than the theoretical constructs of interest that could explain variance in financial performance (dependent variable). As leverage (total assets/total debts), firm age and location have been frequently investigated in extant studies to be factors that affect financial performance of firms (Ullman, 1985; McWilliams and Siegel, 1997), they were included as control variables. For instance, it has long been established that age has shown to correlate positively with entrepreneurial firm performance. With respect to location, Kala and Guanghua (2010) reported that the location of business has a positive correlation with firm performance and sustainability. Finally, the leverage of the firm is an important control variable. Gleason et al. (2000) found a negative and significant relation of leverage level with firm performance measured by the return on assets and profit margin in European countries.

Table 1 Collinearity diagnostic test

<i>Dependent variable = financial performance</i>	<i>Collinearity statistics</i>	
	<i>Tolerance</i>	<i>VIF</i>
Managerial competence	.826	1.211
Stakeholder engagement	.960	1.042
Leverage	.972	1.029
Firm Age	.296	3.378
Location	.446	2.243
MC × SE	.267	3.742

3.4 Measure model analysis

The study followed existing empirical studies (e.g., Adomako and Danso, 2014; Boso et al., 2013) in the construction of the interaction variables. It has been argued that once moderating variables are included in a model, it is expedient to deal with the issue of multicollinearity. Therefore, all the variables employed in the generation of the interactive terms were residually centred. A two step-approach was used in the evaluation of the interrelationship between managerial competence, stakeholder engagement and financial performance. The first step involved the estimation of non-hypothesised variables. In the second step, the regression analysis was estimated with the interaction terms infused into the main model. Findings from the multicollinearity test following the residual centring approach is presented in Table 1. All the variables involved in the

regression estimate recorded a low variance inflation factor (VIF) below the recommended cut off of 10.00 (Baum, 2006). Hence, all the variables can be used to interpret the regression results.

4 Findings and discussions

This study sought to examine the moderating role of stakeholder engagement on the relationship between managerial competence and financial performance. Building on the resource dependency and social capital theories logic, the paper argued that stakeholder engagement will assist managers to enhance the financial performance of their firms. The study intended to advance the entrepreneurship and strategy literature by unearthing the nuances in these relationships. The regression results are presented in Table 2. Model 1 showed that both managerial competence and stakeholder engagement on their own have positive and significant relationships with financial performance as widely espoused by previous literature (Man et al., 2008; Colombo and Grilli, 2015; Orlitzky et al., 2003; Roman et al., 1999; Scholtens and Zhou, 2008; Choi and Wang, 2009).

Table 2 Regression model results

<i>Dependent variable: financial performance</i>	<i>Model 1</i>	<i>Model 2</i>
Control variables		
Leverage	-0.094 (-1.859)*	-0.097 (-1.900)*
Firm age	0.111 (2.200)**	0.113 (2.230)**
Location	-0.058 (-1.278)	-0.058 (-1.288)
Main effects		
Managerial competence	0.184 (3.391)***	0.291 (1.546)
Stakeholder engagement	0.238 (4.409)***	0.386 (1.513)
Interactive effects		
Managerial competence × stakeholder engagement		-0.227 (-0.595)
Model fit		
R ²	0.159	0.160
Adj. R ²	0.149	0.148
ΔR ²	–	0.001
F change	15.764	13.175
Sig. F change	0.000	0.000

The paper also investigated whether stakeholder engagement will support managerial competence in positively impacting financial performance. The result in model 2 provides contrary evidence to this main thrust of the study. In particular, it was found that managerial competence and stakeholder engagement that once had positive and significant relationships with financial performance (model 1) became insignificant, albeit with a positive relationship with financial performance, with the introduction of the interactive effect in model 2. The results indicate that SMEs managed by competent managers can achieve good financial results because stakeholder engagement is not required to support such managers to enhance financial performance.

In both regressions, leverage and firm age had a positive and significant relationship with financial performance. These suggest older firms and firms that tend to employ less debt do record stronger financial performance. The reasoning might be that firms that rely on their internal resources instead of external debts for their investments and operational activities do avoid the high interest charges characterised with funding SMEs' initiatives in Ghana. With respect to firm age, it can be argued that older firms are better positioned to accumulate resources needed to exploit viable opportunities. In addition, they tend to have the strong bargaining power relative to much younger firms in reducing the cost of borrowing since they are more able to meet collateral requirements of financial institutions.

5 Conclusions and recommendations

This paper examines the relationships among managerial competence, stakeholder engagement and financial performance. It hypothesised that the stakeholder engagement supported managerial competence in having a positive effect on financial performance. The literature suggests that stakeholder engagement results in easier access to resources, market share and firm reputation which can assist managers to improve the financial performance of their firms. These effects have primarily been examined separately in prior research initiatives. Hence, this paper examines how managerial competence interacts with stakeholder engagement to improve financial performance.

Several insightful and significant findings were made. First, model 1 which did not contain the interactive effect revealed that both managerial competence and stakeholder engagement have significant and positive relationships with financial performance. In model 2, there was no significant evidence that stakeholder engagement favourably altered the effects of managerial competence on financial performance. The results suggest that SMEs should invest more at employing competent managers or in training existing managers to become more competent as that alone, without the assistance of engaging with stakeholders, can improve financial performance.

6 Limitations and suggestions for future research

While this study has practical implications for both academicians and practitioners in the SMEs sector on the key determinants of their performance, it has a number of limitations that also offer some suggestions for future research. First, the study failed to disaggregate the impact of different stakeholders on the nexus between managerial competence and financial performance. It is possible that the moderating influence of, for example, customers may be radically different from that of community. Thus, future studies could focus on a specific category of stakeholders. Second, this paper is only limited to SMEs in Ghana. It is possible for other researchers to compare the results across a number of SMEs in different countries in Sub-Saharan Africa. Third, the use of cross-sectional data does not allow us to examine any changes in entrepreneurs' managerial competencies and the dynamic nature of stakeholder engagement. Future studies can, therefore, rely on longitudinal research approach.

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