



Effects of Subcontracting on Modern Day Organizations

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The research is supported by Covenant University, Canaan Land Ota, Nigeria

Abstract

Many small businesses hire subcontractors to assist with a wide variety of functions. Subcontracting is a business strategy which came about in Nigeria as an outfall of the practices that were inherent in the industrial sector of the 1960s and 1970s. The adoption of subcontracting to most business organizations in advanced nations has been acknowledged to help such organisations attain organisational goals and aids economic growth and development. Empirical literature in Nigeria reported that the concept is not fully adopted despite emergence of manufacturing and services firms as a result of thriving economy. This study investigates the awareness, adoption and impact of the subcontracting strategy among business organizations in Nigeria. Quantitatively designed questionnaires were distributed to 120 respondents from selected manufacturing and service organisations around Lagos. A Multiple Regression Analysis was carried out to investigate the push and pull factors to subcontracting which could help to find out the decision of organisations to subcontract. Results from the Multiple Regression Analysis reported various levels of significance after testing H1-H4. However, the Pearson Correlation also reported different shared variance figures which is the amount of correlation that exists between both the push and pull factors to the subcontracting decision. However, results from analysis finds that majority of the respondents agreed that subcontracting has indeed assisted the company in realizing positive growth. This study has stirred up the need for a more detailed effort in the use of subcontracting as a tool for success in business activities even in light of the current waves of global financial crisis.

Keywords: Subcontracting Strategy, Micro Entrepreneurs, Business Organizations, Multiple Regression, Nigeria.



1. Introduction

Economies in the world at large seem to increasingly evolve towards unpredictable directions. Considering the new advent of daily crashing of stock prices, falling crude oil prices, increasing devaluation of currencies, today's business environment produces change more suddenly and more frequently than ever (Tallon, 2010; Wills et al. 2010; Christophe & Franck, 2013). Mergers, acquisitions, new technology development, workers downsizing, salary cuts and general depreciation of standard of living are the effects these changes have brought to life which all contribute to the growing climate of uncertainty. Gerald (2012) describe that an economy consists of a community of people, technology as well as other factors which produce goods and services either for commercial purposes or for subsistence consumption depending on the economic system that is practiced. Encarta (2008) opine that among the simplest definitions of an economy that depicts it in its truest sense is that which defines it as the production and consumption of goods and services of a community regarded as a complete system. Tallon (2010) argued that there are many activities that take place in an economy, also each country is differentiated by the type of economic system that it runs such as the market/capitalist system, centrally planned system and the mixed economy. However, this is not to say that all economies do not have identical sectors, but those sectors are run by different parties which are largely dependent on the economic system put in place. Gerald (2012) opine that an economy can be said to comprise of important sectors such as manufacturing, distribution and also services. Wills (2009b) posit that these sectors create goods that help both the organizations and the economy to meet its needs. The organizations would attain various results such as profits, extended market share, and others, while the economy would get results such as increase in its Gross Domestic Product (GDP) and also its Gross National Product (GNP). However, such goals can be achieved from both the organizations and the economy at large through the implementation of key strategies geared towards efficient management of resources.

Rao (2003), Fantone (2007) and Christophe & Franck (2013) argued that organisations are differentiated usually by the structure that they possess, but their goals are likely the same. They authors go forward and added that modern day business organisations are not too different from the organisations that have existed before now in terms of goals but are set apart by the tools that are used to shape its structure. Hamnett (2003) reported that most modern day organisations make strategic choices that allow flexibility in their choices as it pertains to their work environment. Ashiagbor (2006) contributed that this is much more different in cases of organisations that earlier existed which included traditional work tools in which their organisational designs allowed for bureaucracy which would be otherwise harmful in work environment of today. Berardi (2009) argued that subcontracting is among the strategies that will help in achieving the major goals of organizations in an economy. Castel and Klaus (2009) perceives subcontracting as the process of entering a contractual agreement with an outside person or company to perform a certain amount of work. The out-side person or company in this arrangement is known as a subcontractor, but may also be called a free-lance employee, independent contractor, or vendor. Butler and Chris (2009) added that many small businesses hire subcontractors to assist with a wide variety of functions. For example, a small business might use an outside firm to prepare its payroll, an accountant to help with its record keeping and tax compliance, or a free-lance worker to handle a particular project. Schicchi (2002) reported that UNIDO described subcontracting can be said to be an economic relationship where one entity, the contractor, requests another independent entity, the subcontractor or supplier to undertake the production or carry out the processing of material, component part, sub-assembly or the provision of an industrial service in accordance with the main contractors specifications. Ikeanyibe (2006) described subcontracting as a business strategy which emerged in Nigeria as a fallout of practices that were essential in the industrial sector of the 1960s and 1970s. This period was mainly reliant on the mindset that "quantity is better than quality", hence not requiring any specialization in the creation of goods and services. The researchers reported further that competition came up towards the 1980s in various sectors of the economy thereby bringing in the need for better production processes, as well as increased quality in the products offered. Ajagbe & Ismail (2014), Ajagbe & Ismail (2013a) and Ajagbe & Ismail (2013b) argued that the introduction of innovation can also be said to be a contributory factor because it made companies focus their resources on other departments such as research and development, marketing, and product design, as a result, creating a need for better products.

Subcontracting generally is concerned with the breaking down of core production processes of an organization, the broken down processes are further delegated to other organizations (subcontractors) who have better knowledge about such processes. The introduction of subcontracting arose from the

urge to either increase product quality or in some situations lower production cost. The new concept however resulted to the need to assign certain task to specialist firms. Ever since, the concept has witness a rising trend globally. The main objective of this study is to prove that efficiency in processes which an organization engages in, be it production, manufacturing, or distribution can be attained through a comprehensive subcontracting strategy for both the contractor and the subcontractor. Figure 1 shows the conceptual framework of this study indicating the relationship among the push and pull factors to subcontracting which thus resulted to business growth.

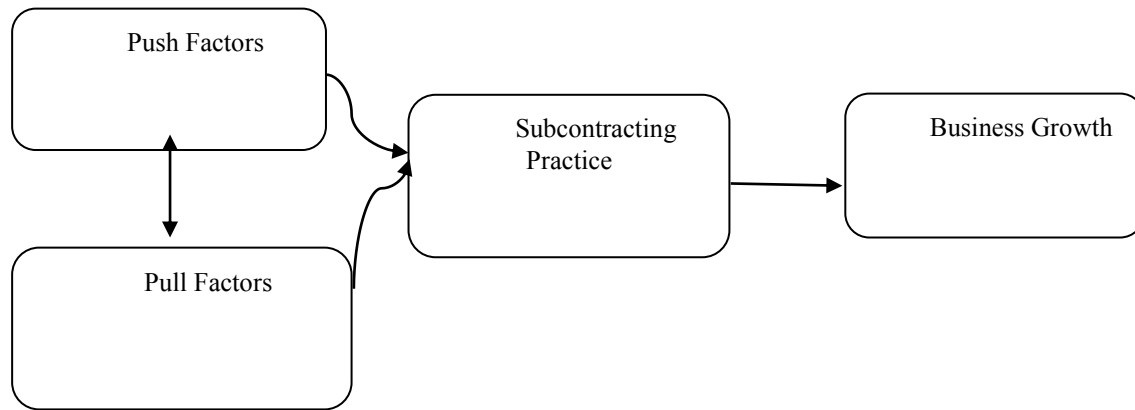


Figure 1: Research Conceptual Framework

1.1 Concept of Subcontracting

Since the period of industrial revolution in Europe, countries have been obsessed with the need to introduce policies to boost their industrial base as industrialization has since become the most important single driver for development (MacKenzie, 2000; Pai, 2004; Pellow & Park, 2002). Nigeria has not been an exception to these efforts because leaders are aware of the potential benefits of industrialization and have since independence experimented with various policies, programmes and strategies in a bid to achieve high level of industrialization (Ikeanyibe, 2006). This constant re-occurrence of the industrial challenges and the backward/forward motion of such programmes, strategies and policies can be attributed to the fact that most under-developed countries and indeed developing countries assume industrialization to consist of replicating the western experience. Robertson (1986) disagreed that applying western principles to the nature of things in the developing countries environment, which would include inadequate socio-economic factors, scarcity of capital, amongst others may not produce similar results as that of the developed countries where such policies originated. Several measures were indeed taken by previous governments to further strengthen the economy through the introduction of policies and programmes.

Christophe & Franck (2013) argued that recently, organisations and nations have evolved in the selection and use of various business strategy to run their firms. Even though, previously adopted strategies are still in place, a change has been made to suit the needs of the present day organisations. Uher & Davenport (2002) opine that subcontracting can be said to have been in existence since time immemorial because most western economies during their prime in the 1950s and early 1960s enjoyed fast economic growth, low inflation and almost full employment. Since the late 1960s, however, the global economy began to experience periodic economic downturns, spiraling inflation, high interest rates and growing unemployment. These economic problems were very visible in all sectors such that it started to impede the developmental processes of some countries. The realisation of these problems gave birth to the need for the firms and nations to find better ways to efficiently purchase raw materials and produce higher quality goods at cheaper rates. Figure 2 below shows the relationship in a subcontract.

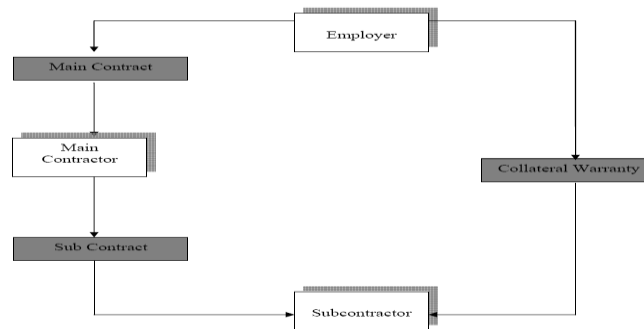


Figure 2: Relationship in a Subcontract

Source: Adapted from Fong (2004 cited in Christophe & Franck, 2013)

1.2 Benefits of Subcontracting Strategy

Grossman & Helpman (2002) views subcontracting to be an important organisational strategy. The authors referred to a case listed in the 1998 World Trade Organization (WTO) yearly data illustrating the benefits of subcontracting in the auto industry of USA. Similarly, Shy & Stenbacka (2003) argued that subcontracting is also beneficial in the duopolistic sector of America for medium and large-sized aircrafts consisting of Airbus and Boeing. The organisation subcontracts about 34, 000 of its components from various manufacturers to be assembled into its 747 passenger aircrafts. Studies further estimates that industrial subcontracting in the USA in 2001 produced about \$300B in turnovers, with about 1.6M firms subcontracting few of their operations. In addition, about 146,000 firms were registered as industrial subcontractors and suppliers. Schicchi (2002) and Shy & Stenbacka (2003) added that more than 30% of large firms were recorded to be involved in outsourcing while about 50% of their production processes are actually outsourced through subcontracting orders.

Imrie et al. (2009) mentioned that specialist firms of this nature are more flexible because management can take decisions more quickly whilst production programmes may be adjusted more easily. They put forward that professional firms are more efficient in their production systems and undertake these operations using more effective strategies than the main contractors. Pai (2004) added that such firms usually conduct little research, marketing, and development activities which reduces their costs of operation in areas of low overhead and administrative costs. Subcontractors usually have less equipment and machinery as well as simpler workshops than large firms. The search for higher quality products with high reliability in a growingly sophisticated environment pushes companies to subcontract (MacKenzie, 2000; Schicchi, 2002; Hayashi, 2002; Pellow & Park, 2002). They argued that in most cases in-house professionals may not match and may not meet the necessary standards and due to this firms refer to the professional knowledge and higher qualifications available through external suppliers. Sassen (2001) thinks these are more resourceful and can provide the parts, components, assembly or sub-assembly with a higher standard of accuracy and precision. Prasad (2006) added that the option of upgrading the knowledge and capabilities of workers through training and development or to source the needed tools requires both time and large economic resources. In this sense, subcontracting presents a perfect system to support the main operations of an organisation with high quality components, parts, packaging or other elements. Schicchi (2002) concluded that some countries, regions or even clusters of industrial sites have assimilated an international standing for producing high quality products, parts or components. Hence, adopting subcontracting agreements enables firms to remain competitive and sustain a competitive edge.

2. Research Methodology

This study sampled 120 participants among which 111 completed questionnaires were returned. The response rate as reflected in the number of completed questionnaires returned is 92.5% showing that majority of respondents completed and returned the questionnaires. The sampling technique used can be said to be convenient and random sampling, this is so because the district chosen for the study is easily accessible to the researcher. The selected population covered employees of a number of companies which are both manufacturing and services based organizations. The companies include; Guinness Nigeria Ltd,



Vita-Foam, May and Baker, IPWA Plc, Nigerian Bottling Company. The instrument used for collection of data was designed in such a way that it consist of 16 questions excluding the bio-data section. The questions were designed in a Likert Scale manner with options that range from strongly agree to strongly disagree. The research instrument was validated through content validity and expert test aimed at measuring the degree of consistency and stability in the instrument. The researcher used Cronbach α coefficient for the set of variables, confirms the internal consistency of the scales used with a 0.849 value which enables their combination in a single factor for approximating. A Multiple Regression Analysis was carried out to investigate the push and pull factors to subcontracting which could help to find out the decision of organisations to subcontract. In addition, Pearson Correlation was used to investigate the shared variance figures which is the amount of correlation that exists between both the push and pull factors to the subcontracting decision.

3. Discussions of Demographic Profile

This study demographic distributions shows the gender representation of the participants involved in the research. However, the results from the collected questionnaires reflects that the male gender who filled the questionnaires is 70% while that of the female is 30%. This is an indication that there is an abundance of male employees over the female employees particularly among the sampled organizations. This further showed that firms in this sector prefer the male than the female probably due to the stressful nature of the job, although some surveys call for more gender equality within the manufacturing industry. The result also indicated that the age distribution of the respondents ranges between 21-25years (16.3%), 26-30years (43.8%), 31-40years (32.5%) and above 40years (7.5%). This shows that average working age in small and medium sized firms (SMFs) fall between 26-30years which conforms to previous research on the age preference for agility and capability to maximize employee work rate (Ajagbe & Ismail, 2013a). The educational qualifications of the sampled population found that 12 respondents (10.8%) are OND/NCE holders, 57 of respondents (51.4%) are First degree holders, 26 respondents (23.4%) are Master degree holders and finally 15 respondents (13.5%) are certified professionals. This is an indication that firms in the SMFs sector have begun to encounter an upsurge in highly educated manpower. This upsurge in academic degrees also results to less job satisfaction with pay and other job packages as reported by earlier researchers (Abdullah et al., 2012). Further analysis of the demographic information revealed that among the questionnaires returned. A total of 82 individuals indicating (73.9%) are from the manufacturing sector while 29 individuals about (26.1%) are from the services industry. The figures also revealed that 31 respondents representing (27.9%) are junior staff members, 48 respondents represented by (48%) are senior staff members and 32 respondents represented by (28.8%) belong to upper level management.

3.1 Test of Hypothesis 1

H_0 : Pull factors have no impact on organizations decision to subcontract.

H_1 : Pull factors have impact on organizations decision to subcontract.

This hypothesis deals with a comparison between the pull factors of subcontracting and how much they affect the decisions of companies to subcontract. The pull factors are varied in nature, hence the use of multiple regression in determining effectively the significance as well as the percentage to which the pull factors affect organizations need to subcontract. In the testing of this hypothesis, the total sample size was considered, as some questions of the questionnaire dully represented the pull factors to subcontracting. In the model summary table 1 below, R^2 of .397 indicates that 39.7% of variation in Y (organizations' decision to subcontract) is explained by the variation in the independent variables (pull factors). This percentage is good enough in determining the goodness of fit for the model (regression equation). After taking into account the number of predictor variables in the model, adjusted R^2 yielded a 36.7% variation which is more than an average and still good enough in this analysis. In table 2 below, the F-value (13.061) is statistically significant at $P=.0001$ value, the coefficients (un-standardized and standardized) indicates the amount of change one could expect in the decision to subcontract, given a one unit change in the value of any of the pull variables listed as the predictor variables (need for equilibrium between costs, profit and process specialization), also given that all other variables in the model are held constant. The coefficient also showed that the t-value of 5.242 suggests that the model still has considerable unexplained variation. The standardized coefficient (beta) measures the importance of the predictor variables to the prediction of decision to subcontract. The

increase in company's efficiency as a result of specialization has the highest beta coefficient with .423 value, and organizations need to achieve equilibrium between production costs and profit as a motivating factor to subcontract is the lowest with a beta coefficient of -.040 value.

Table 1: Model Summary

| Model | R | R Square | Adjusted R Square | Std. Error of the Estimate |
|-------|---------|----------|-------------------|----------------------------|
| 1 | .630(a) | .397 | .367 | .64102 |

Table 2: ANOVA

| Model | | Sum of Squares | df | Mean Square | F | Sig. |
|-------|------------|----------------|-----|-------------|--------|---------|
| 1 | Regression | 26.835 | 5 | 5.367 | 13.061 | .000(a) |
| | Residual | 40.679 | 99 | .411 | | |
| | Total | 67.514 | 104 | | | |

3.2 Test of Hypothesis 2

H_0 : Push factors do not affect organizations decision to subcontract.

H_1 : Push factors affect organizations decision to subcontract.

This hypothesis deals with the company's decision to subcontract considering the push factor variables. The push factors include; stiff market competition and prevalent price-based competition. Just like the pull factors to the decision of a company to subcontract, the push factors are also varied and hence warrants the use of multiple regression analysis. In testing for this particular hypothesis, the total respondents was considered because the research instrument used contained strategic questions that allowed for the easy computation and testing of the hypothesis. In the model summary table 3 below, R^2 of .188 indicate that 18.8% of variation in Y (organizations decision to subcontract) is explained by the variation in the independent variables (Push factors). This percentage is good enough in determining the goodness of fit for the model (regression equation). After taking into account the number of predictor variables in the model, adjusted R^2 yielded a 13.8% variation which is more than an average and still good enough in this analysis. In the table 4 below, the F-value (3.711) is statistically significant at $P=.002$ value, the coefficients (un-standardized and standardized) indicate the amount of change one could expect in the decision to subcontract, given a one unit change in the value of any of the push variables listed as the predictor variables (increase in economic costs, increase in price-based competition), given that all other variables in the model are held constant. The coefficients shows that the t-value of 5.049 suggests that the model still has considerable unexplained variation. The standardized coefficient (beta) measures the importance of the push predictor variables to the prediction of decision to subcontract. However, the question "in order for your company to survive the prevailing price-based competition in the industry, it is better to subcontract has the highest beta coefficient with .390 value and subcontracting as a way of circumventing government regulatory environment with the lowest coefficient of -.0173 value.

Table 3: Model Summary

| Model | R | R Square | Adjusted R Square | Std. Error of the Estimate |
|-------|---------|----------|-------------------|----------------------------|
| 1 | .434(a) | .188 | .138 | .75377 |

Table 4: ANOVA

| Model | Sum of Squares | Df | Mean Square | F | Sig. |
|--------------|----------------|-----|-------------|-------|---------|
| 1 Regression | 12.650 | 6 | 2.108 | 3.711 | .002(a) |
| Residual | 54.544 | 96 | .568 | | |
| Total | 67.194 | 102 | | | |

3.3 Test of Hypothesis 3

H_0 : There is no relationship between pull and push factors to subcontracting

H_1 : There is relationship between pull and push factors to subcontracting

Coefficient of determination

The coefficient of determination is given by the formula;

$$C.O.D = r^2 \times 100$$

Where r = Pearson correlation = 0.467

$$= (0.467)^2 \times 100$$

$$= 0.2181 \times 100$$

$$= 21.8\%$$

The correlation of $r = 0.467$ means 21.8% shared variance between the push factors and the pull factors to the subcontracting practice. This implies that push factors to subcontracting help to explain 21.8% of the variance in the respondent's scores on a company's decision to subcontract its activity. The relationship between push factors and pull factors was investigated using Pearson's Correlation Coefficient. As indicated in table 5 below there is a positive correlation between the two variables ($r = 0.467$, $n = 111$). The correlation ($r = 0.467^{**}$) between push factors and pull factors to subcontracting decision is significant at the 0.01 level, thus we reject the null hypothesis (H_0) and accept the alternative hypothesis (H_1). This means that the push characteristics and pull characteristics have a positive correlation towards the company's decision to subcontract.

Table 5: Correlations

| | | Pull | Push |
|------|---------------------|----------|----------|
| Pull | Pearson Correlation | 1 | .467(**) |
| | Sig. (2-tailed) | | .000 |
| | n | 111 | 111 |
| Push | Pearson Correlation | .467(**) | 1 |
| | Sig. (2-tailed) | .000 | |
| | n | 111 | 111 |

** Correlation is significant at the 0.01 level (2-tailed).



3.4 Test of Hypothesis 4

H0: Subcontracting has not contributed positively to the growth of the organization:

H1: Subcontracting has contributed positively to the growth of the organization:

As shown in table 7 below, 0 cells (.0%) have expected frequencies less than 5, while the minimum expected cell frequency is 22.0 as shown in table 6. However, further analysis found that the calculated value is 101.455, the tabulated value is 9.49 and the level of significance is 0.05. Hence, the decision is that the null hypothesis should be rejected because the tabulated value of 9.49 is lower than the calculated value of 101.455. This proves that subcontracting has indeed contributed positively to the growth of the respondent organizations.

Table 6: Frequency

| | Observed n | Expected n | Residual |
|-------|------------|------------|----------|
| SA | 19 | 22.0 | -3.0 |
| A | 63 | 22.0 | 41.0 |
| U | 15 | 22.0 | -7.0 |
| D | 9 | 22.0 | -13.0 |
| SD | 4 | 22.0 | -18.0 |
| Total | 110 | | |

Table 7: Test Statistics

| | |
|---------------|---|
| | Subcontracting has contributed positively to the growth of the organization |
| Chi-Square(a) | 101.455 |
| Df | 4 |
| Asymp. Sig. | .000 |

4. Discussion of Results

From the multiple regression analysis carried out on Hypothesis 1, the decision was to reject the null hypothesis. This indicate that the pull factors to subcontracting in a way can be attributed to their decision to subcontract. The regression used took all factors of the pull characteristic to subcontract, and then matched them up with the concept of the subcontracting process. This yielded a significance, which firstly states that indeed a link can be seen between the pull characteristics and decision to subcontract. This is consistent with the findings of Berardi (2009) who argued that subcontracting is among the strategies that will help in achieving the major goals of organizations in an economy. In addition, Castel & Klaus (2009) perceives subcontracting as the process of entering



a contractual agreement with an outside person or company to perform a certain amount of work. As represented by the r^2 figure of 39.7% which shows that indeed a positive relationship exists between both factors (pull factors and subcontracting). Factors such as; benefits of process specialization (both in labour and production), cost reduction, and the need to compete favourably. The results also show significant figure of 0.000. Hypothesis 2 was also analysed using the multiple regression tools, which was also used to analyse the first hypothesis. The aim here was also to reject the null hypothesis, which was attained in the computation of the results. Respondents here agreed to the proposition that the push characteristics of subcontracting were responsible for their company's decision to pick up the subcontracting strategy. The alternative hypothesis was taken instead of the null hypothesis because the results of the regression showed an 18.8% agreement to the push characteristics as the reason for subcontracting in the respective organizations. This hypothesis had a 0.002 significance level. The factors under the push characteristics are; increase in economic costs, surviving the prevailing price-based competition and government regulatory policies. This agrees with Butler & Chris (2009) who added that many small businesses hire subcontractors to assist with a wide variety of functions in order to boost organisations profitability and competitive advantage. Hypothesis three was verified using the correlation method, it aimed at establishing a link between both variables (pull and push factors) to the decision of subcontracting undertaken by the sampled organisations. In this study, a significant relationship was reported, this was shown by the significant value obtained which was 0.001. The computation of the coefficient of determination which is done by multiplying the r figure which is also the Pearson Correlation figure by the percentage determinant (100%). This result brought about a 21.8% shared variance figure which is the amount of correlation that exists between both the push factors and the pull factors to the subcontracting decision. From the chi-square analysis conducted to validate the accuracy of the result for Hypothesis four, the decision was to reject the null hypothesis and accept the alternative. Majority of the respondents agree to the fact that subcontracting has indeed assisted the company in realizing positive growth in its dealings, while the rest of the respondents are either undecided or out rightly disagreed with the idea of subcontracting and its positive contribution to the growth of the organization.

5. Conclusion of Study

This study finds that there are ample benefits open to companies that subcontract. In most cases these benefits are visible in the depth of the production processes. Considering the concept or idea of subcontracting, previous studies revealed that such practice is prevalent among Asian and American countries because of their concentration on big technical based industries. Literature also showed that Nigeria has not put any known or physical effort into investing towards the idea of subcontracting on a mega scale such as the Asians and Americans have done. Literature search showed that there are no much empirical research on subcontracting as it relates to Nigeria. The application of subcontracting in developing nations to their production or services processes can be seen as being positively supported by concerned government as shown by various policies set-up so as to aid situations whereby subcontracting could be carried out. These governments see the potential of subcontracting not only to large corporations, but also among micro entrepreneurs who are trying to find their ways to economic prosperity. Available empirical findings showed that the incorporation of subcontracting to processes in business, be it production, distribution of services and in other areas enhances organisational productivity among the firms involved.

Past research in Nigeria revealed not much studies are available pertaining to the subcontracting concept, the findings from this study reported a contrary opinion about a non-awareness of the subcontracting concept in Nigeria. Organisations in Nigeria especially those sampled are found to be fully aware of the concept of subcontracting and the concept is carried out by the concerned firms. Some were into subcontracting at the manufacturing level, some in the provision of vital raw materials and others only subcontracted when it came to the distribution of their goods across the states in the nation. Another important findings reported from this study showed that organisations involved benefited immensely from specialization as a result of the subcontracting relationships engaged with other organisations. These findings showed improved productivity and business development in the organizations that engage in subcontracting relationships. Hence, it would be recommended that more organizations who are struggling in the application of conventional methods to production processes in this new times should employ the use of subcontracting of parts or all of their production process to experienced subcontractors.



Acknowledgement

The researchers wish to thank the Covenant University Ota, Nigeria for making available some of the facilities that enhanced the compilation of this study.

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