AN ANALYSIS OF THE INFLUENCE OF FIRM SPECIFIC VARIABLES ON FINANCIAL PERFORMANCE IN THE NIGERIAN MANUFACTURING SECTOR

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Abstract

This study examined the effects of firm specific variables on firm financial performance in the Nigerian Manufacturing Sector. Ex-post facto research design and secondary data were utilized for the study. Data were sourced from Annual Reports of twenty (20) manufacturing companies from 2008 to 2017. The variables utilized were Sales Growth (SG), Age of the Firm (AF), Tangibility (TAN), Firm Size (FS), and Leverage (LEV) for firm specific variables. Firm performance was measured by Return on Assets (ROA). Pooled Ordinary Least Square (POLS) regression analysis was employed to ascertain the effects of SG, AF, TAN, FS and LEV on ROA at 0.05 level of significance. Findings showed that SG (β = 1.1251, p-value = 0.0013), AF (β = 2.4561, p-value = 0.0045), TAN (β = 0.5602, p-value = 0.0141), FS (β = 0.0308, p-value = 0.0057) and LEV (β = 5.3111, p-value = 0.0353) had positive significant influence on ROA with R^2 of the model = 0.7411, adjusted R^2 = 0.6816 and p-value = 0.0003. It was concluded that firm specific variables exerted significance influence on the financial performance of the sampled companies and recommended that companies should develop policies aimed at promoting and improving firm characteristics.

Key words: Financial Performance, Leverage, Manufacturing Sector, Sales Growth, Tangibility

1.0 Introduction

Business globalization and aggressive competition for large market share has called for firms to maintain high performance. Performance is an indicator or index of corporate success and benchmark for investment purposes (Ruhomaun & Nagaohi, 2019). This means that it is used to measure firm's overall financial health over a given period of time and can also be used to compare similar firms across the same industry or to compare industries or sectors in aggregation. These performances are functions of activities that transpire within and outside the companies. The better their performances, the greater the willingness of investors to invest in the companies. However, many developing countries, including Nigeria have very

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large stock markets but the performances of the companies have continued to be terribly meagre which make it difficult for them to survive competition with their foreign counterparts. Many firms performed far below expectation in terms of innovation, overall output, revenue generation and profitability (Odusanya, Yinusa & Ilo, 2018). In a situation where the financial performance continues to decline, financial distress gradually creeps in. Since financial distress is known to cause major losses and is harmful to various stakeholders, accessing capital becomes difficult, firm's position in the market weakens, sharp decline in firm's value and if financial distress is not curbed early, the situations may eventually lead to bankruptcy. Firms that persistently incur losses exit the market and the profitable ones stay in (Safarova, 2010). Continuous exit of firms from the market in the long run contributes to the slow growth rate of the country. Therefore, organisations should from time to time assess their external and internal environment for opportunities and challenges/threats in order to remain competitive to achieve sustainable growth (Ahmad & Mohammed, 2018). This means that aside from macroeconomic conditions such as inflation and increased interest rates which are beyond the control of the management that affect firm's performance, firm specific attributes, which are within the control of firm's control also influence the changes on firm value and performance. These firm specific variables include leverage, tangibility, sales growth, size and age of the firm etc.

In the quest to determine what and how firm specific variables affect performance of firms and possibly make recommendations on improving the firms performances, several scholars have conducted researches and there have been no consensus in their findings. For instance, Shuaibu and Amin (2019), Olarenwaju, Oladejo, Olaoye and Ogunmakin (2018), Isik, Unal and Unal (2017), Ajao and Ogieriakhi (2018), Tadesse and Kassa (2017) findings revealed positive, negative and mixed findings on the individual independent variable or combination of the independent variables on performance of firms. It is therefore against the foregoing that this study contributes to the body of knowledge by empirically examining the effect of firm specific characteristics on firm performances in the Nigerian manufacturing sector.

The subsequent sections of this paper are as follows: Section 2 reviewed literature relevant to the study, section 3 describes the data and methodology used section 4 presents and discusses the empirical results while section 5 concludes and offers some policy implications and suggested recommendations.

Objectives

The main objective of the study is to evaluate the influence of firm specific variables on financial performance of manufacturing companies in Nigeria. The specific objectives are to:

i. examine the effects of Sales Growth (SG) on financial performance of manufacturing companies in Nigeria;
ii. ascertain the influence of Age of the Firm (AF) on financial performance of manufacturing companies in Nigeria;
iii. determine the effects of Tangibility (TAN) on financial performance of manufacturing companies in Nigeria; and

iv. assess the effects of Firm Size (FS) on financial performance of manufacturing companies in Nigeria;
v. analyse the effects of Leverage (LEV) on financial performance of manufacturing companies in Nigeria.

Research Hypotheses

Based on the specific objectives, the research hypotheses for this study are stated as follows the in null form:

Ho_1: Sales Growth (SG) has no significant effects on financial performance of manufacturing companies in Nigeria

Ho_2: Age of the Firm (AF) has no significant effects on financial performance of manufacturing companies in Nigeria

Ho_3: Tangibility (TAN) has no significant effects on financial performance of manufacturing companies in Nigeria

Ho_4: Firm Size (FS) has no significant effects on financial performance of manufacturing companies in Nigeria

H_{o5}: Leverage (LEV) has no significant effects on financial performance of manufacturing companies in Nigeria

2.0 Literature Review

This section reviewed concepts, theories and empirical studies which are relevant to this study.

Conceptual Review

Firm Specific Characteristics

Factors which are beyond the control of management and which are directly under the control of management are regarded as macroeconomic variables and firm-specific characteristics respectively and both affect the performance of companies. These macroeconomic variables are external factors which affect firms in all sectors through its cost of capital, its ability to access external sources of fund, its after tax net cashflow, the demand for its products and its survival (Usman & Olayiwola, 2019). Such variables include Gross Domestic Product (GDP), inflation, interest rate and exchange rate. Firm-specific characteristics on the other hand are internal attributes of the firm and they can be classified into financial variables and non-financial variables (Malik, 2011). Financial variables are those factors that can be directly derived from items in the financial statements such as size of the firm, leverage, sales growth and tangibility of assets while non-financial variables are those items that cannot be derived from financial statements and they include age of the firm, management quality and scope of operation (Malik, 2011). For the purpose of this study firm-specific characteristics

to be considered are size of the firm, leverage, sales growth, tangibility of assets and age of the firm.

Size of a Firm

The size of a firm is the amount and variety of production capacity and ability a firm possesses or the amount and variety of services a firm can provide concurrently to its customers. The size of a firm is a primary factor in determining the profitability of a firm due to the concept known as economies of scale which can be found in the traditional neo classical view of the firm (Ajao & Ogieriakhi, 2018). It reveals that larger firms are able to recruit skillful employees with professional knowledge compared with small companies, items can be produced on much lower costs, and also have better strategies for its product diversification (Niresh & Velnampy, 2014, Irfan & Ali, 2017). In addition, Wolfgang, Pascal and Gabrielle (2007) made it known that due to better analyst coverage, more information is publicly available about large firms, implying better access to capital markets and lower anticipated costs arising from informational asymmetries thus leading to better performance. But on the contrary, owners of the firms find it challenging to effectively and effectively supervise and control the activities and deviant conduct of the managers as the firms increase in size.

Tangibility

Tangibility imply fixed assets; it is also termed as plants and machinery in financial statements of companies. The degree to which firm's assets are tangible should result in the firm having greater liquidation value. Tangible assets tend to reduce the financial distress cost because of the liquidation possibility in case of default. Lenders are expected to feel more confident suppling loan to a company with high level of tangible assets than an identical company with less tangible assets on its balance sheet (Skoogh & Sward, 2015). The impact of tangibility on profitability is positive and it portrays that assets that are tangible are easily monitored and also aid in providing collateral and helps in mitigating conflicts between lenders and owners of the company (Himmelberg, Hubbard, & Palia, 1999). The impact of tangibility on profitability can on the other hand be negative due to the fact that companies with much tangible assets tend to be less profitable. More investment opportunities in the long run, research and development and innovation are associated with companies with high level of intangible assets (more liquidity).

Age of the Firm

Companies that have been in the market for a long period of time have acquired reputation since they have proven their ability to fulfill long term contract obligations and their financial strength (Dieter, 2011). Knowledge and experience come with age, and older firms tend to possess more systematic and developed firm routines as innovation activity requires assimilating new knowledge with pre-existing firm knowledge to produce new outputs (Noordin & Mohtar, 2014). Older firms are more experienced, have enjoyed the benefits of learning and are not prone to liabilities of newness and can therefore enjoy superior performance. However, new firms are perceived to be unable to achieve economies of scale

because they rarely have the sufficient managerial resources and expertise in the area and older firms are prone to inertia and the bureaucratic ossification that goes along with age; they might have developed routines which are out of touch with market conditions (Liargovas & Skandal, 2008).

Sales Growth

Hutzschenreuter and Hungenberg (2006) classified growth of firm into quantitative and qualitative. According to Penrose (1995), firm growth reflects increase not only in amount of certain variables such as sales, production, or exports but also increase in specific development process leading to increase of size or improvements in quality. Thus, sales growth is defined as incremental change in sales per year. Without the increase in sales, it is practicablly impossible for a firm to survive. An increase in sales will translate into increased profits which thereafter increase dividend payments and increase in the amount of own capital that comes from retained earnings. When sales are relatively stable, it becomes easy for companies to access external flow of funds or secure more loans to improve their operations.

Leverage

It is the ratio of debt utilized in a firm as against its assets. There are cost and benefits that accrue to firms that use more debts in financing their operations (Olayiwola, 2017). Leverage can be beneficial as it is used as a disciplinary tool that guides management of a firm from wasting resources thereby increasing performance. The use of more debts obliges managers to generate cash flows in order to meet their obligations to fixed claimants. Also, since interest payments on certain debts are a tax-deductible expense, taking on qualifying debts can act as tax shields. However, if companies are highly leveraged, there will be greater interest to be paid to claimants as well as greater possibility of being unable to pay the interest. Hence, the greater the possibility of bankruptcy, highly leverage companies may be unable to find new lenders in the future. Therefore, leverage beyond the optimum level could result in higher risk and low value of the firm.

Financial Performance

Financial performance is the blue print of the financial affairs of an entity and reveals how a firm has prospered under the leadership of its management. The financial performance of any firm can always be judged in the lights of its objective to earn profit by making the most efficient use of the resources available to them (Nwaolisa & Chijindu, 2016). Good performance is the criterion whereby an organization determines its capability to prevail. It can be measured in different ways and by applying various methods (Niresh & Velnampy, 2014).

Kakanda, Bello and Abba (2016) noted that managers of corporate entities are much concerned on how to achieve high financial performance as it has a long-term effect on their corporate set-ups which ranges from management efficiency (utilization of limited resources at their disposal); investors goal (wealth maximization) and lenders driven (repayment of

debt and interest charge thereon). Salim and Yadav (2012) reported that firm's performance is significantly affected by various factors such as leverage, age of the firm, sales growth, tangibility and size of the firm. Therefore, managers need to understand the firm-specific characteristics that will maximize their financial performance.

Theoretical Review

Resource Based Theory

This study is hinged on Resource Based Theory. Warnerfelt (1984) coined the term Resource Based View (RBV) while emphasizing the value of focusing on firm's resources rather than their products and afterwards, Barney (1991) established that sustained competitive advantage (performance) of firms in a competitive environment is a function of the firm's specific resources and capabilities. To support this theory, Modigliani and Miller (1958) posited that firm value is determined by company's asset earning's power. Thus, extant use of firm internal resources which are not limited to conceiving and implementing of strategies but include tangible assets (all kinds of physical assets including machinery and equipment, plants and building, physical technology, raw materials), intangible assets (knowledge and information, organizational attributes and capabilities, firm name and reputation, patents and copyrights etc.) and human resources would bring about superior market performance, higher profitability and higher market value relative to their competitors (Ozdemir & Denizel, 2006 and Theriou, Aggelidis & Theriou, 2009). Barney (1991) emphasized that if these firms' resources are generally homogenous, there would be only improved effectiveness and efficiency to the same extent however, it would be difficult to explain the observed performance superiority among these firms. According to this theory, the resources must be valuable, rare, imperfectly imitable and absence of strategically equivalent substitutes to generate competitive advantage.

Empirical Review

Babalola (2013) examined the effect of firm size on firm profitability in Nigeria by utilizing panel data set over the period 2000 to 2009. Using Return on Assets (ROA) as dependent variable and independent variable, firm size represented by both total assets and total sales, it was found that firm size has a positive impact on the profitability of manufacturing companies in Nigeria.

Chandrapala and Knapkova (2013) investigated the role of internal factors in generating financial performance of firms in the Czech Republic. The study used a sample of 974 firms in the Czech Republic and collected data from 2005 to 2008 and used pooled and panel cross-sectional time series techniques for the data analysis. Using ROA as the dependent variable, the study established that the firm size, sales growth and capital turnover had a significant positive impact on financial performance of firms. The study also found that debt ratio and inventory reflect significant negative impact on financial performance of firms.

Kaya (2015) investigated the firm-specific factors affecting the profitability of non-life insurance companies operating in Turkey. The study used secondary data of 24 non-life

insurance companies in Turkey from 2006-2013. The study measured profitability in terms of technical profitability ratio and sales profitability ratio. The findings of the study established that the firm-specific factors affecting the profitability of Turkish non-life insurance companies are the size of the company, age of the company, loss ratio, current ratio and premium growth rate.

In determining the effect of microeconomic factors on financial performance of companies listed on the Nairobi Stock Exchange, Bongoye, Banafa and Kingi (2016) used panel data from 2011 to 2015 of thirty seven (37) companies and found that firm size, liquidity and growth opportunities had positive relationship with financial performance but tangibility had a significant negative relationship with financial performance.

Dioha, Mohammed and Okpanachi (2018) examined the effect of firm characteristics on profitability of sampled 18 listed consumer goods companies in Nigeria from 2011 to 2016. Multiple regression was employed as tool for analysis and it was discovered that firm size and sales growth had positive significant effect while leverage had negative significant effect on profitability. However, firm age and liquidity were not significant. It was recommended that consumer goods companies in Nigeria should conduct careful evaluation and take into consideration the firm characteristics that affect profits of the company before making major business decisions.

In an article "Determinants of firm profitability in Nigeria: Evidence from dynamic panel models", Odusanya, Yinusa and Ilo (2018) sampled 114 firms from 1998 to 2012 and utilized general method of moments to analyze the data from the firms. It was revealed that risk, inflation rate, interest rate and short term leverage ratio were significant determinants and negatively related to profitability. However, long term leverage ratio, firm size, asset tangibility, growth opportunities and firm age were not significant determinants.

3.0 Methodology

The study utilized *Ex-post facto* research design which is suitable for investigating cause-effect relationships among variables without manipulation. Using simple random sampling technique, Twenty (20) companies were sampled from the manufacturing companies listed on the Nigerian Stock Exchange (NSE) and data were obtained from annual reports of the sampled companies from 2008 to 2017. Breusch and Pagan Lagrangian Multiplier (LM) test was utilized to choose between pooled Ordinary Least Square (OLS) and random/fixed effect for the model while pooled OLS regression analysis was used to estimate the specified model for the study.

Model Specification

FP = f (Firm Specific Variables)

Where:

Financial Performance (FP) was proxied by Return on Assets (ROA) and
Firm Specific Variables were proxied by:

- Sales Growth (SG)
- Age of the Firm (AF)
- Tangibility (TAN)
- Firm Size (FS)
- Leverage (LEV)

The model for this study is represented in a functional form as:

ROA = f (SG, AF, TAN, FS, LEV)

In mathematical form, the model is stated as:

$$ROA_{it} = \beta_o + \beta_1 SG_{it} + \beta_2 AF_{it} + \beta_3 TAN_{it} + \beta_4 FS_{it} + \beta_5 LEV_{it} + \varepsilon_{it} \quad \text{.....equ. i}$$

Where:

ROA	=	Return on Assets (Measured as Profit After Tax/ Total Assets)
SG	=	Sales Growth (Measured as Sales in year t less sales in the previous year and divided by sales in previous year).
AF	=	Age of Firm (Measured as Time of Inception of Firm till date)
TAN	=	Tangibility (Measured as Fixed Assets / Total Asset)
FS	=	Firm Size (Measured as Logarithm of total assets)
LEV	=	Leverage (Measured as Long Term Debt/ Total Asset Ratio)
I	=	Cross sectional variable
t	=	Time series variable
ε	=	Error term
β_0	=	Model intercept
$\beta_1 - \beta_5$	=	Regression coefficients of the explanatory variables

Apriori expectation = $\beta_0 > 0$; $\beta_1, \beta_2, \beta_3, \beta_4, \beta_5 > 0$

This infers that the explanatory variables in the study are expected to be positively related with the dependent variable

4.0 Data Analysis, Results and Discussions

In this section, selection of the appropriate analytical tool for the model of the study, analysis of the model and discussion of findings were focused on.

Result of Unit Root (Stationarity) Test

The unit root results which indicate the order of integration of each of the variables is presented in Table 1. In order to determine the stationarity properties of the variables used in the study, the Augmented Dickey Fuller (ADF) Test was performed.

Table 1: Unit Root Test

Variable	ADF Value @ Level	Mackinnon Critical value @ 5%	Order of Integration
ROA	-4.9777	-2.9919	I(0)
SG	2.9750	0.1694	I(0)
AF	-3.8891	-3.0021	I(0)
TAN	4.0335	2.9604	I(0)
FS	3.7523	2.7651	I(0)
LEV	-4.9532	-2.5123	I(0)

Source: Author's computation (2020)

The results in Table 1 depicts that all the variables are stationary at level and are integrated of order zero. This implies that, no long run information is lost thus, the application of ordinary least squares in the estimation process is therefore appropriate and not likely to yield spurious estimates.

Model Estimator Selection

Breusch and Pagan Lagrangian Multiplier (LM) test was conducted to choose between pooled OLS and random/fixed effect for the model (Table 1). The result suggests acceptance of null hypothesis indicating that the variance of the random effect is zero as the p-value is greater than 0.05. From the test, the regression analysis and hypotheses testing were made using the pool OLS.

Table 2: Breusch and Pagan Lagrangian Multiplier Test

ROA[year,t] = Xb + u[year] + e[year,t]

	Var	sd = sqrt(Var)
ROA	14.65745	3.27456
E	21.22224	3.76043
U	0	0
Chibar2(Prob)	38.14(0.0581)	

Source: Author's computation (2020)

Result of Regression Analysis

Table 3 depicts the result of the regression tests, based on the model of the study. It shows the coefficient of determination (R-Square) with a value of 0.7411 which means that in Nigeria about 74% of the total systematic variations in financial performance can be explained by the variables namely SG, AF, TAN, FS and LEV. The adjusted R-square shows that even after adjusting for the Degree of Freedom, the model could still explain about 68% of the total systematic variations in segment disclosure. Only about 32% of the systematic variation of segment disclosure was left unaccounted for by the model which has been captured by the stochastic disturbance term in the model. Also, it was observed that the overall model was statistically significant with F-value of 11.954 at 5% level of significance. This shows that there exists a significant linear relationship between the independent variable and the dependent variables in the study.

As regards the individual statistical significance of influence of explanatory variables (SG, AF, TAN, FS and LEV) on dependent variable (ROA), findings suggest a significant positive relationship between the dependent variable (ROA) and explanatory variable (SG, AF, TAN, FS and LEV) with 1.1251, 2.4561, 0.5602, 0.0308 and 5.3111 as coefficient and p-value of 0.0013, 0.0045, 0.0141, 0.0057 and 0.0353 at 5%.

Table 3 Firm Specific Variables and ROA

Dep. Var. (ROA)		***Co-eff. (P-value)***
Constant		8.9159 (0.0003)*
SG		1.1251 (0.0013)*
AF		2.4561 (0.0045)*
TANG		0.5602 (0.0141)*
FS		0.0308 (0.0057)*
LEV		5.3111 (0.0353)*
R^2	0.7411	
Adjusted R^2	0.6816	
F-statistic	11.954	
P-value	(0.0003)*	

Notes: * denotes statistically significant at 5% significance level respectively.

Also, p-values are reported in parentheses.

Source: Author's computation (2020)

The null hypothesis was that firm specific variables (SG, AF, TANG, FS and LEV) have no significant influence on the financial performance (ROA) of the sampled manufacturing companies in Nigeria. At 5% level of significance, the study found that firm specific variables have significant influence on ROA. Therefore, the null hypothesis is rejected. The result suggests that an addition of 1% of firm specific variables resulted in an increase for the pooled OLS model in ROA. This study provided findings that are contrary to previous study of Odusanya, Yinusa and Ilo (2018). However, Chandrapala and Knapkova (2013) and Dioha, Mohammed and Okpanachi (2018) established that firm size and sales growth had significant positive impact on financial performance of firms. Furthermore, Dioha, Mohammed and Okpanachi (2018) discovered that leverage had negative significant effect on profitability. Bongoye, Banafa and Kingi (2016) suggested firm size had positive relationship but tangibility had a significant negative relationship with financial performance.

5.0 Conclusion and Recommendations

The study focused on the empirical analysis of the effects of firm specific variables on financial performance of manufacturing companies in Nigeria. Based on the findings of this research, with specific reference to the Nigeria manufacturing industry, it was concluded that firm specific variables exerted significant influence on the performance of the sampled companies. Based on the findings of this research, the researcher recommends that companies should develop policies aimed at promoting and improving firm specific which enhances the use of value adding economic activities in terms of innovation and research and development (production and marketing) activities and thereafter, improve performance.

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