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THE MEDIATING EFFECT OF LEVERAGE ON THE RELATIONSHIP BETWEEN GROWTH AND FIRMS' PERFORMANCE: A REVIEW

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ABSTRACT

The growth and performance of companies constitutes central topic of interest to a variety of interest groups. Firm performance and growth are considered as significant construct in strategic management research and support managers inincreasing the success level of their companies. Leverage measure show much firm uses equity and debt to finance its assets; as the better mixture of capital is the oil that lubricates performance and growth. Thus, this paper aims to examine the mediating effect of leverage on the relationship between growth and performance of firms. The methodology of this study is a desk research basically from secondary information through various articles, journals and website. The study proposed an econometrics regression models to test the mediating effect of leverage on the relationship between growth and performance of firms. From the literature review, we conclude that sales growth, assets growth and profit growth influence the performance of firms if proper mix of leverage is utilized.

Introduction:

The performance of a firm is a key to determine the perpetuity of a business for most profit-oriented organizations (Kakanda, Bello & Abba, 2016). A well-performing business is often one that is effective and efficient in securing a long-term success (i.e. one that reasonably follow it standards and judiciously utilized it resources towards achieving high performance). According to Kakanda, Bello and Abba, (2016), 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

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lenders driven (repayment of debt and interest charge thereon).

The importance of firm performance is a central element to managers and their companies as reflected in their various corporate publications. Analogue to firm growth, media frequently praises the highest performing companies, e.g., via the Nigerian Stock Exchange (NSE), Forbes Global High Performers Ranking or the Bloomberg Business Week 50. Every firm want to maximize the shareholder's wealth and this objective may be achieved by reducing the cost and enhancing the profitability of the firm. Furthermore, the firm performance (profitability) has its further influence on cost of equity as because of high profitability the firm's may have more retained earnings, which caused the reduction of cost of equity (Tinger, 2015). Therefore, the firm performance has its own significance for research purpose. In summary, firm performance is a construct of significant matter to several interest groups (i.e. investors, stakeholder and policy makers).

Moreover, the growth of firms is a frequently debated topic in business media (Tingler, 2015). Several of the major business print media have annual issues honoring fast growing companies, e.g., the Nigerian stock exchange (NSE), Nigerian newspapers and Business Week Magazine by Bloomberg or the Fortune Magazine (Nicholls-Nixon, 2005). In summary firm growth is an important topic for several interest groups and it is almost exclusively regarded as a positive phenomenon across these stakeholders. Leverage is the extent to which a business or investor is using the borrowed money. It measures how much firm uses equity and debt to finance its assets. As debt increases, financial leverage increases (Ur-Rehman, 2013). Some commonly believe that a better mixture of an organization's capital is the oil that lubricates its performance and growth (Kakanda, Bello & Abba 2016). Recently, a research has been done to investigate the mediating influence of financial leverage between the ownership concentration and financial corporate performance and findings are showing that the financial leverage explains the relationship between the ownership concentration and financial corporate performance (Noghondari & Noghondari 2017). Therefore, leverage is not only play a role in firm growth and performance but will also be a good mediating variable (Abbasi & Malik, 2015).

Researches have been conducted to ascertain the effect of growth on performance of firms for both developed and developing countries of the world. However, the empirical findings of the studies differ from country to country. In their studies (e.g. Çoban 2014; Abbasi & Malik, 2015; Chashmi & Fadaee, 2016) observed that growth has a significant positive effect on performance of firms in Turkish, Pakistan and Tehran. Whereas some studies (e.g. Cooper, Gulen & Schill, 2008; Gray & Johnson, 2011; Watanabe, Xu, Yao & Yu, 2011) show total firm's growth is negatively related with future stock returns for the United State and Australian. Few researches showed that there is no statistical significance relationship between growth and firm performance for example in their studies (Gschwandtner, 2005; Serrasqueiro, Nunes & Sequeira, 2007) the results show that the relationship between firm growth and performance is insignificance in America and Portugal. Therefore, this could be attributed to institutional differences such as legal systems, financial institutions, government subsidies, rate of inflation and the economy's growth rate between these countries, industry selection, position and administrative practice or even political and cultural institutions ((Matar & Eneizan, 2018; Chashmi & Fadaee, 2016; Ting, Kweh & Chan, 2014).

There is a continuing debate in the literature is whether more resources are better than less for enhancing firm growth and performance (Fitzsimmons, 2017). All else being equal, prior research (e.g. Mishina, Pollock & Porac, 2004) assumed that more resources are usually better than less for promoting firm growth. Despite the fact that growth is highly unpredictable, firm can achieve growth through different ways so one single growth indicator is unable to measure multidimensional growth (Ting, Kweh & Chan, 2014). This reason is the first motivating factor of this study to employ three different growth measures, namely sales growth, total asset growth and employment growth to examine the direct effect of growth (Delmar, Davidsson & Gartner 2003) on firm performance. The evaluation of the firm performance for enterprises is a complex process. Although firm evaluation is very old title to research in Finance, however, still has a charm to explore more gaps for research purpose (Abbasi & Malik, 2015).

Meanwhile, the studies of (Ramlan & Nodin, 2018; Jeleelá & Olayiwola, 2017; Ramli & Nartea, 2017) the findings showed that leverage is positively related to firm performance. Whereas the studies (Abdul Jeleel and Olayiwola, 2017; Matar & Eneizan, 2018) showed negative significance relationship between leverage and firm performance. Also the study of Gohar, Rehman, Shahid, and Baig, (2015)

showed that leverage and firm performance are not related. On the other hand the studies of Zare, Farzanfar and Boroumand, (2013) and Anton, (2016) showed significance positive relationship between leverage and firm growth, where the studies of Sarchah and Hajiha, (2013) and Tuominen, (2015) reported that there is significant but negative relationship between leverage and firm growth. And the study of Yasemia, Khairollahi, Fatahidehpahni and Jalilian, (2014) reported that there is no significant effect of leverage on firm growth.

Nevertheless, Abbasi and Malik, (2015), in their study Firms' Size Moderating Financial Performance in Growing Firms: An Empirical Evidence from Pakistan; suggested that the same study should be done to check the mediating effect of leverage (Debt equity ratio) between firm growth and firm performance. This reason is the second motivating factor of this study to investigate the mediating effect of leverage (Debt equity ratio) between firm growth and firm performance. Ramlan and Nodin, (2018), suggested that future research needs to be conducted on the scope of the topic "the effect of leverage, liquidity and profitability on companies' performance". Also apart from the suggestion of Abbasi and Malik, (2015) and Ramlan and Nodin (2018), ideally some people argued that as a firm growth in term of its assets, sales and profit etc. there is no need for that firm to borrow from external source of financing (i.e. banks) because it continue plotting back it profit into the business, while other argued that no matter how a firm is growing in term of its assets, sales and profit etc. and plotting back its profit into the business it will reach a level where it capital would not be enough to produce a desired goods/services to its target markets, so it must borrow from external source of financing (i.e. banks) for it to perform well. So only a study of this kind will provide solution to this problem.

The consumer goods sector is selected for this study because of its important to Nigeria's GDP (Gross Domestic Product). For instance, consumer goods sector is the third largest sector in Nigeria (NSE Factbook, 2018). There are twenty two (22) companies under consumer goods sector as at March, 2018 (NSE Fact book, 2018). The sector play very active role in the Nigerian stock market and contribute significantly to the nation's export and also the sector contribute about 21% to gross domestic product (GDP) of Nigeria's in 2014 (Uchiena, Olayinka, Nwanneka, & Uzoma, 2017). But recently the consumer goods companies' profit was down by 41% in 2016, the profit after tax for the year 2016 was N67 billion compared to N114.8 billion for 2015 even though, in 2017 there was a slide improvement as the economics of Nigeria is gradually increasing, but

still some companies performing poorly. The most significant drop in profit after tax was from 7up Bottling company plc. with a loss after tax of N10.8 billion compared to N3.34 billion profit after tax in 2016 this represent 422% drop in the profit of the company, Northern Nigeria Flour Mills plc. Having loss of 16.2 million in the year 2017, McNichols Plc. Profit drop by N19.6 billion with profit after tax of N38.2 billion in 2016 compared to N57.8 billion in 2016 (Bello, 2017). In 2015 Asset Management Company of Nigeria (AMCON) take-over Multi-trex integrated company because it unable to pay the borrowed money, even though recently Nigerian export and Import (NEXIM) bank is expected to revive the company with the sum of N5billion to get it up and running, and contribute significantly to economic (Abioye, 2018; Moses-Ashake, 2018).

Based on the gaps identified in the literature, the importance of the consumer goods sector to the growth of the Nigerian economy and the important of growth to any company performance, this study seeks to investigate the mediating effect of leverage on the relationship between firms' growth and performance of consumer goods companies.

Literature Review

To conduct an analysis focusing on the components of firm performance, an introductory definition of the terms "firm" is necessary. The academic literature has created various definitions of the firm over time (Garrouste & Saussier, 2005). However, no generally accepted answer to the definition of a firm exists (Wernerfelt, 2013). In fact, the academic literature provides two streams focusing on the definition of a firm: (1) an economics-based stream dominated by Anglo-Saxon researchers and (2) a business-based stream. In the following, both streams will be illustrated in detail.

From an economics-based context a firm is a structure of bilateral contracts between employees and their employer (Alchian and Demsetz 1972). This contractual structure results in a higher team output than the sum of each factor individually. Thus, team production synergies are referred to as the major reason for the existence of firms. From business-based context Gutenberg (1997) defines the firm as the core element of business theory. By combining human and material factors, a firm aims to produce and sell goods and services to third parties. A firm conducts these activities based on two principles: (1) commercially, firms target to maximize the return on invested capital, since this

is assumed to be most beneficial to economic welfare. (2) The decisions of firms are completely independent from external authorities.

Firm Performance

The word 'Performance is derived from the word 'parfourmen', which means 'to do', 'to carry out' or 'to render' (Trivedi, 2010). It refers the act of performing; execution, accomplishment, fulfillment, etc. In border sense, performance refers to the accomplishment of a given task measured against pre-set standards of accuracy, completeness, cost, and speed (Nwaolisa & Chijindu, 2016). Therefore, firm performance as documented by (Copisarow, 2000) is considered as how good is the position of a firm, and how efficiently a firm is using its assets to earn more revenues and enlarge its operations. The efficiency of the organization's top management team is measured by the performance of the company hence reflecting the role of every individual working in the company and performing a particular task assigned to him (Obaid, Zainon, Eneizan & Abd- Wahab, 2016). Hence performance is the indicator how efficiently the organization is managed and how effectively and efficiently the human and other resources are utilized in the firm (Eneizan, Wahab & Bustaman, 2015).

Meanwhile, Firm performance is the general measure of how well a firm uses its resources to generate profits. A company should earn profits in order to survive and grow over a long period of time (Pandey, 2010). Profits are essential but it would be wrong to assume that every action initiated by a corporation should aim at profit maximization to the detriment of environment, employees and society (Pandey, 2010). Firm performance was measured using the following indicators; accounting measures, market measures, hybrid measures of accounting and market measures, firm survival measures and operational measures (Shook, 2005).

On one hand, the survival measures are measures that assess a firm's past or a firm's future ability to remain in business (Carton & Hofer, 2006). According to Drucker, (2012), a firm's ability to survive should be regarded as the most critical indicator to assess long-term firm performance. Long-term survival requires the satisfaction of all important resource suppliers including shareholders. The hybrid measures are a combination of accounting-based and market-based measures and consequently try to limit the drawbacks of both groups of indicators (Tingler, 2015). Operational indicators provide information about the non-financial performance of a company (Venkatraman & Ramanujam, 1986). It

acts as a mediating instrument between a firm's internal actions, e.g., resource allocation or strategic decisions, and a firm's financial performance (Ray, Barney & Muhanna, 2004).

On the other hand, the market-based measures assess the market value of a firm in rates of change or ratios (Tingler, 2015). Market-based measures only exist for public companies, private equity-owned firms, or firms sold via intermediaries and thus are able to provide transaction value data to academic researchers (Carton & Hofer, 2006). Example of market-based measures includes; Tobin-Q, Market Value Added (MVA), Market-to-Book Value (MTBV), Abnormal Returns; Annual stock return, (RET), Dividend Yield (DY), Price-Earnings Ratio (PE), Log of Market Capitalization, Stock Repurchases, Superior to Cumulative Abnormal Returns (CARs) (Al-Matari, 2014). Several researchers promote market-based measures as the most accurate indicators of a company's economic value (Koller, Goedhart, & Wessels, 2010; Rappaport, 1986). Accounting measures are based on performance data generated in line with the corresponding accounting principles of a company, i.e., the financial statements, and are publicly disclosed (Verweire & Berghe, 2004). Example of accounting measures includes; Return on Assets (ROA), Return on Equity (ROE), Return on Sales (ROS), Return on Investment (ROI), Profit Margin (PM), Earnings per Share (EPS), Return on Capital Employed (ROCE), Expense to Assets (ETA), Cash to Assets (CTA), Sales to Assets (STS), Expenses to Sale (ETS), Labor Productivity (LP), Cost of Capital (COC), Return on Revenue (ROR), Profit per employee (PPE) and Return on Fixed Assets (ROFA) (Al-Matari, 2014).

Therefore, this study will use an accounting-based indicator over other measures because accounting measures indicate actual and realized performance by a company and also are the most readily available measures of the financial performance of a company (Brealey, Myers and Allen, 2017). Meanwhile, this study will use Return on Equity as a measurement for firm performance instead of Return on Assets because it focus on the remaining return which belong to the shareholders' when the interest expenses associated to debt is paid and also company's shareholders (investors) are more interesting in Return on Equity since it shows the return on the shareholders' invested capital (Brealey, Myers & Allen, 2017). Moreover, return on equity can reflect the final results of the company's operating activities and the profitability of shareholders' investment funds. Compared to Tobin Q value, it is more likely to truly reflect the value of the

enterprise (Yanga, Xiaa & Wena, 2016). ROE measures the rate of return on Equity (Singapurwoko & El-Wahid, 2011).

Firm Growth

Although firm growth is a widely used term in academic research, a generally accepted definition was and is still non-existent (Hutzschenreuter & Hungenberg, 2006). Albach, (1965); Brockhoff, (1966) and Grimm, (1966) defined firm growth as an increase in the size of a company. This definition of firm growth establishes the size of a firm as the basis of firm growth. Both parameters are intrinsically tied to each other. However, a clear differentiation between firm size and firm growth is important (Whetten, 1987). The size of a firm, in this case, is an absolute figure representing the scale of a company or an organization at a certain point in time (Kimberly, 1976). Contrarily, firm growth is a figure measuring the change of the firm size over time (Weinzimmer, Nystrom, Freeman, 1998; Whetten, 1987). Penrose, (1995) defines firm growth in two different ways. First, firm growth refers to an increase in a specific amount, e.g., growth of certain parameters such as sales, production, or exports. Secondly, firm growth defines as a specific development process, similar to biological processes, resulting in an increase of size or improvements in quality. However, up to date, academic research primarily focused on analyzing firm growth as a change in the amount of certain parameters, i.e., the quantitative aspect of growth (Davidsson, Achtenhagen, & Naldi, 2010).

The choice of firm growth measures in academic research studies is considerably heterogeneous Tingler, (2015). There is no agreement on a general indicator of firm growth. Consequently, researchers use a large variety of firm growth measures in academic studies (Birley & Westhead, 1990; Coad & Hölzl, 2012). However, the specific choice of a growth indicator used in academic research is of high importance to the respective results. Shepherd and Wiklund (2009) provide the most comprehensive literature review on the choice of growth measure by analyzing 82 empirical firm growth studies, the study showed that a company's sales is the predominant firm growth indicator used in the empirical studies under review appearing in 61 studies and representing 74.4% of all studies. The number of a company's employees represents the second most used growth measure selected in 13 studies and representing 15.9% of the sample. Additionally, a company's profit and its equity or assets were the growth measure of choice in nine and six studies, respectively. An accumulation of further, less

frequently used growth indicators accounts for the remaining 15 indicator choices reviewed.

To this end the indicators of growth in this study are sales, assets and profit growths these are selected because of some supporting factors (i.e. sales is the favorite growth indicator of choice for managers, investors, and entrepreneurs, asset is the basis for increased sales and profitability of the firm, profit help to increase the shareholders equity at the same time firms' objective is fulfilled). Despite supporting factors for sales, assets and profit some researchers choose the number of employees as an indicator of firm growth, but it is selected for this study because; number of employees does not reflect changes in labor productivity, any substitution of employees by machines, the level of a firm's integration as well as additional make-or-buy effects (Delmar et al., 2003). Additionally, managers see a growth in the number of employees not as a primary goal (Robson & Bennett, 2000).

Leverage

Financing or capital structure decision is of tremendous significance for the management since it influences the debt-equity mix of the company, which ultimately affects shareholders' return and risk. Therefore, the concept of leverage helps in examining this aspect.

Leverage is defined in financial studies, as the amount of debt to finance obtaining the required assets (Hampton, 2000). Rajan and Zingales, (1995) defined leverage as the ratio of total liabilities to total assets. It is the residual claim of equity holders. Horne, (2002) defined leverage as the employment of an asset of fund on which the firm pays a fixed cost or fixed return. Thus according to him, leverage is a result of the firm employing on asset or source of funds which has fixed cost or return. The former may be termed as 'fixed operating cost' while the latter may be termed as 'fixed financial cost'. It should be noted that fixed cost or return is the fulcrum of leverage. If a firm is not required to pay fixed cost or fixed return, there will be no leverage (Khan & Jain, 2011).

Moreover, the broadest definition of measures of financial leverage is the ratio of total liabilities to total assets. This measure can be indicated as a proxy for what is left for shareholders in case of liquidation (Bredly, Jarrell & Kim, 1984). Another more appropriate measure of financial leverage is calculated by ratio of debt to total assets, debt that includes short term and long term debts. It is usually expressed as debt over total assets, total debt over net assets or capital employed

or earnings before interest and tax (EBIT) over interest charge (Rajan & Zingales, 1995). It is further notable that Financial leverage ratio is commonly calculated by dividing debt by shareholder equity (Matt, 2000). This study will use the total debt ratio as a measure of financial leverage.

Leverage (LEV1) t-1 = non-current liabilities/book value of equity

Theoretical Framework

In order to provide a proper theoretical foundation for this study, the researcher briefly reviews the Pecking order theory and growth of the fitter theory which will serve as the bedrock for this study (Underpinning theory).

Pecking Order Theory

Pecking order theory was first suggested by Donaldson (1961) and later on modified by Myers & Majluf, (1984). This theory states that companies prioritize their sources of financing according to the principle of least effort. This means that companies first use internal financing at startup. When this is depleted, they use debt financing, and when they cannot get any capital anymore through debt financing, they raise capital by looking for external equity. Moreover, pecking order theory claims that profitable companies use less financial leverage than companies with a low or non-existing profit. This could be seen as that the financial performance affects the financial leverage (Brealey, Myers & Allen, 2017). This claim is supported by the reasoning about financing source. If the company is profitable, they are able to finance the operating business and investments with their own cash flows or retained earnings instead of debt or external capital from investors (Myers, 1984). According to Ebaid, (2009), this is the reason why there should be a negative relation between financial leverage and a company's financial performance. Peaking order theory also claim that the faster the firm growth, the less companies used retained earnings and the more they used external financing (Brealey, Myers & Allen, 2017).

Growth of the Fitter Theory

This theory was presented by Alchian in 1950. According to this theory, fitness is depicted by the firm profit, and the profitable firms grow and survive in the market while the other firms exit due to poor performance. Therefore, this theory is suitable to this study as it shows that there is positive significance relationship between firm growth and performance.

Research Model

To examine the mediation model, the econometric model of Mathieu and Taylor (2006) has been applied. The suggested relationship for the first assumption is as follows:

ROEit=α+β1 AGit +β2Liqit+β4Ageit+ et Model 1
ROEit=α+β1 SGit +β2Liqeit+β4Ageit+ et Model 2
ROEit=α+β1 PGit +β2Liqit+β4Ageit+ et Model 3
LEVit=α+β1AGTit+β2Liqit+ β3Ageit+ et Model 4
LEVit=α+β1SGit+β2Liqit+ β3Ageit+ et Model 5
LEVit=α+β1PGit+β2Liqit+ β3Ageit+ et Model 6
ROEit =α+β1 AGit +β2LEVit+β3 Liqit+β4Ageit+ et Model 7
ROEit =α+β1 SGit +β2LEVit+β3 Liqit+β4Ageit+ et Model 8
ROEit =α+β1 PGit +β2LEVit+β3 Liqit+β4Ageit+ et Model 9

Based on Mathieu and Taylor's model (2006), there are some requirements to have the mediation effect. 1. Path c, a, and b must be significant. 2. If path c′ is significant, there is a partial mediation effect and if path c′ is not significant, then there is a full mediation effect (Fig. I)

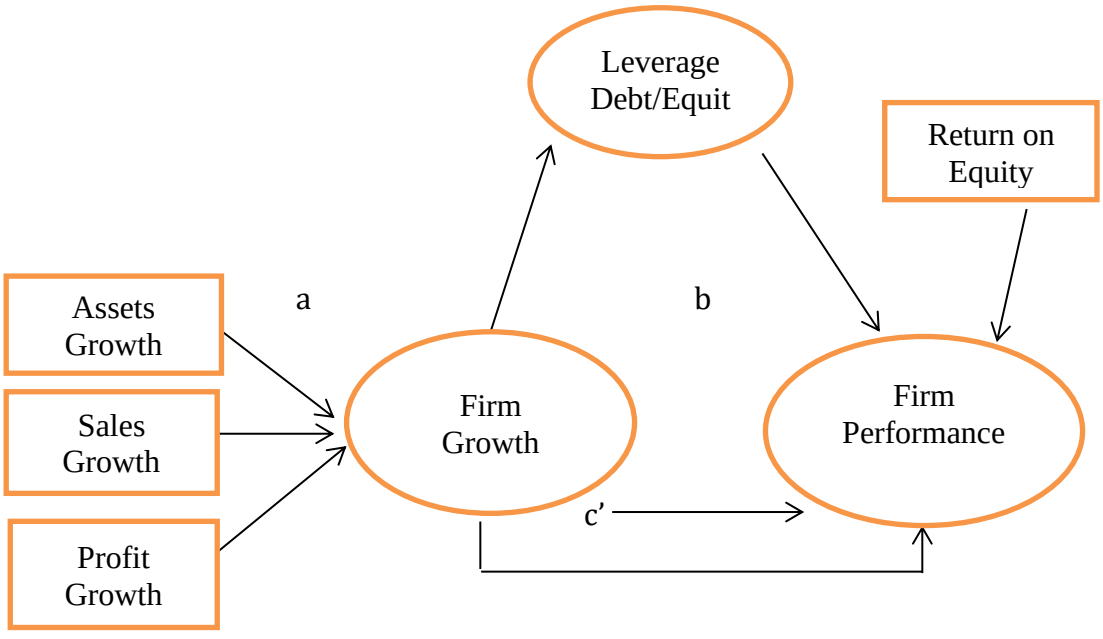

Fig. I. Research framework

Where:

ROE represent firm performance variables which are: Return on equity for firms at time t.
SG, EG and AS represents firm growth; SG stands for Sales Growth, PG stands for Profit Growth and AS stands for Assets Growth.
LEV represents Leverage; this variable is the mediating variables.
Liq represents the Liquidity and Age represents the firm Age; these variables are the control variables.
et; represent the error term which account for other possible factors that could influence ROE*it* that are not captured in the model.

Research Methodology

This research is a desk study on the basis of secondary information basically through various articles, journals and website.

Conclusion

This is a conceptual framework on a study to investigate the mediating effect of leverage on the relationship between firm growth and performance, particularly in consumer goods sector. The theoretical framework and the research hypotheses have been developed based on our review of the literature related to the subject of firm growth, performance and leverage. From the literature review, we can expect to see relationship the between firm growth, performance and leverage. The findings should assist consumer goods companies on better combination of debt and equity so as to increase performance. The findings should also be able to assist the management of consumer goods companies to understand that if firms' performance can/cannot be strengthened and enhanced by raising the level of leverage.

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