



EFFECT OF REVENUE GROWTH AND FINANCIAL PERFORMANCE OF QUOTED MANUFACTURING FIRMS IN NIGERIA

Okerekeoti, Chinedu U.

Department of Accountancy,
Nnamdi Azikiwe University, Awka, Nigeria
Mail: nattyhoodz@yahoo.com

Abstract

From 2010 to 2019, the study looked at the association between revenue growth and Tobin's Q of listed manufacturing firms in Nigeria. Panel data and an ex-post facto research design were used in this study. Secondary data was gathered from the Nigeria Stock Exchange's (NSE) publications as well as the sampled companies' annual reports and accounts. The descriptive and inferential statistics were used to analyze the data. E-Views 9.0 statistical software was used to perform linear regression analysis and the Granger causality test. The results of this study reveal that, at a 5% level of significance, there is a strong positive association between revenue growth and Tobin's Q. According to the survey, manufacturing companies should keep their working capital positive and, in particular, increase sales by offering credit to their customers, who account for about half of their asset structure.

Keywords: Revenue growth financial performance, Tobin's Q

Introduction

Revenue growth illustrates sales increases/decreases over time. It is used to measure how fast a business is expanding. More valuable than a snapshot of revenue, revenue growth helps investors identify trends in order to gauge revenue growth over time. Revenue Growth is the percentage increase (or decrease) in a company's revenue between two or more equivalent fiscal periods (Albrecht, James, Earl & Monte, 2005).

The term "revenue growth" refers to the rate at which a company's business expands. The annual rate of increase/decrease in a company's revenue or sales growth is depicted in the graph. Analysts, investors, and participants can use the numbers to see how much a company's sales are expanding over time. While revenue growth varies from fiscal year to fiscal year and fiscal quarter to fiscal quarter, investors look for revenue growth trends to gauge the company's growth over specific time periods. All other factors being equal, a corporation that can consistently raise revenue should see corresponding improvements in net income. The rate of revenue growth is calculated by taking the derivative of the revenue growth, which informs you how much the rate of revenue growth is changing. This metric is used by investors to predict future changes in profits growth. If a company that has been able to expand its revenues at a steady rate starts to see smaller revenue growth, it is a sign that something is wrong.

Organizational scholars typically employ accounting-based metrics of profitability or stock market-based indicators such as Tobin's Q to examine the financial element of a firm's success (i.e. financial performance) (Hult et al, 2008) as mentioned in Gentry et al, 2010. Accounting-based and stock market-based measures are commonly regarded as reliable indications of a company's financial health. The majority of the studies looked at employed accounting-based profit measurements. To set himself apart, this researcher chose a stock-market-based metric of profitability. Revenue is recognized when non-cash assets, such as commodity inventory, are converted to cash or cash equivalents, such as receivables. It also means that all operations necessary to earn revenue from the sale of a good or service have been completed, and the Company records revenue based on the principle of revenue realization (revenue registration time or revenue realization recognition) (Ball, Gerakos, Linnainmaa & Nikolaev, 2016). Because the incidence of sales or service delivery constitutes objective evidence required to finish the procedure, as well as the potential of collecting the price of the goods or service provided, this means that it is not necessary that the company collects the price of the commodity or value sold until proven as a sale or revenue, and sales and services are recognized as revenue at the time of the transaction (Al-Qashi and Al-Oqlah, 2015). The price of goods or services sold to customers is recorded as revenue for the activity in the period of sale and delivery regardless of the period in which the corresponding cash is collected (Ball, et al, 2016).

The impact of age on company success is still debated, with contradictory results being reported. Furthermore, as a company gets older, the likelihood of it failing decreases (Shih & Fan, 2009). Evans (2007), on the other hand, claimed that as businesses age, their profitability tends to fall. Internal finances of firms are dependent on their level of liquidity when it comes to financing techniques. The ability of a company's assets to be converted into cash quickly and cheaply is referred to as liquidity (Loderer & Waelchli, 2010). Companies keep a specific amount of liquid cash on hand for a variety of reasons, including preventive, speculative, and transactional (Gill & Mathur, 2011). On the other hand, the level of leverage represented by the capital structure shows the degree to which a business is utilizing borrowed money.

Profit may be the hero of every commercial entity on the planet, and the components that make up profit are just as instructive and evaluate income. As a result, the average collection duration, average payment period, and average inventory period define the profitability rate. One can calculate operational efficiency and profitability by dividing sales or revenue by total assets (Sari, 2007). Return on sales, return on investments, and return on sales are used to determine profitability as a dependent variable. Sales income is essential for businesses to create cash flow to pay short-term obligations and invest in company assets. Lee (2009), and Dogan (2013) conducted studies on the effect of firm size on firm performance that completely ignored other potential firm characteristics that have an effect on firm financial performance, such as board size, and did not consider agriculture and healthcare industries as part of the manufacturing sector. In their studies of the relationship between board size and business performance, Yermack (1996) and Pacini, Hillison, and Marlett (2008) overlooked other crucial firm variables such as firm age and leverage. It goes without saying that they did not look into the agricultural or healthcare businesses. The purpose of this research is to see if there is a link between revenue growth and Tobin's Q among Nigerian quoted industrial enterprises.

Review of Related Literature

Revenue Growth and Financial Performance

Revenue measurement is essential for determining your company's profitability. The profit ratio, which is the most popular metric of profitability, is calculated by dividing net income by sales revenue. This indicator will show you how much of every naira in sales ends up in the bank account. Any company that does not sell enough of its goods will go out of business. Profitability is defined as a portion of a company's benefit accrued in the normal course of operations. It is defined as profit generation based on Weetman's comparative metric (2006).

Decline over time, or that it has reached a halt, over one or more fiscal periods (Jean, 2017). Financial Performance is a bit of a mixed bag. As an example,

$$\text{Revenue Growth} = \frac{\text{Current Year Revenue} - \text{Prior Year Revenue}}{\text{Prior Year Revenue}}$$

Corporate executives generally face the dilemma between pursuing growth and profitability. If companies are obsessed with short-term profit-oriented performance, they will settle for past successes and thus be unable to respond to market conditions, thereby falling into a success trap. On the other hand, if they are devoted to innovation only in the long term, they will fall into a failure trap, jeopardizing corporate survival. In this respect, corporate executives use a short-term profit-oriented management strategy rather than pursuing growth (Choi, Yoo, Kim & Kim, 2014). A profit-oriented management strategy can increase corporate resilience in a short-term recession. On the other hand, in a long-term recession, profitability is reduced due to the continued decline of market demand. Accordingly, executives attempt to reduce costs, sell assets, and downsize, ultimately reducing the firm size.

However, the growth-oriented corporate strategy focuses on innovation that can increase the growth potential in the long term. Such a strategy is known to have a positive effect not only on corporate profitability but also on the company's survival in the long term. Although maintaining a high profit without growth is very difficult, growth is a crucial means for future value creation (Lee, 2014). Additionally, the growth of the firm promotes the development and survival of not just the firm itself but also that of the national economy. Given the fact that the growth-oriented corporate strategy expands employment and income, it has become the main focus of policy-makers.

Several empirical investigations on the relationship between revenue growth and financial performance have yielded varied results. Venkatraman and Ramanujam (2016); Tan, Kannan, and Narasimhan (2017), for example, discovered a positive association between revenue growth and financial performance, whereas Rao and Holt (2015) found the opposite.

Tobin's

The Tobin's Q is a ratio established by Nicholas Kaldor in 1966 and popularized by Nobel Laureate in Economics James Tobin of Yale University in New Haven, Connecticut, who postulated that the combined market value of all companies on the stock market should be nearly equal to their replacement costs. Q ratio is calculated as the market value of a company divided by the replacement value of the firm's assets.

$$\text{Q Ratio} = \frac{\text{Total Market Value of Firm}}{\text{Total Asset Value}}$$

For example, a low Q (between 0 and 1) means that the cost to replace a firm's assets is greater than the value of its stock. This implies that the stock is undervalued. Conversely, a high Q (greater than 1) implies that a firm's stock is more expensive than the replacement cost of its assets, which implies that the stock is overvalued. This measure of stock valuation is the driving factor behind investment decisions in Tobin's model (Farlex 2012 in Amahalu & Ezechukwu, 2017).

The formula for Tobin's Q ratio takes the total market value of the firm and divides it by the total asset value of the firm. For example, assume that a company has N35 million in assets. It also has 10 million shares outstanding that are trading for N4 a share. In this example, the Tobin's Q ratio would be:

Tobin's Q ratio = total market value of firm / total asset value of firm = N40,000,000 / N35,000,000 = 1.14.

An undervalued company, one with a ratio of less than one, would be attractive to corporate raiders or potential purchasers, as they may want to purchase the firm instead of creating a similar company. This would likely result in increased interest in the company, which would increase its stock price, which would in turn increase its Tobin's Q ratio. As for overvalued companies, those with a ratio higher than one, they may see increased competition. A ratio higher than one indicates that a firm is earning a rate higher than its replacement cost, which would cause individuals or other companies to create similar types of businesses to capture some of the profits. This would lower the existing firm's market shares, reduce its market price and cause its Tobin's Q ratio to fall (Bhagat & Black, 2002).

A high Tobin's Q is synonymous with high return on Assets (ROA), Maximizing Tobin's Q is the same as maximizing Return on Asset. So Tobin's Q can be used as a measure of a firm's financial performance, because it can represent Return on Assets (ROA). Tobin's Q can be used as an indicator of a firm's economic viability.

Empirical studies

Suntraruk (2013) looked at the link between effective corporate governance and the characteristics of listed companies in Thailand's Market for Alternative Investment (MAI). The results of this study demonstrated that effective corporate governance is significantly associated to return on assets (ROA) and free cash flow using logistic regression analysis.

Because these two variables reflect a firm's profitability, it was determined that well-governed enterprises are more profitable than poorly-governed firms. Abazi-Alili (2013) used firm-level data on sixty (60) privatized enterprises in Macedonia from 2001 to 2010 to investigate the relationship between ownership evolution, innovation activities, and firm performance. The main contribution of this empirical work is the application of new and advanced econometric techniques to the analysis of changes in performance due to changes in ownership in Macedonia, such as the two-step Generalized Method of Moments (GMM) kernel and enhanced Continuous Updated Estimation (CUE) (GMM) estimations. From 2008 to 2012, Khaled, Abdulkareem, Chew, and Mohammad (2014) provided empirical evidence of the impact of firm specific features on corporate financial disclosures in UAE companies. The association between the characteristics of UAE enterprises and the level of their financial disclosure was investigated using descriptive statistics and multiple regression models. The findings of this study reveal that the level of disclosure is highly related to the listing status, industry type, and business size. Bassiouny, Soliman and Ragab (2016) assessed the impact of firm characteristics on earnings management of the listed firms in Egypt. It selects the 50 most active firms in the Egyptian stock exchange and the analysis is done using the financial statements from the disclosure book for the period 2007-2011. The tests for this research were done using the random effect generalized least square regression model using the stata program. Findings found that there is a significant positive relationship between firms' financial leverage and earnings management while other variables of the firm characteristics which are firm size, firm age and firms' audit quality have an insignificant relationship with earnings management. Achoki, Kule and Shukla (2016) investigated the effect of voluntary disclosure on the financial performance of commercial banks in Rwanda for the period 2011 to 2015. This study adopted a descriptive research design. Data was collected through developing a disclosure index consisting of 47 disclosure items. Data was analyzed using a multiple linear regression model. Results revealed that a strong relationship exist between the voluntary disclosure, firm size and financial performance. The study found a positive relationship between financial, forward looking and board and social disclosure and return on equity. Carlos, Andreea and Juan (2017) studied the relationship between social and environmental performance and financial performance in companies from 2007-2016. The research employed the fuzzy-set qualitative comparative analysis (fsQCA) and offers new evidence on the relationship between both types of performance in a sample of companies listed in the Spanish capital market. Financial performance is measured by the return on equity (ROE) ratio, variable that is widely used in Finance and Accounting related research. The results suggest that, for specific industries, return on assets is a necessary condition for companies with leverage to reduce the cost of debt due to their sustainability profile and consequently boost their ROE. Mohammed, Aminu, Rahama, and Murtala (2015) conducted an empirical study of the factors that influence company performance in developing nations. It also uncovered a number of characteristics or elements that influence or affect the success of businesses in developing countries. The majority of the empirical studies assessed use Ordinary Least Square (OLS) as a data analysis method, and the majority of the studies do not state their sample size, data collection method, or the theory or ideas that underpin and guide their research. The findings of the articles evaluated range from good to negative, with some having both positive and bad outcomes. The results of the regression analysis are demonstrating that the alternative hypothesis of the research that firm size has moderating inspiration between independent variable (Firm growth) and dependent variable (Firm performance) is accepted. The influence of Total Quality Management on deposit money bank performance in Nigeria was studied by Ezenyilimba, Ezejiofor, and Afodigbueokwu (2019). The data was obtained through questionnaires and presented in a tabular format, with the t-test performed using the Statistical Package for Social Science (SPSS) version 20.0. The

results show that total quality management practices affect customer satisfaction in Nigerian deposit money banks, as well as total quality management practices affect customer loyalty in Nigerian deposit money banks, and that total quality management practices affect customer satisfaction in Nigerian deposit money banks.

The existing literature on the association between firm characteristics and financial performance yields mixed results. Some researchers suggest that there is a positive association (Majumdar, 1997; Ezechukwu & Amahalu, 2017), while others argue that firm characteristics have a detrimental impact on firm performance (Majumdar, 1997; Ezechukwu & Amahalu, 2017; Banchuenvijit, 2012; Kristiansen et al., 2003; and Islam et al., (2011) both believe that business size has a beneficial effect on firm performance. According to Kanyuru (2010) and Ondiek (2010), leverage has a detrimental impact on company performance. As seen in the fintech industry, current liquidity is projected to have a beneficial impact on business performance. Chogii (2009) found that board size had a detrimental impact on business performance. Majumdar (1997), Nunes, Serrasqueiro and Sequeira (2009), Lee (2009), and Dogan (2013) conducted studies on the effect of firm size on firm performance that completely ignored other potential firm characteristics that have an effect on firm financial performance, such as board size, and did not consider agriculture and healthcare industries as part of the manufacturing sector. In their studies of the relationship between board size and business performance, Yermack (1996) and Pacini, Hillison, and Marlett (2008) overlooked other crucial firm variables such as firm age and leverage. It goes without saying that they did not look into the agricultural or healthcare businesses.

Methodology

Research Design

Ex-post facto research design was employed in obtaining, analyzing and interpreting the relevant data for hypotheses testing since the study utilized secondary data. The data sets employed in this study were generated from Nigeria Stock Exchange fact books and annual reports and statement of accounts of quoted manufacturing firms in Nigeria.

Population and Sample Size

Purposive sampling method was employed in selecting twenty-three (23) manufacturing companies, which serve as the sample size of this study. The criteria for selection was based on firms that were quoted as at 2010 and still subsist till 31st December, 2019; firms whose annual reports and account are available and complete for the studied period; firms that consistently file their annual reports and statement of accounts with NSE for the studied period (without missing any year).

- i. Revenue Growth (RVG) = $\left[\frac{\text{current year's revenues} - \text{last year's revenues}}{\text{last year's revenues}} \right] \times 100\%$

RVG is the most traditional measure that indicates the growth of an organization. RVG measures the changes in firm's revenues. Increase in revenue usually signal firm's opportunities for growth.

Control Variables

- i. Dividend Payout Ratio (DPR):

This provides an indication of how much money a company is returning to shareholders versus how much it is keeping on hand to reinvest in growth, pay off debt, or add to cash reserves (retained earnings). The dividend payout ratio can be calculated as the yearly

dividend per share divided by the earnings per share, or equivalently, the dividends divided by net income (as shown below):

$$\text{DPR} = \frac{\text{Yearly Dividend per Share}}{\text{Earnings per Share}}$$

i. Current Ratio (CUR):

The current ratio is a liquidity ratio that measures a company's ability to pay short-term and long-term obligations. To gauge this ability, the current ratio considers the current total assets of a company (both liquid and illiquid) relative to that company's current total liabilities. The formula for calculating a company's current ratio is:

$$\text{Current Ratio} = \text{Current Assets} / \text{Current Liabilities}$$

Technique for Data Analysis

To obtain the observed values on the expectation of the effect of firm characteristics on financial performance, panel data surveyed for ten (10) years' period (2010-2019) was employed. Panel data structure allows us to take into account the unobservable and constant heterogeneity, that is, the specific features of each quoted firm. The data analysis shall cover the descriptive and inferential statistics via E-Views 9.0 statistical software. The study employed Granger causality test to ascertain the direction and strength of relationship between the variables of this study.

Model Specification

This study adopted the research model used by Ezechukwu and Amahalu (2017). The difference between this model and their model is that their model (Ezechukwu and Amahalu) did not consider non-financial firm characteristics (such as board size and firm age) to assess their effect on firm financial performance, but this model considered both.

The research model is:

$$\text{TQ}_{it} = \beta_0 + \beta_1(\text{LEV})_{it} + \theta(\text{Ln Total Asset})_{it} + E_{it}$$

Therefore, to determine the effect of firm characteristics on financial performance, the following multivariate linear regression models were estimated:

$$\text{Model: } \text{TQ}_{it} = \beta_0 + \beta_1 \text{RVG}_{it} + \beta_2 \text{DPR}_{it} + \beta_3 \text{CUR}_{it} + \epsilon_{it}$$

Where:

β_0 = Constant (intercept)

β_1, β_2 , = Coefficients of explanatory variables

TQ_{it} = Tobin's Q of firm i in period t

RVG_{it} = Revenue Growth of firm i in period t

DPR_{it} = Dividend Payout of firm i in period t

CUR_{it} = Current Ratio of firm i in period t

ϵ_{it} = Error term.

Decision Rule

The significance of the model was tested at 95 percent confidence level. The p-value of the F-statistic will be used in determining the robustness of the model. In other word, when the p-value is less than 0.05, it will be inferred that the model is significant.

Test of Hypothesis

Ho: There is no significant relationship between Revenue Growth and Tobin's Q of quoted manufacturing firms in Nigeria.

H₁: There is significant relationship between Revenue Growth and Tobin's Q of quoted manufacturing firms in Nigeria.

Table 1: Panel Least Regression Analysis between Revenue Growth and Tobin's Q
 Dependent Variable: TQ

Method: Panel Least Squares
 Date: 04/23/21 Time: 15:14
 Sample: 2010 2019
 Periods included: 10
 Cross-sections included: 23
 Total panel (balanced) observations: 230

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0.119144	0.013815	8.624358	0.0000
RVG	0.023569	0.036207	4.650954	0.0001
DPR	0.017492	0.000687	0.118933	0.9054
CUR	0.001777	0.014230	0.124849	0.9008
R-squared	0.432006	Mean dependent var		0.115678
Adjusted R-squared	0.411241	S.D. dependent var		0.104976
S.E. of regression	0.105564	Akaike info criterion		-1.641756
Sum squared resid	2.518501	Schwarz criterion		-1.581963
Log likelihood	192.8019	Hannan-Quinn criter.		-1.617637
F-statistic	7.151441	Durbin-Watson stat		1.315022
Prob(F-statistic)	0.007688			

Source: E-Views 9.0 Panel Regression Output, 2021

Interpretation of Multivariate Regression Analysis

From table 1, it can be seen that the adjusted R² (co-efficient of determination) is 41.1%, meaning that the predictors in the model (Revenue Growth, Dividend Payout Ratio and Current Ratio) can only explain the variation of Tobin's Q by only 41.1%. The model cannot explain a variation of 58.9% in Tobin's Q because there are other variables which are responsible for explaining the 58.9% variation which are not currently in the model. Since the Durbin-Watson is 1.315022 which is less than 2 on the autocorrelation region, then, there was no evidence for autocorrelation in the data.

From table 1, the various coefficients are shown with an intercept of 0.119 which shows that if all the three predictors (revenue growth, dividend payout ratio and current ratio) were to be equated to zero then Tobin's Q will be 0.119. The beta coefficient for revenue growth is; $\beta_1 = 0.024$ which implies that if the growth of revenue of the firm were to be increased by 1 unit of then a corresponding increase of Tobin's Q by 0.024 will increase too. Same thing for an increase in one unit of dividend payout ratio and current ratio will translate to 0.017 and 0.002 increase in Tobin's Q.

The resulting multivariate linear regression model is as follows:

$$TQ = 0.119144 + 0.023569RVG + 0.017492DPR + 0.001777CUR + \mu$$

From the regression result in table 1, there is a statistically significance fit of the overall model since the Prob(F-statistic) of 0.007688 is less than the critical value ($\alpha = 0.05$) at 5%. Hence the overall model is fit for forecasting with a confidence level of 95%.

Decision

Since the P-Value of the test at 0.007688 is less than 0.05, therefore, the alternative hypothesis was accepted which hypothesized that, there is a significant positive relationship between Revenue Growth and Tobin's Q of quoted manufacturing firms in Nigeria at 5% level of significance.

Table 2: Granger Causality Test showing the Causality between Revenue Growth and Tobin's Q

Pairwise Granger Causality Tests

Date: 04/23/21 Time: 15:23

Sample: 2010 2019

Lags: 2

Null Hypothesis:	Obs	F-Statistic	Prob.
RVG does not Granger Cause TQ	184	10.2656	6.E-05
TQ does not Granger Cause RVG		1.23087	0.2945

Source: E-Views 9.0 Causality Output, 2018

Interpretation of Diagnostic Test

Table 2 indicates that there is a unilateral causality between revenue growth and Tobin's Q, since the causality only runs from revenue growth to Tobin's Q at two (2) lags with a F-Statistic =10.2656 and associated P-value = 0.0000, thereby buttressing the fact that, there is a statistically significant relationship between revenue growth and Tobin's Q of quoted manufacturing firms in Nigeria at 5% level of significance.

Conclusion and Recommendation

Tables 1 to 2 exhibit the regression results for the association between company characteristics and financial performance of quoted manufacturing firms in Nigeria. The Tobin's Q results for the hypothesis showed that if all three predictors (revenue growth, dividend payout ratio, and current ratio) were equated to zero, Tobin's Q would be 0.119. The beta coefficient for revenue growth is $1=0.024$, which means that if the firm's revenue growth is increased by 1 unit, Tobin's Q will also increase by 0.024. Same thing for an increase in one unit of dividend payout ratio and current ratio will translate to 0.017 and 0.002 increase in Tobin's Q. The result of this study is in line with the works of Ezechukwu and Amahalu (2017), Achoki, Kule and Shukla (2016), Raza and Mohsin (2011) but opposes the findings of Bassiouny, Soliman and Ragab (2016), Islam, Khan, Obaidullah and Alam (2011).

There was no evidence for autocorrelation in the data when the Durbin-Watson for the regression results of Tobin's Q model in hypothesis is 1.320784, which is less than 2 on the autocorrelation area. According to table 2 the firm size beta coefficient is $1=0.017$, which means that if the size of the firm is increased by 1 unit of natural logarithm of assets, Tobin's Q will also increase by 0.017. When the dividend payout ratio and current ratio are both increased by one unit, Tobin's Q falls by 0.001 and 0.001 respectively. The whole model has a statistically significant fit based on the regression result in table 1, since the Prob(F-statistic) of 0.000011 is less than the critical value ($\alpha =0.05$) at 5%. Hence the overall model is fit for forecasting with a confidence level of 95%.

The findings of this study support the works of Bassiouny, Soliman and Ragab (2016), Ezechukwu and Amahalu (2017). These studies provided evidence that firm characteristics have a positive relationship with financial performance. On the other hand, the findings of this study negate the works of Achoki, Kule and Shukla (2016), Mutende, Mwangi, Njihia

and Ochieng (2017). These studies documented that leverage and board size has a positive relationship with financial performance.

According to the report, manufacturing companies should aim to keep their working capital positive by offering credit to their customers, who account for almost half of their asset structure, and they should also try to lower their current liability component by paying suppliers on time.

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