THE RELATIONSHIP BETWEEN FIRM AGE AND FINANCIAL PERFORMANCE IN NIGERIA:
A PANEL ANALYSIS

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ABSTRACT

Aging of firms slackens performance related sustainability and renewal strategies can be basis whereby managers apply learning from firms' experiences. This study examined the relationship between firm age and financial performance using a pooled and disaggregated dataset for manufacturing industries in Nigeria. Manager's views about the studied variables complemented findings of the secondary data analysed. An inverse relationship was found existing between firm age and financial performance for the panel dataset and heterogeneity defined the nature of the age-performance relationship. Also, managers do not vary in their views on the nature of firm age influence on financial performance. The study concluded that sustainable development can be fostered through managerial practices for resources and capability renewals processes at firm level in Nigeria.

Keywords: Manufacturing Firms, Firm Age, Financial Performance, Resources and Capabilities

BACKGROUND TO THE STUDY

Firms' attributes comprising heterogeneous resources and capabilities create differentials of strategy, strategic choices and profitability levels. Since no two firms are exactly the same in quality and quantity of resources and capabilities, it follows that no two firms can enact equal performance: efficiency and effectiveness. Strategy is firm-environment fit: firm-internal environment fit and/or firm-external environment fit. Crucial to strategising is managerial ability to sustain context consistency with strategic thinking and action towards improving future performances.

Resources and capabilities are embedded in historical antecedents. There is an emergent nature of organisational resources and capability. What is a prevailing organisational context is offshoot of past decisions, deliberate actions and choices influenced interpretation of situational variables by past key decision makers. Each firm has a distinction in experiences accumulated with the passage of time. Experiences are learned, accumulated knowledge and skills. It may serve either positive uses or hinder the growth and future profitability of the firm.

Firms are comparable with organic entities. They have a life cycle of transformations. Each stage has unique features relative to performance. At birth, or early stages, good state of physical capability confers firms with strategic advantages. Physical resource base of plants and equipments, production technology and zeal or passion to satisfy stakeholders or capture unexplored grounds in product-factor market arenas can be exploited through niche strategising efforts. Age increases leads to gained experiences, but physical infrastructures declines in value with passage of time contributing less rents which may extend to negative sometime in the future. Experience gained over time may be 'routinized' or settled in, causing inertia, resistance to change and irreversible and irrecoverable sunk cost. In relation to age, the growth in a firm's profitability is finite; a peak is attained at some point, strategic advantages get exhausted, and a firm may ossify thereafter. The age of Nigerian manufacturing firms differ and their performance differs notwithstanding similarity of industry. The country is faced with a serious economic challenge of low manufacturing performance (Soderbom & Teal, 2002). The sustainable utilization of the nation's massive natural resources endowments clearly bears on the economics associated with its manufacturing sector as engine room for employment generation, growth in export prospects and even competitiveness. Social instability is rife in Nigeria relative to what is found in her less endowed neighbour. It is critical to management scholars, policy makers and practitioners that the nature of link between specific strategic factors with performance is found with a view to overcoming constrain to enhance economic growth.

Statement of the Problem

The firm's constituents are like its building blocks and the basic elements that determine survival, failure, rise or decline (Barney, 2001). Firms accumulate and develop resources and capability at varying pace or speed. The age of a firm influences the quality and quantity of resources embedded in it. In an organic sense, firms may grow old over time. Firms' performance is therefore comparable to outcome of activities in living species. Is it the case that as a firm grows older, its capacity to achieve its purpose and objectives sags? At early periods, biological species are dependent; mid-age coincides with prime capability and at old age, frailty sets in culminating in expiration. Does the growth path of living organisms correspond with that of the business firms' performance?

Firms may experience their best performance at old age and during their early periods they may also have better capability than later on. Firms are capable of being reinvented or reincarnated. With restructuring and redesign interventions, businesses growth trajectories are refocused. Do Nigerian firms' ages influence their performance?

Objectives of the Study

In general terms, this study is aimed at determining the relationship between the age of firms and their financial performance. Related to this broad objective are the following specific objectives:

I.   determine whether older firms achieve higher returns on invested capital than newer ones;

II.   examine the relationship between firm age and returns on invested capital for firms in different industry; and,

III.   examine the covariance of firm size in the relationship between firm age and returns on invested capital.

REVIEW OF RELATED LITERATURE

Conceptual Framework:

The basic constituents of a firm are its resources and capabilities (David, 2009). In combining resources routines are developed. This distinguishes one firm from another and gives each a characteristic distinctiveness that underlies performance differentials (Teece, 2007). Firms with high grade resources and specialised skills to combine them may attain strategic dominance (Mintzberg 1986). Resources such as plants and equipments; organisational resources; financial resources; human resources and locations are the building blocks of firms (Hills & Jones 2009).

The organisational resources comprise the structure, context, systems for rewards and sanctions, management styles, dominant worldview or culture and leadership. Similarity of structure, rewards and management styles generates strategic parity. Firms can be deliberate in differentiating along dimensions of these variables to gain strategic advantages in products as well as factor markets. Capability is identified as the specialised routines for integrating resources that confers strategic competitive advantage on firms (Barney & Wrights 1998; Barney 2001). Age of a firm is its accumulated experience and is reflective of learning (Olumide 2010). It is the continuous length of time often in years that a firm has being in its current business from when: 1) it was incorporated or 2) it was listed for listed companies. As firms grow older, their capability to perform declines. In biology terms, an increase in age of an organism causes aging which is conditions associated with declining functioning of the body. This may occur due to rigidity, inertia and lose of capability for renewal (Loderer & Waelchli 2009). Firm performance is a measure of how well a firm achieves its predetermined objectives or serves its purpose. A performing firm minimizes adverse consequences on the desire for sustainable development involving environmental regeneration and ethical considerations in the use of nature's factors in production processes. Inefficiencies which poor performance implies translates to energy losses, decays and deterioration often found with collapsed manufacturing businesses that deface the environment and challenges sustainability considerations. Financial performance is quantitative expression of goal attainment using financial variables or balance sheet items (Kazmi, 2008).

Theoretical Framework:

The theory of strategic management is deemed appropriate in this study as the attempt is to link strategic variables: firm age and performance. This theory holds that strategic decision making processes and outcomes are determinants of the future performance of any firm (Prevos 2005). There is a performance claim in strategy that any firm which desires to attain positioning of superior competitiveness must approach its planning and control activities from a strategic perspective, in that there is 'a future consequence of present action' and that today's choices manifest as future success or failure. Within strategic management are two streams or theoretical framework: the resource based view and the industrial organisation theory. The resource based stream posits that firms that leverage their resources and capabilities, building and accumulating

them to become valuable, scarce or rare and non-substitutable achieve sustainable competitive advantage (Hills & Jones, 2008).

Age is an element of organisational resources and capability (Ural & Acaravci, 2006). It therefore falls within scope of theorised relationship between firm resources and sustainability of competitive advantage. A firm begins to age from inception. However, firm's experience renewal and performance may increase following such interventions. The aging process can be altered, the firm support systems can be reinvigorated and a new lease of life introduced. These processes fall within two theoretical frameworks: namely, organisational learning (Armstrong, 2000) and organisational development (Cole, 2002). Invariably, the organisational approach is deemed most valid theoretical anchor for this study. Its main postulations are that the context established by structure, formal and informal relationships, span of control, systems, management styles and culture combine to create contexts which varies human performance and in aggregate varies firm performance (Litwin & Stringer, 1968). This complements the resource based view which holds that firms that have resources and capability that are of high value, rare or scarce and non-substitutable achieve sustained competitive advantage (Barney, 2001).

Empirical Framework:

Barney (2001) submits that characteristically, previous studies using the RBV logic specify firm attributes in relation to performance. Among empirical works that confirmed the dominance of firm effects which Rumelt's (1991) inspired are McMahan & Porter (1997); Mauri & Michaels (1998); Powel (1996); Roquebert, Philips & Westfall (1996); Brush, Bromiley & Hendrickx (1999). Mauri & Michaels (1998) found industry effects as main source of variance in the heterogeneity of marketing strategies and R&D (research and development) strategies. However the variance in ROA (returns on assets), which was the performance proxy of sampled firms, confirmed the claims of the resource based view as follows: 36.9 per cent to 6.2 per cent and 25.4 per cent to 5.8 per cent for firm- and industry-effects respectively for 5-years and 15-years periods.

Ural & Acaravci (2006) examined the relationship between specific firm strategic factors e.g. age, size, capital intensity and labour intensity and financial performance of quoted Turkey's manufacturing firms. Vlachvier & Notta (2008) empirically examined firm growth, size and age relationships in a study aimed to confirm Gilbrat's law of proportionate effect. Evans (1987) found that firms grow at rates which decrease with age at a diminishing pace. Dunne, Roberts and Samuelson (1989) had taken the view that firm life expectancy increased with age as only better firms survive, a view empirically verified by Baker & Kennedy (2002). Pastor & Veronesi (2003) reported that profitability and market-to-book ratios decline with firm age, related to investors learning and decline in uncertainty. Variability of stock returns is found to negatively relate with incorporation age (Adams, Almeida & Ferreira, 2005) and with listing age (Cheng, 2008). Chun, Kim, Morck & Yeung (2008) found that the probability of a firm dropping out of the industry's top quartile in the sample distribution of sales increases with age. Firm growth should slow with age (Oliviera & Fortunato, 2006), since older firms have passed minimum efficiency scale of production (Robson & Benneti, 2000).

METHODOLOGY

Documentary evidence concerning age and financial performance of randomly selected manufacturing firms were generated and used. The firms in the survey are all quoted in the Nigerian Stock Exchange Market and are listed in respective sectors in the fact-books which allowed for firm-age and performance (ROIC) match.

Measurements:

The study variables, firm age and returns on invested capital (ROIC) are specified and measured as follows:

From the multiplicity of approaches to performance measurement this study used returns on invested capital. The ease of computation and its wide acceptability in the literature informed this choice. Data for the variable was collected for the entire time and cross sectional scope of the study. The variable was required to resolve the issues pertinent to research objectives one and two on the expected relationship between firm strategic factors and performance.

Computation led to deriving returns on invested capital (ROIC) using equation 1. This was applied for the entire spread and time period i.e. five years. The variables for the parameter include net operating profit after tax and the total assets of each of the firms.

$$ROIC = \frac{NOPAT}{TA}$$ ....equation 1

NOPAT = Net Operating Profit after Tax.

TA= Total Assets.

Firm Age

Experience and learning is a function of duration a firm had been in same or related businesses. For listed firms, relevant duration is period since incorporation or since listing. Firm's age uniqueness shapes managers' risks and decision making dispositions respectively especially under conditions of uncertainty, and fast paced change. Invariably research and development spending, decisions on new projects investments, human resources development and ultimately future performance are affected by age related factors. An assumption in this work is that firm age uniqueness affects resources and capabilities and inadvertently determines the returns on investments over time. This is a critical factor in attainment of sustainable development as only profitable firms would be positioned to exhibit considerations to protect the environment and to use resources from it mindful of the needs of the future.

While old firms may have developed time test capability to wisely block new entrants and sustain first movers' advantage, new firms may have advantages since they are not clobbered with untradeable resources. Inertia increases with age and it is expected that older firms would incur more overheads and exhibit costly corporate governance behaviours (large board sizes). In this study, firm age was delineated by subtracting year of incorporation from each sequential year in the study.

Hypothesis:

The following testable postulations were formulated and assessed:

    i.   firm age has no significant effect on returns on invested capital;

    ii.   firm age effect on returns on invested capital is not variable with industry; and,

    iii.   firm size is not a covariant in firm age and returns on invested capital relationship.

Population and Sample of the Study

The quoted manufacturing firms in Nigeria constitute the population of the study. The Nigerian Stock Exchange market listed 119 (One Hundred and Nineteen) manufacturing firms categorised into 16 sectors. This list was the sampling frame containing all firms that operated in the study period. The firms are all single-business or multi-businesses firms with

component(s) of operations in the transformation of inputs, raw materials, components and parts, and human creativity into goods i.e. tangible products that are domestic or industrial consumables.

The resources and capabilities of these 119 firms are the inputs, partially finished products (works in progress) that are converted to finished products in production processes. Resources and capabilities distinguish the firms from each other and form arrays considered in delineating the population of this study. Resources, capabilities and performances of the firms are people and teams, managerial structures and systems, technology which are allocated and used in the production process, value sets, sub-cultures and dominant cultures, tacit knowledge and collective minds (memory systems) etc. The gamuts of internal factors that determine the performance of the manufacturing industry in Nigeria are in the range of the population characteristics.

Out of the 16 sectors that were represented in the study frame, 8 were randomly selected. Subsequently, judgemental technique yielded a sample of 30 firms from the 8 sectors. This is justified by adequate representativeness of each firm in the variables of the study on grounds of all being quoted firms and having dominance of manufacturing operations. Financial data for 30 firms spanning the period of five years and cutting across eight industries were obtained.

Study Model

Generic linear regression model for panel data analyses involving a dependent and independent variable which is appropriate for this study is expressed as follows

$$y_{it} = \beta_i x_{it} + \alpha_i + \varepsilon_{it}$$ ....equation 2

For this study, y_{it} i.e. dependent variable symbolize returns on invested capital in time (*i*) and cross sectional (*t*) dimensions respectively; x_{it} i.e. independent variable symbolizes age of the firms from date of listing in the stock exchange in time (*i*) and cross sectional (*t*) dimensions respectively. β_i is the coefficient of the independent variable which is the slope of the relationship. Its value indicates the rate of change in the independent variable which is caused by a change in the dependent variable. α_i is the intercept of the line equation on the y axis. Lastly, ε_{it} specifies the error terms or the unexplained effect that may affect the variation of returns on invested capital which is not as a result of the changes in age of the firm. It is anticipated that change in firm size could influence the relationship between firm age and returns on invested capital. Hence an appropriate model that specifies the effects anticipated in the study is as follows:

$$y_{it} = \beta_i x_{it} + \beta_{2i} x_{2it} + \alpha_i + \varepsilon_{it}$$ ....equation 3

β_{2i} represent the coefficient of the size effect which was treated as a control variable and x_{2it} is size of the studied firms (*i*) and the time (*t*) spread dimension.

RESULTS

Returns on Invested Capital:

An analysis of the returns on invested capital (performance) of the studied firms shows some variability. This aligns with resource based logic that firms' performance is heterogeneous presumably due to heterogeneity of resources and capability. It was observed that no two firms have the same level of performance irrespective of the industry and period of time studied.

This may proof that the firms are unique in productive assets and the capability to harness economic rents from the use of common industry strategic factors. Table 1 shows the list of Returns on Invested Capital for the subjects.

Table 1: Mean Returns on Invested Capital for Manufacturing Firms

FIRM	RETURNS (MEAN)	POSITIVE/NEGATIVE
001B	-0.108	Negative
002B	-0.048	"
003B	0.018	Positive
004B	0.038	"
005C	0.058	"
006C	0.23	"
007C	-0.12	Negative
008ID	0.006	"
009ID	0.064	Positive
010ID	-0.108	Negative
011ID	-0.048	"
012ID	0.018	Positive
013PC	0.038	"
014PC	0.186	"
015P	0.068	"
016P	-0.136	Negative
017P	0.046	Positive
018P	0.166	"
019P	0.108	"
020P	0.054	"
021Cn	-0.002	Negative
022Cn	0.06	Positive
023Cn	0.138	"
024F	0.064	"
025F	0.038	"
026F	0.014	"
027F	0.052	"
028Pa	0.04	"
029Pa	0.076	"
030A	-0.018	Negative

Source: Researchers' Compilation 2013

Eight (8) of the firms recorded negative average returns and twenty two (22), positive average returns. A cement maker recorded highest returns on invested capital among the studied firms. It achieved impressive return on invested capital i.e. 23% within the years studied. A Chemical & Allied Producer was next highest returns on invested capital (18.6%). And a

firm in the healthcare sector (16.6%) followed. The return on invested capital for a brewer was negative (-10.8%) and the lowest for the studied firms. In the time series, aggregate least performance was recorded in 2004 and highest in 2007. A growth of approximately 58% in the returns on invested capital occurred between 2003 and 2007. Composite returns of the thirty firms in the study dropped to negative in 2004. This lack of symmetry in the performance over the year dimension suggests some element of year effect on performance.
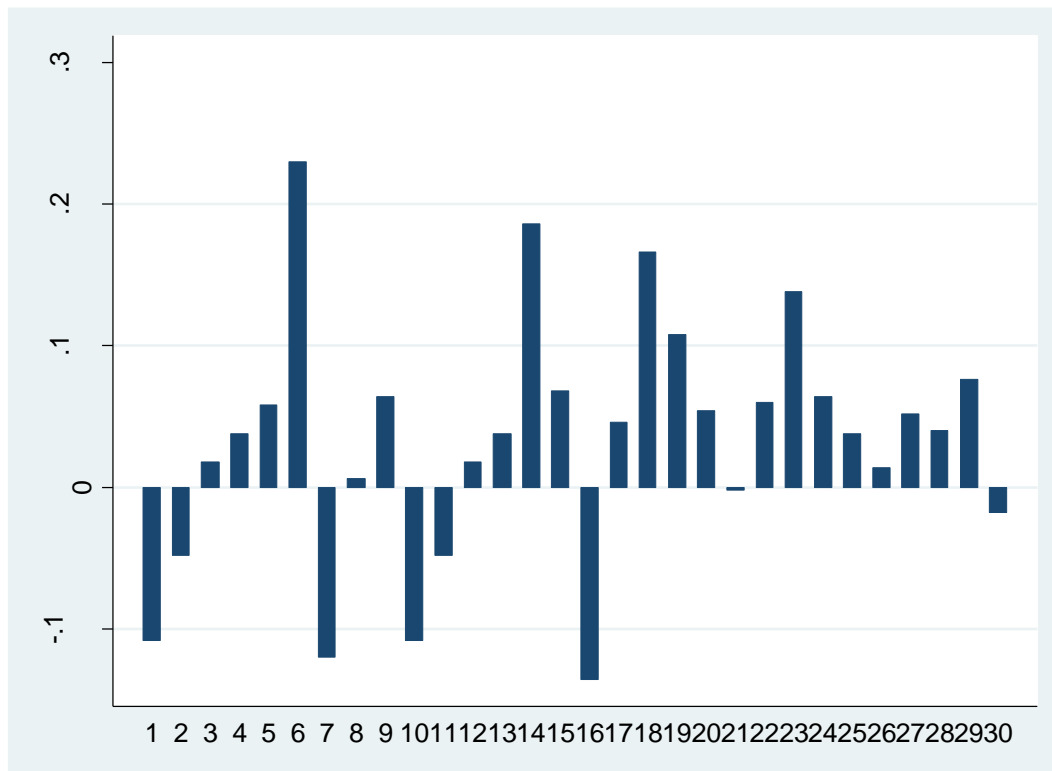
Chart 1:

Figure 1 depicts returns on invested capital for the 30 firms comprised in the cross-section. The figure clearly depicts only one firm recorded above 20% returns on invested capital; five firms were above 10% and the highest concentration of returns on invested capital of the firms hovered between 0% and less than 1%. The time or year dimension is depicted next as figure 2.

Chart 2
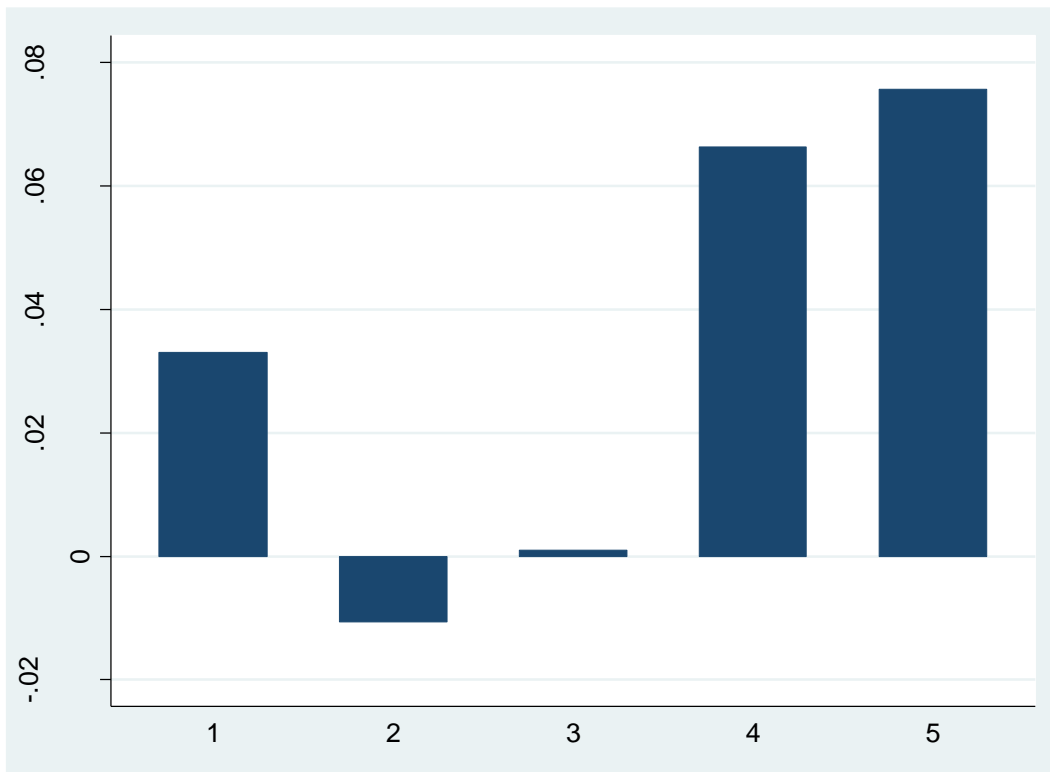
The performance in each year clearly differs. However, those of years 4 and 5 appeared to resemble. The shape drop observed for year 2 (2004) may not be unconnected with the lull occasioned by political uncertainties for that period. The massive recovery between years 3(2005) and 4 (2006) confirms that investors confidence and consumers' behaviour had altered remarkably following the election induced inactivity.

Age of firms

The age of firms were assessed as a heterogeneous factor that could influence the strategic choices managers make and therefore its contribution to sustainable development. Collective learning and experience may differentiate firms' capability to harness resources and take advantages embedded in the operating context. Table 2 provides a representation of average age of the firms involved in the study. Equally figure 3 depicts cross sectional casting of the age of the firms in the study.

Table 2: Mean Value of Firm Ages

FIRM	CAPITAL INTENSITY	RANK
001B	1.82	1st
002B	1.74	4th
003B	1.53	24th
004B	1.52	26th
005C	1.56	21st
006C	1.48	28th
007C	1.5	27th
008ID	1.65	10th
009ID	1.63	16th
010ID	1.65	10th
011ID	1.65	10th
012ID	1.65	10th
013PC	1.66	8th
014PC	1.59	19th
015P	1.68	7th
016P	1.55	22nd
017P	1.7	6th
018P	0.96	30th
019P	1.53	24th
020P	1.79	2nd
021Cn	1.55	22nd
022Cn	1.75	3rd
023Cn	1.64	15th
024F	1.66	8th
025F	1.65	10th
026F	1.59	19th
027F	1.73	5th
028Pa	1.618	18th
029Pa	1.48	28th
030A	1.62	17th

Source: Authors' Compilation 2013

The average age for all the firms had indexed value 1.607.

The absence of symmetry in the distribution is obvious from the figure. The distribution is discontinuous which signifies heterogeneity of age and therefore experience effect on returns on invested capital.

Panel Regression Result

The result of the panel regression suggests that as firm age increases for the pooled data, the returns on invested capital drops. That is there is an inverse effect of firm age on the performance of the manufacturing firms when the data is not disaggregated along industry lines. About 35 % of the variation in the returns on invested capital is found to be caused by age variation of the data set. The remaining 65 % are unexplained effects (see table 4a pooled), which may be fixed or random in nature. The *p* value suggests that the result obtained falls outside acceptance region proving that the firm age does not significantly influence returns on invested capital for the pooled data.

Table 3: Panel Regression Result – Pool

roic		Coef.	Std. Err.	z	P>|z|	[95% Conf.	Interval]
firmsize		.1208819	.0415641	2.91	0.004	.0394178	.2023461
capitalint~y		-.1107705	.0345102	-3.21	0.001	-.1784093	-.0431317
age		-.1139648	.1957417	-0.58	0.560	-.4976115	.2696819
_cons		-.4551105	.4890225	-0.93	0.352	-1.413577	.5033558
sigma_u		0					
sigma_e		.26696639					
rho		0	(fraction of variance due to u_i)				

Source: Authors' Computation, 2013

The coefficient obtained for independent variable is different when data were analysed at industry level. The relationship between age and returns on invested capital though positive in both building sector (40.14%) and pharmaceutical sector (42.08%) was insignificant. The *p* values lie outside the acceptance region; therefore, hypothesised relationship that firm age has no significant relationship with returns on invested capital was accepted for the beverage and pharmaceutical sectors respectively.

The coefficients vary for the other sectors. This proofs that the hypothesis that firm age effect on returns on invested capital is not variable with industry is not supported by findings. The alternate hypothesis which states that firm age effects on returns on invested capital is supported instead.

Lastly, the moderating effect of size on the relationship between firm age and returns on invested capital was examined. For building sector, the relationship between firm age and returns on invested capital changed. Moderating with size, the sign of the relationship was inverse and $p < 10\%$ was obtained. This means that with size moderating, age is found to be directly proportionate with returns on invested capital specifically for the building sector. Does this new finding follow for the pharmaceutical sector? The sign remained the same with what it was previously and size effect was negative. The consistency of the signs with what obtained without size moderation indicates that the effect of size on the relationship was only slight. Irrespective of firm size, age-returns on invested capital relationship was not affected.

Discussion of Findings

The effect of firm age on returns on invested capital was found to be negative. As firms age, the results of the analysis done in this study shows that the returns on related invested capital declines. Older firms are shown to perform less than younger ones. This is a feature of the disadvantage that comes with the passage of time despite that age could mean more experience. Age in this sense is linked to obsolescence which Drucker (1987) argues is regenerative and endangers sustainable development. It is also associated with the concept of the organisational life cycle (Cole, 2002). Younger firms are less prone to the risks of settled cultures as they are at the experimenting phase whereby unlearning of old formulae and paths to success would not be a weakness. Generally, previous empirical works had shown that the older a firm is, the greater its tendency to involve in inefficient corporate governance practices such as large board sizes and higher top management compensations (Loderer & Waelchli 2009).

Aging leads to cementation of rigidity, breeds fixations and rent seeking behaviour such as reduced quest for research and development spending which is vital to innovation and renewal for competitiveness and increased CEO pay is common. But younger firms have their own challenges too. Inexperience may undo the brightest prospects for succeeding. But smartly to benefit from the mistakes of others could be a rewarding strategic response. Indeed new firms do not have 'to reinvent the wheel', by profiting from the misstep of the older ones, they stretch cost reduction and containment to increase earning capacity and leverage scare assets.

CONCLUSION AND RECOMMENDATIONS

The age of firms representing the experience factor each had since incorporation differed and caused a negative effect on returns on invested capital. As the firms aged, their assets became obsolete, rigid and the managerial capabilities suffered owing to increasing cost of corporate governance, higher overheads and lack of regenerative capability often associated with higher spending on research and development (innovation). As found in the study, though two or more firms may contest for opportunities in the same markets, the uniqueness of each in assets worth critically places a limit or constrain to how well each is able to harness its resource basis relative to others. It is only in the area of strategic or competitive advantage that industry and other external forces cannot determine the performance of a focal firm. Indeed the destiny of the firm, its futurity, survival and contributions to sustainable development are determined chiefly by managerial acumen.

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