Firm Growth and Stock Performance: Evidence from Non-Financial Firms Quoted at the Nairobi Securities Exchange.

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ABSTRACT: Firm growth has various undertones which can describe it in the perspective of market share change, sales growth, employment growth, total assets growth and also level of community participation. The aspect of sales growth involves revenue from sales which was considered in this study and applied as revenue change. Total assets growth was also applied to measure firm growth. Firms that create value through selling their products are rewarded by the market through generation of more revenue, which translates to profit and operating cash flow that finally accrues to the stockholders. Hence, stock performance was studied to determine if it is affected by firm growth. This study, therefore, aimed to investigate the effect of firm growth on stock performance. The study targeted the non-financial firms quoted at the Nairobi Securities Exchange in Kenya. Firm growth was measured using revenue change and total assets change. Thus, the study’s specific objectives were to determine the effect of revenue change on stock performance and establish the effect of total assets change on stock performance of non-financial firms quoted at the Nairobi Securities Exchange. The descriptive statistics indicated that the standard deviation values are all clustered around the corresponding mean. The ANOVA results depicted a statistically significant model at 5 percent. The variables are good predictors of stock performance as justified by an F statistic of 39.14 and the reported p-value of 0.0000 which is less than the 0.05 significance level. The Pearson’s coefficient findings observed that there was no correlation between revenue change and total assets change with stock performance. The panel regression results showed that revenue change and total assets change to a large extent affect stock performance of the listed firms. The study revealed that revenue change has a positive impact on stock performance and also total asset change has a positive effect on stock performance. The study therefore concluded that firm growth has a positive effect on stock performance of listed non-financial firms in Kenya.

Key words: Firm Growth, Non-financial Firms, Stock Performance, Revenue Change, Total Assets Change

1.0 INTRODUCTION

1.1 Background of the Study

Firm growth is an organizational outcome resulting from the combination of firm-specific resources, capabilities and routines (Nelson & Winter, 1982). Firm growth has various connotations such as market share change, revenue change, employment growth, total assets growth and also level of community participation. Furthermore, it can be measured in terms of quality of products, market position and customer goodwill (Kruger, 2014).

Stock performance is a measure of returns on shares over a period of time (Kivale, 2013). Stock performance can be measured by ratios of earnings per share, dividend payout ratio, price-to-earnings ratio among others (Osisanwo & Atanda, 2012). Revenue translates to profit and operating cash flow that finally accrues to the stockholders who receive dividends. Several studies have evaluated firm growth using aspects like profitability, productivity, firm size and age. Other studies have further covered the aspect of stock prices and company performance, financial performance and stock return, growth of earnings and stock prices and their effect on price earnings ratio among others. In this study, firm growth was measured using revenue change and
total assets change. Revenue change is broadly used as an indicator for growth of a business (Wiklund, 1998). Share or stock value and growth can be assessed using various indicators and calculations of ratios. Nairobi Securities Exchange is one of the vibrant bourses in Africa (Kiminda, Githinji & Riro, 2014). After a company goes public and starts trading on the exchange, its price is determined by supply and demand for its shares in the market. If there is a high demand for its shares due to favorable factors, the share price would increase. A share entitles the holder to a proportion of the financial gains of a firm. There is scarce study which can be referred to on the aspect of how the growth of a firm affects the performance of shares. The primary source of returns from holding a share is the dividend that is received by the shareholders. Dividend depends upon the profit that the company earns. Share growth comes into play because growth in earnings is expected to be followed by a growth in dividend.

Most of the firms listed at NSE have considerably shown growth with an unequal performance in stock market. For instance, Safaricom Limited is one of the leading integrated communications companies in Africa with over 17 million subscribers (CAK, 2019). Over the last two decades, firm growth has been studied all over the world in various disciplines, such as economics, strategy, psychology, network theory and innovation. Nevertheless, it is observed that knowledge of firm growth is still limited (Davidsson & Wiklund, 2000; Wiklund, Patzelt & Shepherd, 2013). Thus, there exist diverse views, with none of them explaining the effect of firm growth on performance of shares. Other studies have explored links between firm characteristics and stock returns. Studies on security markets have shown or argued about effect of variables like capital structure, receivables management and performance of listed firms. Others have studied on the determinants of firm growth while some have touched on profitability and stock prices. But there is the need to find out more on growth of firm and how it affects the performance of shares of those firms quoted at the exchange. This curiosity contributed to undertaking of this study.

1.1 Statement of the Problem
Growing firms are much appealing to investors, an aspect that attracts them to put their money through buying shares in the firms. In return, they expect to reap benefits from the performance of their shares through dividends. One of the questions that investors may ask is whether a growing firm will have high dividends. The researcher tried to address the question by investigating whether there is any effect of growth of firm and performance of shares.

A number of studies have explored listed firms’ performance, not firm growth, in relation to stock performance. One study has given an outcome of positive correlation between financial performance and stock returns (Ndirangu Ngunjiri, 2016). Some other studies have explored the determinants of firm growth without any specific relation to share/stock performance. The determinants and dimensions of firm growth include availability of assets, human resource growth motivation and firm’s scalability (Haibo, Z. & Gerrit, W., 2009). Measures such as revenue difference, employment, assets growth, market share change and profit change can be used as indicators for firm growth (Delmar, 1997; Wiklund, 1998).

1.2 The specific objectives
ii). To establish the effect of total assets change on stock performance of non-financial firms quoted at the Nairobi Securities Exchange.

1.3 Significance of the Study
Most of the people who are interested in investing in businesses require information about the businesses in which they want to invest so that they can make informed decisions. One of the critical elements they look at is the performance of shares. They are also concerned with the growth of the business in question. The
researcher therefore found it necessary to carry out this study on the effect of firm growth and stock performance of non-financial companies that are quoted at the Nairobi Securities Exchange in Kenya due to availability of financial reports. The study aimed at providing answers to the questions on the effect of revenue change on stock performance and also the effect of total assets change on stock performance. These pieces of information are important to investors who have either invested in a business or are potential ones looking for a business to invest in. In addition to the said benefits, owners and managers of firms can benefit from the study by understanding how the growth of a firm can affect the performance of stock, in other words, shares

2.0 Literature Review
This section has reviewed both theoretical and empirical literature that has been developed based on growth of a firm and stock performance.

2.1 Theoretical Review
Theoretical review looked at various theories that have been developed over time on stock performance of a firm and the variables that affect it.

2.1.1 The Efficient Market Theory
This theory describes a market where share prices always fully reflect available information (Fama, 1970). Information in efficient market shall be recognized as anything that may lead to changes in share prices but is unknown at the present, and thus appears randomly in the future. This study is based on growth in market share change, total assets change and revenue change. When such new information enters to the market, assuming it is an efficient market, it causes some corrections to be applied in the evaluated economic value of securities and its cost in accordance with the offered information to be defined. This implies that the price of securities will be defined efficiently. Stock market efficiency has the important implication for investors. It affects the persons' attitude on the process of investment and investment decisions.

2.1.2 The Greater Fool Theory
This theory gives the idea that, during a market bubble, one can make money by buying overvalued assets and selling them for a profit later, because it will always be possible to find someone who is willing to pay a higher price (Malkiel, B. 1995). An investor who subscribes to the Greater Fool Theory will buy potentially overvalued assets without any regard for their fundamental value. With regard to the stock market, the theory becomes relevant when the price of a stock goes up so much that it is being driven by the expectation that buyers for the stock can always be found, not by the intrinsic value (cash flows) of the company. Under this assumption, any price (no matter how high) can be justified since another buyer presumably exists who is willing to pay an even higher price.

2.1.3 Dividend Signaling Theory
This theory that suggests that a company announcement of an increase in dividend payouts is an indication of positive future prospects (Miller & Modigliani, 1961). The theory is directly tied to game theory where managers with good investment potential are more likely to signal. While the concept of dividend signaling has been widely contested, the theory is still a concept used today by some investors. Increases in a company's dividend payout generally forecast a positive future performance of the company's stock. Conversely, decreases in dividend payouts tend to accurately portend negative future performance by the company.

2.1.4 The Prospect Theory
It’s also known as the loss-aversion theory. Prospect theory states that people's perceptions of gain and loss are skewed (Tversky & Kahneman, 1992). That is, people are more afraid of a loss than they are encouraged by a gain. If people are given a choice of two different prospects, they will pick the one that they think has less chance of ending in a loss, rather than the one that offers the most gains.
2.2 Empirical Literature
Related scholarly review has been done on research areas whereby it has touched on revenue change and total assets change in relation to stock performance. Measures such as revenue change, employment growth, asset growth, market share change and profit can be used as indicators for firm growth (Delmar, 1997; 2003). Overall, Delmar’s study found that revenue change is the most frequently used measure of firm growth. Stochastic models operationalize firm growth with variables such as net sales and employee growth (Laitinen, 1999).

In a study investigating the impact of sales growth on profitability and firm value of industries, the researchers found that asset growth and sales revenue had a strong positive impact on sales growth which in turn impacted positively on firm share value (William, C. & Michael, E., 1995). Another study on the effect of financial leverage and EPS on dividend policy of firms listed at Nairobi securities exchange found that there is negative association between revenue growth and dividend payout or EPS. Firms pay dividend as a sign of current and future prospects (Kivale, 2013).

Another study investigated the effect of sales growth, profitability and firm value in firm value creation strategy (Mwangi, 2008). The study indicated that although both firm profitability and value generally rise with sales growth, an optimal point exists beyond which further sales growth adversely affects profitability and shareholder value. Other researchers argue that firms must use a wide variety of goals, including sales growth, to effectively reach their financial objectives which include increase in share gains (Kaplan and Norton, 1996).

A study was done which emphasized that cross-section of future stock returns can be predicted by annual asset growth rate of a firm (Cooper, Gulen & Schill, 2013). In a study investigating the impact of sales growth on profitability and firm value of industries, it was concluded that asset growth and sales revenue had a strong positive impact on sales growth which in turn impacted positively on firm share value (William, C. & Michael, E., 1995).

In another similar study, researchers investigated the predictive power of fundamental analysis in terms of firm performance and stock returns in Egypt (Mahmoud & Sakr, 2012). Using multiple financial indicators (changes in asset turnover, changes in leverage, gross profit margin, return on assets, changes in return on assets, cash flow from operation, changes in cash flow from operation, changes in ROE) aggregate signals had positive correlation with stock return.

An interesting study was done that studied the firm financial factors and variation in stock returns (Hatta, 2012). Financial signals like earnings per share, price earnings ratio, debt/equity ratio, current ratio, net profit margin, dividend per share and return on assets were selected for the study. The study found that earnings per share and price earnings ratio had positive relation with stock return, while debt to equity and net profit margin had negative relation with stock returns. A company’s ability to consistently pay out increased levels of dividend over time conveys information about the management’s assessment of the firm’s future prospects, thereby sending strong signals to the market about its fundamentals (Inyiama & Ugah, 2015).

Another study found that asset growth and sales revenue impacted positively on firm share value (William, C. & Michael, E., 1995). It’s been over two decades and no similar area of research has been undertaken. Furthermore, the study was carried out in USA. This brings out a research gap since the intended study will give updated results and will be carried out in Kenya. A recent study on market share and stock returns found a negative relationship of market share and subsequent stock returns (Chowdhury, Sonaer & Celiker, 2017).

From the literature, there is need to test the current relationship on stock performance using revenue change and total assets change in Kenya.
2.3 : Conceptual Framework

**Revenue change**
- ([Current Year revenue - Last Year revenue] ÷ Last Year revenue]

**Total assets change**
- ([Current year assets – Last year assets] ÷ Last year assets]

**Stock performance**
- Price/Earning ratio

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**Research Methodology**

This study adopted quantitative research design (Charles, & Benson, 2023). The target population of the study was 38 non-financial firms quoted at the NSE which had been trading in the market for the last 5 years (2018 to 2022). The study gathered its data from secondary sources that comprised the records of published financial reports of quoted firms at the Nairobi Securities Exchange in Kenya from 2018 to 2022 which were obtained from the NSE and companies’ websites. Panel data regression model shown in equation 3.1 below was used for analysis. Panel data analysis was effective for the data because it gave more accurate inference of model parameters.

\[
y_{it} = \alpha + \beta_1(x_1)_{it} + \beta_2(x_2)_{it} + \epsilon_{it} \quad \text{eqt. 3.1}
\]

Where:
- \( y \) - stock performance
- \( x_1 \) and \( x_2 \) - independent variables (revenue change and total assets change)
- \( i \) and \( t \) - indices for individual firms and time

The specification tests carried out to validate the model include coefficient of determination (r-square and adjusted r-square), t-test, ANOVA and multicollinearity.

**Measurement of Variables**
Revenue change was measured by subtracting last year revenue from current year revenue divided by last year revenue as shown in the formula below:

\[
\text{Revenue Change} = \frac{(\text{Current year revenue} - \text{Last year revenue})}{\text{Last year revenue}}
\]

Total assets change was measured by subtracting last year total assets from current year total assets the divide by last year total assets as shown in the formula below:

\[
\text{Total assets change} = \frac{(\text{Current year total assets} - \text{Last year total assets})}{\text{Last year total assets}}
\]

Stock performance as the dependent variable was measured using Price/Earning ratio (P/E) as shown in the formula below:

\[
\text{P/E ratio of this measure} = \frac{\text{Price per share}}{\text{Earnings per share}}
\]

4.1 Descriptive Statistics

Table 1: Range Statistics

<table>
<thead>
<tr>
<th></th>
<th>2018</th>
<th>2019</th>
<th>2020</th>
<th>2021</th>
<th>2022</th>
</tr>
</thead>
<tbody>
<tr>
<td>N</td>
<td>38</td>
<td>38</td>
<td>38</td>
<td>38</td>
<td>38</td>
</tr>
<tr>
<td>Min</td>
<td>-0.08</td>
<td>0.03</td>
<td>-0.02</td>
<td>-0.16</td>
<td>0.03</td>
</tr>
<tr>
<td>Max</td>
<td>0.16</td>
<td>-0.13</td>
<td>0.03</td>
<td>-</td>
<td>-0.11</td>
</tr>
<tr>
<td>Revenue Change</td>
<td>0.12</td>
<td>2.77</td>
<td>0.43</td>
<td>2.26</td>
<td>0.00</td>
</tr>
<tr>
<td>Total assets change</td>
<td>0.10</td>
<td>7.44</td>
<td>0.03</td>
<td>8.72</td>
<td>0.00</td>
</tr>
</tbody>
</table>

The findings from the table 1 above indicate that the maximum ratio of stock price/earnings increased over time from 2019 to 2022 and only decreased between 2018 and 2019. The share price/earnings ratio was highest in 2022 indicating that shareholders did not have high share earnings compared to share price. For revenue change, the smallest change was in 2021 where it was 0.00 meaning revenue neither increased nor decreased compared to previous year. For assets change, the smallest change was in 2020 where it was 0.00 meaning no asset was added or disposed of compared to previous year.

Table 2: Summary of Descriptive Statistics

<table>
<thead>
<tr>
<th></th>
<th>Minimum</th>
<th>Maximum</th>
<th>Mean</th>
<th>Std. Deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>P/E Ratio</td>
<td>38</td>
<td>-0.16</td>
<td>0.05</td>
<td>.0099</td>
</tr>
<tr>
<td>Revenue Change</td>
<td>38</td>
<td>0.00</td>
<td>3.71</td>
<td>.7784</td>
</tr>
<tr>
<td>Total Assets Change</td>
<td>38</td>
<td>0.00</td>
<td>10.43</td>
<td>5.9932</td>
</tr>
</tbody>
</table>

Valid N 38
The findings from table 2 above depict that the level of stock earnings increased over time from a ratio of -0.16 to 0.05. The level of revenue change was found to have a mean score of 0.7784 which was an indication that most listed firms made more sales. Further, the results observed that the mean value for total assets change grew from 0.00 which is the minimum value to 10.43 which is the maximum value. The standard deviation is 0.04477 for price/earning ratio which is near mean of 0.0099, standard deviation of 0.76385 for revenue change which is near mean of 0.7784 and standard deviation of 4.34714 for total assets change that is near the mean of 5.9932 indicating that the standard deviation values are all clustered around the corresponding mean.

4.2 Diagnostic Tests

4.2.1 Unit Root Test

Unit root test were conducted to ensure the data was stationary before proceeding for further analysis. The results indicated that data was stationary for all the variables under study. The table 3 below shows the outcome;

Table 3: Unit Root Test for Stationarity

<table>
<thead>
<tr>
<th>Variable</th>
<th>Statistic</th>
<th>P value</th>
<th>Conclusion</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stock performance</td>
<td>10.374</td>
<td>0.000</td>
<td>Data is stationary</td>
</tr>
<tr>
<td>Revenue change</td>
<td>15</td>
<td>0.000</td>
<td>Data is stationary</td>
</tr>
<tr>
<td>Total assets change</td>
<td>7.813</td>
<td>0.000</td>
<td>Data is stationary</td>
</tr>
</tbody>
</table>

4.2.2 VECM (Vector Error Correction Model)

VECM was used to capture the short run and the long run relationships of the variables in Table 4.

Table 4: VECT Results

<table>
<thead>
<tr>
<th>Variable</th>
<th>Coefficient (long run)</th>
<th>Coefficient (short run)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stock performance</td>
<td>0.11672</td>
<td>0.18145</td>
</tr>
<tr>
<td>Revenue change</td>
<td>0.72093</td>
<td>0.331872</td>
</tr>
<tr>
<td>Total assets change</td>
<td>0.19546</td>
<td>0.182453</td>
</tr>
</tbody>
</table>

The long run model;
Price/Earning ratio = 0.11672 (Stock Performance_{t-1}) + 0.72093 * Revenue Change_{t-1} + 0.19546 * Total Assets Change_{t-1}

The positive coefficient (0.72093) implies that an increase in the revenue change is associated with a corresponding increase in 0.72093 in the long run.

The positive coefficient (0.19546) indicates that an increase in total assets change is associated with an increase in stock performance in the long run.

The short run model;
Price/Earning ratio = 0.18145 (Stock Performance_{t-1}) + 0.331872* (Revenue Change_{t-1}) + 0.182453* (Total Assets Change_{t-1})

4.2.3 Cointegration Test

Cointegration test was used to establish if there is a correlation between several time series in the long term.
From the Table 5 above, both Trace values and Eigen values indicate presence of one cointegrating relationship.

### 4.2.4 Hausman Test

The Hausman test was carried out to test the presence of predictor variable (endogenous regressors) in a regression equation. It enabled the study to identify the panel model – fixed or random effects model – to utilize in the analysis process. Table 6 below presents the results for the Hausman Specification Test;

#### Table 6: Hausman Test

<table>
<thead>
<tr>
<th>Hausman statistic</th>
<th>P value</th>
<th>Conclusion</th>
</tr>
</thead>
<tbody>
<tr>
<td>0.991</td>
<td>0.789</td>
<td>Use Random effects model</td>
</tr>
</tbody>
</table>

From the findings presented in Table 6 above, P-value = 0.789 which was greater than 0.05. Consequently, the null hypothesis was rejected and the alternative hypothesis was accepted. Therefore, the study adopted the Random Effect Panel Model (REM).

### 4.3 Pearson Correlation Coefficient

The correlation results have been presented in the table below;

#### Table 7: Pearson’s Correlation Coefficient

<table>
<thead>
<tr>
<th></th>
<th>Stock Performance</th>
<th>Revenue Change</th>
<th>Total Assets Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stock Performance</td>
<td>1</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Revenue Change</td>
<td>.076</td>
<td>1</td>
<td></td>
</tr>
<tr>
<td>Total Assets Change</td>
<td>-0.208</td>
<td>.696</td>
<td>1</td>
</tr>
</tbody>
</table>

Pearson correlation coefficient means that the system adjusts back to its long-run equilibrium at a normal rate per year. 0 value means no correlation, –1 is total negative correlation and +1 is strong correlation. From the above Table 7 results, the findings observed revenue change and total assets change had a coefficient of 0.696 indicating that there was a weak correlation between revenue change and total assets change. It was also observed that revenue change and total assets change had a coefficient of 0.076 and -0.208 respectively indicating that there was a no correlation of revenue change and total assets change with stock performance of listed non-financial firms in Kenya.
### 4.4 Regression Model Results

#### Table 8: Regression Results

<table>
<thead>
<tr>
<th>Source</th>
<th>SS</th>
<th>df</th>
<th>MS</th>
<th>Number of obs = 38</th>
</tr>
</thead>
<tbody>
<tr>
<td>Model</td>
<td>.139791401</td>
<td>3</td>
<td>.046597134</td>
<td>F( 3, 116) = 39.14</td>
</tr>
<tr>
<td>Residual</td>
<td>.138106979</td>
<td>116</td>
<td>.001190577</td>
<td>Prob &gt; F = 0.0000</td>
</tr>
<tr>
<td>Total</td>
<td>.27789838</td>
<td>119</td>
<td></td>
<td>R-squared = 0.5030</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Adj R-squared = 0.4902</td>
</tr>
</tbody>
</table>

| Stock performance | Coef        | Std. Err. | t     | P>|t|  | [95% Conf. Interval] |
|-------------------|-------------|-----------|------|------|---------------------|
| Revenue Change    | .0391765    | .0116066  | 3.38 | 0.001| .0161881             |
|                   |             |           |      |      | 0621649             |
| Total Assets      | .4809558    | .0500254  | 9.61 | 0.000| .3818742             |
|                   |             |           |      |      | .5800375             |
| Constant          | .0683901    | .0087716  | 7.80 | 0.000| .0510168             |
|                   |             |           |      |      | .0857634             |

From table 8 above, revenue change and total assets change explain 50.3 percent ($r^2$) of the variations on the stock performance of the non-financial firms listed at Nairobi Securities Exchange. The ANOVA results depict a statistically significant model at 5 percent (adjusted $r^2$). The variables are good predictors of stock performance as indicated by the results. This is justified by an F statistic of 39.14 and the reported p-value (.0000) which is less than the 0.05 significance level. Therefore;

$$ y = 0.0 + 0.04x_1 + 0.48x_2 $$

Where $y$ is the stock performance, $x_1$ is the revenue change, $x_2$ is the total assets change.

The panel regression results of the first objective entailed how revenue change affects stock performance. The panel regression results showed that $r^2$=0.1013 which indicates that revenue change only accounted for 10.13% of the variation in the stock performance of listed firms in Kenya. The p-value is 0.018 which is less than 0.05, meaning that revenue change is a good predictor variable of stock performance. The beta coefficient $\beta=9.9$ which imply that a unit change in revenue change will result in 9.9 units change in stock performance. The second objective aimed to examine how total assets change affects stock performance. The findings of the panel regression analysis revealed that $r$ square= 0.436 meaning that total assets change accounted for 43.6% of the variation in the stock performance. The results further showed that total assets change was a good predictor of stock performance as indicated by the f-statistics (p value =0.000). The beta coefficient showed that $\beta=4.4$ which means that a unit change in total assets change results in 4.4 units change.
in stock performance. The study concluded that total assets change to a large extent affect stock performance of the listed firms in Kenya.

5 Conclusion
The study concluded that firm growth contribute positively to stock performance of listed firms in Kenya since the panel regression results indicated that variation in the stock performance can be explained by revenue change and total assets change. The p-value showed that there is an effect of revenue change and total assets change on stock performance of listed non-financial firms in Kenya. The overall model coefficients for revenue change and for total assets change respectively indicated that a unit change in revenue change and total assets change results in a corresponding unit change in stock performance. For revenue change, results indicated that revenue change accounted for a small percentage of the variation in the stock performance. The p-value indicated that revenue change is a good predictor variable of stock performance. The beta coefficient implied that a unit change in revenue change will result in a significant unit change in stock performance. For total assets change, it accounted for a significant rate of the variation in the performance. The results further showed that total assets change was a good predictor of stock performance as indicated by the f-statistics. The beta coefficient showed that a unit change in total assets change results in a significant unit change in stock performance. The study therefore concluded that firm growth has a positive effect on stock performance of non-financial firms listed in Kenya.

6 Recommendations
It is clear that firm growth directly affects stock performance. It is therefore recommended that businesses should operate prioritizing revenue growth by increasing sales to generate profits and make attractive dividends to shareholders. It is also recommended that managers should ensure the efficiency of a company's use of its assets in generating sales revenue or sales income to the company. This will result to good profits which make attractive dividends to shareholders. All these activities will attract potential investors to inject more capital to the firms enhancing better performance and hence spur economic development.

REFERENCES


