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Dr. John Rwakihembo, Dr. Wilbroad Aryatwijuka, Peter Kalinda & Dr. Pereez Nimusiima

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Firm Age and Financial Performance: The Firm Life-Cycle Theoretical Perspective of Private Limited Companies In Uganda

Dr. John Rwakihembo[1*], Dr. Wilbroad Aryatwijuka[2], Peter Kalinda[3] & Dr. Pereez Nimusiima[4]

[1]Mountains of the Moon University
Email: jrwakihembo@mmu.ac.ug
[2]Mbarara University of Science and Technology, Uganda
Email: waryatwijuka@must.ac.ug
[3]Uganda Martyrs University & Mountains of the Moon University
Email: pkalinda@umu.ac.ug
[4]Mountains of the Moon University
Email: nimusima.pereez@mmu.ac.ug

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Abstract

Purpose: While the financial performance of private companies has invoked intense interest globally, this study aimed to investigate the relationship between firm age and the financial performance of private limited companies in Uganda.

Methodology: The study adopted a positivist paradigm and a cross-sectional design. A structured self-administered questionnaire was deployed to gather quantitative data from Accountants, Auditors, CEOs, and Board Members who were purposively selected. Three hundred ninety-four private companies in Central and Western Uganda were sampled. The relationship was assessed using Pearson correlation and standard regression analysis techniques.

Findings: The study established a positive relationship between firm age and financial performance. It was established that firm age accounts for 14% of the variance in financial performance among private limited companies in Uganda. The study recommends that managers prioritize factors that guarantee the long-term existence of businesses by devising sound investment and operational policies that match the life-cycle stages of their firms.

Recommendations: This study cements our insights on a firm age-financial performance nexus in Uganda's private sector and highlights the significance of age towards financial performance. Findings provide insights into devising promising business approaches and guide management in setting priorities to achieve long-term business survival and better financial performance.

Keywords: *Firm Age, Financial Performance, Private Limited Companies*

1.0 INTRODUCTION

The link between firm age and financial performance has lured enormous attention in business research and other organizational studies. In consequence, firm age has gained impetus and visibility in the contemporary research agenda as a predictor of the financial performance of enterprises. In numerous studies, firm age is defined as the number of years of existence of such firms (Cain, 2017; Crane et al., 2019; Bell et al., 2017). On the other hand, financial performance refers to the extent to which the financial targets of a firm have been accomplished (Crane et al., 2019). The Ugandan government appreciated the role of private stakeholders in realizing socio-economic development. The private sector's contribution to GDP is almost 80% (Financial Sector Deepening, 2015), indicating private companies' crucial role in the Ugandan economy and East Africa. However, despite enormous efforts by the government to enable the survival of businesses in Uganda, the financial performance of private limited companies has been declining (Okpara, 2011). According to Van and Bargawi (2018), enterprises in Uganda are rapidly closing, with 90% existing for less than 20 years. Moreover, very few firms have lived beyond the death of their founders (Private Sector Foundation, 2014).

Extant literature suggests that a firm's financial performance is a function of its age, and this relationship is supported by the firm life-cycle theory (Can et al., 2023). According to this theory, like products, organizations go through four life-cycle stages: start-up, growth, maturity, and stagnation, and each stage has distinctive characteristics that affect their financial performance (Ryu & Won, 2022). The theory delineates that firms in the birth or introduction stage are small and struggling as they face a high cost of capital (Matemilola et al., 2019). In the growth stage, firms are older and larger than those in the birth stage, and they make long-term and large-scale investments and have higher sales growth rates than mature and declining ones. They enjoy lower costs of raising external capital than those in the birth stage (Akbar et al., 2019). On the other hand, in the decline stage, firms experience stagnation and suffer from falling returns because of external challenges. They try to improve their short-term performance by recovering or closing lines of business as profitability declines (Yang et al., 2022).

Furthermore, empirical studies pointed out that the age of a firm is critical to its future growth prospects. For instance, Courrent et al. (2018) studied SMEs in France and confirmed that mature firms primarily enjoy more disclosure and liquid trading and attract analysts` interest besides having intense diversity. As a result, they are devoid of financial distress. However, they have limited growth prospects compared to youthful firms whose growth chances are immense despite unfavorable exposure to aggressive market environments. Furthermore, Matemilola et al. (2019) argued that as firms grow older, they use their experience to make effective capital structure decisions (e.g., the optimal debt-equity mix) that maximize the debt interest tax shield and increase shareholders' returns. Moreover, Sharma and Dixit (2017) established that long-surviving companies worldwide are highly skilled and experienced but can hardly cope with dynamics and flexibility in the business arena. Wojan et al. (2018) and Busse et al. (2020) confirmed these assertions, maintaining that mature firms respond adequately to environmental alterations. Besides, Keeble and Wever (2016) determined that new firms in Europe are less profitable than long-existing ones. The little market experience is attributed to firms struggling to deep-root themselves and cover their cost structure. Nonetheless, McKelvie et al. (2017) examined the performance of Swedish firms. They established that much as mature firms` existence is at the blink of winding up, perhaps their exponential-growth stage is exhausted while youthful firms are

proliferating. As a result, they confirmed that new companies have better growth prospects as gauged by a shorter history of incorporation.

However, despite their enormous contribution to the body of knowledge, previous studies that investigated the firm age-performance association are replete with mixed findings and used isolated sectors moreover in developed economies like Sweden (McKelvie et al., 2017), France (Courrent et al., 2018) and generally Europe (Keeble & Wever, 2016). For instance, Waluyo (2017) investigated the firms in real estate, while Karadag (2017) and Bandyopadhyay (2016) examined companies in Turkey and India, respectively. Thus, hardly any study explores the association between firm age and financial performance among private limited companies in Uganda. Thus, besides this being a large-scale study with in-depth exploration, investigating the financial performance of private limited companies against their age will significantly contribute to the existing literature and policy formulation to enhance the performance of private companies in Uganda.

This study is anticipated to be helpful to stakeholders in various dimensions ultimately. First, Private Limited Companies in Uganda will acquire valuable insights concerning the relationship between firm age and its financial performance. In addition, it prompts the management to cautiously weigh the prospects of the long existence of firms and devise sound policies that oversee long-term survival to guarantee a sound financial performance that emanate from experience as a result of many years of operation. The paper is structured into eight major sections. The first section covers the introduction as well as the role of this study. The second section covers a literature review and hypotheses; the third section covers the methodology; the fourth section covers study findings; the fifth section covers a discussion of results; the sixth section covers conclusion and recommendation; the seventh section covers study limitations, and the eighth section covers study implications to managers.

2.0 LITERATURE REVIEW

Firm Life-Cycle Theory

This study is premised on firm life-cycle theory, coined by Mueller D. in 1972 (Can et al., 2023). The theory posits that, like products, organizations go through four life-cycle stages: start-up, growth, maturity, and stagnation, and each stage has distinctive characteristics (Ryu & Won, 2022). The theory delineates that firms in the birth or introduction stage are small and struggling as they face a high cost of capital (Matemilola et al., 2019). In the growth stage, firms are older and larger than those in the birth stage, and they make long-term and large-scale investments and have higher sales growth rates than mature and declining ones. They enjoy lower costs of raising external capital than those in the birth stage (Akbar et al., 2019). Firms in this stage establish formal structures, expand through innovation and diversification, establish distinct competencies, prioritize rapid sales growth, delegate some authority to middle managers, and broaden their product line (Habib & Hasan, 2019).

Conversely, mature firms experience stable market and sales growth and make fewer investments than growing firms. The theory further posits that older firms have more experience and networks of relationships and can obtain superior returns (da Silva Roma et al., 2020). On the other hand, in the decline stage, firms experience stagnation and suffer from falling returns because of external challenges. They try to improve their short-term performance by recovering or closing lines of business as profitability declines (Yang et al., 2022). Moreover, older firms have a more

bureaucratic organizational structure; consequently, they cannot respond faster to unfavorable market conditions that may negatively affect returns (Matemilola et al., 2019). At this stage, innovation is declining, and the firm prefers to maximize profits by avoiding costly changes and maintaining favorable product prices. Firms at this stage are conservative and prefer to protect what they have already accomplished. Managers become more risk-averse than at other stages, with a less innovative and proactive attitude (Akbar et al., 2019). Although the firm life-cycle theory elaborates on the numerous stages of the firm life cycle, it remains unclear whether the same holds for Ugandan private limited firms. Furthermore, there is no agreement on the exact number of stages and the organizational tasks that characterize each stage. Studies (Can et al., 2023) have challenged this viewpoint, claiming that organizations do not always undergo such an inevitable transition from one stage to another. However, knowing a company's life cycle is critical for the comprehension of its financial performance throughout time. As a result, despite the criticism, the firm life-cycle theory applies to this study. As a result, this study hypothesized that as private enterprises grow, their financial performance improves, highlighting the necessity to validate the hypothesis among Ugandan private companies.

Empirical Literature Review

Firm Age and Financial Performance

Whereas some theoretical models and empirical studies (Busse et al., 2020; Ryu & Won, 2022; Akbar et al., 2019; Yang et al., 2022) consider firm age to be linearly related to financial performance, scholars postulate contradicting findings concerning the direction of the relationship. An in-depth examination of the extant literature revealed that little research had been done on private limited companies in Uganda. By sampling Indian firms, Bandyopadhyay (2016) established that younger firms outperformed older rivals in the market. Sadeghi et al. (2016), while evaluating 96 firms on the Tehran Stock Exchange list, found that the long existence of a firm enhances its performance. Osoro et al. (2017) and Njiku et al. (2019) similarly established this association among solely Tanzanian and Ugandan microfinance organizations. Furthermore, studies by Coad et al. (2013), Ismail et al. (2017), Lucas (2017), Gomez and Bernet (2019), and Abdullah et al. (2017) reported a positive association, affirming that financial performance is achieved from firm experience. Likewise, Nanda and Panda (2018) focused on firms listed in the stock market in India, employing panel data methodology over three years. They discovered a strong association between a firm`s age and performance. However, Coad et al. (2018) established a negative relationship between firm age and performance, noting declining profits among old firms.

Astonishingly, Coad (2018) noted a negative relationship, stating the likelihood of a ‘decay’ related to age hence poor financial performance. Petruzzell et al (2018) had the same findings. Loderer and Waelchli (2017) noted that its performance drops with advancement in age hence age adversely impacts performance. Besides, from a sample of 57 companies of non-metallic mineral products factories in India, for a decade, Gaur (2011) focused on the impact of assorted variables, age inclusive as well, on profitability and returns on net worth. Nonetheless, firm age eventually was not a vital determinant. Sucuahi and Cambarihan (2016) sought to find the association between firm performance and age using the return on assets. Initially, it aimed to explore how corporate governance impacts a firm's performance. Age was used as a control variable. As a result, the duration of the sampling spread over four years. Panel data approximations were deployed across 164 firms in the real sector. Consequently, a null association emerged between firm performance

and age. Coad et al. (2018) also analyzed how firm size, as well as its age, influences its performance. Firm age was the control variable in his regression analysis spreading over four years for the sampled 200 listed firms between 2008 to 2011. He established a null relationship. Furthermore, Akben-Selcuk (2016) investigated the influence of a firm`s age on its performance, using three various proxies of the performance of the firm. Contrary to the previous studies, she executed a longitudinal study from 2005 to 2014. Three hundred-two non-financial institutions were utilized while deploying panel data analysis. She established a convex link between firm performance and age.

The studies above reveal that the empirical evidence about the association between a firm's age and financial success is still ambiguous. Despite massive steps accomplished in exploring firms' age- performance association, there are mixed findings (Matemilola et al., 2019; Sharma & Dixit, 2017; McKelvie et al., 2017) with studies focusing on developed economies (Ryu & Won, 2022; Sadeghi et al., 2016; Nanda & Panda, 2018) and others only concentrating on isolated sectors like microfinance institutions (Osoro et al., 2017 & Njiku et al., 2019) and real estate firms (Waluyo, 2017). Therefore, there is still room to improve the understanding of whether firm age predicts financial performance in the context of private limited companies in Uganda. This study, therefore, hypothesized that:

H_1: *Firm age positively associates with financial performance*

3.0 METHODOLOGY

Research Design, Population, Sample Size, Sample Selection and Data Collection

The study adopted a positivist paradigm and cross-sectional research design (Rahi, 2017; Sakız & Bas, 2017; Johnson & Christensen, 2019), collecting data from 394 companies drawn from a population of 30,000 private limited companies (Private Sector Foundation Uganda, 2020). The study focused on companies in the Kampala business district and Mbarara city since they are the main business centers of Uganda and comprise the majority of private companies in the country (UBOS, 2016), thus appropriately representing firms in other areas. The study sample was determined using the following formula by Yamane (1973).

$n = N/ 1+N(e)^2$

Where *n* stands for sample size, *N* for the population, and *e* for tolerable error at 5%.

Private companies were classified by sector and randomly selected from each sector using a simple random sampling technique. The questionnaire was administered to Accountants, CEOs, Auditors, audit committee members, and board members who were purposively selected. The questionnaire method of data collection was preferred because it enhanced the anonymity of respondents and enabled them to respond more freely and at their convenience, increasing the response rate (Brace, 2018; Schnall et al., 2018).

Measurement of Variables and Data Analysis

The present research utilized similar dimensions as the prior studies (Agustina & Baroroh, 2016; Hermuningsih, 2019; Haninun et al., 2018; Cho et al., 2019) where financial performance was proxied by profitability (ROE, Net profit Margin, ROA), liquidity (current ratio), solvency (Debt-equity ratio), and financial efficiency (operating expense ratio and asset turnover ratio). Like in previous studies, firm age was measured using the natural logarithm of the years of operation of

the firm (Legesse, 2018; Petruzzelli et al., 2018; Kahl et al., 2019). Data were cleaned by identifying and treating missing values and outliers using SPSS according to procedures recommended by Pallant (2020). Upon confirming the parametric assumptions of normality, linearity, independence of errors, and homoscedasticity, the study employed Pearson correlation and regression as the primary data analysis techniques (Pallant, 2020; William & Albers, 2019). In testing the association between financial performance and the firm`s age, the survey adopted the ordinary least squares method, and the following regression model was estimated;

$FP = B_0 + B_1FAGE + e$

Where FP is financial performance, B_0 is a constant, B_1FAGE is the coefficient of firm age, and e is the error term.

4.0 RESULTS

Sample Characteristics

A significant proportion (49%) of private limited companies that participated in the study operated in the service sector, with a substantial (35%) in the industry sector and 15.3% in agriculture. Ugandans mainly owned 78 % of these companies, with a marginal proportion (16%) by foreign nationals and a mild 5% by local and international investors. 49% of private limited companies had an asset base below Ugx 500 million, 21% had assets between Ugx 500 million and one billion,n with a small proportion (17%) having assets above 2 billion. A substantial portion (35.5%) of companies had operated for five to ten years, 31% above 15 years, 21% less than five years, with a mild proportion (11.9%) having operated for a period between 10 and 15 years. The majority (68.9%) of these companies were in Central Uganda, compared to 32.2% in Western Uganda. The above results imply that most Ugandan private limited companies are into providing services and are mainly locally owned. Most of these companies operate on a small scale, running for less than ten years and primarily in central Uganda.

Table 1: Pearson Correlation Analysis Results

		Financial Performance
Firm Age	Pearson Correlation	0.377**
	Sig. (1-tailed)	.000
	N	394

**p< 0.01 level (1-tailed)

Source: Primary Data

Table 2: Standard Linear Regression Analysis Results

Model Summary

Model	R	R Square	Adjusted R Square	Std. The error in the Estimate
1	.377[a]	.142	.140	.37731

ANOVA

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	9.243	1	9.243	64.927	.000[b]
	Residual	55.805	392	.142		
	Total	**65.048**	**393**			

Coefficients

		Unstandardized Coefficients		Standardized Coefficients		
Model		**B**	**Std. Error**	**Beta**	**t**	**Sig.**
1	(Constant)	2.265	.046		48.821	.000
	Firm Age	.135	.017	.377	8.058	.000

Dependent Variable: Financial Performance

Sopurce: Primary Data

Pearson correlation analysis results (Table 1) indicated that firm age was positively associated with the financial performance of a company ($r = 0.377$, $p < 0.01$). This was supported by the regression model (Table 2), where age predicted a significant 14% ($r^2 = 0.14$) of the variation of financial performance of private limited firms in Uganda. Furthermore, it was established (Table 2) that for every unit change in firm age, financial performance changed by significant 0.135 units ($B = 0.135$, $p < 0.01$). These findings indicate that as a firm spends more time on operations, its financial performance will also be high. This is a reality because mature firms will have learned from their mistakes, can identify risks, and are well-established. Therefore, this is associated with increased market share and profitability, supporting the hypothesis that firm age is positively related to financial performance (H1).

5.0 DISCUSSION, CONCLUSION AND RECOMMENDATIONS

Discussion

Results from Pearson correlation and linear regression analyses (Tables 1 and 2) indicated a positive association between age and the financial performance of private limited companies, thus supporting hypothesis H1. This means that a long- term survival of a firm relates to an increase in financial performance. This is true because as companies grow older, they obtain more experience in the market, gaining a competitive advantage over young firms that typically suffer the liability of newness while struggling to meet their cost structure. These findings concur with the conclusions of other researchers (Berger & Udell, 2012; Coad et al., 2016; Akben-Selcuk, 2016). These researchers established that the age of a firm is a valuable pointer to its growth prospects. These findings were confirmed by Akben-Selcuk (2016). They posited that mature companies exhibit advanced liquid trading, more disclosure, catch the eyes of analysts easily, and have a diversification of activities, hence not inclined to experience adverse financial agony. The above results also rhyme with the conclusion of other researchers, such as Weng and Chen (2017), Ma et

al. (2019), and Purba and Bimantara (2020). They affirmed that age comes with experience that helps the company to achieve better financial performance.

Similarly, the present study's findings support the preposition of the firm life-cycle theory. It has been observed that firm age is a significant predictor that deserves appropriate consideration in theoretical studies investigating the determinants of the financial performance of organizations. The study concurs with the life-cycle theoretical assumption that mature firms make long-term and large-scale investments with higher sales growth rates. They enjoy lower costs of raising external capital than those in the birth stage (Akbar et al., 2019). Firms that have survived the test of time tend to establish formal structures, expand through innovation and diversification, establish distinct competencies, prioritize rapid sales growth, and broaden their product line (Habib & Hasan, 2019). Moreover, the theory postulates that older firms have more experience and networks of relationships and can obtain superior returns (da Silva Roma et al., 2020).

Conclusion

It should be noted that typically, everything ages and goes out of use. This study endeavored to establish if companies experience a similar fate and gradually become ineffective. Consequently, the study investigated and confirmed the existence of a positive association between firm age and the financial performance of private limited companies in Uganda. This affirms the need for private limited companies in Uganda to guarantee the sustainability of their operations if they are to benefit from the ever-changing business environment.

Recommendation

The study recommends that companies invest in assets and activities that will enable their long-term survival and growth in production capacity, improving their financial performance. Private companies can only stave off extinction if they implement strategies to boost their financial performance through innovation. Managers should also know where their companies are in the life cycle so they can make strategic and investment decisions that are appropriate for where their businesses currently are.

Theoretical Implication

First, this study has confirmed the presumption of the firm life-cycle theory by establishing a positive relationship between firm age and the financial performance of private limited companies in Uganda. Therefore, this study has recognized that as private enterprises grow, their financial performance improves. Furthermore, the results deep-rooted in this study guide policymakers regarding the strategies that should be adopted at different stages in the firm life-cycle for financial success and long-term sustainability.

Implications to Managers And Researchers

Overall, the present study cements our insights on a firm's age-financial performance nexus in Uganda's private sector and highlights the significance of age towards the company`s success. In the organizational context, findings provide insights into devising strategic business approaches and identifying the factors management should prioritize to achieve long-term business survival and better financial performance. Furthermore, using a quantitative approach, the study findings have oriented researchers toward examining a direct firm age-performance relationship.

Study Limitations And Areas For Future Research

The study focused on all private limited companies with different operating environments and regulations without the control of industry-specific factors. This could limit the generalization of results in other countries. Besides, this paper is inclined to only firm age despite many other firm characteristics like size and reputation, the inclusion of which could have changed results. Therefore, future researchers could test the same hypothesis but control for industry-specific factors and incorporate other firm characteristics for a more comprehensive dissection of the financial success of private limited companies in Uganda. Notwithstanding the above limitations, the study endeavored to unearth the predictive power of firm age to the financial performance among private limited companies.

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