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Examining Liquidity, Growth Strategy, Capital Structure, and Earnings Growth

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PRESENTATION**

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Abstract

Business leaders might have an incomplete understanding of growth drivers. Grounded in the firm growth theory, the purpose of this quantitative, correlational study was to examine the relationship between liquidity, growth strategy, capital structure, and earnings growth. Multiple regression was used to identify a predictive model. The results indicated no statistically significant relationship between liquidity, growth strategy, capital structure, and earnings growth ($p > .05$). The study's findings have implications for positive social change as business leaders might direct resources from project investments to support social programs in the local community.

Doctoral Capstone

Problem

To fund growth and sustain the enterprise, access to capital is vital (Feng et al., 2016; Yang et al., 2017).

- The **general business problem** was that some business executives do not understand that liquidity, growth strategy, and capital structure might affect the company's ability to grow.
- The **specific business problem** was that some business executives of publicly traded microcap companies do not know the relationship between liquidity, growth strategy, capital structure, and earnings growth.

Purpose

The purpose of this quantitative, correlational study was to **examine the relationship** between liquidity, growth strategy, capital structure, and earnings growth. Researchers have correlated improved firm performance with support for social programs and community investment.

Significance

This study contributes to a gap in practice related to the relationship between liquidity, growth strategy, capital structure, and earnings growth. By understanding the relationship between these variables, business leaders can adjust the strategic planning process to improve financial results, potentially increasing support for private sector support social programs.

Theory or Framework

The **firm growth theory** identifies the firm as an administrative unit (Penrose, 2013), with leaders of the business developing strategy and deploying resources (Blundel, 2015). The concept of the firm as a collection of resources, including managers and employees, changes the view of the firm from a homogenous entity to a heterogenous entity.

Relevant Scholarship

The availability of firm resources and abilities of managers are factors in establishing a strategic plan (Penrose, 2013). Effective resource management contributes to growing the firm (Douglas, 2016).

Firm growth is a precursor to sustaining the firm and improving financial performance (Eshima & Anderson, 2016).

Sakarya et al. (2012) noted that **businesses may partner with social enterprises** to facilitate social change. Burrus et al. (2018) correlated improved firm performance with **community reinvestment**.

A firm growing earnings might choose to invest increased amounts in social change initiatives.

Research Question

What is the relationship between liquidity, growth strategy, capital structure, and earnings growth?

Participants

Probabilistic random sampling was used to identify 119 constituent firms of the 2019 Russell Microcap Index, excluding firms in the financial and extraction industries, with Form 10-K filings for fiscal years 2014 and 2018.

Procedures

Existing data were obtained from Form 10-K filings for the fiscal years 2014 and 2018 in the Securities and Exchange Commission EDGAR database.

- The independent variables were **liquidity** (cash holdings as a percentage of total assets), **growth strategy** (organic or inorganic), and capital structure (debt-to-equity ratio).
- The dependent variable was **earnings growth** (return on equity or ROE).

Analysis

Hypothesis testing was conducted using multiple regression.

Findings

The sample of 119 firms was assessed for univariate and multivariate outliers. A total of seven firms were removed from the sample, resulting in a final sample of 112 firms (94% usability rate).

The multiple regression results indicated no statistically significant relationship between liquidity, growth strategy, capital structure, and earnings growth.

Single regression analyses of each of the independent variables were performed, however. Liquidity was negatively correlated with earnings growth ($R = -.19$, $p = .04$). Growth strategy and capital structure were positively correlated with earnings growth but were not statistically significant.

Interpretation

Leaders of businesses with high cash holdings might invest in projects with **negative returns**.

Leaders of businesses with an inorganic growth strategy might **realize earnings growth more quickly**, but integration costs negate some returns.

Leaders of businesses with higher debt-to-equity ratios might **experience higher earnings growth** with interest payments offsetting returns.

The multiple regression model is **inadequate as a predictor** of earnings growth for microcap companies.

Limitations

Limitations of this study included use of **preexisting data sets** not intended for use in the study and **excluding external factors**.

Recommendations

Business Leaders of Microcap Companies

- should understand that **ideas regarding allocation of resources** in pursuit of earnings growth **might not be supported by quantitative analysis.**
- should **review assumptions** about the drivers of earnings growth.
- should **understand their resources** and allocate to appropriate projects.

For Future Research

consider further examination of the relationship between liquidity, growth strategy, capital structure, and earnings growth by **using data from a more extended time period, limiting the study to a specific industry, or including external factors.**

Social Change Implications

Improved financial performance might improve the **economic stability of the community** and translate into increased business **donations in support of social programs.**

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