

#### INSPECTING THE EFFECTS OF NATURAL RESOURCES, ECONOMIC GROWTH AND TRADE OPENNESS ON FIRM PERFORMANCE: A CASE OF DANISH ECONOMY

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### ABSTRACT

The performance of the firms is effected bythe changes in the macroeconomic environment in any economy. Considering this perspective, the research study explores the role of economic growth, foreign assets, trade openness, natural resources and the rule of law while targetingtheperformance of 36 multi-sector Danish firms. After considering fully modified and dynamic ordinary least square methods from 2015 to 2022, this research provides evidence of the significantly accelerating role of economic growth, foreign assets, natural resources and the rule of law in promoting the performance of selected firms in Denmark. The results further reveal that trade liberalization is, in fact, significantly discouraging the firm performance. Based on these results, we propose that promoting natural resources and domestic production may help expand Denmark's firms' return on assets and equity. The administrative authorities may also need to look into the trade openness factor that is not increasing the performance of the firms in Denmark.

KEYWORDS: Natural Resources, Economic Growth, Trade Openness, Firm Performance, Denmark

### 1. INTRODUCTION

Among the basic units of an economic system are firms. These firms collectively form industries or sectors, and these industries, in turn, shape the economic system as a whole and the financial regulations of a country. The firms have investors from within, known as the equity holders and external financers, known as the debt holders. Both the financing parties aim to maximize their returns or, in simple words, earn more than their investment to fulfil their own cash needs. Also, the ultimate objective of a firm is to increase its shareholder's wealth. Ignoring all the agency issues, we may narrow down the firm's goal to maximize the profitability visible through the return on its assets and its equity. As we all know, in accounting terms, a firm's assets are equal to the sum of its equity and liabilities. The return on equity is essential for the shareholders; the return on assets also holds immense importance for the external financers while making investment decisions. Maximizing these returns will result in firms with eye-catching accounting ratios attracting potential financiers. It may be safely said that higher returns will result in higher stock prices and indicate efficient firm performance.

Although many indicators of firm performance exist, ratio analysis is integral. Ratio analysis is an accounting analysis. In other words, it analyses the impact of internal changes upon performance, i.e., the microeconomic factors (usually controllable by management) impact firm performance. Then, there are macroeconomic factors affecting individual firm's performances. The changes in GDP, inflation rate, interest rate, money supply, tax rate and other such macro-factors induce changes in the behavior and thinking patterns of the investors, managers, employees, and consumers, ultimately impactingall the firm performance indicators. The literature linking macroeconomic factors to a firm's performance is scant. Also, the literature regarding natural resources' impact on a firm's performance is silent. This study contributes to the literature on a debate regarding the effects of natural resources upon return on assets and equity. Also, the combination of selected independent variables of the study (net foreign assets, rule of law, natural resources) is unique to the literature. Lastly, to the best of our knowledge, this is the first study on Danish firms capturing the impact of macroeconomic variables on performance.

The selected economy here is Denmark, a developed,high-income northern European economy. Denmark's per capita GDP (current US\$) is 9<sup>th</sup> highest as of 2021.<sup>4</sup> The service sector contributes a more significant chunk to the economic growth. The study's dependent variable includes return on assets and return on equity of 36 selected multi-sector firms. In contrast, the independent variables include economic development, net foreign assets, trade openness, total natural resource rents and rule of law. The list of selected firms is in Appendix 1. The chosen period is from 2015-2022. It is essential to mention that during this period, the exports exceeded imports, as shown inGraph 1 below.

Graph 2 shows the per capita GDP of Denmark in local currency with a steady upward trend. The impact of the recent pandemic is also evident from the graph, as the per capita GDP declined abruptly in 2019.Graph 3 represents the net foreign assets of Denmark; the negative value in 2008 indicates the impact of the global financial crisis, whereas the

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resource rents peaked during the crisis, as is evident from Graph 4. During the selected timeframe, the GDP growth is stable and upward, net foreign assets also depict an upward trend except for 2018 and natural resource rents show a variable direction.







This empirical research aims to inspect the impact of economic growth, net foreign assets, trade openness, natural resource rents and rule of law upon performance indicators ROA and ROE in selected multi-sector firms of Denmark during the period of 2015 - 2022. The analysis will aid policymakers in devising regulations related to macroeconomic variables to favour the firms for the betterment of the overall economy.

# 2. LITERATURE REVIEW

Ratio analysis is a widely used accounting methodology to assess firm performance(Delen et al., 2013). In addition to the comprehensive ratio analysis, different individual performance indicators are also considered in literature while measuring the performance of firms. The return on assets and equity are among the widely preferred performance indicators(Al-Matari et al., 2014). Murigu (2014) uses ROA as a performance indicator while analyzingKenyan insurance companies' performance using microfirm-specific factors. In addition to ROA, Chavali& Rosario (2018) use ROE to assess the profitability of non-banking finance companies in India. Thompson (2021) uses ROA, ROE, and total asset growth as

performance measures in his study while exploring the impact of macroeconomic variables in non-banking financial institutes in Jamaica. A strand of literature also uses a combination of firm-specific and external macroeconomic factors as independent variables. Matar et al. (2018) employ GDP, inflation, interest rate and firm-specific factors, including size, leverage, investment, liquidity and sales growth.Ozgur&Gorus (2016) use return on assetsto study Turkish banks' profitability analysis with micro-firm and macroeconomic factors as independent variables.

Another strand of the literature concludes that macroeconomic factors do not impact firm profitability or performance. Most of the studies conducted on banks produce such results. Naceur (2003) found inflation to have no impact on Tunisian Bank's profitability. The studies on U.S. banks by Arias (2011) and Hoffmann & Rodrigo (2011) also report no direct effect of macroeconomic variables upon profitability indicators. Anbar and Alper (2011) also conclude that GDP and inflation have no impact on ROA and ROE.

This paper focuses on two performance indicators: return on assets (ROA) and return on equity (ROE). The ROA measures the efficiency of firms in earning profits per unit of support. In contrast, the ROE measures the profit per dollarof equity(Kanwal&Nadeem, 2013; ali & Zulfiqar, 2018). The literature regarding firm performance and selected macroeconomic variables is summarized below:

## 2.1. FIRM PERFORMANCE AND GDP

GDP is an essentialmacroeconomic factor impacting all economic spheres. The per capita GDP positively impacts businesses and is evident through its positive impact on ROA. Matar et al. (2018) found a positive relationship between variables under observation, i.e. ROA and GDP, while studying Jordanian non-financial sector firms. Thompson (2021) found a positive association between real GDP and ROA in Jamaican non-banking financial institutes. Ali et al. (2011) found a positive association between GDP and firm performance indicators, ROA and ROE, in commercial banks of Pakistan. Using regression analysis on Ethiopian banks, Shuremo (2016) also reported a positive relationship between GDP and ROA. Other studies that support the positive impact of GDP on ROA are Kosmidou et al. (2008), Davydenko (2011) and Zeitun (2012). GDP and ROA mayalso be negatively related, as a study ofMalaysian insurance companies reports (Ismail et al., 2018).

## 2.2. FIRM PERFORMANCE AND TRADE OPENNESS

The literature relating trade liberalization and firm performance is scantand ambiguous. The liberated trade intensifies competition among local firms due to the entry of foreign firms or foreign products or services into the market. It also provides export opportunities to the local market participants (Shu &Steinwender, 2019). This competition incentivizes the local firms to innovate their processes, enhancing firm productivity and performance (Aghion et al., 2002). Ferreira and Rossi (2003) report trade's positive impact on Brazil's productivity. Urata and Yokota (1994) claim that enhanced trade liberalization enhances total factor productivity in the Thai economy. On the contrary, the study on the weaving sector of Pakistan's textile industry reports a negative impact of trade openness on firm performance indicator ROA (Ullah et al., 2020).

# 2.3. FIRM PERFORMANCE AND NATURAL RESOURCE RENTS

The natural resource's impact on different macro and microeconomic variables is a recent research topic. This is the first paper initiating a debate on a country's natural resources and firm performance indicators. In the existing literature, the impact of natural resources on GDP is positive and negative. The resource curse hypothesis highlights the negative impact of resource rents on economic growth (Auty, 1993). Several factors contribute to this negative impact, such as Dutch disease, weak institutional management and rent-seeking dependency (Khan et al., 2020).

On the other hand, this curse may be converted into a blessing, with better institutional quality and skilled labour, contributing positively to economic growth (Dwumfour&Ntow-Gyamfi, 2018; Audi et al., 2021). Another important macroeconomic variable is financial development, and resources' impact on development is positive (Shahbaz et al., 2018). We propose that natural resources' impact on firm performance might be positive because resource abundance positively impacts economic growth and financial development. On the contrary, Gylfason (2001) argues that human capital is usually neglected and suppressed due to higher economic dependency upon the natural resource sector, known as the crowding-out effect. We propose that neglected human capital may impact the firm's need for educated and skilled employees, negatively impacting the firm performance.

# 2.4. FIRM PERFORMANCE AND RULE OF LAW

Demirgüç-Kunt and Maksimovic (1998) report that firms in countries with sound legal systems grow above average compared to firms in legally weak countries. Theseresearchers present the theory that economies with energetic stock markets and higher compliancewith legal norms are better able to acquire external financing, and thus, they grow faster. Gomez (2016) claims that firms in countries with higher crime and violence rates and weak law enforcement tend to get low external financing and investments. It impacts their economic growth, whereas, on the other hand, well-enforced law and order systems tend to contribute positively to economic growth.Barro (2000)also reports positive rule of law index coefficient with a real per capita GDP growth rate.

Based on the above literature, the following hypotheses are formulated:

H1: there is a relationship between per capita GDP and a firm's performance

H2: there is a relationship between net foreign assets and the firm's performance

H3: there is a relationship between trade openness and a firm's performance

H4: there is a relationship between natural resource rents and a firm's performance

H5: there is a relationship between the rule of law and the firm's performance

# 3. RESEARCH METHODOLOGY

This empirical research targets 36 multi-sector firms from Denmark to explore the impact of macroeconomic variables, including economic growth, net foreign assets, trade openness, natural resources and the rule of law upon firm performance proxied by return on assets - ROA and return on equity- ROE. The proposed functional forms are presented as below:

$$\ln ROA_{it} = f(\ln GDPPC_{it}, \ln NFA_{it}, \ln TR_{it}, \ln NR_{it}, ROL_{it})$$
(1)

$$lnROE_{it} = f(lnGDPPC_{it}, lnNFA_{it}, lnTR_{it}, lnNR_{it}, ROL_{it})$$
(2)

The construction of the variables as stated in the above two equations alongwith their data sources are presented in the following presented Table 1:

Table1: Variable Construction				
Variable Name	Representation	Formula	Data Source	
Return on assets	lnROA <sub>it</sub>	Natural Log of Return on Assets	Financial Statements	
Return on equity	lnROE <sub>it</sub>	Natural Log of Return on Equity	Financial Statements	
Economic growth	lnGDPPC <sub>it</sub>	Natural Log of Per CapitaGDP	World Bank (2022)	
Net foreign assets	lnNFA <sub>it</sub>	Natural Log of Net Foreign Assets as a percentage of GDP	World Bank (2022)	
Trade	InTR <sub>it</sub>	Natural Log of Trade as a percentage of GDP	World Bank (2022)	
Natural resources	lnNR <sub>it</sub>	Natural Log of Total Natural Resource Rents as a percentage of GDP	World Bank (2022)	
Rule of law	ROL <sub>it</sub>	Rule of Law Index	World Bank (2022)	

The data is gathered from the mentioned data sources in local currency for better relevance to the Danish policy makers. The descriptive stats are extracted to get a preliminary idea of variable characteristics. The VIF matrix is developed to assess the presence of multicollinearity. Any VIF value greater than or equal to 10 will suggest the company of multicollinearity issue.

Afterwards, to estimate the impact of selected macroeconomic variables upon firm performance indicators, we will be using fully modified ordinary least squares(FMOLS) developed by Pedroni (1996) and dynamic ordinary least squares(DOLS) produced by Stock and Watson (1993) methods. Based on the findings, we will be providing possible policy implications.

### 4. RESULTS AND DISCUSSION

This section provides empirical results and their discussion of the proposed models of the study. Table 2 contains descriptive stats of selected variables of the study. The natural log of GDPPC, NFAGDP, TRGDP and ROL reveals that their mean values are more significant than their corresponding standard deviation values. This shows that the dispersion is less than the mean value. Hence, these are dispersed, revealing that the 36 selected multi-sector firms almost have similar attributes. Besides this, vice versa is true in the case of the natural log of roa, ROE and TNRGDP.

Table 2: Descriptive Stats					
Variables	Mean	Std. Dev.	Skewness	Kurtosis	Observations
lnROA <sub>it</sub>	-2.9108	1.3217	-0.1146	4.3659	288
InROE <sub>it</sub>	-1.8255	0.8698	-0.5042	4.2494	288
lnGDPPC <sub>it</sub>	10.9335	0.0267	-0.4493	2.5159	288
lnNFA <sub>it</sub>	0.7731	0.1218	0.2438	2.0653	288
InTR it	4.6619	0.0352	0.1866	2.0007	288
lnNR <sub>it</sub>	-0.9644	0.3732	-1.2093	3.7585	288
ROL <sub>it</sub>	1.8889	0.0708	1.0931	3.2876	288

To assess the presence of multicollinearity, theVIF matrix is extracted and presented in Table 3. The independent variables should have VIF values lower than 10 to rule out the existence of multicollinearity. The table shows all the values to be less than 10, supporting the absence of a multicollinearity issue.

Table 3: Variance Inflation Matrix					
Variables	lnNR <sub>it</sub>	lnNFA <sub>it</sub>	InTR it	lnGDPPC <sub>it</sub>	ROL
lnNR <sub>it</sub>	1				
lnNFA <sub>it</sub>	2.6406	1			
InTR it	1.0288	1.0649	1		
lnGDPPC <sub>it</sub>	1.0163	1.2067	2.8074	1	
ROL <sub>it</sub>	1.0157	1.0017	1.0026	1.3790	1

The impact of selected independent variables upon ROA and ROE is estimated through fully modified ordinary least square (FMOLS) and dynamic ordinary least square (DOLS) approaches. The empirical results are presented in the below-provided Table 4:

 Table 4: Regression Estimates

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	Dependent Variable: lnROA <sub>it</sub>		Dependent Variable: InROE <sub>it</sub>		
Variables	Coefficients (P-Value)		Coefficients (P-Value)		
	FMOLS	DOLS	FMOLS	DOLS	
InGDPPC.	3.4542	4.4540	1.8047	2.9124	
it	(0.0000)	(0.0012)	(0.0000)	(0.0084)	
lnNFA.	1.2205	0.3963	0.7862	0.3291	
it	(0.0000)	(0.0465)	(0.0000)	(0.0408)	
InTR .	-6.2132	-3.6038	-5.3741	-4.0360	
it	(0.0000)	(0.0001)	(0.0000)	(0.0000)	
InNR.	0.6892	0.3891	0.4714	0.3593	
it	(0.0001)	(0.0000)	(0.0000)	(0.0000)	
ROL.	0.6797	0.6706	0.9034	0.7443	
it	(0.0000)	(0.0118)	(0.0000)	(0.0006)	

The fully modified ordinary least square (FMOLS) regression results indicate that per capita GDP and ROA are positively related. The significant probability of GDP's co-efficient shows that a 1% increase in this macro-factor will increase the ROA of selected firms by 3.45%. The net foreign assets are also positively related to ROA, with a 1% increase accelerating the returns by 1.2%. The impact of trade openness upon ROA is significantly negative, with a 1% increase in tradecausing a decline of 6.2% in asset returns. The natural resources have a statistically significant and positive impact on ROA, with a percent increase in rents impacting the ROA by 0.69%. Lastly, the rule of law also significantly promotes returns, with a 1% increase in index producing 0.68% more return. The dynamic ordinary least squares (DOLS) regression reveals similar results, i.e. per capita GDP, net foreign assets, natural resource rents, and the rule of law promotes return on investments, whereas trade openness suppresses the returns.

Applying FMOLS with ROE as the dependent variable produces results similar to when ROA is used as the dependent variable. The per capita GDP is positively significant, and a 1% increase in it enhances return on equity by 1.8%. The net foreign assets also positively impact0.79% upon ROE. The trade is negatively related to ROE, with a 1% increase in trade liberalization declining the equity return by 5.4%. The natural resources have a positive impact with a 1% increase, enhancing the returns by 0.47%. Therule of law also improves equity returns as a 1% increase in the index promotes ROE by 0.9%. The results produced through DOLS are similar.

Summarizing both regression model results, it may be inferred that per capita GDP positively impacts firm performance. It indicates that when economies excel internally, the firms also expand in their returns. The result is supported bySufian&Habibullah (2009).Trade openness is negatively impacting the performance of firms. Ullah et al. (2020) also produced identical results. The study contributes to the literature by adding the positive impact of natural resources on the firm performance in Denmark. The significant promoting role of the rule of law is supported by Gomez (2016).

#### 5. CONCLUSION AND POLICY IMPLICATIONS

This research inspects the impact of macroeconomic factors to examine the firm performance of 36 firms from multisectors of Denmark's economy. This study considers the sample period from 2015 to 2022 and applies FMOL and DOLS methods to find empirical results. Based on the results, this study concludes that natural resources, foreign assets, rule of law and economic growth significantly expand firm performance. At the same time, openness to trade greatly hindersathletic performance in Denmark.

Based on the empirical results, this study suggests that both exports and imports must be monitored so that the impact of trade openness may turn positive upon firm performance. Besides this, the role of economic growth, natural resources, foreign assets and the rule of law must be managed with care to keep reaping the accelerating impact of these indicators for firm performance in the Danish economy.

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Appendix 1: List of Danish Firms				
ALK-Abello A/S	GN Store Nord A/S	Ringkjoebing Landbobank A/S		
Ambu A/S	H Lundbeck A/S	Rockwool A/S		
AP Moeller - Maersk A/S	Jyske Bank A/S	Royal Unibrew A/S		
Bavarian Nordic A/S	Matas A/S	Scandinavian Tobacco Group A/S		
Carlsberg A/S	Netcompany Group A/S	Schouw & Co A/S		
Chr Hansen Holding A/S	Nilfisk Holding A/S	Simcorp A/S		
Coloplast A/S	Nkt A/S	Spar Nord Bank A/S		
Danske Bank A/S	Novo Nordisk A/S	Sydbank A/S		
Demant A/S	Novozymes A/S	Topdanmark A/S		
DSV A/S	Orsted A/S	Tryg A/S		
FLSmidth & Co A/S	Pandora A/S	Vestas Wind Systems A/S		
Genmab A/S	Per Aarsleff Holding A/S	Zealand Pharma A/S		