

The Impact of Leverage on Improving Financial Performance - Case Study of Condor Electronics for the Period 2018-2023

تأثير الرافعة المالية في تحسين الأداء المالي - دراسة حالة مؤسسة كوندور إلكترونيكس للفترة 2018-2023

Khelaifia Aziz¹, Chekhar Naima², Ait kaci Azzou Redouane³

¹Doctorant, Morsli Abdullah University Center of Tipaza, Laboratory of Studies in Islamic Finance and Sustainable Development, khelaifia.aziz@cu-tipaza.dz

²Doctor, Morsli Abdullah University Center of Tipaza, Laboratory of Green Economy and Development in Algeria, chekhar.naima@cu-tipaza.dz

³Doctor, Morsli Abdullah University Center of Tipaza, aitkaciazou.redouane@cu-tipaza.dz

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Abstract:

The purpose of This study is to examine the impact of financial leverage on improving financial performance, measured by financial and economic profitability, at Condor Electronics during the period from 2018 to 2023. A time series consisting of 24 observations was used, which were converted from annual data to quarterly data using the EVIEWS10 software. Based on the results of the stationarity tests, we found that the series is stable in first differences, either with or without a constant and a trend. Therefore, the Autoregressive Model was adopted.

Our findings indicate a positive relationship between financial profitability and financial leverage, as well as between economic profitability and financial leverage, suggesting that financial leverage does have an impact on improving financial performance. On the other hand, we also concluded that there is no causal relationship between the study variables in either direction within Condor Electronics during the 2018-2023 period.

Keywords: Financial performance; Financial profitability; Economic profitability; Financial leverage.

JELClassificationCodes: M21 ,G12 ,G32.

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ملخص:

تهدف هذه الدراسة إلى فحص تأثير الرفع المالي في تحسين الاداء المالي المقاس بالمردودية المالية والمردودية الاقتصادية في مؤسسة كوندور إلكترونيكس للفترة 2018-2023، حيث تم الاعتماد على سلسلة زمنية مكونة من 24 مشاهدة بعد تحويلها من بيانات سنوية إلى ربع سنوية باستخدام برنامج EVIEWS10، وبالاعتماد على نتائج استقرار السلاسل الزمنية التي توصلنا إليها مستقرة في الفروق الأولى بقاطع أو بقاطع واتجاه عام، لذا تم اعتماد نموذج الانحدار الذاتي.

حيث توصلت دراستنا أنه هناك علاقة طردية بين المردودية المالية والرفع المالي، والمردودية الاقتصادية والرفع المالي، إذا هناك أثر للرفع المالية وتحسين للاداء المالي هذا من جهة ومن جهة أخرى توصلنا إلى أنه لا توجد علاقة سببية بين متغيرات الدراسة في الاتجاهين في مؤسسة كوندور إلكترونيكس خلال الفترة 2018-2023.

كلمات مفتاحية: أداء مالي، مردودية مالية، مردودية اقتصادية، رفع مالي.

تصنيفات JEL: M21، G12، G32.

Corresponding author: Khelaifia Aziz, e-mail: khelaifia.aziz@cu-tipaza.dz.

1. INTRODUCTION

The financial landscape in which economic institutions operate is undergoing significant transformations, making financing a key challenge for financial managers. They are tasked with securing the necessary funds to ensure the organization's ongoing operations and long-term viability. With the evolving market conditions, a variety of financing options have emerged, providing financial managers with multiple opportunities. The challenge now lies not in finding funding sources, but in selecting the most suitable combination of financing alternatives to create an optimal financial structure.

Financial performance serves as the primary metric that stakeholders use to inform their decisions, as it indicates the ability of an organization to

enhance shareholder value, generate returns on invested capital, and effectively utilize funds. To assess financial performance, key indicators such as financial profitability and economic profitability are commonly employed. In light of this, the following issue arises:

What is the impact of financial leverage on improving the financial performance of Condor Electronics?

The following sub-questions arise from the research question:

- Is there an impact of financial leverage on financial profitability?
- Is there an impact of financial leverage on economic profitability?

As a preliminary answer to the sub-questions of the study, the following hypotheses can be formulated:

- There is no statistically significant effect of financial leverage on financial profitability.
- There is no statistically significant effect of financial leverage on economic profitability.

Objective of the study: The main objective of this study is to find out the impact of leverage on the financial performance of Condor Electronics during the period 2018-2023.

Approach to the study: The descriptive-analytical approach was adopted as the most appropriate for our study, and the quantitative method was adopted by relying on various statistical tools and programs to address the issue at hand.

2. Financial performance

2.1 What is the financial performance?

Financial performance is the extent to which an organization is able to optimally use its long and short resources to create wealth and achieve goals set by management (Allioui, 2019, p. 36).

Financial performance is defined as the optimal utilization of an organization's available resources to achieve desired financial goals.

2.2 Financial Performance Indicators

To measure the financial performance of an economic organization, there are several indicators, the most important of which are:

2.2.1 Financial profitability: It represents the relationship between the result achieved by the organization and the private funds (Belkheir &

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Daghom, 2017, p. 102).

and can be calculated with the following relationship:

$$R_f = R_n / CP$$

2.2.2 Economic profitability: It expresses the efficiency in using the resources available to it to achieve profits regardless of the method of financing these resources, and is expressed by the following relationship (Hamlaoui, 2007/2008, p. 207)

$$R_e = \text{economic result} / \text{capital utilized}$$

3. Financial leverage in the economic institution

The economic institution has many alternatives, some of which are internal (self-financing) and some are external (financial leverage).

3.1 The concept of financial leverage

It is the extent of the organization's reliance on fixed-cost debt (Aqel, 2009, p. 369) To finance part of its assets. (Al-Khalaileh, 1998, p. 152) Financial leverage refers to how institutions use a combination of equity and debt to finance their assets (Abdul & Shagufta, 2021, p. 668) With the aim of achieving a greater return than the cost of borrowing (Mounir & others, 2000, p. 255).

Based on these definitions, we can say that financial leverage refers to the extent to which an organization relies on fixed-income financing sources to fund its assets in order to achieve the highest possible return for its owners. The ratio of total liabilities to total assets represents financial leverage.

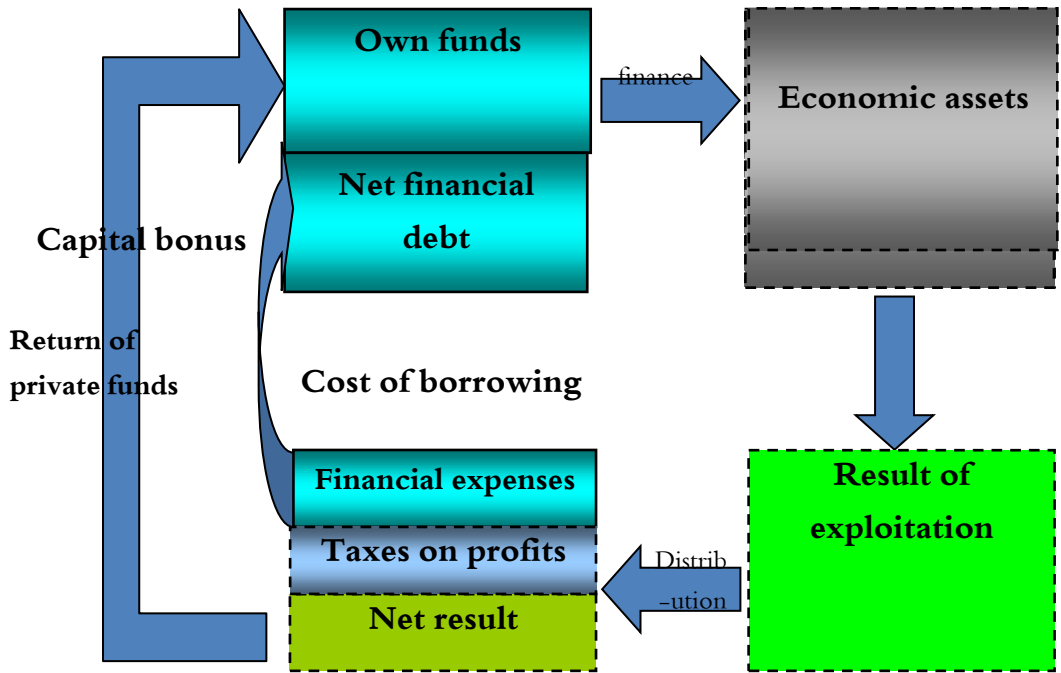
3.2 The impact of financial leverage

The effect of financial leverage depends on the financial structure of the economic institution (chiha, 2005, p. 57), It is explained by the rate of return of private funds in relation to the rate of economic return and the cost of debt (vernimmen, 2016, p. 290).

We will consider that the funds used take one of two forms: either

private funds or borrowed funds, and these funds are invested in the form of assets that are expected to achieve results, as shown in Figure No. (01):

Figure No. (01): Distribution of wealth generated by the institution



Source : vernimmen pierre, financed'entreprise, 2016.

The principle of leverage is that the institution invests borrowed funds with the aim of achieving financial surpluses from the economic result after covering debt costs. This is why it is called the leverage effect, because the leverage increases the return on private funds.

3.3The relationship between financial leverage and financial performance:

The effect of financial leverage can be formulated based on the following data (Bilghazli , 2015/2016, p. 79):

RE: Result of exploitation

I: Financial expenses (cost of borrowing)

D: Net cost of debt

CP: Private funds

Is: a tax on profits

Rcp: return on private funds

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Re: Economic return

Rn: net result

To determine the relationship to the effect of financial leverage, we will start from an equation that represents the net result in terms of the result of exploitation:

$$R_n = [RE - i.D] \cdot (1 - I_s)$$

By dividing one side of the equation by the private funds CP:

$$R_{cp} = R_n / C_p = (RE - i.D) (1 - I_s) / C_p \dots\dots\dots (1)$$

Where:

$$RE = Re \cdot (C_p + D) \dots\dots\dots (2)$$

By substituting equation (2) into equation (1), it becomes:

$$R_{cp} = (Re \cdot (C_p + D) - i.D) (1 - I_s) / C_p$$

$$R_{cp} = [Re \times C_p / C_p + Re \times D / C_p - i.D / C_p] \times (1 - I_s)$$

$$R_{cp} = [Re + (Re - i) D / C_p] \times (1 - I_s) \dots\dots\dots (3)$$

Financial profitability = Economic profitability + Leverage Impact

From relation (3) we find (Lachheb , p. 111)

D/Cp: represents the lever arm;

(Re - i) ×D/Cp: represents the effect of the crane;

(Re - i): represents the leverage difference.

3.4 Leverage situations

Depending on the institution's condition, borrowing can have either a positive or negative impact on financial returns.

3.4.1 The case of the institution without debt: This is a rare case where the institution resorts to self-financing without resorting to debt, and thus the mathematical formulation of the effect of financial leverage becomes as follows (Ben Sassi & Ghrishi, 2006, p. 274):

$$D = 0 \longrightarrow i = 0 \longrightarrow R_{cp} = [Re + (Re - 0) \times 0 / C_p] \times (1 - I_s)$$

In this case, there is no effect of financial leverage, and therefore

$$R_f = Re \cdot (1 - I_s)$$

3.4.2 The institution is in debt: In this instance, we differentiate between three alternative scenarios:

The first case: The positive effect of financial leverage ($R_e - i$) > 0: In this case, the financial return (R_f) increases with the increase in the debt ratio (D/C_p), and the formulation of the effect of financial leverage becomes as follows:

$$R_{cp} - R_e = (R_e - i) \times D / C_p > 0$$

The second case: The negative effect of financial leverage ($R_e - i$) < 0:

In this case, the financial return (R_f) decreases as the debt ratio (D/C_p) decreases, and the formulation of the effect of financial leverage becomes as follows:

$$R_{cp} - R_e = (R_e - i) \times D / C_p < 0$$

Third case: Neutral effect of leverage ($R_e - i$) = 0: In this case, there is no effect of financial leverage and the financial return is equal to the economic return after tax, regardless of the level of borrowing (Mamshe & Dadi Addoun, 2008, p. 30).

4. An analysis of the impact of financial leverage on enhancing the financial performance of Condor Electronics.

4.1 About Condor Electronics:

Condor Electronics, known by its trade name ANTER TRADE, belongs to the Ben Hamadi Group. (Meghdass & Ben Talbi, 2020, p. 30)

The "Condor" company is a private joint-stock company located in the industrial zone of the state of Bordj Bou Arreridj. The company registered in the commercial register in April 2002 and commenced its operations in February 2003. The company focuses on promoting and developing its core activities, which are mainly the assembly and manufacture of electrical and electronic household products. Under the Ministerial Decree 2000/74 dated 04/02/2000, the company markets all its products under the "Condor" trademark, symbolizing a South American mountain bird. One of the world's largest birds, it is known to soar to high altitudes. The letter ® indicates that the current trademark is registered with the National Office of Publications and Innovations, which guarantees adequate protection for its products from

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imitation (Cherad & Hmache, 2023, p. 110).

4.2 The nature of the relationship between variables:

To estimate the relationship between variables, we relied in our study on an annual time series extending from 2018 to 2023, where we divided the values of the variables according to the equations into four ratios (quartiles) in order to use and apply one of the standard models to explain the relationship between the variables.

4.2.1 Definition of study variables:

A phenomenon requires the presence of either a dependent or independent variable, or both.

- **Independent variable:** According to our study, there is one independent variable, which is financial leverage, and its values were obtained through the relationship referred to in the theoretical aspect.

- **Dependent variable:** Financial return (RF) and economic return (RE), which are calculated through the relationship referred to in the theoretical aspect.

4.2.2 Data sources and tools used: In this study, we relied on time series derived from the financial budget and the results accounts table of Condor Electronics, where the values of the variables were calculated according to the mathematical formulation of each variable, and based on the Eviews 10 program as well as the Excel 19 program, the annual values were converted to quarterly values according to the program requirements.

4.3 A standard study of the development of the study variables during the period 2018-2023:

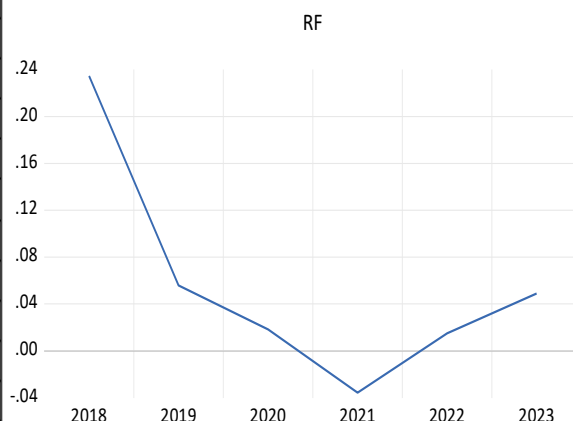
The study variables change from year to year according to the circumstances affecting the institution, where the change in the values of all study variables in Condor Electronics is tracked during the study period 2018-2023.

4.3.1 Statistical analytical study of the development of financial return (RF) during the period 2018-2023:

Figure (02): Development of the financial return ratio during the

period 2018-2023

	RF
Mean	0.056111
Median	0.033525
Maximum	0.234708
Minimum	-0.035720
Std. Dev.	0.093297
Skewness	1.294219
Kurtosis	3.463830
Jarque-Bera	1.728786
Probability	0.421307
Sum	0.336666
Sum Sq. Dev.	0.043522
Observations	6



Source: Prepared by researchers based on Eviews 10 outputs.

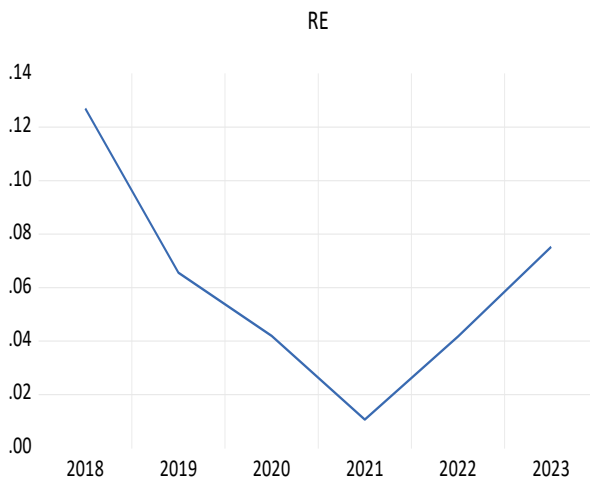
Figure (02) reveals a continuous decline in the financial return value from 2018 to 2023, with the institution achieving its highest financial return rate in 2018. However, this decline continued until 2021, when the institution recorded its lowest rate during the study period. The Corona pandemic, a global epidemic crisis that started in late 2019 and peaked in 2020, explains this decline during this period. After 2021, the institution started to recover and saw an increase in financial return rates.

4.3.2 Statistical analytical study of the development of economic return (RE) during the period 2018-2023:

Figure (03): Development of the economic return ratio during the period 2018-2023

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	RE
Mean	0.060371
Median	0.053785
Maximum	0.126988
Minimum	0.010644
Std. Dev.	0.039604
Skewness	0.576545
Kurtosis	2.545541
Jarque-Bera	0.384037
Probability	0.825292
Sum	0.362228
Sum Sq. Dev.	0.007842
Observations	6

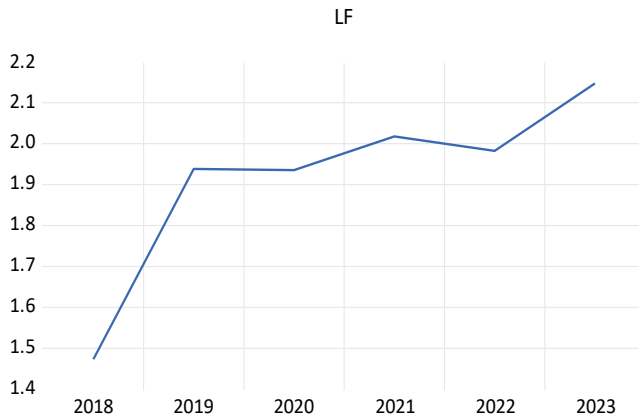


Source: Prepared by researchers based on Eviews 10 outputs.

Through curve No. (03), we notice that the value of economic return during the period from 2018 to 2021 is in continuous decline, as in 2018 the institution achieved the highest rate of economic return during the study period, then it began to decline until it reached its lowest value in 2021, which is the lowest rate recorded by the institution during the study period, and this decline during this period can be explained by the Corona pandemic, the global epidemic crisis that began in late 2019, which had its first peak in 2020, and after 2021 the institution began to recover and achieve an increase in economic return rates.

4.3.3 Statistical analytical study of the development of financial leverage (LF) during the period 2018-2023:

Figure (04): Development of the financial return ratio during the period 2018-2023



Source: Prepared by researchers based on Eviews 10 outputs.

Through the curve and table (04), we notice that the value of the arithmetic mean is 1.916025 and the value of the median is 1.960584, while the highest value of financial leverage was 2.147601, while the lowest value was 1.473665, while the standard deviation was 0.230330. Through the curve, we notice that the financial leverage of Condor Electronics is constantly increasing, with almost stability in the period 2019-2022, and this stability can be attributed to the epidemic crisis that the world witnessed.

4.4 Test of stability and causality:

4.4.1 Test of stability of study variables (unit root test for series stability):

Table No. (01): Results of unit root test for series stability according to the (ADF) test

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Degree of integration $I(D)$						Variables
Second difference test with a secant and general						
Second difference test with a secant						
First difference test with a secant and general						
First difference test with a secant						
Level test with a secant and general direction						
Level test with a secant						
	$I(2)$	$I(1)$	$I(2)$			RF
						RE
						LF

Source: Prepared by researchers based on Eviews 10 outputs.

From Table No. (01), we note that each of the financial leverage series, the economic return series, and the financial return series is not stable at the level with a secant or with a secant and a general trend (the calculated value in absolute value is less than the table values in absolute value), and we also note that the series (financial leverage, financial return, and economic return)

have become stable in the first differences with a secant or with a secant and a general trend (the calculated value in absolute value is greater than the table values in absolute value), so the series are stable and integrated from the first degree.

4.4.2 Granger causality test: By causality, we mean the ability of one variable to predict the other variable, and the direction of causality may be in one direction or reciprocal, or there is no causal relationship between the variables. Table No. (02) shows the results of causality between the study variables.

Table No. (02): Granger causality results between the study variables

Pairwise Granger Causality Tests			
Date : 12/14/24 Time : 07 :58			
Sample : 2018Q1 2023Q4			
Lags : 2			
Null Hypothesis :	Obs	F-Statistic	Prob.
RE does not Granger Cause LF	22	1.99307	0.1669
LF does not Granger Cause RE		0.82596	0.4546
RF does not Granger Cause LF	22	1.99371	0.1668
LF does not Granger Cause RF		0.00654	0.9935
RF does not Granger Cause RE	22	0.82514	0.4550
RE does not Granger Cause RF		0.00651	0.9935

Source: Prepared by researchers based on Eviews 10 outputs.

- From Table No. (02), it appears to us that economic return does not cause financial leverage, and the latter does not cause economic return, and thus Granger causality does not work in both directions.

- We also note from the table that financial return does not cause financial leverage, and financial leverage does not cause financial return. Therefore, Granger causality does not work in both directions.

We also note that financial return does not cause economic return, and economic return does not cause financial return. Therefore, causality does not operate in both directions.

4.5 Measuring the impact of financial leverage on financial performance

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measured by financial and economic return:

In the standard study, we relied on a time series consisting of 24 observations after converting them from annual to quarterly data through the Eviews 10 program, where we rely on the results of the stability of the time series to choose the appropriate model for the study in which financial leverage was adopted as an independent variable and financial return and economic return as a dependent variable, and based on the results of the stability of the time series, we rely on the VAR model to explain the impact of financial leverage on financial return and economic return ("financial performance").

4.5.1 Measuring the impact of financial leverage on financial return: To apply the VAR model, which explains the impact of financial leverage on Condor Electronics' financial return, we must first determine the model's lag periods.

- **Testing the number of time lags for the VAR model:** To determine the optimal number of time lags in the VAR model, the following statistical criteria must be used: (AIC), (Shiwartz SIC), (Hanen Kun HQ), where the smallest value for each of the aforementioned criteria is chosen that corresponds to the optimal time lag, and Appendix No 2 shows that.

Appendix No 2, the number of observations in our study is 22 observations, and from the same table, the degree of lag that corresponds to the smallest value in each criterion, which corresponds to (L=1)1.

- **VAR model criteria for financial leverage and financial return:** According to the autoregressive model, any variable depends according to the number of time periods specified for the lag on its previous values in addition to the previous values of the other variables, and the following equation explains this:

$$\begin{array}{l} \text{RF} = 0.749414077423 * \text{RF}(-1) + 0.191935201325 * \text{LF}(-1) + 0.0016176287009 \\ \quad (0.00449) \qquad \qquad \qquad (0.30255) \qquad \qquad \qquad (0.5026) \\ \text{R-squared} = 0.872994 \qquad \qquad \text{F-statistic} = 68.73656 \qquad \qquad \text{N} = 22 \end{array}$$

Through the previous equation, we notice the following:

- Financial return is defined through this equation as a constant and a delay for financial return and financial leverage, meaning that financial return in

year N is determined and affected by both financial return and financial leverage during year (N-1).

- There is a direct relationship between financial return and its value in year (N-1), meaning that if the institution achieved a positive financial return in the previous year according to the model, it will also achieve this in this year.
- There is a direct relationship between financial leverage and financial return.
- As for the overall statistical aspect, we notice that $R^2=0.87$, which is a positive value close to one, which indicates the strength of the relationship between the two variables. In other words, the change in financial return is due to financial leverage by 82%, and the rest is due to other factors outside the model. The value of $F= 68.73656$ is greater than its tabular value, which indicates that the model as a whole has statistical significance.

4.5.2 Measuring the impact of financial leverage on economic return: In order to be able to apply the VAR model that explains the impact of financial leverage on the economic return of Condor Electronics, we must first determine the model's lag times.

- **Testing the number of lag times for the VAR model:** To determine the optimal number of lag times in the VAR model, the following statistical criteria must be used: (AIC), (Shiwartz SIC), (Hanen Kun HQ), where the smallest value for each of the previous criteria is chosen that corresponds to the optimal lag time, and Appendix No 3 shows.

From Appendix No 3, the number of observations in our study is 22 observations, and from the same table we take the degree of lag, which corresponds to the smallest value in each scale, which corresponds to (L=1)1.

- VAR model criteria for financial leverage and economic return: According to the autoregressive model, any variable depends according to the number of time periods specified for the lag on its previous values in addition to the previous values of the other variables, and the following equation explains this.

$$RE=0.602401481272*RE(-1)+0.195690478812*LF(-1)+0.0050220394215$$

(0.18653)
(0.13668)
(0.00277)

$$R\text{-squared}= 0.745860 \qquad F\text{-statistic}= 33.28315 \qquad N= 22$$

Through the previous equation, we note the following:

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- The economic return is defined through this equation as a constant and a delay for the economic return and financial leverage, meaning that the economic return in year N is determined and affected by both the economic return and financial leverage during year (N-1).
- The value of the economic return (constant) is positive in the absence of economic variables and is an economically acceptable value.
- There is a direct relationship between the economic return and its value in year (N-1) (positive value), meaning that if the institution achieves a positive economic return in year (N-1) according to the model, it will also achieve this in this year.
- There is a direct relationship between financial leverage and economic return.
- From the overall statistical point of view, we note that $R^2 = 0.75$, which is a positive value close to one, and it indicates the strength of the relationship between the two variables. In other words, the change in economic return is due to 75% of financial leverage, and the rest is due to other factors outside the model. Also, the value of $F = 33.28315$ is greater than its tabular value, which indicates that the model as a whole has statistical significance

5. Conclusion:

Through this study, we reached a set of results, which are:

- The chains are stable in the first differences with a secant or with a secant and a general trend, i.e., the chains are stable and integrated of the first degree.
- That economic return does not cause financial leverage, nor does financial leverage cause economic return, and thus Granger causality does not work in both directions.
- That financial return does not cause financial leverage, nor does financial leverage cause financial return, and thus Granger causality does not work in both directions.
- That financial return does not cause economic return, nor does economic return cause financial return, and thus causality does not work in both directions.

- There is a direct relationship between financial leverage and financial return.
- There is a direct relationship between financial leverage and economic return.

- Recommendations:

Based on the results reached, we can provide the following recommendations:

- The institution should continue to rely on financial leverage, taking into account liquidity risks and default risks.

It is necessary for the institution to work on aligning the sources of funding with the methods of employing the funds.

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6. Appendices

Appendix No. 1

Mean	1.916025
Median	1.960584
Maximum	2.147601
Minimum	1.473665
Std. Dev.	0.230330
Skewness	-1.303982
Kurtosis	3.521864
Jarque-Bera	1.768453
Probability	0.413033
Sum	11.49615
Sum Sq. Dev.	0.265260
Observations	6

Appendix No. 2

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VAR Lag Order Selection Criteria
 Endogenous variables : RF LF
 Exogenous variables : C
 Date : 12/11/24 Time : 22 :04
 Sample : 2018Q1 2023Q4
 Included observations : 22

Lag	LogL	LR	FPE	AIC	SC	HQ
0	153.1826	NA	3.68e-09	-13.74388	-13.64469	-13.72051
		43.78208		-	-	-
1	178.5302	*	5.31e-10*	15.68456*	15.38700*	15.61446*
2	181.3263	4.321337	6.00e-10	-15.57512	-15.07919	-15.45829

* indicates lag order selected by the criterion

LR: sequential modified LR test statistic (each test at 5% level)

FPE : Final prediction error

AIC : Akaike information criterion

SC : Schwarz information criterion

HQ : Hannan-Quinn information criterion

Appendix No. 3

VAR Lag Order Selection Criteria

Endogenous variables : RE LF

Exogenous variables : C

Date : 12/11/24 Time : 22 :00

Sample : 2018Q1 2023Q4

Included observations : 22

Lag	LogL	LR	FPE	AIC	SC
0	153.1845	NA	3.68e-09	-13.74405	-13.6448
1	178.5339	43.78536*	5.30e-10*	-15.68490*	-15.38734
2	181.3303	4.321619	5.99e-10	-15.57548	-15.0795

* indicates lag order selected by the criterion

LR: sequential modified LR test statistic (each test at 5%)

FPE : Final prediction error

AIC : Akaike information criterion

SC : Schwarz information criterion

HQ : Hannan-Quinn information criterion