A Study On Impact Of Financial Management On Business Performance

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Abstract

Today's business houses have to cope with the ever changing business environment. These business houses would be able to do so with good financial management practices. Performance of any organization is measured by the profits that it makes and profitability of any firm is dependent on efficient financial management policies.

The basic purpose of undertaking this research is to underline the important link between financial management policies of the firm and business performance. This study would be based on an analysis of financial statements of private financial services sector companies in India.

Different factors of financial management like capital structure decision, dividend policy, working capital policy and financial position has a direct impact on the performance of business and this study would emphasize this relationship.

Suggestions would be given to firms on how they can improve their performance through this study.

Keywords: Financial Management Policies, Capital Structure, Dividend Policy, Working Capital, Investment Appraisal, Performance.

Introduction: Financial management is one of the most fundamental aspect which contributes to the growth of the firm. If the factors of financial management are not considered appropriately it may lead to financial crisis. Financial services sector plays a critical role in the development of the economy. In this era of competition in order to survive in the market you need to have a business plan with a strong understanding of the principles of financial management to generate profits and to increase shareholder's wealth. Factors that need to be considered for formulating a good financial policy for the firm includes Capital structure decision, Dividend policy, Working capital policy and Financial position.

Capital Structure: Capital structure is the combination of different sources of funds employed by the firm. It includes both the owners' funds and funds provided by the investors. An optimum capital structure of the firm contributes to the long term survival and profitability of the firm. Capital Structure comprises of Equity Shares, Preference Shares, Debenture and Bonds .The risk profile of the firm can be determined by Debt-to-equity ratio. More the proportion of debt in the capital structure of a firm, higher is the leverage. Lack of long term debt in the capital structure of a firm indicates that the firm is not willing to accept risk or the cost of equity capital is less than the cost of debt.

To generate maximum profits for the firm as well as the stakeholders it is necessary that the source of funds for the firm should have the lesser cost of capital.

Dividend Policy: Dividend policy indicates the profitability of the firm and its distribution to the shareholders. Companies prefer to give dividends to the shareholders either in the form of cash or equity. Dividend policy has to be given due consideration by the firm as it contributes towards shareholders gain which impacts the performance of the firm.

Working Capital Policy: Working capital is the fund requirement for day to day functioning of the firm. It aids the firm in managing short term assets and liabilities. It is used to assess the liquidity, efficiency and overall strength of a firm. A company's working capital indicates activities like inventory management, debt management, revenue collection and payments to suppliers. Positive working capital means the company is in a good financial condition and is able to pay- off its short term liabilities almost immediately while negative working capital indicates incapability of the firm which may lead to the failure of the business.

An extremely high working capital turnover ratio may lead to the collapse of the company as it is not having enough capital to support it sales growth.

Financial Position: Financial Position refers to Revenue Statement and Balance Sheet of the firm which reflects the financial soundness of the firm in a particular period.

It summarizes the expenses incurred and revenue generated and hence the profit and loss position of the firm during a particular period.

The balance sheet gives an overview of the assets and liabilities position of the firm.

Assets of the Company include buildings, trucks, and inventories of products, cash and intangible assets such as goodwill, trademarks and patents.

Those assets which can be converted to cash within one year are shown under Current assets. Examples- cash, cash equivalents, accounts receivable and inventory.

Sources of Funds show the bifurcation of the company's funds – Owned and Borrowed.

Current liabilities include accounts payable, wages payable, interest payable. Examples of liabilities include money owed to banks and other lenders, money owed to suppliers of goods and services (accounts payable), taxes owed to government authorities and rents owed to owners of land and buildings. Liabilities are either current (short term) or long term. Current liabilities are due within one year. Long term liabilities are due after one year. Management of liabilities is the responsibility of the firm and needs careful planning. Example if the coupon payments are not made on time by the companies, it reflects a poor performance and may lead to decrease in market value .Therefore sound financial management policies have a direct positive impact on the profits of the firm which in turn leads to wealth maximization of the firm's stakeholders.

Objective of Study:

- To understand the factors influencing Financial Management Policies
- To study the correlation between the various factors affecting financial management and profitability of the firm.
- To study the impact of factors like capital structure decision, dividend policy, working capital management and financial position on the performance of the business.

Methodology: The study was conducted using secondary data. The revenue statements and Balance Sheets of Financial Services Companies were analyzed for the purpose of the study. The financial ratios measuring liquidity, financial leverage, working capital and profitability of business organizations were used to study the impact of factors of financial management.

In developing a causal relationship and testing hypothesis of association, there are two kinds of variables involved: dependent and independent variables. The dependent variable would measure the efficiency of financial management practices. Independent Variables Related to Financial Management Practices includes efficiency in capital structure decision, dividend policy, working capital policy and financial position. The relationship between dependent and independent variables would substantiate the objective of the study.

Research Layout:

Target Group: Private Financial Services Sector.

Data Source: Annual Reports (Secondary data)

Sampling Procedure: Convenience Sampling

Sample Size: 30 companies

Data Analysis Tools: Multiple Regression Analysis using SPSS

Independent variables: Debt Equity ratio, Current ratio, Fixed Assets Turnover ratio, Interest coverage ratio, Dividend payout ratio

Dependent variables: Profit after tax margin

Profit after tax margin(PATM) = b0 + b1(D/E)+ b2(CR) + b3(FATR) + b4(ICR) + b5(D/P)

Where: b0 to b5 are the coefficients

D/E- Debt Equity ratio

CR- Current ratio

FATR- Fixed Assets Turnover ratio

ICR- Interest coverage ratio

D/P- Dividend payout ratio

RESULT & DISCUSSION

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.722[a]	.521	.422	.13788

a. Predictors: (Constant), DP, FixedAssetTurnoverRatio, InterestCoverageRatio, DebtEquityRatio, CurrentRatio

ANOVA[b]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	.497	5	.099	5.229	.002[a]
	Residual	.456	24	.019		
	Total	.953	29			

a. Predictors: (Constant), DP, FixedAssetTurnoverRatio, InterestCoverageRatio, DebtEquityRatio, CurrentRatio
b. Dependent Variable: PATM

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	.247	.054		4.605	.000
	DebtEquityRatio	-.040	.011	-.593	-3.824	.001
	CurrentRatio	.034	.017	1.441	2.016	.055
	FixedAssetTurnoverRatio	.005	.002	.425	3.009	.006
	InterestCoverageRatio	-.001	.000	-1.757	-2.422	.023
	DP	.012	.023	.075	.519	.608

Profit after tax margin = 0.247 + (-.040)(D/E)+ (0.034)(CR) + (0.005)(FATR) + (-.001)(ICR) + (0.012)D/P)

Multiple regression analysis using SPSS was used in order to predict the value of independent variable Profit after tax margin based on the values of five dependent variables as mentioned above.

From the result above we can conclude that dependent variable Profit after tax margin is significantly correlated with five independent variables with the correlation coefficient R= 0.722.

Coefficient of determination, R Square= 0.521 which indicates that 52.1% of the variation in Profit after tax margin for the sample of 30 firms of financial services sector can be explained by changes in Debt Equity ratio, Current ratio, Fixed Assets Turnover ratio, Interest coverage ratio, Dividend payout ratio.

From the Anova table we can see the value of F= 5.229 which is large enough to give the justification that independent variables are contributing to the variation in Profit after tax margin. This model represents the actual performance of the firms under study.

Conclusion & Recommendations: The research was conducted to identify the role of financial management on business performance. Different factors such as capital structure decision, dividend policy, working capital policy and financial position were considered. The results of the study which was based on a sample of financial services sector companies in India reveal that financial management has a positive and significant impact on organization performance. So efforts should be made by all the companies in other sectors also to promote this culture. It should be the duty of the top management to understand the benefits and promote financial management in organizations for business performance. In addition, a more comprehensive survey through all other sectors is suggested as a future study area.

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