FINANCIAL MANAGEMENT PRACTICES ON FINANCIAL PERFORMANCE

*Md. Abdul Kader

*Md. Abu Zahar Khan

Abstract

This study sought to examine the effect of financial management practices on financial performance of insurance companies in Bangladesh. Financial management is one of the several functional areas of management but it is the center to the success of any business. Inefficient financial management, combined with the uncertainty of the business environment often led business enterprises to serious problems. Careless financial management practices are the main cause of failure for business enterprises. This study used only primary data. Data collection tools used are questionnaires. The primary data was collected using semi-structured questionnaire which comprised of both open and closed ended questions. The sample size was 52; and that was selected by using Slovic's formula. Validity is the quality of the test doing what is designed to do. The formula that has been used to calculate the validity of the instrument is: Content Validity Index (CVI) = No. of items declared valid/ Total No. of items. Reliability of the instrument will be established through a test-retest technique.

Keywords: Firm, Financial Management Practice, Financial Performance, Small Scale Business, Capital; etc.

Objectives of the Study

This study pursued the following objectives:

1. To establish the effect of working capital management on financial performance of small scale business in Bangladesh.
2. To find out the effect of capital budgeting techniques on financial performance of small scale business in Bangladesh.
3. To determine the effect of capital structure decisions on financial performance of small scale business in Bangladesh.

Methodology of the study

Research Design

A research design is the structure of research. It is the glue that holds all the elements in a research process project together. A design is used to structure the research, to show how all of the major parts of the research project work together to try to address the central research questions (Orodho, 2003). This study used correlational research design. In general, correlational study is a Qualitative method of research in which you have two or more quantitative variables from the same group of subjects, and you are trying to determine if there is a relationship (or covariation) between the variables.

Population of the Study

Population is a large collection of individuals or objects that is the main focus of a scientific query. It is for the benefit of the population that researches are done (Castillo, 2009). A population also refers to an entire group of individuals, events or objects having a common observable characteristic.

This study the researcher selected only 2 financial institutions in Bangladesh from currently more than 100 financial institutions are working in the country. The population of this study was comprised only the employees in both enterprises which consists a population of 60. The major reason for selecting this type of people from the others was due to the facts that the researcher expected them to have a very good understanding the effectiveness of financial management and small business profitability.

*Assistant Professor of Marketing, Department of Business Administration, Asian University of Bangladesh

**Lecturer in Management, Department of Business Administration, Asian University of Bangladesh

Sampling Frame

A sampling frame is a list of population from which a sample will be drawn (Leary, 2001). It is the source material or device from which list of all elements within a population that can be sampled is drawn (Sandal, Swensson & Wretman, 1992) and may include individuals, households or institutions.

Sampling Design

A sample design is the architecture or the strategy used to select study participants or respondents (Kothari, 2004). Sampling refers to the systematic selection of a limited number of elements out of a theoretically specified population of elements.

Sample Size

Sampling is the selection of a subset of individuals from within a population to yield some knowledge about the whole population, especially for the purposes of making predictions based on statistical

inference (Black, 2004; 2011). The advantages of sampling are cost, speed, accuracy and quality of the data (Ader, Mellenbergh, & Hand, 2008). The sampling process comprises of defining the population, sampling frame, sampling method, sample size and sample plan (Lavrakas, 2008).

Out of the total population of 60, a sample size of 52 was selected, using Sloven's formula. The sample is sufficiently high and representative enough to validate the findings, so the findings of this study can be replicated the whole population. The table below can give you the selected population their respective organization and city.

$$n = \frac{N}{1 + N(e^2)}$$

Where, n = sample; N = target population; α = constant variable: equivalent to **0.05**, which is the allowed margin of error.

Table 1 .Respondents of the Study

Population Category	Population Name	Population Sample	Sample Size
House Building Financing Ltd	Employees	30	18
Lanka Bangla Financing Ltd	Employees	29	34
Total		60	52

Source: Primary Data

Therefore given the formula, the sample size of 52 was calculated as follows;

$$n = \frac{N}{1 + N(e^2)} = \frac{60}{1 + 60(0.0025)} = \frac{60}{1.15} = 52$$

Data Collection Instrument

This study used only a primary. Data collection tools used are questionnaires. The primary data was collected using semi-structured questionnaire which comprised of both open and closed ended questions.

Validity and Reliability of the Instrument

Validity is the quality of the test doing what is designed to do (Salkind, 2000). The researcher will consult his supervisor for expert knowledge on questionnaire construction. After the assessment of the questionnaire, the necessary adjustments will be made bearing in mind the objectives of the study.

The formula that will be used to calculate the validity of the instrument is: Content Validity Index (CVI) = No. of items declared valid / Total No. of items.

Reliability is a measure of the degree to which a research instrument yields results or data after repeated trials (Mugenda & Mugenda, 2003). Reliability of the instrument will be established through a test-retest technique.

Researcher will conduct a pre-test of the instrument on group of subjects that have a similar characteristic to the respondents.

Review of the Literature

Theoretical Review

A theoretical framework consists of concepts, together with their definitions, and existing theory/theories that are used for a particular study (Van Ryan & Heaney, 1992). The theoretical framework presented herein demonstrates an understanding of theories and concepts that are relevant to the topic of the research.

Conceptual Framework

The scholars further define a conceptual framework as a set of broad ideas and principles taken from relevant fields of enquiry and used to structure a subsequent presentation. The goals of a conceptual framework are threefold. Firstly, to describe existing practice, secondly, to prescribe future practice; and thirdly, to define key terms and fundamental issues. A conceptual framework aims to broadly define a number of key terms and

concepts that can be used in identifying and debating the issues.

The conceptual framework developed for this research is intended to assist the researcher to develop awareness and understanding of the effects of financial management practices on financial performance of small enterprise of companies in Somalia.

Financial Management Practices

Figure 1: Conceptual Framework

Working Capital Management

Working capital management was explained by use of cash management, refund and maturity management and current debt management indicators. Good management of debtors is key to having good profits for the company, creditors can be used to manage cash flow deficits and avoid loss of good performance (Appuhami, 2008).

According to Jagongo and Makori (2013) study on the effects of working capital management on firm's profitability in Kenya adopted number of day's accounts receivable and cash conversion

cycle.

Capital Budgeting Techniques

Capital budgeting decisions are critical to the success of any firm. Brigham and Ehrhardt (2008) argued that capital budgeting decision is vital to a firm's financial well-being and are among the most important decisions that owners or managers of a firm must make. Their rationale for that belief is that capital budgeting decision often involves significant capital outlay to acquire fixed assets.

Capital Structure Decisions

The concept of capital structure can be defined as the proportional relation between a firm's debt capital and equity capital. Firms use capital structure usually to fund their business and expand. This decision is vital for a firm as it has a direct influence on the risk and return of a firm. Basely and Brigham (2008) conceptualized capital structure as the blend of long-term debt capital, preferred share capital and the net structure as the blend of long-term debt capital, preferred share capital and the net worth that is being used as a method of permanent financing by the firm worth that is being used as a method of permanent financing by the firm.

Firm Characteristics

According Budhwar, Varma, and Katou (2009) argue that the intensity of the interface between firm characteristics and firm performance are dependent on the operational model of the organization. The model may involve the business strategies and human management policies. The outcome of the interface can be affected by management style. Organizational culture and reverse causation which are controlled by size of the firm, age, staff, and the industry the firm belongs to. Namada (2013) proposes need for right configuration of strategic planning to improve performance. The study confirms firm size as one of the most influential characteristics in organizational studies. According to Golan et al. (2003) firm's resources and objectives summarized as firm characteristics, influence performance of organizations. These include structure, market and capital-related variables. Structure-related variables include firm size, ownership and firm age. Market-related variables include industry type environmental uncertainty and market environment. Capital-related variables entail liquidity and capital intensity. According to Kaguri (2013), taking all firm characteristics into account; size, liquidity, leverage, age, diversification, claim experience and premium growth financial, the study found out that these variables are statistically significance to influencing financial performance of life insurance companies as indicated by the positive and strong Pearson correlation coefficients.

Financial Management Practices

Financial management refers to the systems of efficient and effective management of resources in such a manner as to accomplish the objectives of the organization (Chung & Chuang, 2010). Financial management practices include working capital, investment, financing, accounting information systems, financial reporting and analysis (Firer et al., 2004; Gitman, 2007). Walker and Petty as cited by Kieu (2004) defined the main

areas of financial management including financial planning (cash planning, fixed asset planning, profit planning), investment decision- making, working capital management (cash, receivable and inventory management) and sources of financing (short-term and long-term financing, intermediate financing and going public).

Working capital is defined as a company's total investment in current assets or assets that a company expects to be converted into cash within a year or less (Keown; Martin; Petty; & Scott, 2005). The investment in working capital involves carrying costs and shortage costs, so the firms have to find the tradeoff between them. Working capital management involves managing the short-term assets and claims of a firm. Working capital management ensures that a firm has sufficient cash flow in order to meet its short-term debt obligations and operating expenses (Gitman, 2007). According to Munyao (2010), capital budgeting techniques is used to evaluate whether investments in fixed assets such as new machinery, new plants, new products, and research development projects are worth pursuing. Capital budgeting techniques include non-discounted cash flow techniques (payback period and the accounting rate of return) and the discounted cash flow techniques (net present value, internal rate of return, profitability index and discounted payback period). Capital Structure Management (CSM) is the other financial management practice under review in this study. According to Romney (2010), Capital structure is defined as the relative amount of debt and equity used to finance a firm. It's the relative amount of permanent short term debt, long term debt, preferred stock and common equity used to finance a firm. When determining a company's cost of capital, the costs of each component of the capital structure are weighted in relation to the overall total amount. A company's capital structure refers to the combination of its various sources of funding. Most companies are funded by a mix of debt and equity. Capital structure is part of financial structure, representing the permanent sources of a firm's financing (Boating, 2004). Corporate governance is a financial management reviewed by this study. Cadbury (2002) defined corporate governance as the systems by which a corporation is directed, controlled and held to account. Akinpelu (2012) define corporate governance as referring to private and public institutions, including laws, regulations and accepted business practice, which in a market economy govern the relationship between corporate managers and entrepreneurs (corporate insiders) on one hand, and those who invest resources in corporations (corporate outsiders), on the other hand. Corporate governance is concerned with relationship between the internal governance

mechanisms of corporations and society's conception of the scope of corporate accountability.

Financial Performance

According to Nandan (2010) financial performance can be defined as a subjective measure of how well a firm can use assets from its primary mode of business and generate revenues. Further this term is used as a general measure of a firm's overall financial health over a given period of time, and can be used to compare similar firms across the same industry or to compare industries or sectors in aggregation. Financial performance of companies can be measured by use of accounting information or stock market values in a financial management practices context. When applying stock market values as a measure of performance, one is interested in analyzing the change in market value. Firm performance is measured over time by using the average stock market change per year. This value is usually obtained by calculating the yearly change in stock price.

According to Maseko and Manyani (2011) aver that accounting systems provide a source of information to businesses operating in any industry for use in the measurement of financial performance. It is crucial therefore that the accounting practices of insurance companies supply complete and relevant financial information needed to improve economic decisions made by entrepreneurs. In the context of business entities, accounting information is important as it can help the firms manage their short-term financial problems in critical areas like costing, expenditure and cash flow, by providing information to support monitoring and control. At all levels of organizations, budgets are getting tighter and there is an increased need for financial management initiatives to directly contribute to providing timely, accurate, reliable financial information to support management decisions (Nandan, 2010).

Financial Management Practices and Financial Performance

Financial management practices directly contribute to the financial performance of any company. Bhattacharya (2006) states that for a business firm to be able to sustain its business operations and meet its goals and objectives it must manage its financial practices effectively and prudently. Financial management helps to improve the profitability position of business organizations with the help of strong financial control devices such as budgetary control, ratio analysis and CVP analysis (Paramasivan et al., 2009). Capital budgeting decisions are critical to the success of any firm. Brigham and Ehrhardt (2008) observes that capital budgeting decision is vital to a firm's financial wellbeing and are among the most important decisions that owners or managers of a firm must make. Their rationale for that belief is that capital budgeting decision often involves significant capital outlay to acquire fixed assets. Olawale and Garwe. (2010) observes that the use of sophisticated investment appraisal techniques such as NPV and IRR methods have a positive impact on the profitability of firms.

Research Gap

A critical review of past literature show that several conceptual, contextual and methodological research gaps existed in the effects of financial management practices on financial performance of small scale business in Somalia.

Research Findings and Discussion Profile of Respondents

The first objective of the study was to determine the profile of staff organization namely administration to achieve it, closed ended questions were asked in the questionnaire. Frequencies and percentage distributions were used to summarize the profile selected employees in selected organizations in Puntland in terms of Gender, Age, Educational Level, Job position, and Year of working experience these are indicated in the bellow table 1.

Categories	Sub Categories	Frequency	Percentage
Age	20-29	13	43.3%
	30-39	11	36.7%
Gender	40-49	6	20.0%
	Total	30	100%
	Male	13	43.3%
	Female	17	56.7%
	Total	30	100%
Educational Level	Secondary	6	20%
	diploma	5	16.7%
	Degree	14	46.7%

	Master	2	6.7%
	PHD	3	10%
Job Title	Total	30	100%
	Top management	3	10%
	Middle management	10	33.3%
	Lower management	7	23.3%
	Staff	10	33.3%
	Total	30	100%
Work Experience	Less than 1 year	8	26.7%
	1 – 3 years	7	23.3%
	4-6 years	4	13.3%
	7 and Above	11	36.7%
	Total	30	100%

The Level of Effective of Financial Management Practices In Selected firms in Bangladesh.

The second objective of this research was to determine the extent of effectiveness of financial management in selected organizations Puntland Somalia. All questions were rated using a four point like scale, were: 1= Strongly disagree, 2= disagree, 3= agree, 4= Strongly agree. The self-rating of respondents were analyzed using mean

indicating the extent effectiveness of financial management to which they recognize each indicated in Table 1.

For interpretation of responses the following numerical value and description were followed:

Mean Range	Description/Response Mode	Interpretation
3.26-4.00	strongly agree	Very satisfactory
2.51-3.25	agree	satisfactory
1.76-2.50	disagree	fairly satisfactory
1.00-1.75	strongly disagree	Poor satisfactory

Table 1: Creditors are used to manage cash flow deficits and avoid loss of good performance.

Respondents	Frequency	Percentage
Strongly Agree	1	3.3%
Dis Agree	6	20.0%
Agree	10	33.3%
Strongly Agree	13	43.3%
Total	30	100%

Source: Primary Data 2019

The results in the figure and table shows that greater fraction of the respondents accept and

confessed that there is high level of Conversely, efficient financial management will help SMEs to

strengthen their profitability and, as a result, these difficulties can partly be overcome. The majority 43.3% of strong agree while 33.3% have agree

is 20.0% have dis agree while 3.3% have strong disagree.

Figure 2. Creditors are used to manage cash flow deficits and avoid loss of good performance.

Table 2. Payback period is considered before investing in projects.

Respondents	Frequency	Percentage
Strongly Agree	2	6.7%
Dis Agree	3	10%
Agree	12	40%
Strongly Agree	13	43.3%
Total	30	100%

Source: Primary Data 2019

The results in the figure and table show that a greater fraction of the respondents accept and confessed that there is a high level of this, SME profitability could be damaged because of

inefficient financial management is the majority 43.3% of strong agree while 40% have agree 10% have dis agree while 6.7% have strong disagree.

Figure 3. Payback period is considered before investing in projects.

Table 3. The capital structure of the company is appropriate.

Respondents	Frequency	Percentage
Strongly Disagree	1	3.3%
Disagree	5	16.7%
Agree	15	50%
Strongly agree	9	30%
Total	30	100%

Source: Primary Data 2019

The results in the figure and table shows that greater fraction of the respondents accept and confessed that there is high level of SMEs have often failed due to lack of knowledge of efficient

financial management is the majority 50% of agree while 30% have strong agree 16.7% have disagree while is 3.3% have strong disagree.

Figure 4. The capital structure of the company is appropriate.

Table 4. Claim management policies is a key driver of company's financial performance.

Respondents	Frequency	Percentage
Strongly disagree	5	16.7%
Dis agree	9	30%
Agree	7	23.3%
Strongly agree	9	30%
Total	30	100%

Source: Primary Data 2019

The results in the figure and table shows that greater fraction of the respondents accept and confessed that there is high level of most owner-managers have no formal training in management

skills, especially without financial management is the majority 30% of strong agree and dis agree while 23.3% have agree 16.7% have strong disagree.

Figure 5. Claim management policies is a key driver of company's financial performance.

Table 5. My company is transparent and Accountable. It does ensure transparency by allowing its books of accounts to be audited.

Respondents	Frequency	Percentage
Strongly disagree	4	13.3%
Disagree	6	20%
Agree	14	46.7%
Strongly agree	6	20%
Total	30	100%

Source: Primary Data 2019

The results in the figure and table shows that greater fraction of the respondents accept and confessed that there is high level of the financial management should be concerned with are

liquidity management, profitability management and growth management is the majority 46.7%of agree and dis agree while 20% disagree and strong agree have agree 13.3%have strong disagree.

Figure 6. My company is transparent and Accountable. It does ensure transparency by allowing its books of accounts to be audited.

Table 6. our firm financial leverage has increased over the last five years Our firm has a higher market value.

Respondents	Frequency	Percentage
Strongly disagree	3	10%
Disagree	3	10%
Agree	4	13.3%
Strongly agree	20	66.7%
Total	30	100%

Source: Primary Data 2019

The results in the figure and table shows that greater fraction of the respondents accept and confessed that there is high level of profitability is very important in determining the success or failure

of a business is the majority 66.7%of strong agree while 13.3% agree have agree 10%have strong disagree and disagree.

Figure 7. our firm financial leverage has increased over the last five years, our firm has a higher market value.

Table 7. The interest expense to total operating revenue ratio is low (meaning the firm may be less reliant on overdraft).

Respondents	Frequency	Percentage
Strongly disagree	5	16.7%
Disagree	11	36.7%
Agree	13	43.3%
Strongly agree	1	3.3%
Total	30	100%

Source: Primary Data 2019

The results in the figure and table shows that greater fraction of the respondents accept and confessed that there is high level of Small-business owners are willing to risk failure on some

experiments is the majority 43.3%of agree while 36.7% disagree have 16.7%have strong disagree and strong agree have3.3%.

Figure 8. The interest expense to total operating revenue ratio is low (meaning the firm may be less reliant on overdraft).

Table 8. The firm budget outrun ratio is low (meaning the firm always spent less than it had budgeted).

Respondents	Frequency	Percentage
Strongly disagree	12	40%
Disagree	11	36.7%
Agree	2	6.7%
Strongly agree	5	16.7%
Total	30	100%

Source: Primary Data 2019

The results in the figure and table shows that greater fraction of the respondents accept and confessed that there is high level of Small businesses are unrestricted in the products and the

services that they import is the majority 40% of strong disagree while 36.7% disagree have 16.7% and have 6.7% agree.

Figure 9. The firm budget outrun ratio is low (meaning the firm always spent less than it had budgeted).

Table 9. The insurance company is more inclined to decisions that enhance.

Table 9. The insurance company is more inclined to decisions that enhance.

Respondents	Frequency	Percentage
Strongly disagree	1	3.3%
Disagree	5	16.7%
Agree	14	46.7%
Strongly agree	10	33.3%
Total	30	100%

Source: Primary Data 2019

The results in the figure and table shows that greater fraction of the respondents accept and confessed that there is high level profitability measured by return on sales, return on assets and/or

return on equity is the majority 46.7% of agree while 33.3% strong agree have disagree 16.7% and have 3.3% strong disagree.

Figure 10. The insurance company is more inclined to decisions that enhance.

Table 10. Returns on its physical capital rather than relational capital.

Respondents	Frequency	Percentage
Strongly disagree	8	26.7%
Disagree	3	10%
Agree	12	40%
Strongly agree	7	23.3%
Total	30	100%

Source: Primary Data 2019

The results in the figure and table shows that greater fraction of the respondents accept and confessed that there is high level a business may not be profitable because of investment and

expenses for starting the business is the majority 40%of agree while 26.7% strong disagree 23.3% strong agree have 10% disagree.

Figure 11. Returns on its physical capital rather than relational capital.

Recommendations of the study

Based on the results, findings and conclusions the following recommendations have been deciphered. It is therefore recommended that the management of small scale business to consider putting in place the recommended steps seen as probable ways of ensuring that their financial management practices are improved for better financial performance.

Conclusion

From the regression result of the study, it shows that liquidity has really and strongly impacted on the profitability of listed deposit money banks in Somalia, it is therefore concluded that the liquidity in the banking sector within the period of the study has helped to improve their profitability.

Also, the study concluded that both current ratio and quick ratio has significantly, strongly and positively influenced the profitability of listed deposit money banks in Somalia, while the cash ratio was concluded to have significant, strong and negative impact on the performance of the banks.

However, the firm size used as control variable in this study was concluded not to have any significant influence on the performance of listed deposit money banks in Somalia. Therefore firm size is not a major determinant factor of bank's performance but their level of liquidity.

The objectives of this study are to determine the capital budgeting techniques employed by listed companies and the effect of those techniques on the financial performance. The results of most studies have reported the use of both the naive capital budgeting and discounted cash flow techniques.

The naive methods include; the payback method and the accounting rate of return. The discounted cash flow methods otherwise referred to as sophisticated capital budgeting include the net present value and the internal rate of return. Many companies seem to prefer the payback method and net present value to accounting rate of return and internal rate of return respectively. This study examined capital structure and financial performance: a study of listed trading companies in Sri Lanka. The analysis of listed trading companies show that debt ratio is negatively correlated with all financial performance measures Gross Profit (GP); Net Profit (NP); Return on Equity (ROE) and Earnings Per Share (EPS) similarly debt-equity ratio (D/E) is negatively correlated with all financial performance measures except GP and only (D/E) ratio shows significant relationship with NP.

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