Strategic Management Practices In Indian Companies: A Financial Analysis

Dr G. S. Rathore
Associate Professor & Ex-Dean, Faculty of Commerce, Udai Pratap Autonomous College, Varanasi &
Chief Editor, International Journal of Economics & Managerial Thoughts (IJEMT)

Abstract

Internationally accepted practices in strategic financial analysis around the world suggest that good quantitative and qualitative analytical financial synthesis is the grass root for successful and sustainable strategic operations. Some would even say that without strategic financial analysis any unit cannot achieve sustainability. Sustainability means relying on commercially priced and internally generated funds rather than on donors for growth. There are certain parameters on which thrust have to be given during strategic financial analysis. Much of the information can be handled within a graphical format, such as tables and graphs, though a paragraph explanation of each is generally required. Analyst has to make sure to include total currency amounts as well as percentage market share. For more detailed marketing plans or for plans for seasonal products, providing monthly or even weekly sales figures may be required. Financial Analysis Profiles generally includes financial ratios, industry-wide and small business versions and industry financials by sales class, yearly income-expense tables, balance sheets etc.

Financial analysis refers to an assessment of the viability, stability and profitability of a business, sub-business or project. It is performed by professionals who prepare reports using ratios that make use of information taken from financial statements and other reports. These reports are usually presented to top management as one of their bases in making business decisions. Based on these reports, management may follow any one or combination of the following:

(1) Continue or discontinue its main operation or part of its business
(2) Make or purchase certain materials in the manufacture of its product
(3) Acquire or rent/lease certain machineries and equipments in the production of its goods
(4) Issue stocks or negotiate for a bank loan to increase its working capital
(5) Other decisions that allow management to make an informed selection on various alternatives in the conduct of its business.

Every Financial Analysis Profile includes number of firms to be analyzed, capital structure, cost of capital , ease in raising capital , financial plan, pattern of shareholding, relationship with financiers, use of financial resources, tax advantages etc. Required activities when quality financial ratios have to be computed are customizing reports with business inputs, immediate easy industry search tools, permanent online access printing, downloading facilities etc.

Objective and Methodology:

The basic objective of the study is to understand financial analysis in the backdrop strategic management practices in Indian companies. For the purpose of the study, 100 companies were selected on stratified random sampling from the top 500 companies as identified by Economic Times Research Bureau, All, the companies included in the universe were divided into three categories-multinational controlled companies, public sector companies and private sector Indian companies. The number of these companies in the universe was 60, 28 and 412 respectively. It was decided to select 33 percent of MNC controlled companies, 50 percent of public sector companies and 16 percent of private sector companies with a view to have adequate number of companies from each category of companies. (Table on next page)

For selecting sample from each category of companies, they were ranked on the basis of their sales. Based on these ranks, required number of companies from each

Table - 2
Degree of Importance

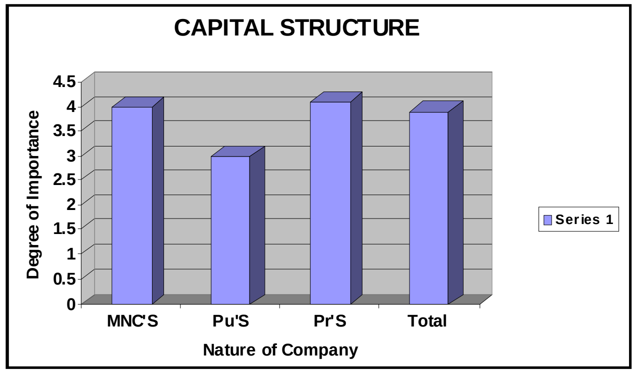
Factor	Degree of Importance			
	MNC 'S	Pu 'S	Pr 'S	Total
Capital Structure	4.0	3.0	4.1	3.9
Cost of Capital	4.4	4.2	4.5	4.4
Financial Position	4.7	4.5	4.7	4.7
Shareholding	3.5	1.7	3.5	3.2

category was selected on random using lottery method. Data from these companies were collected through a structured questionnaire containing questions relevant for the study. (See Appendix)

Capital Structure

Company's proportion of short and long-term debt is considered while analyzing capital structure. When people refer to capital structure they are most likely referring to a firm's debt-to- equity ratio which provides insight into how risky a company is? Usually a company more heavily financed by debt poses greater risk, as this firm is relatively highly levered. Debt comes in the form of bond issues or long-term notes payable, while equity is classified as equity stock, preferred stock or retained earnings. Short-term debt such as working capital requirements is also considered to be part of the capital structure. The capital structure is how a firm finances its overall operations and growth by using different sources of funds. This analysis can then be extended to look at whether there is in fact an optimal' capital structure exist or not ? Optimal Capital Structure is the one which maximizes the value of the firm. In nutshell we can say that capital structure refers to the way a corporation finances itself through some combination of equity, debt or hybrid securities. As far as respondents are concerned on a five point rating scale MNCs provided 4 points, public sector units provided 3 points and private sector units provided 4.1 point regarding importance of capital structure. The aggregate total of all the responses taken together is 3.9/-. However pictorial representation (Graph 1) of the responses of various respondents are as follows:

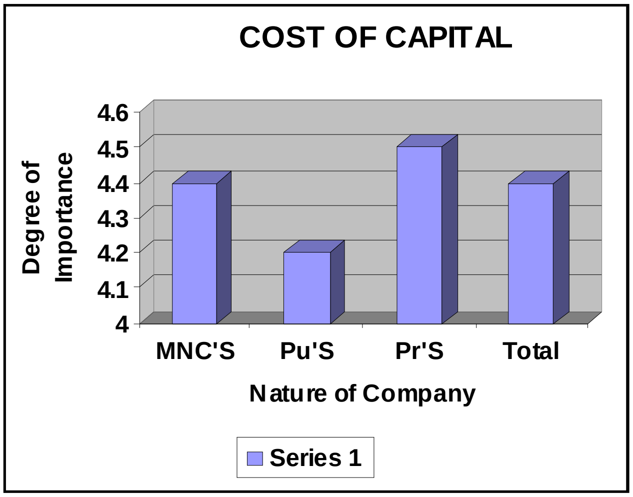
GRAPH 1



Cost of Capital

Cost of capital determines how a company can raise money through stock issue or borrowing or mix of two. This is what a firm would receive if it invested its money somewhere else with similar risk. Cost of capital would include the cost of debt, the cost of equity cost of retained earning. The cost of capital for a firm is a weighted sum of the cost of equity and the cost of debt, Firms finance their operations by three mechanisms issuing stock, issuing debt and reinvesting prior earnings. The opportunity cost of an investment i.e. the rate of return that a company would otherwise be able to earn at the same risk level as the investment that has been selected. The cost of capital for any particular business or project is the rate of return required by the providers of capital (both debt and equity) having regard to the risk characteristics inherent in the project. Businesses or projects which are able to earn returns greater than the cost of capital add value for investors. Equity investors have two components for their cost of capital. First is explicit opportunity cost such as dividend payments and second is implicit opportunity cost in the form of an expected cash equivalent gain in share price. The return to debt investors is in the form of interest payments. As far as respondents are concerned on a five point rating scale MNCs provided 4.4 points, public sector units provided 4.2 points and private sector units provided 4.5 points regarding importance of cost of capital. The aggregate total of all the responses taken together is 4.4. However pictorial representations of the responses of various respondents are as follows (graph 2):

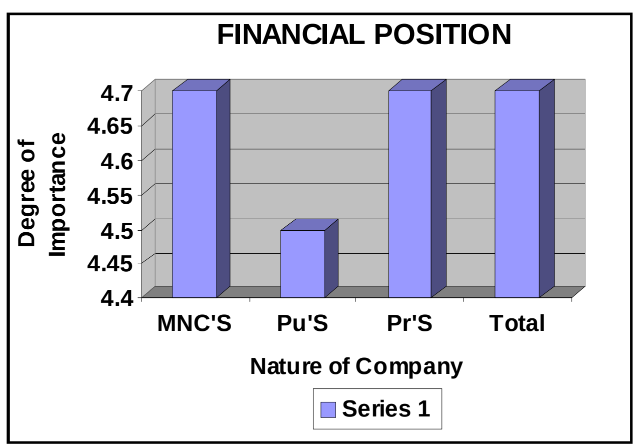
GRAPH 2



Financial Position

Statement of financial position reports a company's financial status at a set date. The statement is like a snapshot because it shows what the company is worth at that date, The statement shows what the company owns? What belongs to the owners? Analysts often call the statement of financial position as balance sheet because of the way one part i.e. assets is in balance with the sum of the other two parts liabilities and stockholders equity. In an annual report, the statement of financial position includes information for at least the last two years to allow comparison of changes between years. The statement of financial position shows three main categories of information for each year covered. To interpret this information, analysts look at three key aspects related to the categories namely, liabilities and stockholder's equity. Companies own things which may be physical assets such as buildings, trucks, inventories of products and cash. Other things may be intangible assets such as goodwill, trademarks and patents. Assets are either current or non current. Current assets are things a company expects to convert to cash within one year. Examples are accounts receivable or inventories of products to sell. Finally, current assets include cash and securities such as treasury bills and certificates of deposit the company expects to convert to cash within the year. Non-current assets are things a company does not intend to convert to cash or that would take longer than a year to convert. Non-current assets include fixed assets, often listed as "property, plant, and equipment" because that is what they usually are. Companies use fixed assets to manufacture, display, store, and transport products. The amounts of fixed assets vary by company and industry. For example manufacturing companies generally have a large investment in fixed assets because making things requires property, plant, and equipment. Service companies usually have fewer fixed assets. On the statement of financial position debts are called liabilities. All companies have liabilities. 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. Although liabilities are a necessary part of doing business, companies must manage their liabilities carefully. If a company cannot make interest payments on time and repay the principal when due, the company can be forced to declare bankruptcy. As far as respondents are concerned on a five point rating scale MNCs provided 4.7 points, public sector units provided 4.5 points and private sector units provided 4.7 points regarding importance of financial position. The aggregate total of all the responses taken together is 4.7. However pictorial representation of the responses of various respondents are as follows (Graph3):

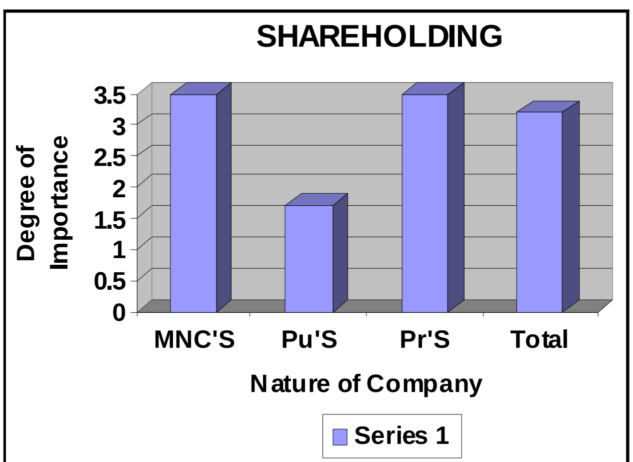
GRAPH : 3



Shareholding

Unlike public limited companies shareholdings in private limited companies are not readily available to the public. This can lead to situations where shareholders are "locked in" to a company and although their shareholding may be very valuable on paper, they are unable to realize that value. Even if a buyer can be found shareholders often then face a number of further hurdles before any sale to that buyer can proceed. The problems faced in trying to realize the value of a shareholding in a private limited company can be made all the more difficult by provisions in the Companies Articles or in a Shareholders Agreement. In particular, it is very common to find that these documents contain further restrictions on the disposal/transfer of shares. Unless the shareholding to be sold represents a majority shareholding in the company, a "fair value" will normally include a very substantial discount on what the owner will normally regard as the "real" value. This is known as a "minority discount" and it seeks to reflect the fact that the shareholding is not a majority shareholding and does not therefore in itself carry the ability to control the company. A further difficulty sometimes faced in seeking to sell a minority shareholding is that the

GRAPH 3



Articles of Association for many companies will also contain provisions enabling the Board of Directors to refuse to "register" a transfer of shares on specific grounds or in some circumstances on whatever grounds they choose and without giving any particular reason.

As far as respondents are concerned on a five point rating scale MNCs provided 3.5 points, public sector units provided 1.7 points and private sector units provided 3.5 points regarding importance of shareholding. The aggregate total of all the responses taken together is 3.2. However pictorial representations of the responses of various respondents are as above. (graph 4).

Conclusion

Almost all the companies set their hierarchal order of important aspects in terms of development. In least important areas comparatively lesser number of companies set objectives. As far as importance of capital structure is concerned Indian companies rate 78 % importance to capital structure. On the other hand, cost of capital secured 88 % significance from Indian companies. Among all the factors tested, financial position got maximum importance of 94 % from respondent Indian companies. As far importance of shareholding to modern Indian companies is concerned, Indian companies have provided 78 % significance to shareholding pattern.

Appendix

(1) How you rate (on five point rating scale) the impact of capital structure on the performance aspect?

(2) On a five point rating scale, how influential you think is financial position keeping in mind strategic managerial decisions?

(3) How much points you would assign (on five point rating scale) to the significance of cost of capital regarding ground realities of today?

(4) How you rate (on five point rating scale) the significance of shareholding on the performance of Indian companies?

References

Yoshino, M Y and U, Rangan, Strategic Alliances An Entrepreneurial Approach to Globalisation, Boston: Harvard Business School Press, 2005.

Whittington, R, Strategy and its Impact, New York: American Press 2006.

Thompson, J L, Strategic Management: Awareness and 'Change, London International Thompson Business Press, 2006.

Thomas, J G, Strategic Management: Practices and Cases, New York: Harper and Row, 2005.

Steiner, G A , Miner and Gray , Management Policy and Strategy Text, Readings and Cases, New York, MacMillan , 2005.

Campbell, A M, Goold and M Alexander, Corporate Level Strategy Creating Value in the Multibusiness company, NewYork: John Wiley & Sons, 1994.

Chandler, A D, Strategy and Structure: Chapters in the History of the American Industrial Enterprises, Cambridge, Mass: MTP Press, 1962.

Chopra, B S K S, Business Policy for Indian Industries, Pune, Times Research Foundations, 1985.

Christensen, C R, K R Andrew, J L Bower, R G 1-Tamermesh and ME Porter, Business Policy - Texi and Cases, 5th edn, Hornewood, Richard D Irwin, 1982.

Drucker, P F, Management - Tasks, Responsibilities, and Practices, New York: Harper and Row, 1974.

Drucker, P F, Innovation and Entrepreneurship, London: William Heinemann, 1985.

Ghosh, P K, Strategic Planning and Management, New Delhi: Sultan Chand & Sons, 1990.

Glueck, W F and L R Jauch, Business Policy and Strategic Management 4th cdn, New York: McGraw-Hill, 1976.

Ghemawat,P Commitment: The Dynamic of Strategy, New York: Free Press, 1991.

Abdullah F.A. Financial Management of A Multinational Firma PHI Publishing, 2006.

Apte PG: International Financial Management: Tata McGraw Hill, 2005.

Burton Gene, Manab Thakur: Management Today: Principals and Practice, Tata McGraw Hill, New Delhi. 2000.

Garg A.K.: MNCs in India, Friends Publications, Meerut, 2006.

Wheelen Thomas L, J David: Strategic Management and Business Policy: Entering 2l' century Global Society: Sixth Edition, Addison Wesley, Reading, Massachusetts, USA.

Benedict E. M. Steenkamp: Response Styles in Marketing Research: A Cross National Investigation. Journal of Marketing Research, May 2006.

Business Week, Asian edition, Nov. 18, 2005 IBM, Q&A: "Gerstner takes off the gloves".

"Inside The Simputer" Digit, November 2006.

e-business Advisor: Technology Architecture, Strategies and Know how, April 2002 and "Emerging Technologies that will shape your E- Business strategies" April 2006.

H Ramnathan "The Changing Fact of Technology Support": Information Technology: Nov. 2005 Vol. 12, No.1.

"How effective is your secrecy policy" Network Magazine: Vol.3, No.4, November 2006.