



MENTOR | The Journal of Business Studies

JBS

Faculty of Commerce and Management, Eastern University, Sri Lanka

THE IMPACT OF FINANCIAL DECISIONS ON FINANCIAL PERFORMANCE OF LISTED MATERIAL COMPANIES IN SRI LANKA

W.K.A.Wijayasiri^a, D.D.K.Sugathadasa^b and J.M.N.Wijekumara^{c*}

^{a b c}Department of Accountancy & Finance, Faculty of Management Studies Rajarata University of Sri Lanka.

ABSTRACT

Financial decisions are deemed to be a key component in today's fiercely competitive business environment to enhance the company's financial success. Hence, this study investigates the impact of financial decisions on financial performance of listed material companies in Sri Lanka. Leverage decisions, working capital decisions, dividend decisions and investment decisions were considered as financial decisions variables and financial performance was measured using return on assets (ROA). Data were collected from published financial statements of 20 listed material companies in Sri Lanka from 2017 to 2021 using simple random sampling method. Data were analyzed using regression analysis. Correlation analysis confirmed that all independent variables are positively correlated with financial performance of listed material companies in Sri Lanka. Moreover, the regression results and findings revealed that there is negative insignificant impact between leverage decisions, working capital decisions, and investment decisions on financial performance. And also, there is positive significant impact between dividend decisions on financial performance of listed material companies in Sri Lanka. The study therefore recommended that there is a need for well-developed financial planning in material companies to enhance their performance. The findings of the study hold practical implications for policy makers, owners, managers and investors.

Keywords: Financial Decisions, Financial Performance, Material Companies

*Corresponding nishanthawijekumara93@gmail.com

© Faculty of Commerce and Management, Eastern University Sri Lanka. All rights reserved.

1. Introduction

The materials companies try to preserve a favorable position in their industry in the current competitive business environment. As a result, financial managers at companies strive to make wise financial decisions. In any business organization, managers have a responsibility to take better judgments to survive in fast changing business environment during compete with homogeneous organizations. Managers can therefore make better financial decisions for the company as potential investors take the firm's financial structure into account.

The finance decisions directly involving leverage, working capital, investment and dividend decisions on the financial performance of the materials companies. The financial managers are required to use the limited resources to ensure the growth of companies. The key financial decisions of companies that require financial manager's involvement include leverage decisions, working capital decisions, dividend decisions and investment decisions (Faulkender & Wang, 2006). According to Loof and Heshmati (2008), the investment decisions affect to the financial performance of companies positively and significantly. Uweigwe, Jafari, Ajayi (2012) explained the dividend decisions have a significant outcome on financial performance of a company. As well as according to Dellof (2003) there were the impact between working capital decisions such as

accounts payable, inventories and account receivable and financial performance was negative but significant. The previous researches stated the different conclusions regarding the impact of financial decisions and financial performance. They established there were positive impact between financial decisions and financial performance or negative impact between financial decisions and financial performance regarding the sample of their studies. In this study try to answer the question, **“Whether there is any impact of financial decisions on financial performance of listed materials companies in Sri Lanka”**

Objectives of Research

In this study, it intends to examine the impact of financial decisions on the financial performance of Listed Materials companies in Sri Lanka. Under the main objective, there are four objectives have been developed as below.

- To examine the impact of leverage decisions on the financial performance of Materials sector in Sri Lanka.
- To investigate the impact of working capital decisions on the financial performance of Materials sector in Sri Lanka.
- To study the impact of dividend decisions on the financial performance of Materials sector in Sri Lanka.
- To identify the impact of investment decisions on the financial performance of Materials sector in Sri Lanka.

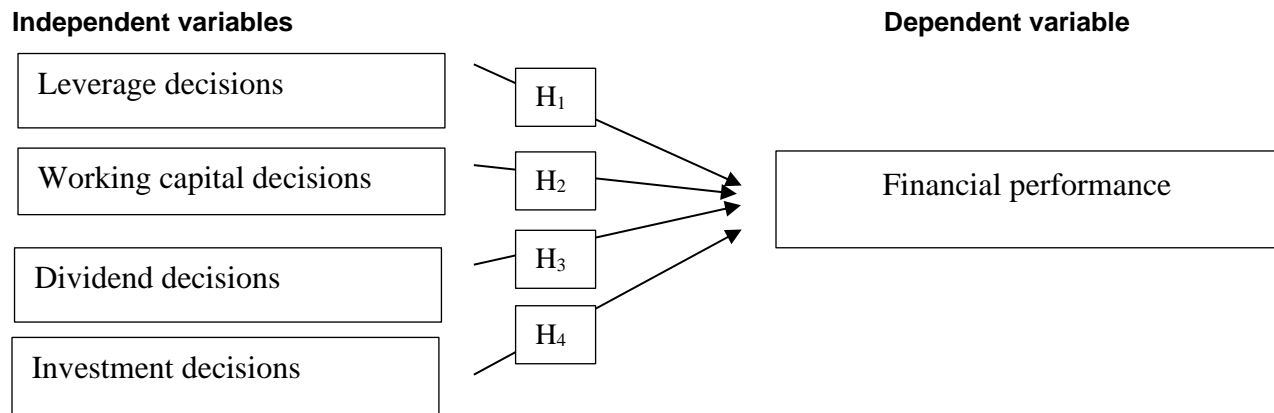
2. Literature Review

Financial decision is one of the major fundamental functions of decision making in organizations. Under corporate finance theory, decisions concerning to investment planning and capital combination have a bearing on funding and long period investments whereas working capital management connect funding resolution on working capital with concern to management of short-term funds and funding that assume concurrently the current liability as well as current resources (Magginson, 1997).

The trade-off theory suggest that debt finance is mostly used when a company has a great level of tangible assets while equity finance is mostly used when a company has a great portion or level of intangible assets. Thus, a company should maintain an optimal debt–equity ratio (Al-Tally, 2014). The trade-off theory states that an optimal debt amount is determined by a comparison of the costs related to debt financing against the benefits that will be obtained if debt financing is used by a company. Therefore, a great financial leverage can be taken by a more profitable firm to finance its investments or operations. Therefore, most firms try to balance between the tax’s advantages on the use of leverage against the costs associated with utilization of leverage as a financing means of investments in a company (Aliu, 2010). The trade-off theory holds that companies only borrow to an extent where tax shield on debt financing immediately offset total cost that is usually associated with debt financing (Itiri, 2014). Therefore, debt finance can lead to better financial performance of a company and expansion as well as fail of a company. Since that financial decision making process is crucial in a company, finance managers should carefully look into the matter precisely (Zhao & Wijewardana, 2012).

Banafa, Muruti, & Ngugi, (2015) investigated impacts of leverage on financial performance of listed Kenyan non-financial firms. The study employed a causal research design and to examined the effect of financial leverage of the 42 listed non - financial firms at NSE. Secondary data from company financial statements was used for a period of five years from the year 2009-2013. This study revealed that leverage had a negative and significant impact on corporate financial performance. Moreover, Omesa, Maniagi, & Musiega, (2013) described the impact between working capital management and the organization performance of firms listed at the NSE. In this study, they considered 20 publicly listed companies and analyzed data between 2007 and 2011. They relied on the principal component analysis technique as it is effective in drawing required data from contradicting data sets. They also employed multiple regression, CCC, working capital variables average collection period, fixed financial ratio and current liabilities, and control variables net working capital turnover ratio. The findings of the study described significant impact between working capital and corporate performance at a confidence level of 95% when measured using return on equity.

Namachanja, (2016) described the effect of dividend policy on the financial performance of listed commercial banks in Kenya. The study used secondary data from 10 banks from 2011 to 2015. The result indicated there was no effect of dividend decisions on the return of assets of listed commercial banks. Ariemba, Evusa, & Muli, (2016) examined the impact of investment decisions on financial performance among 12 savings and credit companies in Kuttu central sub- country. The study design for a time-series data over a ten year period from 2006 to 2015. Simple multivariate analysis was used for data analysis, while Karl Pearson's correlation was used in determining the correlation within variables. Data presented by using tables. The study found the significant impact between investment decisions and financial performance of savings and credit companies in Kuttu central sub-countries in Kenya.



Source: Literature Survey (2022)

Figure 1: Conceptual Framework

3. Research Methodology

Referring the studies of Mayech, (2012), Evusa and Muli, (2016), Gabow (2017) and many others, following hypotheses have been developed as they have assumed that the below decision may impact the financial performance.

Research Hypotheses

- H₁:** There is significant impact between leverage decisions and financial performance of listed material companies in Sri Lanka.
- H₂:** There is significant impact between working capital decisions decision and financial performance of listed material companies in Sri Lanka.
- H₃:** There is significant impact between investment decisions and financial performance of listed material companies in Sri Lanka.
- H₄:** There is significant impact between dividend decisions and financial performance of listed manufacturing companies in Sri Lanka.

Population & Sampling

This study was focused on the listed materials companies in Sri Lanka. The study of population covers only the 23 materials companies listed in Colombo Stock Exchange. Researcher selected 20 listed materials companies in Sri Lanka as an overall sample of this study. The data were relevant to the financial year 2017 to 2021. The data have been selected by using simple random sampling method.

In this study, data was analyzed by statistic package for social science (SPSS). The researcher used descriptive analysis and correlation analysis to identifying the relationship between financial performance, leverage decisions, working capital decisions, investment decisions and dividend decisions and also it used multiple regression analysis to evaluate the impact of financial decisions on financial performance.

Multiple Regression model:

$$Y = A + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 \dots\dots\dots(1)$$

4. Results and Discussion

Table 1: Results of Descriptive Statistics

	Minimum	Maximum	Mean	Std. Deviation
FP (ROA)	-0.2900	0.4940	0.0798	0.1207
LD	0.0059	0.7550	0.1614	0.1588
WCD	0.7660	11.7530	2.4468	1.8721
DD	-0.1602	1.3404	0.2832	0.3110
ID	14.1400	23.6260	19.7183	1.8522

Source: Survey Data (2022)

According to table 1, it presents the descriptive statistics of both dependent variable and independent variables. This statistic described the data used for this research. Financial performance (FP, ROA) minimum value is -0.2900 and maximum value is 0.4940 in the used data set. It means, minimum value of return on assets in the sample of selected material companies is -29.00% and maximum value is 49.40%. The average return on assets ratio for the sample of material firms is 0.0798. It implies that nearly 7.98% return relative to the assets of selected sample material companies. Standard deviation is the measure that shows how far sample data values deviate from its mean value. In this study 7.98% of return on assets can be increase or decrease by 12.07%.

Leverage decisions (LD) measured by debt-to-equity ratio. Its minimum value is 0.0059 and maximum value is 0.7550 in the used data set. It means, minimum value of debt included in the sample of selected material firm is 0.05% and maximum debt included is 75.50%. The average debt ratio is 0.1614. It implies that nearly 16.14% of total assets are financed by debt capital. In this study standard deviation of debt to equity is 0.1588. It means, 16.14% of debt to equity can be deviated by 15.88%.

Working capital decisions (WCD) measured by current ratio. Its minimum value is 0.7660 and maximum value is 11.7530 in the used data set. It means, minimum value of current ratio included in the sample of selected material companies is 76.60% and maximum current ratio is 1175%. The average current ratio is 2.4468. It implies that nearly 244% current assets relative to the current liabilities of selected sample material companies. Standard deviation of this study is 1.8721. It means, 238% of current assets to current liabilities can be deviated by 187%.

Dividend decisions (DD) measured by dividend payout ratio. Its minimum value is -0.1602 and maximum value is 1.3404 in the sample. It means, minimum value of dividend payout in the sample of selected material firms is -16% and maximum dividend payout is 134%. The average dividend payout ratio is 28.31%. It means, nearly 28.31% dividends payout in the selected sample of material companies. In this study standard deviation is 0.3110. It implies 28.31% of dividend payout can be deviated by 31.10%.

Investment decisions (ID) measured by logarithm of property plant and equipment. Its minimum value is 14.14 and maximum value is 23.6260. The average logarithm value of total property plant equipment is 19.7183. It can deviate by 1.8522.

Table 2: Results of Correlation Analysis

		LD	WCD	DD	ID	FP
LD	Pearson Sig.	1				
WCD	Pearson Sig.	-0.225* 0.024	1			
DD	Pearson Sig.	-0.015 0.880	-0.354** 0.000	1		
ID	Pearson Sig.	0.290** 0.003	-0.343** 0.000	0.131 0.194	1	
FP	Pearson Sig.	-0.000 0.999	-0.180 0.072	0.461** 0.000	0.082 0.420	1

As above table 2, in this study leverage decisions (LD) have -0.000 correlation core efficient with financial performance (FP). Therefore, leverage decisions and financial performance have negative relationship of the selected sample of material companies in CSE. Since the significant value is 0.999, there is an insignificant relationship between leverage decisions with the financial performance. Similarly, working capital decisions (WCD) have -0.180 correlations core-efficient with financial performance (FP). It implies that working capital decisions have insignificant negative relationship between financial performances as its significant value is 0.072. Moreover, dividend decisions (DD) have 0.461 correlation core efficient with financial performance (FP). Therefore, dividend decisions have positive impact between financial performances of the selected sample of material companies. It also reported a significant value is 0.000, which found to be significantly related at the 0.01 level with financial performance of listed material companies in Sri Lanka. Furthermore, investment decisions (ID) have positive relationship of 0.082 correlations core-efficient with financial performance (FP). In line with that, investment decisions insignificantly related to the financial performance of listed material companies in Sri Lanka since it is having a significant value of 0.420.

Panel Regression Analysis

Table 3: Results of Panel Regression Analysis

	Coefficient	Std. Error	t-Statistic	Prob.
C	.0216	.035	.607	.545
LD	-.0002	.072	-.004	.996
WCD	-.0012	.006	-.188	.851
DD	.177	.039	4.62	.000
ID	.001	.001	0.548	.584
R-squared	.215		F-statistic	6.53
Adjusted R - S	.182		Sig	0.000
Std. Error of the Estimate				.109

In the model summary, it shows the impact of independent variables and dependent variable. Hausman Test was utilized to select most appropriate model to run the panel regression. Hence the test value is lower than 0.05, the random effect model used to panel regression. According to table 3, it interprets the R square value is 0.215, which means that the financial performance depend nearly 21.5% on all the selected independent variables and control variables. The remaining 78.5% is influenced by other factors which are not considered

for the study. The adjusted R square value is 0.182. It means that R square value of study 21.5% can be deviated by 18.2%.

In addition to that, table 3 exhibits the results of the coefficients of regression model with financial performance as dependent variable. According to the B-values for independent key variables, the coefficient for leverage decision is -0.0002 and P value is 0.996, which means that leverage decisions negatively and insignificantly influenced the financial performance of listed material companies in CSE. The coefficient for working capital decision is -0.0012 and P value is 0.851, it denotes that working capital decisions negatively and insignificantly influenced the financial performance of listed material companies in CSE.

Moreover, the results have proved that coefficient for dividend decision is 0.177 and P value is 0.000, it signifies that dividend decisions positively and significantly influenced the financial performance of listed material companies in CSE. Similarly, the coefficient value for investment decision is 0.001 and P value is 0.584, means that investment decisions negatively and insignificantly influenced the financial performance of listed material companies in CSE.

5. Implication and Limitations

The result of this study indicates that the financial decisions are significantly impact on the financial performances of the firms. Thus, the firm's adherence to financial planning leads to determine their financial performance. Accordingly, from this study various parties can gain benefits and also this helps to enhance the financial decision making practices and stabilize the performance of the company. Financial managers should maintain the best debt to equity ratio in their companies. Debt to equity ratio is greater than two it is good for the financial performance of companies. The company should maintain good current ratio. It is 1.5 to 2 is interpreted as indicating a company on solid financial ground in terms of liquidity. And also, it is greater than 2 is not necessarily considered to be better. Financial managers should have more attention in the investment of assets. They should invest in asset more effectively to the company and shareholders.

This study was used financial data of listed material companies in Sri Lanka. Therefore, those findings cannot be generalized to the international context or other countries. Moreover, this research was mainly conducted based on secondary data and listed material companies are used as case studies for the entire population. Therefore, other companies with different characteristics that could otherwise provide different results were not considered. Therefore future researches can be replicate while considering the use of a small sample of companies in the sectors such as capital goods, transportation, consumer services and bank sector which are available in Sri Lanka. From a methodological point of view, future research could test a new research model using a qualitative (rather than a quantitative) survey instrument. Such an approach would increase the sample size and improve the generalizability of the findings.

References

- Aliu, N. O. (2010). *Effect of Capital Structure on the Performance of Quoted Manufacturing Firms in Nigeria*. Ahmadu Bello University .
- Banafa, A. S., Muruti, W., & Ngugi, K. (2015). The impact of leverage on financial performance of listed non-financial firms in Kenya. *International journal of finance and accounting*, pp 1-20.
- Deloof, M. (2003). Does working capital management affect profitability of Belgian firms? . *Journal of Business Finance and Accounting*, pp 573-587.
- Gabow, S. N. (2017). *Effect of financial decision on financial performance of companies listed at the Naibori security exchange*. University of Naibori.
- Mayech, A. K. (2012). *The effect of dividend policy on financial performance of companies quoted at the Naibori securities exchange*. University of Naibori.
- Namachanja, L. (2016). *Effects of dividend policy on financial performance of listed commercial banks in Kenya*. University of Naibori.

- Omesa, N. W., Maniagi, G. M., & Musiega, D. (2013). Working capital management and corporate finance. *International journal of innovative research and development*, pp 177-183.
- Uwuigbe, U., Jafaru, J., & Ajayi, A. (2012). Dividend policy and firm performance: a study of listed firms in Nigeria. *Accounting and management information systems*, pp 442-454.
- Zhao, B., & Wijewardana, W. P. (2012). Financial Leverage, Firm Growth and Financial Strength in the Listed Companies in Sri Lanka. *Procedia - Social and Behavioral science*, pp 709-715.