Financial management practices and their impact on organizational performance

Financial Management is a deliberate management of planning and organizing of financial activities. It applies the basic management principle to control the flow of funds and properly utilizes the financial resources. It sets the financial goals by properly analyzing the available data. The common methods to carry out financial activities like accounting and budgeting are considered to be the financial management practice. According to Kitonga, (2011), financial management practices, " is the discipline dealing with the financial decisions for long and short term goals to ensure the return on capital exceeds the cost without taking excessive financial risk." It clarifies the efficient financial management practices and are used in the business to respond other business environment. It also entails practices across the other organizations to provide an evaluating approaches to the financial management. It has some impact on the organizational performance because of the relationship between them. The effective management leads to the successful growth of an organization.

The outcome of the business and the financial management is like the two sides of a coin and has turn out to be more significant to the success. The effective management of the available funds and the completion of a mission needs the right financial management practice. The top management of a company or business holds the financial management practice and then it circulates the practice to all sections of the company. Rehman et al (2010) state that, " Optimal application and commitment towards financial management practices result in an increased company's performance." The inter relation between the business practices and the potential of an organization is important for the growth of organization. The financially

strong organizations are prepared and are resourceful. Since the different factors are responsible for the success of an organization, the relationship between the organization performance and the financial management practice also contribute some help in the growth of an organization. The profits and the cash inflows are the bases of the financial condition of a business. It is necessary to develop business objectives and the performance standards for the future. In this essay, I will analyze the effects of financial management practice and the impact of the practice over organizational performance. To analyze the relationship, I will explain some factors like capital structure decision, investment appraisal techniques, dividend policy, working capital management and financial performance assessment. Since the impact of practices on organizational performance bring improvement in products and services, it also increases profitability and attracts the important sponsors.

Capital Structure Decision

Capital Structure is simply defined as a business's debt and equity ratio which is calculated by dividing a business's total debts by its stockholders' equity. It is used to measure an organization/business's financial leverage which means it shows how much debt is used to finance its assets in the long term operation. The debt to equity ratio gives the common insight to investors regarding how much risk is associated with a firm. It is a sign of financial well being for a company. It shows how a business finances its activities. If it is considered high risk business then it will have no investors or the short term investors. Managers shows their interest in the capital structure as it shows the company's exchange theory and manage the debt

ratios. Some factors like agency costs, free cash flows and asset substitution had some effect on capital structure decision. Financing a company solely with equity or debt may not be an optimal capital structure decision. Capital structure optimization is critical for short-term and long-term growth. An organizations' capital structure influence policies, product and service pricing, credit terms, management structure and resource allocation (" 8 Factors That Influence Capital Structure of a Business"). It reduces risk generated by loan and revenue and shareholder returns are increased.

Investment Appraisal Techniques

A company requires planning to use funds as a long term investments such as purchasing a brand new machines, research and development projects etc to assess the capability of project. This is called Capital Investment Appraisal or Capital Budgeting. In this process, a business establishes its long and short term investment opportunities which are influenced by company stakeholders. Some of the techniques include Net present value, Pay Back Period, Accounting rate of return, Internal rate of return, Profitability index etc. These investment appraisal techniques are used to improve the financial possibility. The techniques are used to prioritize the projects. Companies may have different projects that are appraised at the same time to make right predictions. Investment appraisal is the important area of management practices. Some of the Techniques are explained below in brief:

Net Present Value : The Net Present Value is based on the time value of money. It is used to appraise an investment's worth in a present day. It is

determined by calculating the negative cash flows and the positive cash flows for each period of an investment. Once it is calculated, the present value is attained by discounting its future value at a periodic rate of return. Many organizations and accountants uses net present value to determine the value of market premium because the value in the market are different on certain assets than the book value.

Pay Back Period : The payback period is another capital budgeting technique where it calculates the time that s required to recover the original cost of an investment. It does not follows the time-value of money in the calculation. Most business uses this techniques to choose from different possible capital projects. The analysts uses cash flows and initial investments as a factor to calculate a business payback period. The net annual cash inflows are sometimes replaced by an investment and it becomes the investment net annual incremental cash flows. The advantage of payback period technique is that it favors the project that recover their investment as quickly as possible. It focuses on cash flow than the profit and it is a general technique for small businesses.

Accounting Rate of Return : It is a capital investment appraisal technique and it is not calculated over the time value of money. It is used to measure the expected profit of an investment over the investment period so as to contribute the initial investment capital for the project. The higher return investment is chosen or preferred over the lower return investment.

Internal Rate of Return : It is also one of the capital investment appraisal technique where the discounted rate gives a zero value to the net present

value of an investment. Within all the techniques, this technique is found to measure the effectiveness of the capital investment. The project is most likely to be rejected if the capital investment cost is greater than the IRR value and the it has more chance of being accepted if it has a low cost of capital involved.

Profitability Index : This capital investment appraisal technique is used to measure a project costs and benefits. It is a useful tool to rank projects as it allows to measure the value produced per unit of investment. The measurement of the ratio between the present value of future cash flows and the initial investment is the probability Index. It is also called profit investment ratio.

Dividend policy

Dividends is a form of revenue for all investors. It is very important for all the investment. There are many factors involved to decide the dividend amount. Some are internal and some are external factors. No matter what, as long as the revenue is more than the expenses, the investors will continuously receive dividends. Dividend policy provide guidelines to a company on how to calculate and how much to payout to its shareholders as a dividend. The dividend policies are an important decisions taken by the organization. Repurchasing shares can also be a dividend distribution which is more appropriate and more common. Different factors outline the dividend policy of a company which includes new investment openings, unpredictability of future earnings, financial flexibility, legal constraints etc affects dividend policy. Dividend policy helps in valuation of a company. The impact of

dividend policies has affect on the stock price as well. The share repurchases on the stock and the valuation is the main cause of dividend policy. The issue of dividends is the policy that outlines whether the dividends is issued on an ongoing basis or will be infrequent.

Working Capital Management

The process of managing operations and activities related to a firm's working capital is the working capital management. The healthy cash flows is supervised to sustain everyday operations with the help of the working capital management. The company's current assets and current liabilities provides all the information about working Capital Management. To facilitate an efficient daily operation, the working capital management monitors and analyzes the current assets and current liabilities. It may involve utilizing company's short term strategies too. It ensures that the company has enough cash flow to provide its operation expenses and to pay its short term debts. This working capital management serves as a balancing system to make the business aware that the cash flowing into the business is enough for the operation. It is an continuing process and it may involve to execute the short term decisions. If a working capital management is utilized correctly, it can help in doing things correctly and the right way.

Financial Performance Assessment

Financial Performance assessment determines the assets of an organization to generate income. According to federal securities laws, public companies in the united states are required to disclose financial information on a regular basis which is at least once a year. Financial performance of a company

includes balance sheet, income statement and cash flow. Financial performance assessment, a vital aspect of financial risk management, is the measure of a company's profitability, and its ability to achieve its financial goals (Verma, 2017). Most companies require a complete measurement of the financial performance and the structure. Proper analyzing of the financial performance impacts decisions and the projects of short term and long term. The complete financial health also can be measured. Financial performance measures how much the use of an assets can generate income. The financial performance term also compares the firms with similar other firms.

CONCLUSION

It measures the impact of financial management practices on organization performance. The explanation discussed above shows that the capital structure decision, dividend policy, investment appraisal techniques, working capital and financial performance assessment have a positive effect on organization. The importance of the financial management practices is more important for the smooth run of the organization. If these practices are need to be followed and it can be ensured that the financial structure and practices of an organization are the key to sustainability and growth. Good steady returns and maintaining long-term investment attract new investors in a continuous basis. An organization's financial health also depends on internal structure and operation efficiency including goods and services. This means it can maximizes returns, and can make investors confident about their investment.

References:

- 8 Factors that influence capital structure of a business. (n. d.). Retrieved November 01, 2018, fromhttps://onlinemasters. ohio. edu/8-factors-that-influence-capital-structure-of-a-business/
- Kitonga, K. G. (2013). The relationship between Financial Management Practices and Financial Performance in the shipping industry in Keya (Doctoral dissertation. School of Business, the University of Narobi).
- Verma, E. (2017, July 27). Financial Performance – Understanding its Concepts and Importance. Retrieved November 01, 2018, fromhttps://www. simplilearn. com/financial-performance-rar21-article