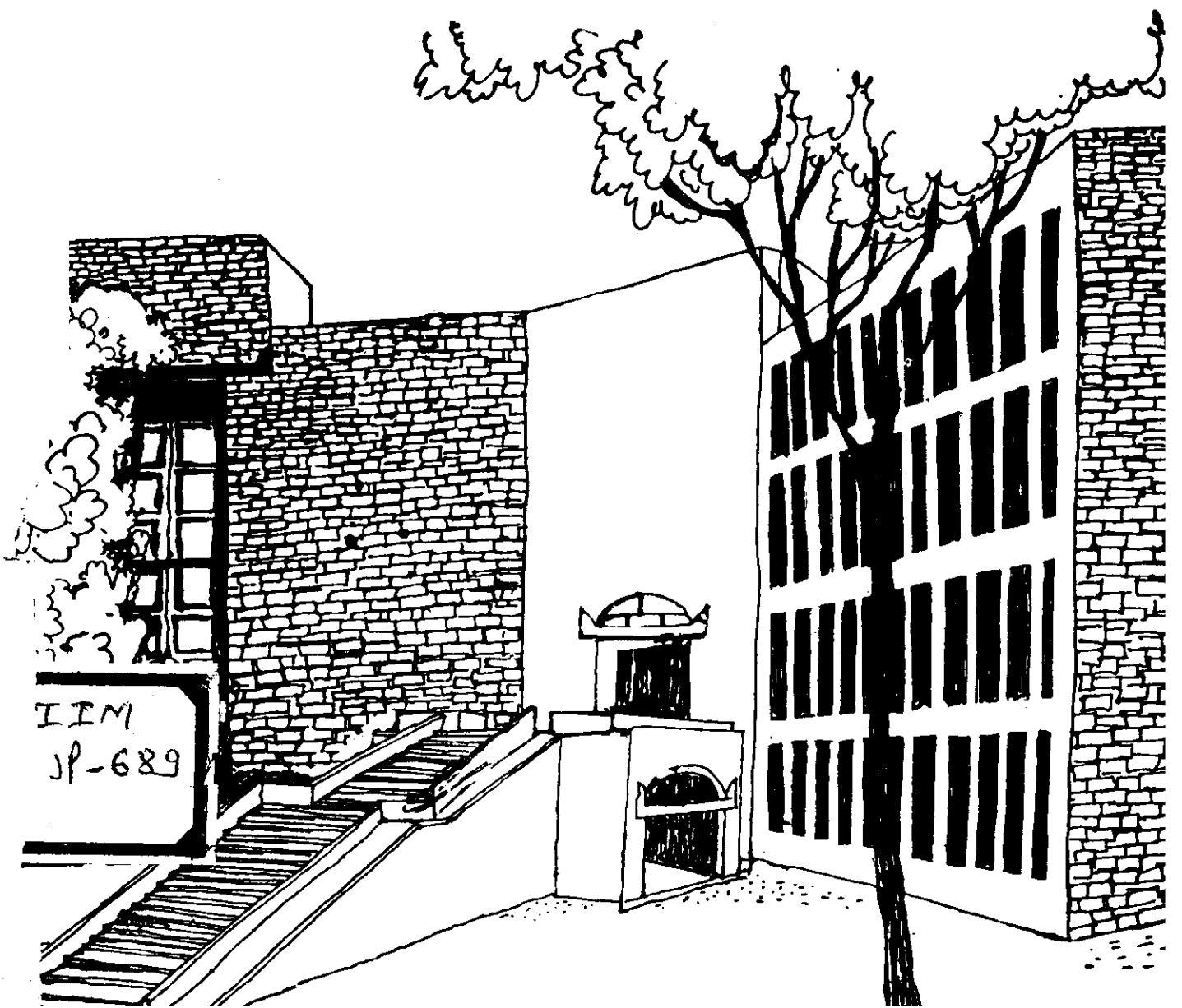




Working Paper



FINANCIAL GOALS: A SURVEY OF
EXPERIENCES IN INDIA

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ABSTRACT

The Study* aimed to test the existence of multiple financial goals and to find the relative significance of the financial goals pursued by companies in India. A questionnaire was sent to companies listed in the Investors' Guide of Economic Times. Sixty one questionnaires were received back, of which fifty seven were found useful for analysis.

The results of the study are: (1) Companies follow multiple financial objectives. The cumulative percentage of companies using two or more financial objectives is 100 per cent. (2) Out of the total respondent companies, only 19.3 per cent inter-alia consider maximization of market value per share in the financial decision-making. This objective is least considered in financial decision-making. (3) The overall rank ordering of the financial objectives suggest the following four objectives to be important: (a) maximization of operating profit before interest and taxes; (b) maximizing the rate of return on investment; (c) maximizing the growth rate in sales; and (d) ensuring that funds are available. (4) An international comparison of financial objectives reveal that 'guarantee funds are available' and 'maximization of EBIT' have been ranked very high in France, Norway and India. Unlike in France, Netherlands and USA, Indian managers do not consider growth in EPS of high importance. It is also indicated that Indian managers' views on financial goals are significantly correlated with that of France, Japan and Norway.

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FINANCIAL GOALS : A SURVEY OF EXPERIENCES
IN INDIA

The process of financial management involves the direction of a corporation towards its financial objective(s) within the constraints imposed by other corporate aims. The profit maximization as a financial objective dominated the scene for a long period. This objective was challenged, which led to a shift to the maximization of shareholders' wealth, reflecting a greater concern for the long-term benefits of financial policies to the firm's owners. The text books suggest the shareholders' wealth maximization (SWM) as the key financial goal that should discipline short- and long-range financial planning and decision-making. SWM as a normative goal is central to the finance theory.

In recent years, the subject of corporate financial goals has attracted much attention as the importance of an organization interactions with its uncertain environment and of the welfare of the individuals and groups of which it is composed have been generally recognized. More realistically, the process of setting the financial goals from managerial perspective is unlikely to be directed exclusively towards SWM. It is also unlikely that managers set the financial goals so precisely defined as to be a specific point in the state space. The objective of this study is to identify financial objective(s) which the Indian managers consider important.

METHODOLOGY AND SAMPLE

A questionnaire, containing fourteen objectives that the company may consider when making financial decisions, was sent to all companies listed in the Investors' Guide of Economic Times. Sixty one questionnaires were received back, of which fifty seven were found useful for analysis. The industry-wise classification of the responding companies is provided in Table 1. The sample contains good mix of companies belonging to different industry groups. The respondent companies also belong to various size categories as shown in Table 2. Sales is used as a proxy of the size of the firm. The sample includes a smallest company with a sales of Rs.4 crores and a largest company with a sales of Rs.708 crores. Table 3 classifies respondent companies according to market capitalisations. We find that companies are reasonably distributed to various capitalisation ranges. Looking at the industry and size profiles of respondent companies, it may be assumed that they fairly represent the experiences of the varied companies in the corporate sector in considering the objectives in their financial decision-making.

The questionnaire was addressed to the chief executive of each company, where the respondent was asked to check from the list of fourteen financial objectives, the ones that his company considers while making the financial decisions (for questionnaire, see Appendix 1). For the purpose of analysis, the objectives have been divided into five broad categories:

A. Maximising the levels of :

1. Book value of net worth (NW)
2. Market value per share (MV)
3. Cash flow per share (CF)
4. Operating profit before interest and tax (EBIT)

B. Maximising the ratio of :

1. Price-earnings (P/E)
2. Market Rate of return (ROR)
3. Return on investment (ROI)
4. Net profit to net worth (NP/NW)
5. Net profit margin (NP/SA)
6. Market share (MS)

C. Maximizing the growth in :

1. Earnings per share (EPS)
2. Total assets (TA)
3. Sales (SA)

D. Ensuring that funds are available

E. Others

ANALYSIS

The questionnaire was designed: (i) to test the existence of multiple financial goals, and (ii) to find out the relative significance of the financial goals pursued by companies in India.

Multiplicity of Objectives

The results presented in Table 4 specifically bring out that no company in practice follows a single financial objective. The cumulative percentage of companies using two or more financial goals is 100 per cent. Table 5 presents the information about the number and percentage of companies considering a particular financial objective in their decision-making. Out of total respondent companies, only 19.3 per cent of the companies inter-alia consider maximization of market value per share (A2) in their financial decision-making. The table suggests that this objective is least considered in financial decisions. The maximization of operating profit before interest and taxes (A4) gets highest consideration in the first category. Maximising the return on investment seems to influence the financial decisions in great deal. The three objectives, viz. maximisation of net profit to net worth, net profit margin and market share seem to be equally popular in 'B' category of objectives. In 'C' category of objectives, maximising the growth in sales is mostly followed. About 87.7 per cent of companies ensure that funds are available at the time of making any financial decision.

Ranking of Objectives

The second part of the questionnaire asked the respondent to rank the financial objectives checked in first part. The summary

results of overall rank ordering of financial objectives is provided in Table 6. It is shown in Table 6 that only one company has given the first rank to maximization of market value per share. No company is considering the maximization of cash flow per share for ranking it for first three places. The findings here are very much contrary to the objectives suggested in financial theory. In category 'A', 24 companies have given first or second rank to the maximization of operating profit before interest and taxes. All other objectives get the least priority in this category. In Category 'B', the maximization of return on investment gets the highest priority. This is followed by the maximisation of the net profit to net worth ratio. Only three companies have given the first rank to the maximization of 'market' rate of return. No company seems to give the first priority to the price-earnings multiple in their financial decisions. The maximization of the growth in sales gets the highest priority in category 'C'. A good number of companies have also indicated the consideration of funds availability at the time of financial decision-making. The overall rank ordering of the financial objectives suggest the following four financial goals to be important:

- (1) Maximization of operating profit before interest and taxes (A4)
- (2) Maximizing the rate of return on investment (B3)
- (3) Maximizing the growth rate in sales (C3)

(4) Ensuring that funds are available (D1)

The empirical results reveal that the objectives which depend on the maximization of the market-determined variables such as market value per share, price-earnings multiple and market rate of return get the least priority in the financial decisions of the Indian companies. This may suggest that the Indian managers mistrust external sources as they are neither predictable nor controllable. Stock market values are prospective, uncertain and determined in great part by parties external to the business organization itself. Market values remain intangible until and unless the shareholders decide to exercise their claim on the company by selling their stock. In this sense their wealth becomes real only when it has been separated from the company; it is wealth the management must do without.¹

One company has very succinctly summarized the financial objectives as follows:

The growth coupled with healthy return on investment has been main financial objective with more emphasis on asset management. The debt-equity ratio, current asset ratio, stock turnover and working capital control are of special importance to the company.

Yet another company has clearly brought out the process of determining financial objective in India. It points out:

In a country such as ours, which is subject to Government regulations, the financial objectives tend to be

a lot more "flexible" than a country with free economy. The financial objectives are seen in such a manner which ensures (a) the optimum intrinsic value of assets; (b) optimum post-tax returns on investments subject to proper adjustments for timing of inflows and outflows; (c) optimum balance between profitability, liquidity and security. The investment in welfare (e.g., employees' housing) and social responsibility (e.g., pollution control) are more prompted by our desire to be good corporate citizens and our genuine concern for the employees and the society. In such areas, non-financial factors out-weigh financial objectives.

Some companies pointed out that their financial goals also include maximization of the product-wise sales margin, minimization of overhead costs, emphasis on average collection period, maximization of value added, payback period etc. One company observed that they put emphasis on maintaining the debt-equity ratio within the range of 45 per cent.

INTERNATIONAL COMPARISON OF FINANCIAL GOALS

Over the past two decades, various surveys on financial management practices have been conducted in US and other countries.⁴ In personal interviews of eight medium and large firms conducted during 1969, Mao⁶ found that managers in general do not explicitly state that the objective of the firm is to maximize the market value of its common equity. This observation has been substantiated

by Petty, Scott and Bird³ in a survey of Fortune "500" companies in 1975, which showed that managements consider several other goals to be more important than the maximization of share prices. The respondents in their study identified the following three goals as being most important to their firms:

1. To maximize the per cent return on total asset investment.
2. To achieve a desired growth rate in earnings per share.
3. To maximize aggregate dollar earnings.

Share price maximization followed these three objectives in order of importance. Operationally, the finance function in large enterprises appear to be multidirected. In 1973, Osteryoung² also provided evidence in favour of multiple objectives being considered by "500" Fortune companies in their capital budgeting decisions.

In an international survey, Stonehill, et.al.⁷ examined the practices of financial goals in five countries viz., France, Japan, Netherlands, Norway and United States. The respondents in these countries were asked to check from a list of ten objectives those which they considered in financial decision-making. Each respondent was also asked to rank the objectives. The following procedure was adopted in assigning the score to each goal:

Ranks Assigned	Score
1 or 2	5
3 or 4	4
5 or 6	3
7 or 8	2
9 or 10	1
Blank	0

In order to make our study on financial goals comparable with that of Stonehill et.al.,⁷ we also adopted the similar methodology of assigning the scores to each financial goal. Since in our case the list of objectives were more than ten, (viz., fourteen) the ranks 9 or above were assigned score of 1, wherever applicable. Table 8 presents the average score obtained for each financial goal. Table 9 presents the comparison of average scores obtained in our survey with that of other five countries.

'Guarantee funds are available' has been ranked very high in France, Norway and India. Maximization of growth in EPS appears to be very important objective in France, Netherlands and USA. The other studies also substantiate this objective to be of high importance in case of USA.⁴ The Indian managers do not see this objective to be of great importance. Maximization of EBIT again

gets high score in France, Norway and India. In order to see which two countries' managers are close to each other with regard to their views on financial goals, we obtained rank correlations between countries' average scores. Rank correlation matrix is presented in Table 10. It is indicated that Indian managers' views on financial goals are significantly correlated with that of France, Japan and Norway. We also find a significant correlation between views of France's and USA's managers.

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Table 1

Industry-wise Classification of Respondent
Companies

<u>Industry</u>	<u>No.of Companies</u>	<u>%</u>
1. Cement	4	7.0
2. Textiles	4	7.0
3. Paper, Pulp and Hardboard	3	5.3
4. Electric Equipment and Cables	5	8.8
5. Aluminium Metals, Alloys, Metal Products and Structurals	6	10.5
6. General Engineering	11	19.3
7. Chemicals, Dyes, Pharmaceuticals, Refin- eries and Plastics	15	26.3
8. Sugar and Breweries	2	3.5
9. Miscellaneous	7	12.3
	<u>57</u>	<u>100.0</u>

Table 2

Size-wise Classification of Respondent
Companies

<u>Sales (Rs.crores)</u>	<u>Number of companies</u>	<u>Number of companies as % of Total</u>
Above 200	7	12.3
100 - 200	14	24.6
50 - 100	9	15.8
10 - 50	8	14.0
Below 10	19	33.3
	<u>57</u>	<u>100.0</u>

Table 3

Frequency Distribution of Respondent Companies on
the basis of their Market Capitalization Rank

Market Capitalization Rank	Number of Companies	%
0 - 10	3	5.3
10 - 100	15	26.3
100 - 250	15	26.3
250 - 500	9	15.8
500 and above	15	26.3
	<u>57</u>	<u>100.0</u>

Note: Market Capitalization rank is based on the average market price per share in December 1985.

Source: Piparaiya, R.K., Corporate Number Game, Aridhi Investment Consultants (P) Ltd., Bombay, 1980, pp.112-135.

Table 4

Multiple Objectives in Financial Decisions

Objective(s)	Number of companies	Number of companies as % of Total
Single Objective	0	zero
2 - 4 Objectives	8	14.0
5 - 9 Objectives	36	63.2
10 and above	13	22.8
	<hr/> 57	<hr/> 100.0

Table 5

Objective Considered in Financial Decisions

Financial objective	Number of companies	Number of companies as % of total in each category	Percentage of companies using the objective
A. Maximizing the levels of:			
i) Book value of net worth	29	30	6.4
ii) Market value per share	11	11	2.4
iii) Cash flow per share	13	13	2.9
iv) Operating profit before interest and taxes	45	46	10.0
	<u>98</u>	<u>100</u>	
B. Maximizing the ratio of:			
i) Price-earnings multiple	14	7	3.1
ii) Market rate of return	18	9	4.0
iii) Return on Investment	53	29	11.8
iv) Net profit to net worth	35	18	7.8
v) Net profit margin	37	19	8.2
vi) Market share	36	18	8.0
	<u>193</u>	<u>100</u>	
C. Maximizing the Growth in:			
i) Earnings per share	31	30	6.9
ii) Total assets	26	27	6.2
iii) Sales	45	43	10.0
	<u>104</u>	<u>100</u>	
D. Ensuring that the Funds are available			
	50	100	11.1
E. Other			
	5	100	1.2
Total	<u>450</u>		<u>100.0</u>

Note: * The percentages have been obtained from the totals referring to each subgroup of objectives.

**Figures are percentage of total 450.

Table 6

Overall Rank Order of Financial Objectives

Rank	A		B				C				D			
	Maximizing the levels of		Maximizing the ratios of				Maximizing the growth in					Funds availability		
	NW	MV	CF	EBIT	P/E	ROR	ROI	NP/NW	NP/SA	MS			EPS	TA
1	4	1	-	10	-	3	18	5	1	1	1	-	9	4
2	-	1	-	14	2	1	12	3	7	4	4	3	3	5
3	1	1	-	5	3	1	8	3	8	5	5	1	6	9
4	2	2	2	3	-	3	1	6	4	3	5	6	9	10
5	4	1	-	7	-	1	3	1	5	4	3	6	10	6
6	4	-	1	3	2	2	4	5	4	8	2	4	2	4
7	4	-	-	3	-	3	4	4	4	5	4	1	4	5
8	5	2	-	-	2	2	1	3	3	4	4	1	1	4
9	2	2	3	-	3	1	-	2	-	1	3	4	-	1
10 and above	3	1	7	-	2	1	2	3	1	1	1	2	1	2

Table 7

Importance of Financial Objectives

Objective		Level of Importance					No Response
		None	Slight	Moderate	Fair	High	
A	1	5 (8.8)	9 (15.8)	8 (14.0)	3 (5.3)	4 (7.0)	28 (49.1)
	2	3 (5.3)	2 (3.5)	1 (1.8)	3 (5.3)	2 (3.5)	46 (80.7)
	3	10 (17.5)	0 (0.0)	1 (1.8)	2 (3.5)	0 (0.0)	44 (77.2)
	4	0 (0.0)	3 (5.3)	10 (17.5)	8 (14.0)	24 (42.1)	12 (21.1)
B	1	5 (8.8)	2 (3.5)	2 (3.5)	3 (5.3)	2 (3.5)	43 (75.4)
	2	2 (3.5)	5 (8.8)	3 (5.3)	4 (7.0)	4 (7.0)	39 (68.4)
	3	2 (3.5)	5 (8.8)	7 (12.3)	9 (15.8)	30 (52.6)	4 (7.0)
	4	5 (8.8)	7 (12.3)	6 (10.5)	9 (15.8)	8 (14.0)	22 (38.6)
	5	1 (1.8)	7 (12.3)	9 (15.8)	12 (21.1)	8 (14.0)	20 (35.1)
	6	2 (3.5)	9 (15.8)	12 (21.1)	8 (14.0)	5 (8.8)	21 (36.8)
C	1	4 (7.0)	8 (14.0)	5 (8.8)	10 (17.5)	4 (7.0)	26 (45.6)
	2	6 (10.5)	2 (3.5)	10 (17.5)	7 (12.3)	3 (5.3)	29 (50.9)
	3	1 (1.8)	5 (8.8)	12 (21.1)	15 (26.3)	12 (21.1)	12 (21.1)
D	1	3 (5.3)	9 (15.8)	10 (17.5)	19 (33.3)	9 (15.8)	7 (12.3)

* Figures in the parentheses indicate the percentages.

* The level of importance for each financial goal has been obtained on the basis of ranks provided by the respondent companies. Companies ranking any objective at first two places has been put in high category rank, 3-4 in fair category, rank 5-6 in moderate category, rank 7-8 in slight and finally all other ranks in none category.

Table 8

Average Scores of Financial Objectives

Objectives	Mean score	Standard Deviation
A. Maximizing the levels of:		
i) Book value of net worth	1.39	1.63
ii) Market value per share	0.56	1.33
iii) Cash flow per share	0.36	0.87
iv) Operating profit before interest and tax	3.30	1.92
B. Maximizing the ratio of:		
i) Price-earnings multiple	0.65	1.36
ii) Market rate of return	1.00	1.56
iii) Return on investment	3.84	1.55
iv) Net profit to net worth	1.98	1.90
v) Net profit margin	2.28	1.89
vi) Market share	1.98	1.75
C. Maximizing the growth in:		
i) Earnings per share	1.67	1.79
ii) Total assets	1.46	1.73
iii) Sales	2.14	2.68
D. Ensuring that the funds are available	3.02	1.56
E. Others	0.35	1.22

Table 9
International Comparison of Scores in Financial Objectives

Financial Objective	France	Japan	Nether- lands	Norway	USA	India
	8	20	13	26	20	57*
A. (Max. market value plus dividends and minimize variance)						
Mean	3.88	.10	0	2.12	2.40	1.00
Standard Deviation	.93	.44	0	1.85	2.08	1.56
B. (Guarantee funds are available)						
Mean	4.25	1.90	2.62	3.58	1.95	3.02
Standard Deviation	.97	2.21	2.24	1.80	1.66	1.56
C. (Max. book value of firm)						
Mean	.38	1.10	.92	1.88	1.65	1.39
Standard Deviation	.99	1.76	1.54	1.65	1.96	1.63
D. (Max. market value of common stock)						
Mean	2.63	.10	1.62	0	2.50	0.56
Standard Deviation	1.73	.44	2.06	0	2.36	1.33
E. (Max. liquidation value)						
Mean	.38	0	.23	.19	.35	-
Standard Deviation	.99	0	.42	.96	1.11	-
F. (Max. growth in EPS)						
Mean	4.63	2.95	3.92	1.81	4.39	1.67
Standard Deviation	.70	2.06	1.77	1.52	1.24	1.79
G. (Max. price/earnings ratio)						
Mean	3.13	0	1.92	1.42	2.00	0.65
Standard Deviation	.93	0	2.06	1.52	1.76	1.36
H. (Max. EBIT)						
Mean	3.25	.95	1.46	3.42	1.85	3.30
Standard Deviation		1.53	1.99	2.02	1.85	1.92
I. (Max. RCE)						
Mean	2.25	1.90	2.69	3.73	2.60	1.98
Standard Deviation	.66	1.87	2.23	1.74	1.85	1.90
J. (Max. return on sales)						
Mean	3.63	2.10	1.69	2.77	2.20	2.28
Standard Deviation	1.58	1.69	2.01	1.83	2.04	1.89
K. (Max. cash flow per share of common stock)						
Mean	2.63	.55	2.00	1.85	1.45	0.36
Standard Deviation	1.11	1.02	2.08	1.81	1.43	0.87
L. (Others)						
Mean	.38	1.00	1.00	.54	1.15	0.35
Standard Deviation	.99	1.90	1.88	1.39	2.03	1.22

Note: Figures below each country indicate the sample size.

Source: Financial Management, Autumn, 1975, pp. 34-35, except for results for India.

Table 10

Rank Correlation Matrix of the Average Scores of
Financial Goals

	France	Japan	Nether-lands	Norway	USA	India
France	1.00	0.38 (1.30)	0.43 (1.51)	0.38 (1.30)	0.59 (2.31)	0.60 (2.37)
Japan		1.00	0.56 (2.14)	0.53 (1.98)	0.37 (1.26)	0.64 (2.63)
Netherlands			1.00	0.31 (1.03)	0.51 (1.88)	0.39 (1.34)
Norway				1.00	0.25 (0.82)	0.83 (4.71)
USA					1.00	0.45 (1.59)
India						1.00

Note: Figures in parentheses indicate the t-values.

Annexure - 1

Title : FINANCIAL GOALS OF INDIAN COMPANIES

Name of the Company : _____

The following statements are alternative ways of describing the financial objectives of a company. You may kindly check (✓) from the list of the objectives that your company considers when making financial decisions. If your company pursues any other objective(s), please describe under O.

The financial objective(s) of our company is(are) to:

- A. Maximize the book value of net worth.
- B. Maximize the market value of common shares.
- C. Ensure that funds are always available when needed.
- D. Maximize cash flow per share.
- E. Maximize net operating profits before interest and taxes.
- F. Maximize the shareholders' rate of return as measured by dividends plus change in the market price of the common share over a specific time horizon and subject to some maximum allowable risk.
- G. Maximize return on equity as measured by net profit after taxes divided by book net worth.
- H. Maximize price-earnings ratio.
- I. Maximize the return on investment.
- J. Maximize net margin, viz., net profit after taxes divided by net sales.
- K. Maximize growth in earnings per share.
- L. Maximize growth in sales.
- M. Maximize growth in total assets.
- N. Maximize market share of products.
- O. Other (Please describe).

Please rank the objectives as checked above in terms of their importance to your company with the highest rank being number 1 and onwards:

Rank:

- | | | | | |
|-----------------------------|-----------------------------|-----------------------------|-----------------------------|-----------------------------|
| A. <input type="checkbox"/> | B. <input type="checkbox"/> | C. <input type="checkbox"/> | D. <input type="checkbox"/> | E. <input type="checkbox"/> |
| F. <input type="checkbox"/> | G. <input type="checkbox"/> | H. <input type="checkbox"/> | I. <input type="checkbox"/> | J. <input type="checkbox"/> |
| K. <input type="checkbox"/> | L. <input type="checkbox"/> | M. <input type="checkbox"/> | N. <input type="checkbox"/> | O. <input type="checkbox"/> |