CHAPTER I

INTRODUCTION
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Over the past two decades not only have political systems and economic systems been changed but also many of the basic notions on which personal and corporate financial decisions have been contested, rewritten and even discarded. Companies now compete with others from all over the world for customers, suppliers of labour, goods and capital. These changes have affected all our lives as citizens, customers, employees and shareholders. Thus it is important that corporate managers, shareholders, lenders, customers and suppliers should understand the past performance and forces that will affect the future performance of companies upon which they rely.

Organisation requires many resources enable them to operate successfully in a competitive environment. In private sector the success of an organization is measured by the ability of making profit, generating sales revenue, market capitalization and their services. Both the public and private sectors require people, materials, machinery, equipment, buildings, money and information to get success, other than that finance is a life-blood of any business activity. It is defined as provision of money at the time when it is required and it is concerned with application of skills in manipulation, procurement and control of money. Thus, in consequence finance functions affect the size, growth, profitability and value of a firm. Hence managing finance functions are an important task for the financial executives.
In today's global economy, investment capital is always on the move through organised capital markets, investors each day shift billions of investment dollars among different companies, industries and nations. Capital flows to those areas where investors expect to earn higher returns with the least risk. The decision of financial managers and chief executives are translated into the international language of money, which gives a common understanding of plans and enables the performance of organisations and individuals. This could be achieved by frequent and accurate financial information in the right form reaching the right people at the right time to enable them to make good use of it. Personnel managers, among many others, need to keep a close eye on the companies financial position.

In an economic society all the active participants become interested in varying degrees of performance of a business enterprises.\textsuperscript{1} Some of the interested groups are owners, employees, customers, society, government, suppliers, managers, news agencies, trade associations, economic and commercial research institutions, stock exchanges, economists and research workers, members of parliament, members of public accounts committee in respect of Government are also interested in the result of corporate enterprises. Moreover, in the present era

business enterprises excel through their power of creativity and innovations, in fact they could equate themselves in the market place with such power only. In this regard, it could be said that the promotion of new and innovative business proposals put forward by entrepreneurs having sound knowledge in technology and managing the finance functions could lead the economy to high growth.

Growth in the industry is fuelled by increase in number of business expansions; acquisitions and Greenfield projects funded both with domestic and foreign private investments. Of course, there is no denying that both employee count and wage bills are on the rise, smaller companies could have a tough time with the biggies mopping up the prime talent and have to pay more to attract talent. Mergers and acquisitions are the order of the day in the industry that a major chunk of acquisitions are made abroad. While foreign companies are aiming to improve long-term profitability by accessing Indian skill sets, Indian companies are driven by the need to have local presence in the overseas markets.  

1.1 SIGNIFICANCE OF THE STUDY

The study focuses on overall financial position of particular software companies during the specific period based on the selected variables, which may create interest not only for the respective

2. Fortune India, 15th May 2006, p.17
companies in the industry but also brings a process of development in operational aspects of the entire industry. The study is much important to the management from the point of decision-making purpose, to identify the strength, weakness areas of the company and finally helps to maximise the intrinsic value of the company. The study has academic and practical significance. It helps the academicians and researchers to develop new ideas for further study.

1.2 STATEMENT OF THE PROBLEM

The decade of 1990's witnessed various changes taking place throughout the world. Although the move towards privatization, initiation of policies pertaining to economic reforms had their origin in 1980's it is only in the wake of the globalisation process this acquired new momentum. The economic reforms initiated in the early 1990's in India are considered as a landmark change. The economic reforms are considered as landmark in the development of national economy as they lifted state controls. Major emphasis was laid down on private investments, opening the economy to foreign investments, reforms in the financial sector, structural adjustment policies and integrating the national economy into the world economy. A most remarkable feature of the so-called "New Economy" is the role of the services sector of which the Information Technology (IT) sector is a part in generating growth of income and employment. The potential of IT sector, especially the software industry could be understood by looking at its contributions to
the national economic growth and in accommodating large chunk of human resources. It is commendable when compared with the any other industries.

India's Software Industry is currently the only Indian Industry that has become world-renowned. It has expanded from 0.5 per cent of GDP in the year 1991 to 1.5 per cent in 1999. Exports have increased by a greater amount rising from one per cent to 10 per cent of total export in the same period. Software export destination accounted to 165 countries. Exports recorded Rs.78,230 cr. in 2004-05, which is up by 34 per cent from Rs.58,240 cr. in 2003-04. In response to the growth of software industry in the year 1998 the government created a task force within the prime minister's administration for information technology/software development and in the year 1999 created the Ministry of Information Technology. India's software industry is a rare case that has developed almost completely free of government intervention, and the government's role is only to create the environment for its development. India has still to go for product development in the consumer space but in the business-to-business space companies like I-flex, Infosys and Polaris have made a name for themselves. Recently some smaller companies are also getting involved in product development and generating intellectual property rights. India has a mature Information Technology (IT) industry

3. www.nasscom.org
with abundant talent and world-class systems. It has state-of-the-art
technologies to provide total solutions to outsource turnkey projects.
India will soon become a leader in the highest number of International
Organisation for Standards certified companies around the world in
forthcoming years.

Performance does mean action or achievement. It could also be
said as the ability to move quickly or operate something efficiently.
Financial performance is the right tool for judging the working efficiency
of any organization irrespective of the nature. To measure the financial
performance, in general, business enterprises use financial analysis
tools. The financial analysis provides a method for assessing the
financial strengths and weaknesses of a firm with a view to understand
the firm's current financial condition, which, in turn, could serve as the
basis for decision making.

Interpretation of financial statement is an intellectual process with
a view to forming an opinion on the value of its business. It guides the
present and prospective shareholders and creditors to understand the
operations of a business enterprise in a highly competitive economy. It is
only the searching analysis of the published accounts that brings to light
any camouflage that might have been practiced by the people.

Primary goal of a financial manager is to maximise the stock price
however accounting data do influence stock prices and to evaluate the
performance of a company in such a way by analysing the accounting
In the first place, interpretation of financial statements and their review by business executives compel them to think ahead and provide for future.

Survival of the fittest is the law of jungle, which is equally applicable to today's changing world. When compared to the traditional role of financial executives in manufacturing firm, the role of financial executives has quite changed in case of services companies particularly the IT sector.

From the above point of view the present study is focused to examine the impact of selected financial parameters, their growth performance and their contribution towards earnings of the particular Indian software companies.

1.3 OBJECTIVES OF THE STUDY

Following are specific objectives of the study.

- To study the growth and development of Indian Software Industry.
- To examine the consistency and growth rate of selected financial parameters of the particular software companies.
- To test the equality of variance, to examine the mean differences and to forecast the trends of the selected variables between the selected groups.

5. Dr. Saksena S.C., 'Business Administration and Management', Sahithya Bhawan, Agra. 1982
To examine the overall contribution of selected financial parameters and clustering them into groups, to identify the most influencing factor towards earnings and classify the companies into groups by applying discriminant analysis.

To study the working capital practices followed and to examine the efficiency of working capital management.

To evaluate the financial health and viability of particular software companies.

1.4 HYPOTHESES
The following hypotheses have been framed in consonance with the objectives of the study.

1. There is no significant difference in the mean total assets among different groups of companies.

2. There is no significant difference in the mean net worth among different groups of companies.

3. There is no significant difference in the mean net sales among different groups of companies.

4. There is no significant difference in the mean earnings before interest and taxes among different groups of companies.

5. There is no significant difference in the mean gross profit among different groups of companies.

6. There is no significant difference in the mean net profit margin among different groups of companies.
7. There is no significant difference in the mean profit after tax among different groups of companies.

8. There is no significant difference in the mean score of total debts between different groups of companies.

9. There is no significant difference in the mean return on investment among different groups of companies.

10. There is no significant difference in the mean return on equity among different groups of companies.

11. There is no significant difference in the mean earnings per share among different groups of companies.

12. There is no significant difference in the mean retained earnings among different groups of companies.

1.5 METHODOLOGY
1.5.1 SOURCES OF DATA

Secondary data are used in this study, which were collected from the Capitalineplus corporate database and PROWESS of the Centre for Monitoring Indian Economy. Variables pertaining to behaviour of liquidity, leverage and profitability were collected from the balance sheet and profit and loss account of the selected software companies for a period of 10 years i.e from the financial year 1995-96 to 2004-05. Besides the corporate database, reports were collected from RBI Bulletin, Annual survey of Industries, Libraries of various institutions and Research publications. Editing, classification and tabulation of financial
data collected from the above-mentioned sources have been done as per the requirements of the study.

1.5.2 SELECTION OF THE SAMPLE

The study is confined to the software industry in India.

The companies, which have

- Continuous data available for all the ten accounting years.
- The companies' shares were actively traded in Bombay Stock Exchange.
- The companies for which the data were not available for one and more than one year in between or in the beginning or at the end of the study period have been ignored.

There are 267 listed software companies available in BSE India by the year 2005 out of these only 69 software companies were selected by using simple random method.

To examine their financial profile, growth rate and to forecast trends all the 69 companies were classified as small, medium, large and giant groups based on their size. Size has been determined on the basis of paid up share capital of the companies, Financial year of 2005. The amount of paid up capital falls below Rs.10 cr, Rs.10 cr to Rs.50 cr, Rs.50 cr to Rs.100 cr and above Rs.100 cr. From the total sample of 69 software companies, 33 companies (47.8%), 29 companies (42%), 04 companies (5.8%) and 03 companies (4.4%) are categorized into small group, medium group, large group and giant group respectively. The
rationale for the above said classification stanch from a RBI study on performance of private corporate business sector during First Half of 2005-2006 for 2355 companies, where the companies are classified as whose paid up share capital below Rs.1 cr, Rs.1 to Rs.5 cr; Rs.5 cr to Rs.10 cr; Rs.10 cr to Rs.15 cr; Rs.15 cr to Rs.25 cr and above Rs.25 cr. Since the sample of selected software companies paid up share capital is comparatively high the limits are categorized for the purpose of convenient.

To analyse the working capital management practices, measure the working capital efficiency and to examine the financial viability 50 companies were selected from the 69 software companies in such a way for those companies required data were available in the corporate database.

1.5.3 PERIOD OF THE STUDY

The study covers a period of ten years from 1995-96 to 2004-05 to mean an accounting year of the company consisting of twelve months.

1.5.4 FRAME WORK OF ANALYSIS

Analysing the performance of a company can be done through a careful and critical analysis of financial statements. The two important financial statements are 'Balance Sheet' and 'Profit and Loss' account.

It indicates the operating results and financial position of a concern, therefore by analyzing and interpreting these statements, performance can be appraised.\textsuperscript{7} It is a preliminary step towards the final evaluation of results drawn by the analyst towards appraisal and evaluation.\textsuperscript{8} The analysis spotlight the significant facts and the relationship concerning management performance, corporate efficiency, financial strength and weakness that could have otherwise been buried in maze of detail.\textsuperscript{9}

In the interest of sound financial policy, every company must analyse its accounts periodically. Preparation of financial statement is not the end. The purposes of preparing these statements are to determine the significance and meaning of the financial statement data. The techniques of analysis are frequently applied to study the accounting data with a view to determine continuity or discontinuity of the operating policies, investment value of the business, credit rating and testing the efficiency of operations. The techniques which used are ratio analysis, trend analysis, analysis of variance, common size statement analysis, cash flow analysis by applying statistical techniques such as mean, range, coefficient of variation, skewness, kurtosis, correlation and

\textsuperscript{8} Aziz A., "Performance Appraisal-Accounting and Quantitative Approaches" Pointer Publishers, Jaipur, 2003, p.9
regression with diagrammatic and graphical representations. All the techniques provide a scientific assessment of efficiency and effectiveness of operations of a company.

In the light of the above in this study various financial ratios and variables have been used to examine the objectives of the study. The selected financial parameters are total assets, net sales, net worth, gross profit, earnings before interest and taxes, profit after tax, total debt, retained earnings, earnings per share, current ratio, debt equity ratio, interest coverage ratio, net assets turnover ratio, net profit margin, return on investment, return on equity, price earnings ratio, pay out ratio and retention ratio.

Statistical tools like Summary statistical measures, Compound Growth Rate, Hartley's F Max test of equality of variance, One-way ANOVA, Trend Analysis (polynomial cubic trend), Factor Analysis, Step wise multiple linear regression analysis, Discriminant function, Bhattacharya model of performance index, utilization index, efficiency index and Altman's Z score analysis are used.

1.6 SCOPE OF THE STUDY

The study is basically restricted to companies listed in Bombay Stock Exchange. Physical and market performance of the companies were not paid any attention because good performance in them would ultimately be reflected in the financial variables which is taken for consideration. A random sample of sixty-nine software companies has
been taken up for the study. The study has taken financial, accounting and quantitative data covering a period of ten years from the financial year 1995-96 to 2004-05. By identifying the important key variables namely return on investment and return on equity and the factors which influences earnings are paid more attention to examine their performance.

1.7 LIMITATIONS OF THE STUDY

◊ The study covers a period of ten years from 1995-96 to 2004-05 for sixty-nine software companies listed only in Bombay Stock Exchange were taken. Secondary data were collected from Centre for Monitoring Indian Economy and Capitalineplus corporate database due to cost and time constraints. Considering the availability of continuous data sample size has been fixed.

◊ A few of the sample companies have not been following uniform accounting period, in that case the financial data have been so organized that they relate to the twelve months of the relevant accounting year.

◊ A few companies had to be compulsorily excluded from analysis because of non-availability of continuous data either due to non-submission of statement or due to closure/ mergers/ suspension of operation during the study period.

◊ Sample size was restricted by sixty-nine only because most of the companies were incorporated at the end of the year 2000.
The companies that fall under the software industry category in the Capitalline plus corporate database alone were selected for the purpose of study.

Since the companies selected for the study are incorporated during 1991-94 age-wise classifications was not able to do for the purpose of analysis.

Financial statements from which the data have been extracted are historical and quantitative in nature the study is incorporated with all the limitations that are inherent in the financial statements.

The effect of inflation has not been considered.

There are different methods to measure the profitability of an industry views of experts differ from one to another.

The present study is largely based on ratios, which have its own limitations.

The study covers only selected companies in the industry, therefore it implies that the conclusions drawn are tentative in nature and firm generalization should be avoided for entire undertakings.

1.8 SCOPE FOR FURTHER RESEARCH

Any research study can explore only a limited field of knowledge. Every attempt has been made to make the study more intensive but due to lack of time and resources there exists a certain gaps in the present study also. From the point of view this part specifies further scope of research work in the same software industry.
The present study is based on secondary data. Efforts can be made to study the determinants of corporate capital structure, cost of capital, risk and return analysis, technical analysis, market analysis, share holders value creation, measurement of economic value added, market value added, dividend practices followed, profitability analysis and leverage analysis.

On the basis of primary data employees salary survey, job satisfaction, study on attrition rate, stress management, study on most preferred employers, labour turnover to be closely examined for further research work.

1.9 CHAPTER SCHEME

The Present study is organized as seven chapters.

The First Chapter covers introduction, significance of the study, statement of the problem, objectives of the study, hypotheses framed, sources of data, selection of the sample, period of study, frame work of analysis, scope of the study, limitations of the study and scope for further research.

Review of literature on related researches are presented in the second chapter.

The Third chapter studies the evolution of Indian Software Industry.

Financial profile and its growth rate of particular software companies are analysed by applying summary statistical measures,
compound growth rate, test of equality of variance, test of hypotheses and forecasted trend pattern of finance variables are presented by group-wise classification in the fourth chapter.

Empirical classification of the underlying factors and grouping them by using factor analysis, identification of variables which influences earnings and discriminant analysis for classification of groups are dealt in the fifth chapter.

The Sixth chapter deals with analysis of working capital management practices with the help of selected variables and ratios, measurement of working capital management efficiency by applying utilization index, performance index and efficiency index and finally examination of financial health is done by applying Altman's Z score for the selected software companies.

Summary of findings, conclusion and suggestions are presented in the last chapter.