PERFORMANCE ANALYSIS OF SOFTWARE COMPANIES IN KERALA

WITH SPECIAL EMPHASIS ON FINANCIAL ASPECTS

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Introduction

Information technology is playing an important role in India today and has transformed India's image from a slow moving bureaucratic economy to a land of innovative entrepreneurs. India is the world's largest sourcing destination, accounting for approximately 55 per cent of the US$ 146 billion market. The country's cost competitiveness in providing Information Technology (IT) services, which is approximately 3-4 times cheaper than the US, continues to be its Unique Selling Proposition (USP) in the global sourcing market. India's highly qualified talent pool of technical graduates is one of the largest in the world and is available at a cost saving of 60-70 per cent to source countries. This large pool of qualified skilled workforce has enabled India's IT industry amounts to 12.3 per cent of the global market, largely due to exports. Export of IT services accounted for 56.12 per cent of total IT exports (including hardware) from India. The Business Process Management (BPM) segment accounted for 23.46 per cent of total IT exports during FY15. The IT-BPM sector is estimated to expand at a CAGR of 9.5 per cent to US$ 300 billion by 2020.The Government of India has extended tax holidays to the IT sector for software technology parks of India (STPI) and Special Economic Zones (SEZs). Further, the country is providing procedural ease and single window clearance for setting up facilities.

Financial performance of IT companies is driven by factors such as digitisation, and non-linear models, and the depreciation of the Indian rupee. Indian IT firms continue to move up the value chain by providing more end-to-end solutions and engaging more closely with clients. The drive towards digital technologies, internal cost optimisation to improve profitability continued in FY16. Digital revenues grew 1.5 times faster than revenues from traditional

services. India's IT industry can be divided into six main components, viz. Software Products, IT services, Engineering and R&D services, ITES/BPO (IT-enabled services/Business Process Outsourcing), Hardware, and e-commerce. Export revenues (US$ 61 billion) continue to drive growth

IMPLICATIONS OF FINANCIAL PERFORMANCE IN SOFTWARE COMPANIES

 The technology sector is a category of companies and related stocks that conduct research, development and or distribution of technologically based goods, services and products. This sector encompasses businesses that manufacture electronics; create software; and build, market, and sell computers and products related to information technology.Technology companies are unique in they often carry little or no inventory, are commonly not profitable and they might not even make revenue. Additionally, many technology companies take on large venture capital investments or issue large amounts of debt to fund research and development. The strategy of technology companies is generally different from other companies in that many of them seek to be acquired rather than turn a profit. Due to these facts, there are key financial ratios used when analyzing a technology company. The ratios are described below:

Liquidity Ratios

Liquidity ratios give information about a company's ability to meet short-term obligations. Since many technology companies do not make a profit or even generate revenue, it is extremely important to analyze how well a technology company can meet its short-term financial obligations. These types of ratios take into account long-term debt and any equity investments, both of which highly impact technology companies. This ratio is extremely important for the analysis of technology companies. This is due to the fact that technology companies make large amounts of investments in other technology companies and take on investments and debt from other organizations to fund product development. When a technology company decides to acquire another company or fund necessary research and development, it normally does so through outside investments or by issuing debt. When a stakeholder analyzes a technology company, it is important to look at the amount of debt the company has issued. If this ratio is too

high, it could mean the company will become insolvent before turning a profit and paying back While most technology companies are not profitable, even large ones such as Amazon, it is necessary to look at what margins these companies have; other ratios, such as the gross profit margin, are a good indicator of future profitability even if there is no current profit.This profit margin measures the gross profit earned on sales. It is only applicable if a technology company is generating revenue, but a high gross profit margin is a signal that once the company scales, it could become very profitable. A low gross profit margin is a signal the company is unable to become profitable.

LITERATURE REVIEW

Hamsalakshmi and Manickam (2004) has made "A study on financial performance analysis of selected software companies" The study has been focused on examining the structure of liquidity position, leverage and profitability. The study has revealed a favorable liquidity position and working capital position. The study has also pointed out that the companies rely more on internal financing and the overall profitability has been increasing at a moderate rate. Shurveer S. Bhanawat (2011) in this study "Impact of Financial Crisis on the Financial Performance of "Indian Automobile Industry". In this study the impact of financial crisis on Indian Automobile Industries with the help of statistical significant techniques is analysed. On the analyses of the t-Test and Analysis of Variance, it is found that the impact is not significant which proves that though the global economies are impacted by recession, the Indian Automobile Sector showed resilience and was not affected significantly by the recession. It goes to show that the Indian automobile market, though impacted by export income, did not crumble under recession, as the volumes were significantly met by local demand, thereby proving that the Indian economy is a self sustaining economy, not significantly impacted by the financial crisis.

BACKGROUND OF THE STUDY

Financial performance of the organisation should be sound enough to adapt itself in such a complex and rapidly changing corporate environment.A sound financial performance enables a

firm to attain profitability, market share and sustainable competitive advantage for its survival, growth and expansion(Patra, 2009). Financial performance refers to a firm's ability to generate new resources from day to day operations over a given period of time. Financial performance evaluation is a process of determining the financial health of a concern from different angles, identifying its strengths and weaknesses and suggesting ways for improvement in its future workings (Patra, 2009). Financial performance measures evaluate how well a company is using its resources to make profit . "Profit is the engine that drives the business enterprise". The efficiency of a business is measured by the amount of profit earned by it. The greater the profit, the more efficient the business will be. The profit of a business may be measured by studying the profitability of investment in it. All the activities in the business are the means and profit earning is the end. Therefore, an evaluation is done from time to time to assess the efficiency of operations and the profitability of the organization. This evaluation is called financial analysis or financial performance analysis.

Statement of the problem

The information technology industry has made outstanding contribution to the growth of the corporate sector in terms of employment generation, revenue, entrepreneurial skills, standard of living and thereby overall economic development. Its magnificent performance resulted in high rate of return to investors and it in turns attracted investors from within and abroad. Foreign Direct Investment and Foreign Institutional Investments have increased considerably in Information Technology industry. Indian software companies cater to the software requirements directly and through Business Process Outsourcing. This enormous growth of Indian IT industry made it a knowledge destination in the world. But these outgrowth give rise to some major issues such as to whether the performance of Indian software companies is sustainable or not, Whether the performance of every software companies is equally well or not and whether the software company is investment worthy.

The present study will find the answers to the above questions apart from giving policy implications for the betterment of software companies in India

Objectives of the study

1. To identify the factors influencing the financial performance
2. To evaluate the overall financial performance of selected software companies at Technopark.
3. To assess financial strength of IT companies with the help of comparison of Company's ratios with industry average ratios.
4. To examine the profitability and liquidity position of the selected IT companies
5. To study the impact of profitability on liquidity and solvency of the companies.

HYPOTHESIS

Ho: There is no significant impact of Solvency on Financial performance of the organisation

Ho: There is no significant impact of Liquidity on Financial performance of the organisation

Ho: There is no significant impact of financial performance measures on Market Value Added.

Ho: There is no significant difference between Profitability and industry average profitability.

Ho: There is no significant impact of Management Efficiency on Financial performance

Ho: There is no significant difference between Liquidity and industry average Liquidity.

Ho: There is no significant difference between Solvency of and industry average Solvency.

Ho: There is no significant difference between Management Efficiency and industry average Management Efficiency.

SIGNIFICANCE OF THE STUDY

The significance of the study is manifold. The benefits of the present study are varied. It is highly beneficial to all stakeholders of the IT industry. It would help the management to understand the strengths and weakness of a company. It would help the policy makers to decide on policy

implications. It would be useful to the creditors in assessing the credit worthiness of a company to grant credit. It is beneficial to prospective employees to select the company for employment. It would help Government in formulating various policies. The study will benefit the investors in making better investment decisions. The results of the financial analysis are also useful to the bankers, employees, researchers, academicians, customers and public in knowing the financial condition of the companies.

Scope of the Study

The study is focused on financial performance of software companies working at Technopark. The study covers different aspects of financial performance which includes analysis of profitability, liquidity, solvency, management efficiency, market valuation and value creation by the company under study. The study also provides empirical evidence on Economic Value Added (EVA) and Market Value Added (MVA) as tools of value creation. The study investigates relationship between Economic Value Added (EVA), Market Value Added (MVA) and financial ratios of the company. The study assesses financial strength of software companies with the help of comparison of Company's financial ratios with industry average ratios.

METHODOLOGY

Sampling design

The study is confined to software companies at Technopark, Trivandrum. There are 350 software companies working at Technopark . From the population, the sample companies were selected based on the following criteria: (1) The company should have been listed with any of the stock exchanges in India. (2) The companies which have the required financial data for a continuous period of 10 years (2006-2007 to 2015- 2016) have been selected, as the study has used 10 years data for the analysis. The companies for which the data was not available for one or more than one year in between or in the beginning or at the end of the study period have been ignored. 40 companies which satisfied the above conditions were selected as sample for the study.

Sources of data

The data required for the study is secondary in nature. The Reserve Bank of India Bulletin, Annual survey of industries , Bombay Stock Exchange official Directory, NASSCOM Annual Report, Research publications, Dailies and periodicals such as Economic times, Financial Express, Business Standard, Capital Market, Business World, Business India, Business today and various news papers. Editing, classification, and tabulation of the financial data collected from the above mentioned sources have been done as per the requirements of the study.

Variables used in the study

Financial ratios were used in the present study to analyze the financial performance of software companies at Technopark. Financial ratio analysis is an important and powerful technique of financial performance evaluation. Therefore, various financial ratios under the categories of liquidity, profitability, management efficiency, solvency and market valuation have been calculated and analyzed. Along with the traditional technique of financial ratio analysis, advanced value addition techniques in the form of Economic Value added (EVA) and Market value Added (MVA), have been used to analyze the financial performance.

Tools & techniques for analysis

For analyzing the data, statistical techniques like measure of central tendency, measures of dispersion, Pearson correlation analysis, multiple regression analysis, t test etc., have been used and hypotheses have been tested at confidence level of 95%.The present study will use multi-regression technique to analyze the impact of liquidity, solvency and management efficiency on profitability. Industry average financial ratios have been used as benchmark ratios in the study.

Data Analysis

Current ratio

Analysis of current ratio show that the ratio ranges from 0.71:1 in small companies to 10.10:1 in medium companies, corresponding to ideal ratio of 2:1. Having high current ratios shows more investment in current assets, which ensure high cushioning on liquidity but profitability will be a challenge. The average investment in current asset is more in overall industry and employment of current liability is very low. High current ratio in medium companies is associated with high risk shown in the values of standard deviation.

Debt Equity Ratio –

Usually debt equity ratio will not portray negative value, but in the present study due to negative networth of one small company (due to huge accumulated losses) the values are negative. Industry standard for debt equity is 2:1, analysis of 45 companies showed that majority of IT companies have only equity capital, they have not taken financial risk or leverage. Companies should learn to trade on equity so as to give more returns to shareholders.

Reserves to Net-worth Ratio –

Analysis of portion of reserve in shareholders fund show a enormous amount of accumulated profits with companies. This is because most of the companies follow no dividend policy (shown in Dividend per share analysis). The payout ratio is very less compared to retention ratio. This will also result in increased book value shown in further part of the study

Debtors Turnover Ratio

Analysis of debtors turnover shows that the maximum cycles completed is 47.13 times in big companies and a minimum of 0.14 times in small companies. More times of turnover shows quick recovery of receivables and high efficiency and vice versa with low ratio. Big companies show

high turnover but the variation within the group is high as shown in standard deviation and also is inconsistent as compared to the other two.

Fixed Assets Turnover Ratio

Analysis of fixed asset turnover ratio shows an attractive figure of 260.43 times in big companies with a minimum of 0.09 times. The vast difference is seen in all the three categories of companies, resulting in more inconsistency in asset turnover.

Gross Profit Ratio

Analysis of gross profit shows that it is as less as 2.65% and ranges upto 100% among the three groups. Big companies have more profit margin as the average value of big companies is more as compared to the other two. Risk is more in small as it has high standard deviation. From covariance values it is clear that big companies are more consistent and small companies are inconsistent with high value of 43.58%

Net Profit Ratio –

Analysis of net profit shows that the net profit ranges between losses of 742.31% in small companies to profit of 81.67% in medium companies. Medium companies are better in terms as profit making, less variation and more consistent. In small companies 5 out of 15 companies had incurred loss which is shown negative covariance, which indicates that, higher than average values of one variable tend to be paired with lower than average values of the other variable

Earnings per Share

EPS ranges between negative return of Rs. 20.70 in small companies to a positive return of Rs. 160.76 in big companies. Due to negative profits and ROI, negative covariance persists in EPS.

Findings

The liquidity position of all the three categories is good with current ratio high and cash ratio little more than industry standard. Solvency position of all three categories is good with high value for investment which is shown in book value and reserves. Majority of the IT companies are not using debt. Debt equity ratio is much lesser than industry standard. Activity ratio is fine in debtors and fixed asset, but its low in capital turnover. Big companies have high activity ratios. The major component of cost in IT sector is employee cost the reason is, this is the sector mainly driven by human. Gross profit margin is high in all three categories, operating profit made by medium companies is high, with better average in big company and medium companies take lead in making net profit is both high value and average value. ROI, EPS and dividend paid by big companies is more in terms of high and average values. The risk and return relationship analysis shows big companies provide high return to moderate risk, medium companies have low risk and low return but small companies are more uncertain with high risk and moderate return. Through ranking it was found that big companies are better performers and medium companies are consistent performers

Conclusion

Increasing competition, pressure on billing rates of traditional services and increasing commoditization of lower-end services are among the key reasons forcing the Indian software industry to make a fast move up in the software value chain. The new digital technologies like social media, mobility, analytics, and cloud computing (SMAC) has permanently changed the way Indian IT firms do business. The Indian government is emphasizing on better technology enabled delivery mechanisms for a multitude of government projects. Further, with the new digital India and start up Indian initiatives being launched, the domestic market for software services has a bright future ahead. Abundant supply across segments, mainly lower-end, such as ADM. Lower supply in higher-end areas like IT/Business Consulting, but competition is very tough. Competition is global in nature and stretches across boundaries and geographies. It is expected to intensify due to the attempted replication of the Indian off shoring model by MNC IT majors as well as small startups.

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