

# Consequences of Financial Management Practices on Profitability on Selected Private Manufacturing Companies in Mekelle City

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## Abstract

The objective of this study was to analyze the relationships of the existing practices with the profitability of the companies. Data were collected from secondary sources and primary sources. An Econometric tool, i.e., Order probit regression technique was applied to assist the researcher verifying the relationship between the practices and the profitability of the companies. Moreover, the study has analyzed the consequences of existing financial management practices on profitability and found that there was direct relationship between profitability and financial reporting and analysis; and the accounting information system. On the other hand, profitability was inversely related with age of the company, capital budgeting and capital structure management practices. The companies should exercise to maintain suitable ratio between debt and total capital; use effective financial leverage and should review the debt level in order to use it for making finance decisions. Moreover, the companies should evaluate their future projects and fixed assets after acquisition using different capital budgeting techniques rather than a simple determination of accounting profit. The variables used in the study were not exhaustive. Thus, future research may incorporate other financial management practices such as budgeting and CVP analysis and the potential researchers may also assess the practices in different sectors.

**Keywords:** Accounting Information System, Capital Budgeting, Capital Structure, Financial Management Practices, Financial Management, Financial Reporting and Analysis, Profitability, Working Capital

## 1. Introduction

Developments in financial management started in the early 1900s with an emphasis on various activities such as, the legal aspects of mergers, the new firms' formation, and the various types of securities firms that can issue to raise capital. During the period of depressions i.e. 1930s its emphasis shifted to bankruptcy and reorganization, to liquidity of corporations, and to the security market regulation. During the 1940s and early 1950s the finance continued to be taught as a meaningful, institutional subject, viewed more from the standpoint of an outsider rather than only from manager (Uwadiae&Akintola, 2008).

The focus of financial management is also very essential in our country. Because Ethiopia has become one of Africa's fastest growing economies over the last two decades. The manufacturing sectors play an important role in the economic growth in Ethiopia. This sector contributes to the economic development of the country in various ways: by creating employment for rural and urban labor force, providing sustainability and innovation in the economy as a whole. Besides, these organizations should be competent and perform their activity efficiently and effectively to survive.

Profitability is the most concerned goal of companies. Profitability is the most important goal since it represents the ability to earn income and measure the end result of a business. As a result, stakeholders look for profitable enterprise to give their final commitment. So profitability takes a very important role in company performance (Narjess, 2005). For this financial management is an essential part of the economic activities which leads to decide in order to efficiently utilize the available finance in profitable manner as Paramasivan & Subramanian (2009) stated. Even if the concept of financial management broad in nature, this study would be focus on the five major practices of financial management that commonly used by many researchers to assess the existence of the financial management practices and their relation with profitability. These practices were: the capital structure management practices, working capital management practices, financial reporting and analysis management practices, capital budgeting management practices and the accounting information system management practices.

According to the study of Asuquo , Effiong, Tapang and Arzizeh (2004), Kieu (2001), McMahan (1991), McMahan (1998), McMahan,Holmes, Hutchinson and Forsaith (1993) and pham(2010), summarized the existence of the above selected financial management practices in different countries. From this, profitability is viewed as the dependent variable. However, profitability is an abstract concept and a latent variable, it can be measured indirectly. To overcome this difficulty, many researchers often use indicated variables to measure indirectly the profitability of the organizations. Thus, many researchers used different indicated variables to measure the profitability of the company. The three selected most common and important ratios of profitability used in the previous researches most researchers were: Return on sales, return on assets, and return on equity.

Beyond this, the motive of the researcher would be to investigate the relationship of the existing financial management practices with profitability of the sampled companies. In general the purpose of this

endeavor would be to examine consequence on profitability of the companies.

## 2. STATEMENT OF THE PROBLEM

The manufacturing sector contributes for economic development of one country in various ways. Profitability is the most important goal since it represents the ability to earn income and measure the end result of a business. In order to give their final commitment stake holders always look for profitable enterprise. So that profitability is the most important one for companies in order to measure their performance for long term survival. Beyond this, there are financial and activities that whether directly and indirectly affect the profitability of the company.

Regardless whether owner-manager or hired-manager, if the financial decisions are wrong, profitability of the company will be adversely affected. The attitude and characteristics of an owner/manager in investing time and money in a better financial control system would allow a secured growth of the company. The reason for SMEs failure is inevitably the poor application of financial management as Poutziouris, Michaelas, & Chittenden (1998&1999) concluded. Because, lack of knowledge in financial management combined with the uncertainty of the business environment often lead organizations to serious problems regarding financial performances. So it is important for the development of enterprises to take a dynamic view of efficient financial management practices (Deakins et al., 2002). From this point, financial management is an essential part of the economic system in order to evaluate the financial activity of the companies with a profitable manner.

McMahon and Holmes (1991) that pointed out the financial management are crucial to the profitability, existences and well performed their activities of small enterprises. Consistent with this, a study by Asuquo et al. (2004), Bank of England (2001& 2002) and Kieu (2001) concluded, financial management has an important role in small firms for their successful survival, development and profitability. Therefore companies can improve their profitability by raising the efficiency of the existing of financial management practices.

In general Davies (1994) scrutinized the significant associations between these practices and that leads to achieve the growth rate and financial performance. On other hand, researchers specifically found the relationship between efficient financial management practices and profitability. The studies by Deloof (2003), Lazaridis and Tryfonidis (2006), Peel and Wilson (1996), Raheman and Nasr (2007) and shin and Soenen (1998) and Smith (1980) found working capital management is important because of its positive significant effect on the firm's profitability and uncertainty, and consequently its value. In contrast to this, Muluaem (2011) and Ahmad et al. (2012) found the statistical significance negative relationship between profitability and working capital management. On the other hand the result of Alu and Owolabi(2012) indicated that each working capital component affected the company's level of profitability at different, but, these effects when pooled together are not significant.

Likewise, the studies of Titman and Wessels (1988), Pham (1993) and Myers (1984) suggests that debt is negatively related to the level of profitability that was consistent with Kieu (2001) that finds debt has not been used to boost profitability even if Kester (1986) does not found any support for the predicted negative relationship that was consistent with Thomas & Evanson (1987) that unable to demonstrate a significant association between the number and frequency of use of financial ratios and enterprise profitability. In contrast to this, Myers (1984) stated that companies with high debt level would have a tendency to pass up positive NPV (net present value). Specifically, Studies by Rausch (1982), McMahon (1986), Meredith (1986), Walker and Petty (1986) and Barrow (1988) were also give prominence to the importance of developing skills in reading and interpreting historical financial statements to monitor financial health and progress through an upgrading of financial reporting and analysis systems as concluded by Hutchinson and Ray (1986). This was reliable with the study of McMahon (2001) and Marriot and Marriot (2000) that put forward the SMEs have little management information and poor control, financial awareness among managers of SMEs varies considerably and that the use of computers for the preparation of management accounting information is not at its full potential.

So that concerned with the basic financial management practices, most previous researchers have concentrated on examining and investigating the actions of the organizations in practicing financial management with a consideration of the five specific areas of efficient financial management practices.

In addition to this, their findings were mainly related to these activities in consideration of existing financial management practices and they provided much descriptive statistical data and empirical evidence on these organizations existing financial management practices, but it appears that there still are some gaps in the literature, which need to be addressed.

Firstly, examination variables that represent the existing financial management practices was conducted mainly in different separate studies by providing interesting insights into each separate aspect of the selected financial management practices, the consequence of the combined variables on profitability of the companies have not been more examined and investigated. Secondly, more or less most of the empirical evidences come from the developed economies. There seems to be a lack of evidence from emerging economies. Lastly, even if many studies were conducted in relation to the financial management practice and profitability in different organizations; there is no consistent result among these studies because of different factors that exist in

different organizations and countries.

Thus, there is a need to investigate the existence of the financial management practice and its relationship with profitability of the manufacturing companies by extends existing research into these companies.

## **2. OBJECTIVES OF THE STUDY**

The objective of the study was to analyze the consequences of financial management practices on profitability of the selected private manufacturing companies operating in Mekelle City.

## **3. SCOPE OF THE STUDY**

Because of the broad nature of this area of study, the researcher would not access all the literature concerning financial management practices and profitability because it will have been very voluminous. Thus, the researcher flits around in a limited aspect within the literature, thereby around the existence of selected financial management practices and the relationship with profitability of the sampled manufacturing companies.

Secondly, in conducting this study only the private limited manufacturing companies that are operated in Mekelle City with provision of full data for the study was selected purposefully for the assessment. Since, it is limited on these companies; the findings cannot be generalized to all manufacturing companies of Ethiopia.

Thirdly, among the management context that may have a consequence on the profitability, this study would be assess only the selected financial management practice in relation to the profitability of the manufacturing companies in the Mekelle City.

## **4. LITERATURE REVIEW**

### **4.1. THEORETICAL LITERATURE**

#### **4.1.1. SELECTED FINANCIAL MANAGEMENT PRACTICES AND PROFITABILITY**

##### **1. The consequence of capital structure management practice on profitability**

Modigliani and Miller (1958) argue about the capital structure irrelevance, financial leverage does not affect the firm's market value with assumptions related to homogenous expectations, perfect capital markets and no taxes.

On the contrary, the study of Sarkar and Zapatero (2003) found out a positive relationship between leverage and profitability in contrast to the studies of Myers and Majluf (1984) that found a result to firms that are profitable and generate high earnings are expected to use less debt capital comparing with equity than those that do not generate high earnings. In addition to this Borigham and Gapenski (1996) argued that the optimal capital structure can be achieved if there is tax sheltering benefits provided; an increase in debt level is equal to the bankruptcy costs. They suggest that managers of a firm should be able to identify when the optimal capital structure is attained and try to maintain the optimal level. The optimal level is the point at which the costs of financing are at minimal level, thereby increasing firm value and performance.

According to Sheel (1994) also found out that all leverage determinants factors studied, excepting firm size, were significant to explain debt behavior variations.

##### **2. The consequence of Working Capital Management practice on Profitability**

Working capital management is a vital issue in financial decision making since it is a part of investment in asset and it directly affects the liquidity and profitability of the company. The way of managing working capital can have a significant impact on both the liquidity and profitability of the company as concluded by Shin and Soenen (1998).

The study of Egbide (2009) and Falope and Ajilore (2009) on the working capital management and profitability of listed companies in Nigeria, made a cross sectional survey design of some quoted companies between 2005 – 2006 and 1995 - 2005. Their data were analyzed using the ordinary least square regression analyses and panel data econometrics in a pooled regression; and the result revealed that all the components of working capital management affect profitability at varying levels of significance with debtor's collection period having the highest and significant impact which is negative.

Samiloglu and Demirgünes (2008) analyzed the consequence of working capital management on firm profitability in Turkey for period of 1998-2007. Empirical results showed that the long account receivables, inventory and leverage significantly and negatively affect on profitability, while, the firm growth significantly and positively affect the profitability. In addition to this, they proved that the cash conversion cycle and the size of the company had no statistically significant consequence on profitability.

##### **3. The consequence of financial reporting and analysis on profitability**

Financial ratio analysis can help investors in making investment decision and predicting firm's performance for in the future. It can give also an early warning about the slowdown of firm's financial condition. Research in finance shows that firm's characteristics such as growth, company size and efficiency can predict the future price of stocks. Johnson and Soenen (2003) analyzed 478 firms in USA during 1982-1998 and concluded that big sized and profitable firms with high level advertising expenditure have better performance in terms of those three measurements.

As Hutchinson and Ray (1986) indicated growth can result in financial stresses such as cash-flow difficulties and use of more debt. These financial problems create a critical need for improved financial control which can come about through an increase the quality of financial reporting and analysis systems.

#### **4. The consequence of capital budgeting management on profitability**

In contrast to the working capital decisions, capital budgeting decisions place funds for a longer period that exceeds a year and may have a consequence of a company's long run position within its industry. The capital budgeting process encompasses the initial investment screening and selection through the post completion audit of the project. A number of factors combine to make capital-budgeting perhaps the most important function financial managers and their staffs must perform as confirmed by Brigham and Houston (2001). On the other side, since the results of capital budgeting decisions continue for long period of times, the firm loses some of its flexibility. Further, because asset expansion is based on expected future sales activity, a decision to buy an asset that is expected to last 10 years requires a 10-year sales forecast. Lastly, a firm's capital budgeting decisions define its strategic plan of the business, because moves into new items, activates, or markets must be preceded by capital expenditures.

Brigham and Houston (2001) dealt with erroneous forecast of asset requirements that have serious effect on its performance. If the firm invests much more, it will incur high depreciation and other expenses. On the other side, if it does not invest, other problem may exist. Brigham and Houston (2001) stated that capital budgeting typically involves significant expenditures, and before spending a large amount of money, it must have the funds lined up with because large amounts of incurrence are not available directly. Therefore, a firm considering a major capital expenditure program should plan its financing far enough in advances to be sure funds are available. To manage a business, the management must have information about the current location, uses, and future usefulness of its productive assets. For this, the chief financial officer has a duty to ensure a system is in place to provide this information (Raymond, 2002).

#### **5. The consequence of accounting information system on profitability**

Accounting Information Systems (AIS) are devices exist when an accounting practices are incorporated into the field of information and technology systems (IT), were designed to help in the management and control of topics related to firms' economic-financial area as concluded by Elena et al.(2011).

Mitchell et al. (2000) argued that accounting information could help SMEs manage short-term problems in areas such as valuing a cost of product, determining the expenditure and cash flow by providing information to support monitoring and control.

When Kieu (2001) studied about the relations of efficient financial management practices and profitability, he concluded that the SME profitability is positively related to the efficiency of principal components of efficient financial management practices. Furthermore, as Burns and Vaivio(2001) stated that the advances in information technology have driven change in the collection, measurement, analysis and reporting of f information within the organization and other entities. During the periods of 1990s, the change has been activated by materialization of Enterprise Resource Planning (ERP) systems, which enabled companies to better monitor their company by integrating the whole business cycle including the human resources. Vendors claimed that even if the Enterprise Resource Planning System (ERPS) would support the strategy process and integrate this to the everyday business. However, this promise was not fulfilled and ERPS turned out to be a system for efficiency, not effectiveness because of inability to handle effective (shortage of experience. Even though promises are not fulfilled and many ERPS projects are failing, IT investments in organizations every year investments amounts to trillions of dollars worldwide (Fichman, 1992).

Generally, other things remain constant the more efficient financial management practices, the higher profitability. By raising the efficiency of efficient financial management practices, companies can improve their profitability.

## **4.2. EMPIRICAL FINDINGS ON FINANCIAL MANAGEMENT PRACTICES AND PROFITABILITY**

Below are a summary of prior empirical studies on financial management, the effects of financial management practice attributes on profitability of different organization in different countries. Hunjra et al. (2011) concluded from their study that quite beneficial for capital providers – lenders and shareholders are when they would think their funds are being utilized in proper financial practices. On one side, capital providers will be hesitant to provide the capital to those firms which are not using appropriate financial practices and have poor disclosure. Consistent with this result, Asuquo et al. (2004) found the positive relation between existing financial reporting and analysis and Profitability of the organizations. Bent (2003) concluded farmers who conducted detailed financial analyses were substantially more profitable than those farmers who performed the calculations “in their head” or did not make the calculations at all—a finding which demonstrates there are positive returns to conducting detailed financial analyses.

The study of Hutchinson and Ray (1986) also concluded that financial problems create a critical need for improved financial control which can come about through an upgrading of financial reporting and analysis



systems. In addition to this, Thomas and Evanson (1987) examined possible associations between financial reporting and analysis practices and performance characteristics. Bek (2007) stated that sound financial management is essential to the success of a business. This implies, managing financial resources successfully is important for both new as well as expanding businesses. So that if the entity taken only time to develop and implement financial plans it will ensure the success of small firms.

The study of Harif et al. (2010) also showed that the range of financial management tools used by SMEs in Malaysia still low and use only predictable and often used components such as financial accounting and working capital management. This resulted in a negative effect on the performance of the SMEs in that county. Butt et al. (2010) concluded the positive consequences of financial structure practices, dividend policy, techniques of investment appraisals, working capital management and financial performance assessment on organization performance. The results reveal that the decision makers and practitioners should be well aware of and agreed on the positive contribution of financial management practices in the corporate sector.

Asuquo et al. (2004) investigated the significant effect of financial management practices on profitability of SMEs in Nigeria. They analyzed the relationship between financial Structure management practices, management of working capital, management of financial reporting and analysis, management capital budgeting and accounting information System with Profitability using the Multiple Regression analysis. In addition to they have been measured profitability with clearly stated financial ratios such as: net profit on total sales revenue, net profit on operating total assets, net profit on shareholders' equity. Finally they found the positive relationship between the existing practices and the profitability of the SMEs. They reason out that, because of the owner / manager regularly pay attention and review the financial activities, financial ratios, there was good practices in these entities. After all, they summarized that, the more efficient financial management practices the higher profitability.

The study of Jafer and Mohammad (2012) revealed the significant negative relationship between debt management and profitability. Their findings implied that an increase in debt concern is associated with a decrease in profitability; thus, if there is higher level of debt, the profitability of the firm will be adversely affected. They found also profitability increases with control variables; size and sales growth. Ikram (2011) concluded that, there was a moderate relationship between working capital management and firm's profitability from findings. Regarding to the working capital management, Asuquo et al. (2004) found a positive and significant relationship between Working capital management and Profitability. Based on the findings of the study, the survey found that SMEs was strongly supported all areas of working capital management practices even if SME owners/ manager's have a low level of management knowledge and experience. This finding was consistent with the findings of many researchers in different countries like Deloof (2003), Lazaridis and Tryfonidis (2006), Raheman and Nasr (2007) and shin and Soenen (1998). These results clearly showed that the practice that shorten the cash conversion, the more profitable the firm is likely to be. The firms should also put much importance on their receivables management and payables management to derive the best out of their profitability.

Smith (1980) and Peel and Wilson (1996) concluded that Working capital management is very essential because of its positive consequences on the firm's profitability and risk, and consequently its value. Inconsistent with this, Muluaem (2011) and Ahmad et al. (2012) found the statistical significance negative relationship between profitability and working capital management. This implies companies managers can create profits or value for their companies and share holders by handling correctly the cash conversion cycle and keeping each different component of working capital to a possible optimum level. Consistent with finding, On the other hand the result of Alu and Owolabi(2012) indicated that each working capital component affected the company's level of profitability at different, but, these effects when pooled together are not significant. A study by Asuquo et al. (2004) didn't find a positive and significant consequence of the capital budgeting management on profitability. This was because of the differences in short-term and long-term activities of SMEs in Nigeria. Specifically the reason was, profitability was calculated by each month, each period of three months or each year (short-term period), meanwhile capital budgeting management is the process of identifying and selecting investments in long-lived assets, or asset expected to produce benefits over more than one year. This result also supported by Pham (2010) that there is no a positive and significant effect of capital budgeting management practice on profitability of SMEs in Vietnam

As Bent(2003) concluded that the producers who used some form of investment analysis—whether it be the payback period, cash flow analysis to assess repayment, or discounted cash flow analysis—were substantially more profitable than their peers. So that, who wish to improve performance may benefit from applying appropriate investment analysis techniques. Elena et al. (2011) concluded that the average returns generated by the company indicates that, firms which use AIS for the whole of their management obtain a higher and more positive result with regard to the other groups of firms which show a negative average. This implies that, the effort made by firms to apply, invest more and advance their AIS is related to their economic and financial results, since firms not using AIS obtain losses. Additionally, the study of Tourna and Germanos (2000)

suggested that the use of accounting information is the most significant factors that facilitated them during the design and implementation of their strategic plans. Mitchell et al. (2000) also added that accounting information could help SMEs to manage short term problems by providing information to support monitoring and control easily. The study by Asuquo et al. (2004) was also consistent with this study by providing a result that indicates a positive effect of the existence of efficient accounting Information System management on profitability of the organizations.

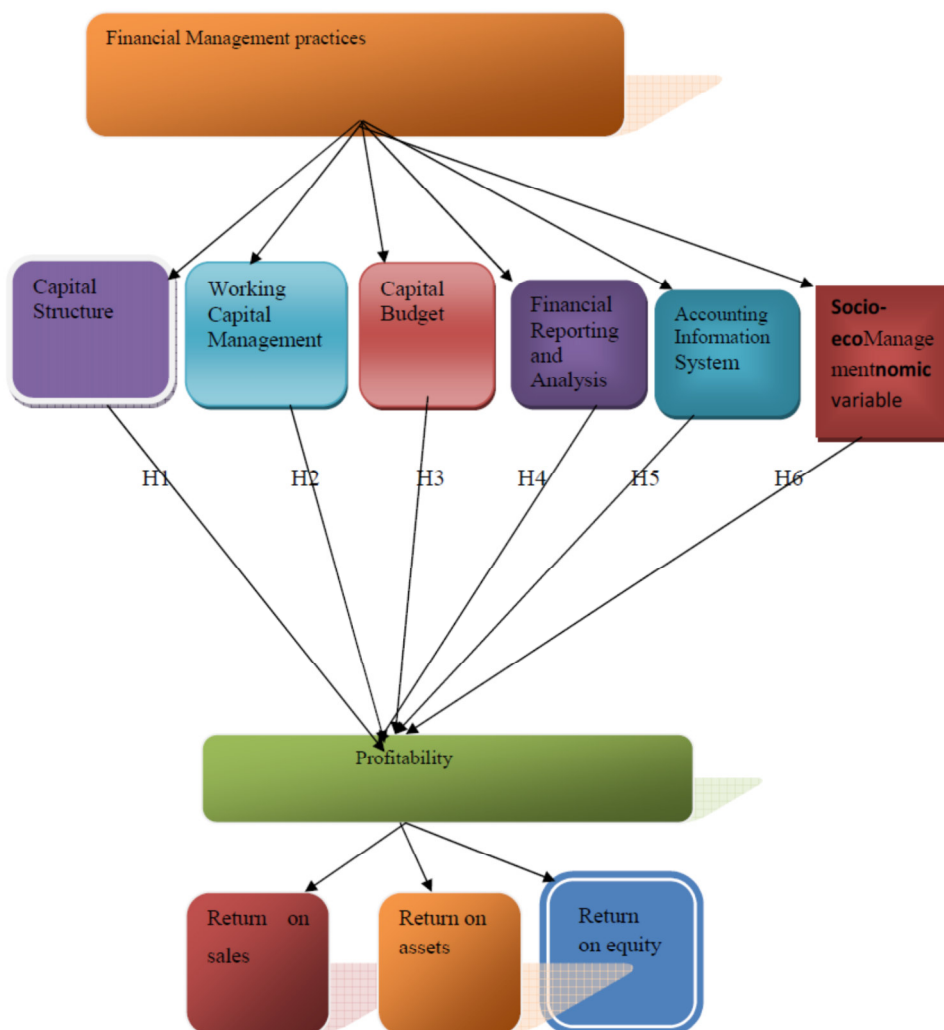
In general, Davies (1994) scrutinized significant associations between these practices and achieved growth rate and financial performance. In addition to this Asuquo et al. (2004) entailed that factors of financial management of SMEs were good tools of improving enterprise's profitability. Their finding also leads to the conclusion that the efficiency of financial management practices can bring about a higher profitability for these entities. Therefore, these entities can improve their profitability by raising the efficiency of efficient financial management practices.

**TABLE4.1: SUMMARY OF PREVIOUS FINDINGS**

| Author                     | Title(study)  | Study Dimensions  | Methodology (Model used/ Statistical techniques) | Results /Out come  |
|----------------------------|---|---|--|--|
| Hunjra et al. (2011)       | Determinants of financial management practices  | Earnings management, stakeholder theory, Behavioral factors, corporate social disclosure, organizational performance, shareholder Wealth maximization | Qualitative method                               | Capital provider and shareholders are quite beneficial when they would think their funds are being utilized in proper financial practices and they should hesitant to provide the capital to those firms which are not using appropriate financial practices and have poor disclosure. |
| Bek(2007)                  | Financial management practices of Small Firms   | AISMP, CSMP , CBMP and WCMP   | Mixed-method strategy                            | Sound financial management is essential to the success both new as well as expanding businesses,   |
| Poutziouris et al. (1999)  | Financial management  | Planning, financing, investing and dividend decisions   | Survey   | Reasons for SMEs failure certainly show lack of care in financial management practice  |
| Harif,Harif (2010)         | Financial management practices: An In-Depth Study Among The CEOs of Small and Medium Enterprises (SMEs) | Financial Planning and Control, Financial Accounting, and WCMP  | Survey /factor analysis                          | Showed that the range of financial management tools used by SMEs in Malaysia still low and still use only predictable and often used components such as financial accounting and working capital management.   |
| Jaafer and Mohammad (2012) | The relation between capital structure and profitability  | CSMP and PF   | MRA  | Reveals significantly negative relation between debt and profitability. Findings were imply an increase in debt position is associated with a decrease in profitability; thus, the higher the debt, the lower the profitability of the firm.   |
| Mulualen(2011)             | The impacts of working capital management of firms profitability  | WCM and PF  | MRA  | Results showed that there is statistical significance negative relationship between profitability and working capital management.  |

| Author                | Title(study)  | Study Dimensions   | Methodology (Model used/ Statistical techniques) | Results /Out come   |
|-----------------------|---|--|--|---|
| Ikram( 2011)          | The Relationship between Working Capital Management and Profitability   | WCMP and PF  | Techniques of correlation coefficient and MRA.   | Concluded that there is a moderate relationship between working capital management and firm's profitability.  |
| Brent(2003)           | Financial management practices and farm profitability   | Business analysis and control, capital acquisition, farm management, financial management, investment analysis | MRA  | Concludes that farmers who used either payback period, cash flow (ability to make loan payments), or discounted cash flow techniques to evaluate a major expansion were significantly more profitable than their peers.                       |
| Babar(2010)           | Financial management practices and their impact on organizational performance   | capital structure decision, dividend policy, investment appraisal techniques, WCMP and financial performance   | Structural Equation Model                        | Concludes the capital structure decision, dividend policy, investment appraisal techniques, working capital and financial performance assessment all have positive and significant impact on organization performance.                        |
| Pham (2010)           | The effect of financial management practices on profitability   | FRAMP, AISMP, CSMP , CBMP and WCMP   | Multiple regression analysis                     | There is a positive and significant effect of financial management practices on profitability except the capital budgeting management practice on profitability of SMEs in Vietnam that was insignificant.                                    |
| Elena et al. (2011)   | The impact of Accounting Information Systems (AIS) on performance measures: empirical evidence in Spanish SMEs            | AISMP, performance measures and productivity   | ANOVA  | concluded that the average returns generated by the company indicate that firms which use AIS for the whole of their management obtain a higher / more positive figure with regard to the other groups of firms which show a negative average |
| Alu and Owolabi(2012) | The effective working capital management and profitability: A Study Of Selected Quoted Manufacturing Companies In Nigeria | WCM and PF   |  | Concludes that each working capital component affected the company's level of profitability at varying rates, but not significantly affected when they are pooled together.   |

### 4.3. CONCEPTUAL FRAME WORK



Sources: Adapted from Pham (2010).

## 5. MATERIALS AND RESEARCH METHODOLOGY

### 5.1. RESEARCH DESIGN AND STRATEGY

In accordance with the purpose and objective of this study, the research design of this study was used survey study. The data was collected from different directors and officers of the organization. Survey research provides a quantitative or numeric description of trends, attitudes, or opinions of a population by studying a sample of that population. It includes cross-sectional and longitudinal studies using questionnaires or structured interviews for data collection, with the intent of generalizing from a sample to a population (Babbie, 1990). Thus, this study used a cross-sectional survey that is used to gather information on a population at a single point in time.

### 5.2. DATA TYPE AND SOURCE

The types and sources of data were both primary from respondents and secondary data from documents of the organization. On the other hand, the quantitative type of data was employed in this research. According to the study of Kuhn (1961) the process of measurement was central to quantitative research because it provides the fundamental connection between empirical observation and mathematical expression of quantitative relationships. In addition to this, the qualitative data was used to the extent of the questionnaire that was prepared as open ended question to the directors and officers. In order to confirm the trustworthiness of the responses, the researcher collected a secondary data from the audited financial statements of the organizations.

### 5.3. SAMPLING DESIGN

The target population of the study was the selected private manufacturing companies in Mekelle city. From the total thirteen populations of private manufacturing companies that operating in Mekelle city before six years, the researcher selected eleven of these companies that fulfill the criteria for availability of financial data at least for



six years. Since the main purpose of the study was to examine the existence of financial management practice and its relationship with profitability of the companies; choosing the right and appropriate sample for the problem identified may augment the output of the study and help achieve its objective. Thus, the decision to select these organizations was based on the following two facets that enhance the soundness of the study. First, these companies represent an appropriate sample in order to assess the overall existing financial management practices. The reason is, all the selected components of financial management practices may not set in motion in all sectors.

Second, most of the previous studies in different countries in relation to this topic were conducted on SMEs. But in our country there is no available information related to SMEs financial statements to assess their profitability. For this reason, the researcher supposed that manufacturing companies were fitting for the problem under study. As a result this may increase the reliability of the study.

To investigate and examine the existence of financial management practice and its relationship with profitability of the companies, the researcher considered total respondents of 116 directors and officers in these organizations. Unlike census, the researcher selected purposefully 96 of the total respondent because there was more than two assignments for a single individual in some organizations and it was based the assumption of (50+1) percent would be representative. In addition to this the researcher was used the stratified random sampling techniques to assign the respondents in to different strata. Procedures were used to determine the sample size from the strata. The researcher classified the related respondents in to different strata's based on the majority of the selected companies classification on their tasks as financial manger, head of divisions and officers in each division. After placing the elements in appropriate strata, the researcher used disproportionate stratified and selected the required elements from each stratum.

**TABLE 5.1: DETERMINATION OF SAMPLE SIZE**

| S/no  | Strata                         | Population | Sample- disproportionate stratified<br><i>Sample Size(n)</i><br>$= \frac{\text{Number of strata}(k)}$ |
|-------|--------------------------------|------------|---|
| 1.    | Finance managers               | 11         | 11  |
| 2.    | Financial account head         | 11         | 11  |
| 3.    | Cost and budget head           | 11         | 11  |
| 4.    | Management account head        | 11         | 11  |
| 5.    | officers in financial account  | 25         | 13  |
| 6.    | Officers in cost and budget    | 24         | 13  |
| 7.    | Officers in management account | 23         | 13  |
| Total |                                | 116        | 96  |

**Sources:** own survey, 2013

#### 5.4. DATA COLLECTION INSTRUMENT

Primary data was collected through survey from directors and officers (concerning to the efficient financial management practices) who was responsible for financial function in the companies using a structured questionnaire. The questionnaire was structured in such a way that the first part covers the socio-economic variables such as the age of the respondents, position, gender, education qualification, name and age of the company. The second part would deal with the financial management practice and profitability of the company.

Kieu (2001) stated that the argument for choosing survey is two-fold. Firstly, surveys provide quick, efficient and accurate means of assessing information about the population. Secondly, surveys are more appropriate in cases where there is lack of secondary data.

From the total 96 questionnaires only 77 were collected from the respondents. From this, the researcher had collected around 80.21 %( response rate) from total sampled respondents. In addition to this, secondary data was necessary to see the profitability of the selected companies and was collected from the companies directly and from the Ethiopia Revenue Custom Authority (ERCA).

#### 5.5. DATA PROCESSING AND ANALYSIS TECHNIQUES

##### 5.5.1. INFERENCE STATISTICS ANALYTICAL METHOD

On the other hand, an Econometric tool specifically ordered probit was employed in order to verify the relationship between the financial management practice and the profitability of the companies. Because, the dependent variable was measured by using an ordered of agreements (starting from 1 for strongly disagree, 2 for disagree, 3 for neutral, 4 for agree and 5 for strongly agree). This applies often to a context where an agent (individual, household, firm, decision maker.....) chooses from a set of alternatives. Sometimes the values/categories of such discrete variables can be naturally ordered, i.e. larger values are assumed to correspond to "higher" outcomes. The ordered probit model is a latent variable model that offers a data generating process

for this kind of dependent variables (Kurt, 2007).

## 5.6. RESEARCH HYPOTHESIS

Both theoretical literature and empirical findings of similar studies have generated many results that attempt to relate the selected financial management practices and the profitability of the organizations. As perception of usefulness of information represented the extent to which these characteristics of information existed that would have consequences on the organization performance positively. However, when the researcher assessed the previous studies, some of the selected existing financial management practices may have significance negative effects on the organizational performance. Further, the independent variables of the study and the hypotheses to be tested based on the literature via statistical tools were as follows.

### Independent variables

#### I. Financial reporting and analysis practices:

It is the tool of financial management that is useful in evaluation of the financial condition and operating performance of a business firm, an industry, or even the economy, and the forecasting of its future condition and performance. This practice constitutes the nature, frequency and purpose of financial reporting, auditing, analysis and interpretation of financial performance. So that using this practice the responsible body can evaluate the overall performance of the companies.

From this stand, in this study the variable was expected to have a positive sign.

***Ho1: The existing financial reporting and analysis management practice has no consequence on the Profitability of the selected private manufacturing companies.***

#### II. Working capital management practices :

It is a practice that Attempt to manage the current assets, the current liabilities and the interrelationship that exists between them. Most of previous researcher stated that, the practices of working capital management is a vital issue in financial decision making since it is a part of investment in asset and it directly affects the liquidity and profitability of the company. Consistently others concluded that working capital management has significant impact on firms' performance and managers can increase value of share holder and return on asset by reducing their inventory size, cash conversion cycle and net trading cycle. In contrast to this, other previous researchers found that each working capital component affected the company's level of profitability at varying rates, but not significantly affected when they are pooled together. In supporting to these findings, others found that there is negative significant effect of working capital management in the profitability of the companies.

From this stand, the variable in this study was has no known expected sign.

***Ho2: The existing Working capital management practice has no consequence on the profitability of the selected private manufacturing companies.***

#### III. Capital budgeting management practice

It is a practice with non-financial and financial considerations in asset acquisition, quantitative techniques for capital project evaluation, investment hurdle rate determination and handling risk uncertainty. Thus, previous findings stated that producers who used some form of investment analysis techniques were substantially more profitable than their peers. So that, who wish to improve performance may benefit from applying appropriate investment analysis techniques. In contrast to this, because of differences in time consideration, profitability was calculated by each period (short-term period), meanwhile capital budgeting management is the process of identifying and selecting investments in long-lived assets, or asset expected to produce benefits over more than one year. Thus, the practice does not affect the profitability of the company significantly (either negative or positive). From this stand, in this study the sign of variable was unexpected.

***Ho3: The existing Capital budgeting management practice has no consequence on the profitability of selected private manufacturing companies.***

#### IV. Capital structure management practice

This practice incorporates financial leverage or gearing, accounting to lenders, knowledge of sources and uses of finance, non-financial and financial considerations in financial structure decisions. Most of the findings of previous researchers stated that the existence and efficiency of these practices has a positive contribution on the profitability of the organization. In contrast to these studies, some researchers found a result to firms that are profitable and generate high earnings are expected to use less debt capital comparing with equity than those that do not generate high earnings.

***Ho4: The existing Capital structure management practice has no consequence on the profitability of the selected engineering and construction companies.***

#### V. Accounting information system practice

It is a practice in relation with the incorporation of accounting activities into the field of information and technology systems, were designed to help in the management and control of topics related to firms' economic-financial area. Based on this concept the previous researchers argued that accounting information system practices could help to manage problems in areas such as costing, expenditure and cash flow by providing

information to support monitoring and control. As a result its sign was estimated to be significance positive.

***Ho5: The existing Accounting information system management practice has no consequence on the profitability of the selected private manufacturing companies***

#### ***VI. Demographic factors***

The standing point for the incorporation of the demographic factor to assess the existing practice unlike the previous researchers was, the researcher believes that the more experienced, educated and those who provide relevant profession with the practices have a significant contribution on the efficiency and effectiveness of existing financial practices consequently on the profitability of the companies. In addition to this, the researcher believes, the age of the sampled companies may have an effect on existing financial management practices with an assumption of the more existed the more practitioners of the practices effectively and efficiently. So that, perception of usefulness of information represented the extent to which these factors of information existed at maximum level that would have a significance effect on the existing practice accordingly on the performance of the sampled manufacturing companies.

***Ho6: Demographic factors such as Age of the company, Education level of the employees, experience of the employees and related academic profession have no consequence on the profitability of the manufacturing companies***

#### **5.7. MODEL SPECIFICATION**

To examine the relationship between the efficient financial management practices and the selected companies' profitability, the ordered probit regression would be the appropriate technique. The equation would be as follow:

$$Y = \alpha + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \beta_5 X_5 + \beta_6 X_6 + e$$

Where: Y = Profitability

X1 stands for the existence of capital structure management practices

X2 stands for the existence of working capital management practices

X3 stands for the existence of financial reporting and analysis practices

X4 stands for the existence of capital budgeting management practices

X5 stands for the existence of accounting information system practices

X6 stands for socio economic characteristics of sample

Where,  $\alpha$  is constant (intercept) and  $\beta_1, \beta_2, \beta_3, \beta_4, \beta_5, \beta_6$  are Regression-coefficients of independent variables to estimate, and e-is the Error term.

**TABLE 5.2: SUMMARY OF CONVERSION OF CONCEPTS INTO VARIABLES AND THEIR MEASUREMENT**

| Concepts  | Variables   | Measurable scales(nominal and ordinal)      | Methods(descriptive/inferential econometric tools)                    |
|---|---|---|---|
| The nature, frequency and purpose of financial reporting, auditing, analysis and interpretation of financial performance  | Financial reporting and analysis management practices | Existence – nominal<br>Efficiency – ordinal | Existence –percentage<br>Efficiency –order<br>probit econometric tool |
| Financial leverage or gearing, accounting to lenders, knowledge of sources and uses of finance, non-financial and financial considerations in financial structure decisions                 | capital structure management practices                | Existence – nominal<br>Efficiency – ordinal | Existence –percentage<br>Efficiency –order<br>probit econometric tool |
| Non-financial and financial considerations in asset acquisition, quantitative techniques for capital project evaluation, investment hurdle rate determination and handling risk uncertainty | capital budgeting management practices                | Existence – nominal<br>Efficiency – ordinal | Existence –percentage<br>Efficiency –order<br>probit econometric tool |
| Attempting to manage the current assets, the current liabilities and the interrelationship that exists between them.  | working capital management practices                  | Existence – nominal<br>Efficiency – ordinal | Existence –percentage<br>Efficiency –order<br>probit econometric tool |
| The nature and purpose of financial records, book keeping, cost accounting, and use of computers in financial record keeping and financial management                                       | accounting information management practices           | Existence – nominal<br>Efficiency – ordinal | Existence –percentage<br>Efficiency –order<br>probit econometric tool |
| Level of Education qualification respondents  | Education   | nominal                                     | probit econometric tool   |
| Experiences of respondents  | Experience  | nominal                                     | probit econometric tool   |
| Academic profession of respondents  | Profession  | nominal                                     | probit econometric tool   |
| Age of the company's operation  | Age   | nominal                                     | probit econometric tool   |
| Profitability of the company  | ROA   | Ordinal and nominal                         | probit econometric tool   |
| Profitability of the company  | ROS   | ordinal and nominal                         | probit econometric tool   |
| Profitability of the company  | ROE   | ordinal and nominal                         | probit econometric tool   |

## 6. DATA ANALYSIS AND DISCUSSION

### 6.1. CONSEQUENCES OF EXISTING FINANCIAL MANAGEMENT PRACTICES ON PROFITABILITY

The regression is estimated and run using existing financial management practices as an independent variable. Further, all the independent variables are measured their existence and efficiency from the perception of the individual respondents on behalf the organization. On the other side, the dependent variable is the profitability of the manufacturing companies variable also measured using the average of three common measures of the profitability supported by most researchers (ROA, ROE and ROS) and is called average profit return of the companies. To confirm whether there is profit or not, the measures would be compared with the risk free saving rate (5%) that is offered by the commercial banks. This was used by previous researchers while there is *no average industry* profit in these countries. Similarly, this idea will be necessary in our country in order to check whether the companies are profitable or not. Therefore, this section present the relationship of the existing financial management practices of the companies with their profitability.

**Decision rule:** The existing practices of financial management are identified by using the p-value of the ordered probit model. Therefore, if the p-value of the ordered probit model is less than or equal to 1%, it is significant relationship at 1% significance level, if p-value is greater than 1% but less than or equal to 5%, it has

significant relationship at 5% significance level, and there is significant relationship at 10% significance level if p-value is between 5% and 10%. However, if p-value is greater than 10%, the dependent variable and independent variables have not significant relationship. Furthermore, a coefficient with a negative sign shows the opposite existence of the variables and a positive sign of coefficients shows that existence of independent variable is positively correlated with the dependent variable. In general the signs in the coefficient show the consequences of the existing practices on the existing profit of the sampled companies with the given significant level of the variables. The following analysis under ‘A and B’ will be based on the result revealed in table 4.26 below.

**TABLE 6.1: THE ORDER PROBIT ESTIMATES FOR THE RELATIONSHIP BETWEEN PROFITABILITY AND FINANCIAL MANAGEMENT PRACTICES**

| Ordered probit regression  |           | Number of obs = 77   |                              |                     |
|----------------------------|-----------|----------------------|------------------------------|---------------------|
| Log likelihood = -29.75699 |           | LR chi2 (9) = 283.25 | Prob > chi2 = 0.0000         |                     |
|                            |           | Pseudo R2 = 0.8264   |                              |                     |
| averprRt                   | Coef.     | Std. Err.            | z P> z  [95% Conf. Interval] |                     |
| FRA                        | 12.8207   | 2.110355             | 6.08 0.000*                  | 8.684483 16.95692   |
| WCM                        | .4912936  | .375987              | 1.31 0.191                   | -.2456274 1.228215  |
| CBM                        | -.8196565 | .4119531             | -1.99 0.047**                | -1.62707 -.0122432  |
| CS                         | -2.344901 | .7313598             | -3.21 0.001*                 | -3.77834 -.9114625  |
| AISM                       | 2.540477  | .605453              | 4.20 0.000 *                 | 1.353811 3.727143   |
| educ                       | .8279433  | .5522337             | 1.50 0.134                   | -.2544148 1.910301  |
| experience                 | .1309574  | .3975081             | 0.33 0.742                   | -.6481442 .910059   |
| Profession                 | -.1595209 | .2062891             | -0.77 0.439                  | -.5638401 .2447982  |
| agecomp                    | -.6965205 | .3175204             | -2.19 0.028 **               | -1.318849 -.0741921 |
| /cut1                      | 15.72699  | 4.112541             |                              | 7.666563 23.78743   |
| /cut2                      | 18.87059  | 4.200553             |                              | 10.63766 27.10352   |
| /cut3                      | 22.79506  | 4.559719             |                              | 13.85817 31.73194   |
| /cut4                      | 32.65173  | 5.758354             |                              | 21.36557 43.9379    |
| /cut5                      | 36.50078  | 6.467918             |                              | 23.82389 49.17767   |
| /cut6                      | 38.30266  | 6.679713             |                              | 25.21066 51.39465   |
| /cut7                      | 44.59726  | 7.594049             |                              | 29.7132 59.48133    |
| /cut8                      | 48.85823  | 8.304473             |                              | 32.58176 65.13469   |
| /cut9                      | 52.44973  | 8.755683             |                              | 35.2889 69.61055    |

Note: \* indicate significant at 1% and \*\* significant at 5%

Source: STATA output from own survey, 2013

**A. FINANCIAL MANAGEMENT PRACTICES ON PROFITABILITY**

As the above table 4.26 depicts a variable FRA that represent the existing financial reporting analysis of the sampled companies and has significant effect on the profitability with  $\beta = 12.8207$  at a significance level of 0.000. Further the data showed strong support for alternative hypothesis (Ha1) as depicted in the above Table (4.26) Sig <0.000, that means the existing financial management practice in the organization has a positive and significant consequence on the companies’ profitability.

The second variable in the above table WCP, represent the working capital management practices of the companies. The result from the above table reveals, there is positive insignificant effect on the profitability of the companies’ with  $\beta = 0.49$ . The data supported by the null hypothesis as indicated in the (Table4.26) Sig = 0.191 > 0.1, the result rejects the alternative hypothesis, that means the existing working capital management practice does not have a significant effect on profitability of the sampled companies.

Thirdly, the above table revealed that capital budgeting management practices of the organization have negative significant effect on the profitability of the companies with  $\beta = -0.82$ . This data supported by the alternative hypothesis that was stated as the existing capital budgeting management practices has a consequence on the existing profitability.

Fourthly, the above estimated result from table (4.26) indicates the capital structure management practice (CS) has a negative and significant consequence on the profitability of the sampled companies with a beta coefficient of -2.34 and sig<0.001. This data supports the alternative hypothesis (Ha4) that was stated as the existing capital structure management practices has a consequence on the existing profitability.

As depicted from the above estimated table (4.31) the fifth independent variable, the existing accounting information system management practice has positive and significant effect on the profitability of the sampled companies with a beta value 2.54 and sig< 0.000. This data is strongly supported by the alternative



hypothesis (Ha5) that stated as the existing accounting information management practice has a consequence on the profitability of the company.

#### **B. DEMOGRAPHIC FACTORS ON PROFITABILITY**

As revealed from the above table 4.26 the related demographic factors with the practices such as education qualification, experience of the employees have no significant effect on the profitability of the company as estimated as  $0.134 > 0.1$ ,  $0.439 > 0.1$  and  $0.742 > 0.1$  respectively. This result was supported with null hypothesis (Ho6). On the other hand, the above result about the age the company indicated that there is a negative and significant relation between the age and their profitability sampled companies with beta coefficient value of  $-0.70$  and  $\text{sig} < 0.028$ . This result was supported with alternative (Ha6) that stated as the age of the company increases there is a negative and significant effect on the profitability of the company.

#### **C. MARGINAL EFFECTS OF THE EXISTING FINANCIAL MANAGEMENT PRACTICES ON THE PROFITABILITY**

The coefficients in the above regression does not explain degree of effect of the independent variables on dependent variable rather they show direction of effect, i.e., either positive or negative signs. However, this marginal effect in the regression indicates the degree on how independent variables affect the dependent variable in each order. In the ordered probit model, the marginal effects of the various covariates on the probabilities are different from the coefficients because of rule of marginal effect that states the sign of marginal effect is opposite of coefficient at lower threshold and have identical sign on higher cutoff point. So, the directions of the marginal effects of the covariates are not necessarily the same as the respective coefficients. According to these criteria, appendix III shows the marginal effect of significant variables that are identified by ordered probit regression. From the appendix III responses agreed on the effects of the accounting information system management practices by 89.86%, Capital structure by 73.93%, Working capital management 11.82%, 400.88% and 15 to 19 years of the company affects the profitability by 34.85%. The other ranks have no more effect marginally on the profitability of the companies.

### **6.2. DISCUSSION**

Even if most of the previous researchers separately tried to explore the existence of financial management practices such as accounting information system, financial reporting and analysis, capital structure, working capital management and capital budgeting in the manufacturing companies, in one or another way they had got the existence of these practices with different efficiency and quality in the manufacturing company. In addition to this, previous researchers tried to explore the existence of most of the selected financial management practices in SMEs and farms. In support of the previous findings, the selected private manufacturing companies tried to practice the selected financial management practice with some degree of difference in efficiency.

Previous researchers stated that, in manufacturing companies, understanding the existing nature and behavior of the cost of production and cost of sales is a fundamental to profitability. In contrast to this to maximize profitability rather than only costs and expenses of the company, the analyst should considered the opportunity costs related to the money or net worth, labor, and the management ability. Opportunity cost is the investment returns given up by not having the money invested elsewhere and wages given up by not applying elsewhere. These are deducted, inconsideration with ordinary business expenses, in calculating economic profit. Economic profit can show a long term perspective of the business organization. Because of the difficulty in measuring the economic profit, the previous researchers were used the accounting profit to measure the profitability of the company. After determination of the return of the companies using the most common measures, they are compared with the average industry and with free risk rate (if there is no average industry). Most of the findings that were used the risk free rate as comparison was with the average profit return, the average profit return of the companies were above the risk rate. Consistent with the previous studies, the average profit return of the selected private manufacturing (16.77%) is above the risk free rate (5%) providing by commercial banks of Ethiopia which was decided by the central bank of Ethiopia.

Practices and performance are two different things; it could be argued that practices lead to performance. Logically, the best performance is constructed from the best practices. Researchers have devoted considerable effort in classifying and categorizing various facets of practices and hypothesizing about their impacts on different performances organizations such as SMEs, Farm and manufacturing companies. As stated by the previous researchers, perception of usefulness of the accessible information represented the extent to which these characteristics of information existed that would have consequences on the organization performance. However, when the researcher assessed the previous studies, some of the selected existing financial management practices may not have a consequence on the organizational performance.

In support to the previous findings, the selected practices of financial management in the private manufacturing companies had both significance (positive and negative) and insignificance effect on the profitability of the selected manufacturing companies in Mekelle city.

Financial reporting and analysis is one of the selected financial management practices, most of

previous studies concluded as financial reporting and analysis is a tool of financial management that is use full in evaluation of the financial condition and operating performance of a business firm, an industry, or even the economy, and the forecasting of its future condition and performance. As a result of this, the existence and efficiency of this practice significantly affects the firm profitability throughout its survival. Consistent with previous findings, the existing and efficiency of practice of financial reporting and analysis of the selected private manufacturing company is positive significantly affected their profitability. This may be as result of different reason; - the sampled manufacturing companies are preparing the basic financial statements to evaluate the overall performance of the organization with help of related officers in the financial account division continuously at the end of the period within a year (monthly, quarterly, semiannually and annually). When they are prepared the basic financial statement, they engaging in evaluating current financial condition and operating performance and future condition and performance of the organizations. To evaluate the overall performances the sampled companies, the financial account head analyzes the report with some meddling by the fiancé head. For analysis purpose the manufacturing companies *more or less tried* to analyze their report using the ratio analysis techniques such as liquidity, activity and profitability ratios.

Working capital management practice is the second selected practice of financial management practice in this study. Previous researchers found that each working capital component affected the company's level of profitability at varying rates, but not significantly affected when they are pooled together. Others found that there is negative significant effect of working capital management in the profitability of the companies. Differently others concluded that working capital management has significant impact on firms' performance and managers can increase value of share holder and return on asset by reducing their inventory size, cash conversion cycle and net trading cycle. The findings on the existing working capital management of the private limited manufacturing company revealed that there is insignificance effect on the profitability of the companies. Compared with previous study it is both consistent with researchers that states pooled working capital management variables are insignificant except they treated separately. Thus, may be the sampled organization has no smooth running working capital management practice so as to enhance the level of profitability. Because some findings revealed that in order to increase profitability reduce the inventory level net trading cycle .etc. so that even if there is an existing practice in the sampled companies there is significant effect on their profitability.

Related to the practice of capital budgeting management and profitability, previous researcher stated that, because of a differences in time consideration, profitability was calculated by each month, each period of three months or each year (short-term period), meanwhile capital budgeting management is the process of identifying and selecting investments in long-lived assets, or asset expected to produce benefits over more than one year. Thus, the practice does not affect the profitability of the company significantly (either negative or positive).

In contrast to this, other previous findings found positive and significant effect of capital budgeting management practice on profitability of SMEs without any justification. Consistent with, previous findings stated that producers who used some form of investment analysis—whether it be the payback period, cash flow analysis, or discounted cash flow analysis they were substantially more profitable than their peers. So that, who wish to improve performance may benefit from applying appropriate investment analysis techniques. Finally others added to this finding that, even if it is a good practice that may use as an evaluation criterion for the long term performances of the business organization, but it is always impractical. This practice always affects the performances of the organizations negatively. Consistent with one of the above finding the existing practices of capital budgeting in the companies affects significantly negative as result of inability to apply the existing practice of effectively and efficiently by the sampled companies. Likewise, this indicates the sampled companies didn't use of fixed-assets efficiently (not efficient) after acquisition.

The forth selected practice in the financial management is the capital structure management. Previous researchers found negative and positive significance and insignificant effect of profitability. In support of these findings, this study found the existing capital structure has a negative significance on the profitability of the selected private manufacturing companies. This may be as result of unsuitable ratio between debt and total capital, ineffective use of financial leverage, not reviewing debt level company timely by considering the usefulness for making finance decisions, may not continuously preparing comprehensive annual budget, which includes sources and uses of funds for all aspects of operations, as well as grant and contract agreements with funders. So that the statistical significance negative relationship between capital structure and profitability of the companies may imply companies' managers can create profits or value for their companies and share holders by handling the above activities to a possible optimum level.

The last selected variable from the financial management practices is the accounting information system. As most the previous studies conclude that, the significant positive relationship between the existence accounting information system and the profitability of the company. Because, it is a devices exist when an accounting practices are incorporated into the field of information and technology systems, were designed to help in the management and control of topics related to firms' economic-financial, manage short term problems

by providing information to support monitoring and control easily, minimizing cost of processing and increasing the efficiency of the overall financial practices. In supporting to the previous findings, the accounting information system applied in sample manufacturing companies affects profitability positively. This implied that, the sampled organizations applied the computer system to plan, process, evaluate and control their financial transaction effectively even they have different software. So that, existence of this practice with an availability of more integrated computer software has played an important role in improving the accounting information systems and the overall system of the company. Because many operational accounting functions of the company like payroll accounting, preparation of accounts receivables and payables, general ledger, sales analysis and cost and budget control are now computer aided. The availability of computerized accounting systems has not only improved the standard of financial reporting in the company but has also shortened the time required by firms to produce summary information in the form of balance sheets, income statements, funds statements, bank reconciliation and operating summaries. After all the practice in the company is more effective and efficient and thus, leads to increase the profitability of the company.

In contrast to the findings, previous findings stated that, even if there is an existing system in the different organizations, the actual application of financial reports by employees is to some extent held back because of the inability the majority the employees to correctly interpret such reports and utilize them in managerial decision making.

Finally the last variable in this study was the demographic factors of the respondents and the sampled companies. Even if the researcher believes that the more experienced, educated and those who provide relevant profession with the practices have a significant contribution on the efficiency and effectiveness of existing financial practices and consequently affect the profitability of the company. However, the results indicated that the more experienced, educated and those who provide relevant profession with the practices have an insignificant effect on the profitability of the sampled companies. This may be as result of constant or the same existence of these factors in the sampled manufacturing companies. In addition to this, the standing point, as the age of the sampled companies have an effect on existing financial management practices with an assumption of the more existing company, the more practitioners of the practices effectively and efficiently consequently affects significantly the profitability of the company.

On the other hand the age of the company affects negatively the profitability of the sampled companies. As most the previous studies conclude investment in product development generates profitability increases for young firms while competitive pressures from new entrants lead to profitability declines for mature firms and young firms realize profitability jumps more frequently and that the effect of age on firms' policies would be stronger for young firms. This result also may be as result of increase the completion from the new entrant firm by increase product quality from the beginning and existing firms already incur a cost for the existing product. On the other hand this may be because as the company become older assets become obsolete, and also seems to advance the diffusion of rent-seeking behavior.

## **7. CONCLUSION AND RECOMMENDATIONS**

### **7.1. CONCLUSIONS**

The purpose of this study was to explore and assess the existing financial management practices and profitability of the companies and determine the relationships between the existing financial management practices and the companies' profitability. Based on the findings in this study, the following conclusions are derived regarding the practices of financial management and the relationship with the companies' profitability.

- The findings of the study revealed the sampled manufacturing companies are preparing the basic financial statements with help of officers in the financial account division continuously at the end of the period within a year (monthly, quarterly, semiannually and annually). After preparing the reports the division head from financial account will analyze the report with some meddling by the finance head. During analysis the manufacturing companies more or less tried to analyze their report using the ratio analysis techniques such as liquidity, activity and profitability ratios.
- The sampled manufacturing companies provide rarely a product/service to their customers on credit basis. Some of these companies have their own credit policy. In addition to this these companies are engaged in reviewing their receivable on quarterly basis. But some companies review their receivables on weekly basis. To sum up this idea companies are review their receivable based on their credit policy. As result of providing a product on credit basis, there may be a bad debt. The companies are assessing their bad debt on annual base. Most of the companies have bad debt less than 2 percent of the total sales during the year.
- The findings of the study revealed the existing practices related cash activities of the companies. Most of the sampled companies prepared, review and determine their target cash balance always weekly and monthly.
- Related to the inventory management of the companies', the study showed that companies prepared and reviewed their inventory on annual basis.

- As the findings shows the majority of sampled private manufacturing companies did not apply the capital budgeting techniques even if some of the remaining sampled private manufacturing companies used often the accounting rate of return, profitability index and sometimes the payback period and net present value. Those companies used the techniques are also applied differently for different purpose. The profitability index is used more in order to evaluate the capital investment projects by the companies and upon their expansions in an existing projects. In addition to this, most of the users of the technique applied during the end of accounting period. But, most of the respondent discloses in the open ended question, the projects were reviewed based on the length of time taken to finish the project.
  - As the findings of the study show, even if there are different factors that affects the companies investment decisions; the matter of preservation of high competitiveness towards the rivals, forecasted cash flows from investment, and financial flexibility are the most affecting factor for the sampled manufacturing companies. In contrast to this idea, the corporate tax rate, depreciation level, control consideration, Potential financial distress costs and cliental tax rates are the least affected factors on the firm's investment funding decision with a given choice available.
  - Capital structure management is one part of the financial management practices. Related to these practices the findings revealed that, most of the companies are reviewing their capital structure quarterly. As the above findings showed that, there are different factors which affect the choices of the company in selecting the amount of long-term debt. From these factors, maintaining of competitiveness towards industry rivals, debt repayment capacity, and corporation norms and volatility of present and forecasted earnings and cash flows are highly influential factors in choosing the long term debt of the organization. In addition to this there are different stake holders that influence the capital structure of the companies. As indicated from the findings of the study the opinions of investment banks and commercial banks are the most influential stakeholders for the capital structure of the sampled companies. In addition to this the corporation from the corporation also highly affects for the relative companies. Finally, when the sampled companies needs to assess the capital structure of the firms the, these companies are mostly used the level of debt level of the company over time as standard of comparison. Unlike this, most of the companies not compared with debt level of other companies during the period.
  - In addition to the above findings of financial management practices, the findings of study shows that, almost all of the sampled companies utilize the computer in order to process their accounting information. But there is a difference among the sampled companies in using different package of software to fasten and incorporate all activities in one system. Some of the companies used the latest and licensed software's unlike others.
  - To sum up, there is strength and weakness in applying the practices effectively and efficiently.
- Strengths: These sampled companies have on average a good financial reporting and analysis management practices, working capital management practices, and accounting information system management practices as shown from the total responses of the sampled companies; even if the working capital management has no significance effect on profitability of the selected companies.
- Weakness: the sampled companies have not good practices related to the capital structure and capital budgeting management practices as shown from the summary of descriptive statistics. They didn't apply the capital budgeting techniques in evaluating different types of projects in different stages. In addition, even if there is an existing accounting information management practices in the sample companies, but there is a difference among the sampled companies in using different package of software to fasten and incorporate all activities in one system.
  - Finally the findings of the study revealed the consequences of the existing financial management practices on profitability of the sampled manufacturing companies. As the regression analysis shows the existing financial reporting and analysis management, accounting information system management practices in the organization has a significance positive effect on the profitability of the sampled manufacturing companies. In contrast to this, the existing practice of the capital budgeting and capital structures affects negatively significance the profitability of the sampled companies. But the existing working capital management practices have no effect on the profitability of the company.
  - The last finding from this study is the consequences of the demographic factors on profitability of the company. The findings revealed the education qualification, academic profession and experience of the employees have no significance effect on the profitability even if the researcher expects a significant effect on profitability. But the age of the company that has negative significance on the profitability of the sampled companies.

## 7.2. RECOMMENDATIONS

Based on the above findings and conclusions this study can give information for those stake holders who will be



able to know financial management practices that have an effect on the performance of the sampled manufacturing companies.

From the findings of this study there is an existence of significance negative effect of the capital structure management practices on the average profit return of the sampled manufacturing companies. So that to remove this negative significance effect of this practices on profitability the companies, the companies should exercise to maintain suitable ratio between debt and total capital, use effectively financial leverage and should review the debt level in order to use for making finance decisions. On the other hand, the company should prepare a comprehensive annual budget, which includes sources and uses of funds for all aspects of operations, as well as grant and contract agreements with funders. In addition to this, as the above findings revealed there is negative significant effect of the capital budgeting management practices on the profitability of the companies. This is a result of inability to apply such practices that have a negative impact on the profitability of the company. So that the company should evaluate their project and the assets of the company after acquisition using different capital budgeting techniques rather simple determination of accounting profit( considering revenue cost and expense of the operation).

Even if the there is good average accounting information system management practices in the sampled companies, these companies should struggle and move violently to introduce latest software's that have multi-dimensional (more integrated) purpose like ERP that is introduced and applicable in some of the EFFORT companies. To remain competitive, these companies must boost the accounting information management practices effectively wherever possible. After all, improve specific knowledge and competence in this practice is some best ways to help a business in order to control the overall financial activities of the organization easily and effectively. In addition to this, even if this system is currently not applicable, these companies should be used this software for the management of human resources by sharing an experience from other companies that exercised previously.

### **7.3. LIMITATIONS AND SUGGESTIONS FOR FURTHER RESEARCH**

This study has some limitation in relation to the selection of variables, methodology and other challenge that needs attention if there is a potential researcher to do his/her research on this title. Specifically, the study sought to explore the existing financial management practices and determine the relationships with profitability of the selected private manufacturing company; however, the variables used in this study were not exhaustive. Other variables of the financial management practices such as budgeting, CVP analysis and other finance related practices were not incorporated. On the other hand, even though there are five selected variables in this study, it does not have deep insight in each aspect because of broadness of the topic. In addition to this, the study does not supported by theories as a result of broadness. The selected variables were also tested only on a single sector.

Second, in this study the sample size was not significantly large and this may affect the order probit model that needs large sample size even if it was used as the only alternative that fit with the given data.

Thirdly, respondents were reluctant and refuse to answer the questionnaire during the data collection period. Such situations are difficult or even impossible to avoid given the limited free time that people have. To solve this problem the researcher was collected the necessary data by using maximum effort.

Fourthly, this study has a limitation in considering the selected financial management practices and demographic factors that relatively affect the existing practices. Because, there may exist other factors (such as the size of the companies) relatively affect the existence and efficiency of the practices accordingly companies' performance.

Finally, the conclusions and recommendations would be based on the data analysis that would be used by the researcher; hence they are valid only to the extent of the validity of the data. Except the above mentioned limitations, the study was believed to put in significant information about the selected existing financial management practices and their consequence on profitability of the selected manufacturing companies.

*Furthermore*, future researchers shall consider the above limitation and challenges in order to fully explore all necessary practices and determine their relationships with the profitability of the sampled organizations.

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## APENDIX I: RESULTS OF REGRESSION

### a. Oprobit results

**oprobit averprRt FRA WCM CBM CS AISM educ exprice profession agecomp**

**Iteration 0: log likelihood = -171.38214**

**Iteration 1: log likelihood = -94.767105**

**Iteration 2: log likelihood = -62.62604**

**Iteration 3: log likelihood = -43.194974**

**Iteration 4: log likelihood = -34.024572**

**Iteration 5: log likelihood = -30.506759**

**Iteration 6: log likelihood = -29.796842**

**Iteration 7: log likelihood = -29.757156**

**Iteration 8: log likelihood = -29.7569**

**Ordered probit regression**

**Number of obs = 77**

**LR chi2 (9) = 283.25**

**Prob > chi2 = 0.0000**

**Log likelihood = -29.75699**

**Pseudo R2 = 0.8264**

|     | averprRt | Coef.     | Std. Err. | z     | P> z  | [95% Conf. Interval] |
|-----|----------|-----------|-----------|-------|-------|----------------------|
| FRA |          | 12.8207   | 2.110355  | 6.08  | 0.000 | 8.684483 16.95692    |
| WCM |          | .4912936  | .375987   | 1.31  | 0.191 | -.2456274 1.228215   |
| CBM |          | -.8196565 | .4119531  | -1.99 | 0.047 | -1.62707 -.0122432   |

|            |            |          |       |       |           |           |
|------------|------------|----------|-------|-------|-----------|-----------|
| CS         | -2.344901  | .7313598 | -3.21 | 0.001 | -3.77834  | -9114625  |
| AISM       | 2.540477   | .605453  | 4.20  | 0.000 | 1.353811  | 3.727143  |
| educ       | .8279433   | .5522337 | 1.50  | 0.134 | -2544148  | 1.910301  |
| expiience  | .1309574   | .3975081 | 0.33  | 0.742 | -6481442  | .910059   |
| Profession | -1.1595209 | .2062891 | -0.77 | 0.439 | -5638401  | .2447982  |
| agecomp    | -6.965205  | .3175204 | -2.19 | 0.028 | -1.318849 | -0.741921 |

|       |          |          |  |  |          |          |
|-------|----------|----------|--|--|----------|----------|
| /cut1 | 15.72699 | 4.112541 |  |  | 7.666563 | 23.78743 |
| /cut2 | 18.87059 | 4.200553 |  |  | 10.63766 | 27.10352 |
| /cut3 | 22.79506 | 4.559719 |  |  | 13.85817 | 31.73194 |
| /cut4 | 32.65173 | 5.758354 |  |  | 21.36557 | 43.9379  |
| /cut5 | 36.50078 | 6.467918 |  |  | 23.82389 | 49.17767 |
| /cut6 | 38.30266 | 6.679713 |  |  | 25.21066 | 51.39465 |
| /cut7 | 44.59726 | 7.594049 |  |  | 29.7132  | 59.48133 |
| /cut8 | 48.85823 | 8.304473 |  |  | 32.58176 | 65.13469 |
| /cut9 | 52.44973 | 8.755683 |  |  | 35.2889  | 69.61055 |

**b. Marginal Effect Results**

a. mfx compute, predict(outcome(1))

Marginal effects after oprobit

$$y = \Pr(\text{averprRt}=1) (\text{predict, outcome(1)})$$

$$= 7.56e-220$$

| variable  | dy/dx | Std. Err. | z | P> z | 95% C.I.    | X |
|-----------|-------|-----------|---|------|-------------|---|
| AISM      | 0     | 0         | . | .    | 0 0 4.08117 |   |
| CS        | 0     | 0         | . | .    | 0 0 3.99351 |   |
| WCM       | 0     | 0         | . | .    | 0 0 3.87792 |   |
| FRA       | 0     | 0         | . | .    | 0 0 3.89425 |   |
| educ      | 0     | 0         | . | .    | 0 0 2       |   |
| expiience | 0     | 0         | . | .    | 0 0 1.85714 |   |
| profes~n  | 0     | 0         | . | .    | 0 0 5.16883 |   |
| agecomp   | 0     | 0         | . | .    | 0 0 3.28571 |   |

b. mfx compute, predict(outcome(3))

Marginal effects after oprobit

$$y = \Pr(\text{averprRt}=3) (\text{predict, outcome(3)})$$

$$= 6.707e-25$$

| variable  | dy/dx | Std. Err. | z | P> z | 95% C.I.    | X |
|-----------|-------|-----------|---|------|-------------|---|
| AISM      | 0     | 0         | . | .    | 0 0 4.08117 |   |
| CS        | 0     | 0         | . | .    | 0 0 3.99351 |   |
| WCM       | 0     | 0         | . | .    | 0 0 3.87792 |   |
| FRA       | 0     | 0         | . | .    | 0 0 3.89425 |   |
| educ      | 0     | 0         | . | .    | 0 0 2       |   |
| expiience | 0     | 0         | . | .    | 0 0 1.85714 |   |
| profes~n  | 0     | 0         | . | .    | 0 0 5.16883 |   |
| agecomp   | 0     | 0         | . | .    | 0 0 3.28571 |   |

c. mfx compute, predict(outcome(4))

Marginal effects after oprobit

$$y = \Pr(\text{averprRt}=4) (\text{predict, outcome(4)})$$

$$= .46880838$$

| variable | dy/dx      | Std. Err. | z     | P> z  | 95% C.I.          | X       |
|----------|------------|-----------|-------|-------|-------------------|---------|
| AISM     | .8986048   | .22891    | 3.93  | 0.000 | .449959 1.34725   | 4.08117 |
| CS       | -7.7393268 | .27586    | -2.68 | 0.007 | -1.28001 -.198644 | 3.99351 |
| WCM      | .1181532   | .13991    | 0.84  | 0.398 | -1.56057 .392363  | 3.87792 |
| FRA      | 4.87804    | .84903    | 5.75  | 0.000 | 3.21397 6.54211   | 3.89425 |
| educ     | .2778313   | .21532    | 1.29  | 0.197 | -1.44194 .699857  | 2       |

---

|          |           |        |       |       |          |          |         |
|----------|-----------|--------|-------|-------|----------|----------|---------|
| exprie~e | .1038382  | .15127 | 0.69  | 0.492 | -.192644 | .40032   | 1.85714 |
| profes~n | -.0837587 | .08114 | -1.03 | 0.302 | -.242781 | .075264  | 5.16883 |
| agecomp  | -.348469  | .11904 | -2.93 | 0.003 | -.581774 | -.115164 | 3.28571 |

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d. mfx compute,predict(outcome(5))

Marginal effects after oprobit

$$y = \Pr(\text{averprRt}=5) (\text{predict}, \text{outcome}(5))$$

$$= 4.493e-33$$

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| Variable | dy/dx     | Std. Err. | z     | P> z  | [        | 95% C.I. | ]       | X |
|----------|-----------|-----------|-------|-------|----------|----------|---------|---|
| AISM     | 9.23e-23  | .00000    | 4.07  | 0.000 | 4.8e-23  | 1.4e-22  | 4.08117 |   |
| CS       | -7.59e-23 | .00000    | -2.77 | 0.006 | -1.3e-22 | -2.2e-23 | 3.99351 |   |
| WCM      | 1.21e-23  | .00000    | 0.85  | 0.395 | -1.6e-23 | 4.0e-23  | 3.87792 |   |
| FRA      | 5.01e-22  | .00000    | 5.88  | 0.000 | 3.3e-22  | 6.7e-22  | 3.89425 |   |
| educ     | 2.85e-23  | .00000    | 1.29  | 0.196 | -1.5e-23 | 7.2e-23  | 2       |   |
| exprie~e | 1.07e-23  | .00000    | 0.69  | 0.492 | -2.0e-23 | 4.1e-23  | 1.85714 |   |
| profes~n | -8.60e-24 | .00000    | -1.03 | 0.304 | -2.5e-23 | 7.8e-24  | 5.16883 |   |
| agecomp  | -3.58e-23 | .00000    | -2.98 | 0.003 | -5.9e-23 | -1.2e-23 | 3.28571 |   |