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Evaluating the Financial Performance by Considering the Effect of External Factors on Organization Cash Flow

Hussein Jalil Mohsin¹, Sahbaa Abdulqader Ahmed¹, and Dalia Streimikiene²

ABSTRACT

Financial performance is the measure of an organization's productivity and effectiveness. It is used as an indicator of an organization's ability to use available resources in generating returns and profits for its stakeholders. Determinants of financial performance include employee productivity, leadership in the organization and resource use. An organization's financial performance defines its continuity. Stability in an organization is dependent on its financial accounting and management. In the world today, an organization's corporate success is influenced by factors that are often out of its control. The external environment of an organization entails a variety of factors whose existence influences its performance and behaviors. The action of these factors directly or indirectly affects organizations. Organizations have to conform to these external factors for their survival. Organizations are environment-dependent and environment serving. An organization is impacted by the environment in which they operate and its success is solely dependent on its ability to adapt to its environment. Changes in external environment factors have a significant impact on the organization's survival and success. The purpose of this research was to assess the effect of external factors on an organization's cash flow. The aim of the study was to obtain data on these external factors and analyze them with the view of finding out their relationship with financial performance of organizations. Linear regression analysis was to find the correlation between the external factors and organization's financial performance.

KEY WORDS: financial performance, accounting, finance, economics

JEL Classification: G000, M000, M410.

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1. Introduction

Organizational factors are elements of a business or company or that control its performance and operations. Organizations are comprised of several aspects that are related. These aspects form the basis on which organizations are built and focus on accomplishing their targets and goals. Factors that may influence an organization's financial performance include corporate governance, audits, leadership, politics and the

organizational environment (Alexiev, Volberda, & Van den Bosch, 2016). According to Namada (2018), the organizational environment is comprised of internal and external environmental factors which affect its performance. Organizations today are facing unparalleled challenges in maintaining its financial being and success. The global market place is changing, and new business and organization practices are emerging, therefore, making an organization vulnerable to failure if it does not keep up with the trends and changes in its external environment (Aldrich, 2008). Organizations are open systems that interact with the environment and the environment help to shape them (Scott, 2019).

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The environment is perceived as a crucial determinant of an organization's performance (Namada, 2018). Buchanan and Huczynski (2019) argue that organizations do not operate in a vacuum, but within an external environment, therefore, changes in any external environment, external factor will influence activities within the organization. The evolution of organizations, change management systems in planning, requires organizations to continuously adapt to environmental changes in and outside the action (Hayes, 2018). Therefore, in formulating policy options, organizations must consider external environmental opportunities and threats, strengths and weaknesses and competitiveness of the organization over other competitors.

2. The Concept of an External Environment

The external environment is an organization's aggregate of factors that are exogenic to the organization and have an impact on the organization's performance (Liao, 2018). The external environment provides inputs that they change to outputs through its internal processes. The external environment causes contingencies, constraints, opportunities, as well as problems that affect the organization's ability to conduct its operations. Ortiz-de-Mandojana and Bansal (2016), argues that regardless of the industry in which the organization operates, the external environment impacts it as it seeks strategic competitiveness. Whereas internal factors entail elements from within the organization that affects its performance, external factors entail those from outside the company that affect financial performance and productivity. Organizations often have no control over these factors. For organizations to ensure good financial performance, they ought to develop strategies and policies that will control their threats and exploit opportunities; therefore, enhancing their competitiveness. The external environmental factors can be categorized into micro and macro environments. The microenvironment is made up of elements that directly affect an organization's operations. These factors include customers, suppliers, financiers, intermediaries, and public perceptions. On the other hand, macro-environment entails the general factors that organizations have no control over. The success and performance of an organization rely on its ability to adapt to these factors. They

include sociocultural, economic, legal, environmental, technological and political dimensions.

The external environment is complex and dynamic, and impact organizations by the threats and opportunities that they present. According to Ibrahim and Harrison (2020), external factors effects influence an organization's strategy. Therefore, understanding these factors enables management to make appropriate decisions to enable organizational success. Ali (2016) argues that for organizations to be successful, they ought to respond and align to the external environment which often may entail shifting goals and priorities

3. Financial Performance

Financial performance is a measure of an organization's ability to use its assets to generate revenues. The process is essential for the sustainability of any organization. It can also be described as the organizations actual output as measured against its intended output. According to Zahra (1993), organizational financial performance measurement is the process of obtaining and analyzing an organization's financial information. Financial performance measurement entails studying the process to determine whether the actual output is in line with what ought to be accomplished. There are various indicators of indicators, and they include; operating cash flow, working capital, and current ration, debt to equity ratio, inventory turnover, accounts payable and receivable turnover and return of equity. Previous studies have often used return on assets, return on investments and cash flow as a measure of an organization's financial performance (Azar & Ciabuschi, 2017). According to Kim, Watkins and Lu (2017), an organization survival positively correlates with its financial performance measures. Several measures including strategic planning and a balanced scorecard are used by organizations to align their activities with its strategy, monitor its performance against strategic goals and improve both its internal and external communications.

Finance is at the core of any business or organization's survival. Financial performance is defined as the level of organizational accomplishments in terms of profits and losses over a specified period. Evaluating an organization's financial performance enables management to judge the results of its activities and

strategies in objective monetary terms. Finance ensures the smooth running of an organization and informs its decisions and actions. Organizations cannot achieve their objectives without focusing on its financial performance; therefore, they are often focused on the management of corporate resources in an external environment that is continuously putting pressure on them (Zink, 2017). Performance measurement systems determine the measurements of organizational performance as efficiency in financial performance and quality return. Other organizational performance measures include cost reduction, customer satisfaction, and asset utilization.

Organizations often face a rapidly changing environment which can be interpreted into multifaceted, complex and interlinked initiatives. The changes in the external environmental factors affect organizational designs, work, and resource allocations; therefore, resulting in variations in financial performance. Chunget al. (2016) attributes political interference and economic situations variations to poor organization financial performance. Kribikova (2016) argue that even with an adequately formulated strategy, changes in the external environmental factors impact the organizations' financial performance. According to Kim, Watkins & Lu, Z. (2017), financial performance is to some extent, predicted by the external environment manifestations. External environmental changes may be favourable or unfavourable towards the organization's performance. High financial performance is achieved when the organization's responsiveness towards its strategy remains an essential aspect of its strategic management. Therefore, it can be stated that external environmental factors impact organizational performance.

4. Literature Review

In the literature review, relevant available knowledge on the external environmental factors is discussed. The literature review consists of previous researches, comments and arguments from scholarly authors about external environmental factors.

4.1. Theoretical Foundation

For survival and stability, an organization must address its external environmental challenges. Namada (2018) argued that an organization's competitive ad-

vantage is determined by its ability to position and differentiate itself from other competitors in the industry. Pereira-Moliner et al. (2016) assert that the organization also ought to deliver against the success factors that as a result of demand from its customers. To achieve higher performance, however, is depended on the competencies and resources available. When the external environment is unfavourable, an organization allocates more resources on environmental scanning.

4.2. Open Systems Theory

Open systems theory refers to the concept that organizations are controlled or affected by their environment. According to Foster (2016), the environment contains other organizations that exert forces on the political, economic and social nature of an organization. The environment is essential for any organization as it provides resources necessary for its survival or success. The open systems theory was developed by Ludwig von Bertalanffy to counter other theories that had been developed earlier, for instance, the administrative theories by Henri Fayol and the human relation perspective by Elton Mayo (Seidl&Schoeneborn, 2016). Adebisi, Adeku&Oyedele (2018), defines a system as a set of things that collaboratively work together as an interconnecting network or as a complex whole. Scott (2019) argues that the systems are characterized by their combination of various elements or aspects of whole relationships that make them interdependent. Therefore, they are considered to be similar and different. In the application of the theory to an organization, the organizational environment influences organizational structure and behaviour. In turn, the organization also affects its environment.

According to Adebisi, Adeku, &Oyedele, (2018), the system is classified based on its level of complexity. The classifications can be grouped into Framework, cybernetic systems, clockworks, blueprinted growth systems, symbol processing systems, internal image systems, and social systems. (Adebisi, Adeku, &Oyedele, (2018) argues that the systems become progressively loosely coupled, more complex and capable of self-maintenance and renewal, open to the environment and more dependent on the information flows. (Kahneman,&Henik, A. (2017) asserts that organizations run their operations in a way that influences

the external environmental factors while also being affected by external environmental change in both the local and global business environment. These substantial changes are often referred to as the active adaptive changes. Organizations and communities are considered open systems that influence and change each other over time. Through their operations and activities, they often change and affect their external environment while also being influenced by the changes that occur in the external environment. Organizations are considered open systems because their competitiveness is affected by the external environmental factors which influence their performance. The open systems theory has changed how people understand organizations — treating organizations as if they are independent of their environment results in misperceptions of factors influencing organizational change.

4.3. Contingency Theory

Contingency theory is an organizational theory that states that a contingent course of action in an organization is dependent on the internal and external factors. This theory provides a framework for corporate design. It is considered a rational and dominant model at the structural level of analysis often used in organization theory. The underlying idea of this theory is that the organizational environment influences its operations (Zink, 2017). It is also based on the argument that there is no widely applicable performance management system. They do not apply equally in all organizations, but particular elements of the system and its effectiveness depend on the contextual and organizational factors (Carter & Tamayo, 2017). Previous studies indicate that variables relating to culture, external environment, organizational structure, technology, strategy, and organizational structure influence the control system. According to Zink (2017), non-profit specific attributes of an organization affect the appropriate design of an organization management control system. Shin & Konrad (2017) observes that organizational performance and effectiveness relies on the organizational environment and context. However, financial management theorists have often claimed that the global enterprise financial performance is dependent on the external organizational factors, which are economic,

cultural, technological or political. Strategic contingency theorists have asserted the roles of individual and corporate goals, politics, and power. Power is considered a determinant and result that provides individuals and organizations with an advantage in the political struggle due to their structural position. A contingency approach has often been used to acquire more knowledge and information on various areas within organizations.

4.4. Institutional Theory

The institutional theory explains the processes of organizational behavior and the impacts of organizational behavior patterns in an inter-organizational context. Zhao et al. (2017) argue that organizations as being forced to imitate, adapt and respond to the ebb and flow of regulatory and normative currents in the external environment. Lok and Willmott (2019) observed that an organization's competitive force influences its business strategy. The external environment is dynamic; therefore, globalization and technological advances have reshaped and changed the organization's external environment.

4.5. PESTEL Framework

PESTEL framework is a tool that is used to monitor and analyze the effect of external environmental factors on an organization's performance. These external environmental determinants include economic, political, technological, social, legal, and social factors. Song, Sun & Jin, (2017) argue that the external environment is dynamic and rapidly changing; therefore, there is a need for improvement in strategies, operations, and policies to maintain and enhance the competitive edge of an organization.

The PESTEL framework shows the effect of external environmental factors on an organization's financial performance. Economic factors are crucial in an organization's operations. Strategic management understands the nature of the economic factors develops strategies that positively influence an organization's financial performance. Kribikova (2016) states that the nature of the economy influences an organization's success. The various market segments often influence consumption patterns; therefore, an organization's management needs to understand its economic trends and forecast what is likely to hap-

pen in the future. Pereira-Moliner et al. (2016) state that its economic development of a country determines the opportunities that an organization gets; an expanding economy offers an operational scope for the existence of organizations as well as the establishment of other new organizations.

The political environment entails the government's regulations on the organization's political instability. Political factors involve peace and stability of a country. Organizations and business thrive in an environment where there are peace and stability. Political factors can also be defined as the laws and regulations of a nation. Political factors influence an organization's financial performance. Bhandari & Bhandari (2017) state that political and legal factors are interrelated. Favorable laws and regulations positively impact an organization's performance while unfavorable laws fail.

According to Bhandari & Bhandari (2017), the legal environment entails regulations, laws, and policies. Improvement and existence of favorable laws and regulations lead to increased levels of investment, job creation, and more wealth. Governments

enact laws and pass regulations of organizations and industries. The laws regulate the organization's operations and activities. Rules and regulations facilitate organizations' operations.

Social factors are the beliefs, attitudes, values, opinions, and lifestyles of people on which the organization activities affect. The social factors influence how customers view and relate to the organization and its activities.

Technological factors are variables that relate to the availability, development, and existence of technology. Technology use affects an organization's performance; modern technologies improve the efficiency of an organization's operations. Yeo and Grant (2019) assert that technology plays a significant role in an organization's success. Technology is fast changing; therefore, organizations ought to be creative, innovative and adaptive to the emerging technologies.

5. Research Methodology

A research methodology is a process, procedures, and techniques that are used in data collection and analysis.

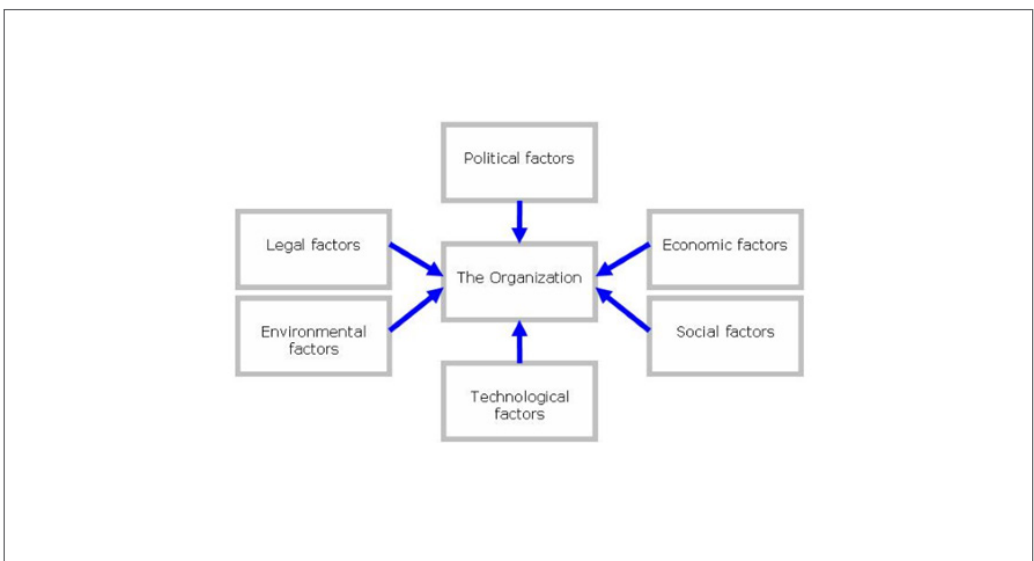


Figure 1. PESTEL framework factors.

5.1. Research Design

In this study, there was a need to remain objective, move from the known to unknown, and test theories; therefore, a positivistic approach was applied. This philosophy has been successfully employed in numerous studies. A descriptive research design was adopted in this research study. Descriptive design enabled data collection across numerous organizations. Quinlan et al. (2019) assert that descriptive research design is effective in allowing researchers to collect, analyze, interpret and present data. In this study, the researcher utilized a descriptive research design to determine the effect of external factors on an organization's cashflow. According to Quinlan et al. (2019), the descriptive design is appropriate in testing the link between different variables. Because of this, Opoku, Ahmed&Akotia (2016) argue that descriptive design is useful in establishing a hypothetical relationship in variables. Therefore, it is suitable for the current study. In this study, the research also used secondary data to determine the influence of external environmental factors on organization financial performance.

5.2. Population

The population in research is a set of elements that have similar traits as those defined in the sampling criteria that have been used by the researcher. In research, this entails the target and accessible population. The target population is made of the whole group of organizations that the research focuses on and seeks to generalize study findings. Accessible population, on the other hand, is the organizations that the researcher can gain access to (Goldstein et al., 2019).

5.3. Data Analysis

Data that had been collected was analyzed and used to report the findings of the research. Linear regression was used to determine the influence of external factors on organization financial performance.

5.4. Results

The sections analysis of data on the external factors affecting the financial performance of organizations. The findings and discussion of the study are represented.

6. Organizations' External Environment Factors

6.1. Organizational Environmental Complexity

External environment complexity in the study was assessed through the issues that organizations deal with in various environmental aspects. Various issues affect different environmental aspects of an organization. These factors which are ranked differently by professional bodies include technological, market factors, economic factors, the threat to substitutes, bargaining power of suppliers, industry competition, socio-cultural environmental factors, labor market factors, the threat of new entrants, and legal factors. Technological and market factors received the highest rating which is an indication of issues that many organizations deal with.

7. Discussion

The study sought to determine the effect of external factors on an organization's financial performance. It is evident from the study that external environmental factors have a significant influence on an organization's cash flow. According to Anatan (2017), asserts that competitive forces in an organization's environment influence its business strategy. The study findings indicate that technological and market forces ranked highly that presented many challenges that various organizations often had to deal with. The result shows that whether the external environmental aspects were ranked at any level among organizations, still there was a disparity among different organizations on issues that they ought to deal with. Theses result demonstrates that external environmental complexity has a bearing on the financial performance of an organization.

The drivers of external environmental complexity are distributed across socio-economic, political, technological, legal and socio-cultural environments. The external environment is dynamic with globalization and technological developments reshaping many organizations external environments. Therefore, organizations and business are experiencing turbulence. Many organizations indicated that technical factors, rivalry and industry competition, the threat of substitutes, and threat of new entrants, environmental factors, and economic

Table 1. Results of External Environment Complexity Aspects

External Environment Aspects	Mean
Political factors such as tax policy, political climate, trade restrictions, political stability tariffs and environmental law	3.52
Economic factors such as interest rates, inflation rates, and interest rates	3.77
Socio-cultural factors including people's lifestyle and preferences, age distribution, population growth rate, social norms that influence decision making, and career attitudes,	3.7
Technological factors that include environmental and ecological aspects such as automation, research and design activity, technology incentives and technological development and change	4.01
Environmental factors such as climate, geographical location, infrastructure and physical conditions.	3.64
Legal factors include consumer law, health and safety laws, employment law and discrimination law	3.3
Market factors entail composition of customers and customer behaviors.	4.15
Labor market factors include an organizations ability to attract capable employees	3.7
The threat of new entrants in the organization's service sector	3.5
Suppliers bargaining powers to service providers	4.15
Industry competition	3.76
Competitive intensity entailing the extent of price competition in the industry, degree of market place price competitiveness and the extent of foreign competitors	3/54

factors competitive intensity had experienced the most significant change in the last couple of years. Changes in the external environment are inevitable; therefore, organizations ought to create a fit between them and the external environment.

Hitt, Xu and Carnes, (2016) argue that organizations depend on the environment for resources. Resource dependence is affected by its abundance, munificence, interconnectedness, the pattern of linkages among different organizations in the environment, and the

extent to which authority and power are concentrated and dispersed in the environment in which the organizations operate. This theory is consistent with the study's findings which that organizations ought to deal with the technological factors, market factors and legal factors to bolster their financial performance. Comparing the resource dependence theory with the institutional theory, which considers organizations as being forced to adapt, respond, and imitate regulatory and normative currents in the environment.

8. Conclusion

The main objective of this study was to establish the effect of external factors on the financial performance of an organization. The research's findings indicate that all the research's hypothesis was supported. The study findings establish that the external environmental factors affected all the indicators of financial performance. The open system theory's main suggestion is that as firms conduct their operations and activities, they will be influenced by the changes and occurrences in the external environment. This study's results support this theory. A more significant effect of the study to the open systems theory is the findings that external environmental factors dimensions were determined to have both positive and negative impacts on organizational financial performance. It is, therefore, imperative that practitioners and scholars be cognizant of the external environmental factors' influence on organizations' financial performance.

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