CHAPTER ONE: INTRODUCTION

Introduction

This particular study is associated with understanding how the macroeconomic factors such as exchange rate, inflation, political stability and other lead to having an impact on the performance of firms. It has been observed that businesses operating in different industries and sectors face a set of varied circumstances and situations which they have to go through. Their operations and activities are affected by several different factors and these lead to positively or negatively impact the businesses and their output. It is further understood that both internal and external factors contribute towards the overall activities of the organization and while some factors may lead to affect one firm in certain situations, the same may not lead to impact the company.

Firm are the organizations that combine and classifies resources for producing goods and services to sell in the market and earn profit. The ultimate goal of the firm is to maximize the value of the goods and gain the maximum profit. If the firm performs better its investors are satisfied. To compete in a market environment, firms have to improve their efficiency engaging in strategic restructuring, i.e. updation of tools and machineries. There are different ratios that measure financial health’s of the firms, such as GDP, Cash Flows, liquidity ratio, turnover ratio, revenue, sales, growth (Van Horne, 2008). Since macroeconomics is the study of behavior of the whole economy, these variables have a direct impact on the firm’s performance and return on assets. Inflation is also one of the most important indicators to analyze financials and economic conditions of the markets economy.

Considering that all these aspects play their part in impacting the company, the external factors could be regarded as more complex and intricate in terms of having an impact on the financial performance of firms. Every organization focuses on attaining its own set of goals and objectives and one of the main aims among these is the attention towards profitability. The strategies and approaches of the businesses are therefore developed in order to maximize the revenues and improve the overall financial performance of companies. For such companies to improve their performance and lower down the associated adversities, it is imperative that all the macroeconomic indicators are clearly understood and the effect of each of these is analyzed to better understand which element may impact the company in what way.

The study found out that the rate of interest and the increase in price both has a direct impact on productivity of the organization. The political factor has also a greater influence on the inflation rate. The regression results discloses that the rates, stability and size of the firm also has a direct relation on the return of equity in the automotive sector where as the inflation, gross domestic product and rate of interest has a negative effect on the equity return which conclude that the macroeconomic indicators has a significant effect on the equity return in the automotive sector of Pakistan (Omondi and Muturi, 2013). It is also obvious that the higher interest rate and inflation have no significance which means that the shareholder‘s return is protected from the external factor that their wealth in either direction.

The findings by Haider et al (2018) suggested that the macroeconomic conditions have negative relations with ROE. It was also found that the macroeconomic indicators affect the return on assets after the regression results. Return on assets is an effective measure of firm’s gross profit. The correlation results indicated that the relation of return on assets with size of the firm is positive and insignificant, while it has negative relation with the increase in prices. ROA has positive significant relation with the exchange rate and interest rate. The research also concludes that the higher inflation in Pakistan reduces the ROE in Automotive Sector of Pakistan (Cheung and Sengupta, 2013).

Background of the Study

Friedman (1998) studied that monetary growth roughness increases the amount of supposed uncertainty. Where investor’s expectations are based on price level of financial assets, Boyle (1990) projected that changes in uncertainty of money supply will affect prices of financial instruments and suggests that changes in monetary uncertainty modify the stock prices risk premium to replicate the added expected prices that investors demand for assuming the risk of keeping stocks.

The Indicators of macroeconomics are used to evaluate the economic performance of the world economy (Ooi and Liow, 2014). GDP, stock price indicators, interest rates are the most important factors which determine the welfare of the country’s economy. Policy makers are always hoping that these factors remain constant to ensure the growths of the businesses. Firms have to improve their productivity by engaging in strategic restructuring to compete in the world’s economy i.e. updating the equipment and production process.

Work complexities have increased over time and it has become difficult for businesses to function at an optimum efficiency level. With high intricacies in this regard, firms have been focused to make sure that effective strategies are developed and implemented in order to ensure growth and success (Haidar, 2012). Profit maximization could be regarded as one of the major objectives of every organization and so all the related activities are associated with achieving the specific goal. In this regard, companies are highly concerned and keen regarding the factors and aspects that may lead to having an impact on their profitability and financials. All these factors have to be carefully understood and assessed to make sure that any associated risks are mitigated and the company is aligned with its short and long terms objectives. With a set of different factors affecting the financial performance of firms, it further becomes imperative to identify which particular elements are having a higher impact and which ones could be less prioritized (Mokhova and Zinecker, 2014).

Every firm wishes to optimize on its resources and internal strengths, there are a set of different external factors that have an impact on its performance. While the firm may be able to manage and control the internal factors to a certain extent, the external factors may become very difficult for an organization to control or to have an influence over it. These external factors could also be identified as macroeconomic factors i.e. political, economic, social, competition within the industry and the government policies and regulations. Each of these factors may have different effects on the performance of firms and the impact may vary in different situations and circumstances (Bruneau et al, 2012). While it has been understood that controlling external factors may be very difficult for a business, keen attention and focus towards these may allow firms to mitigate the associated adversities and better manage the consequences. A number of different macroeconomic indicators are useful and crucial but this study has mainly focused upon inflation, exchange rate, political stability, interest rate, GDP and money supply. All of these defined aspects are highly critical specifically in the case of Pakistan and could be used for conducting an effective analysis (Haddow et al, 2013).

Problem Statement

The macroeconomic indicators have a significant impact on financial performances of the country because they show the risks of loss and capital of the firm. The behavior of both internal and external macroeconomic variable has an effect on the financial performance of the firm (Taylor, 2013). The automobile sector is so important to the economy, knowledge of its relationship with the macroeconomic variables present in its economic environment, is crucial. It is a vital facilitator for economic growth in many developing countries worldwide and in Pakistan. The effects of these indicators on automotive industry of Pakistan are very high. Financial analysis depends totally on information provided by the financial intermediaries; the basic statements are the balance sheet, cash flow statement and the income statement. Besides these three major reports, the earning statement, changes in equity and discussions by the managements take place to see the profitability or loss of the firm.

According to Bastic (2012), the price level shocks have severe effects on prices of the assets. The modern theories show that the returns of firm are interconnected to few factors associated to the collective economy.

Omondi and Muturi (2013) along with various other researchers have identified the impact of external factors on firms' performance. In this regard, while all such studies have been established related to the study topic, less has been studied and understood regarding Pakistan and its varied industry. This has created a gap in the literature regarding this domain particularly in the automotive industry and requires the development of critical studies which may put light on such aspects and their implications.

Aim and Objectives

The main aim of the study is to assess the impact of macroeconomic indicators on the financial performance of Pakistani automotive firms. In this regard, the following research objectives have been developed:

- To assess what strategies can firm apply to mitigate the influence of external factors influencing the business
- To understand that to what extent does the macroeconomic indicator influence the returns of equity (ROE) of the automotive firms in Pakistan
- To find out the extent to which the macroeconomic factors affect the returns on assets (ROA)of the automotive firms in Pakistan

Research Questions

Several studies earlier have presented their findings regarding the impact of external factors on the performance of the firms. However, there is still a gap in studies regarding the same domain specifically from the context of the Pakistan automotive industry that is dominated by few major firms and is an important industry from the context of the country's growth. In this regard, the researcher has focused upon assessing; what is the impact of macroeconomic indicators (inflation, exchange rates, political instability, interest rate, GDP and money supply) on the financial performance of the Pakistani automotive firms? The other secondary questions that have been developed are as follows:

- What strategies can firms apply to mitigate the influence of external factors influencing the business?
- To what extent do the macroeconomic indicators influence the returns of equity (ROE) of the automotive firms in Pakistan?
- To what extent do the macroeconomic factors affect the returns on assets (ROA) of the automotive firms in Pakistan?

The rationale of the Study

The study basically uses four major macroeconomic variables that have higher effects on the financial performances of the automotive industries in Pakistan. The variable is interest rate, inflation, GDP and exchange rates which are measured through return on assets return on equity and gross profit margin. This study also reveals the relationship of important factors of macroeconomics with automotive assembling sector of Pakistan stock exchange that these variables influence on the performance of this sector. One of the basic purposes to conduct this study is to provide the stake holders with a clearer picture of what company's growth is like, so having all the data around they can gauge performance of the company and make their strategies accordingly.

Businesses are highly concerned with their financial performance and other related objectives. In order to attain the desired objectives, firms develop and implement different strategies and approaches. Considering that the macroeconomic factors lead to impact the company, it is further essential to understand how and which factors specifically have an effect on the same (Jalil et al, 2012). Also, while there have been several studies that have focused on assessing the factor that impacts the financial performance of organizations, less has been studies regarding the automotive sector of Pakistan. Through this study, it has become clearer and justified as to which factors lead to having an effect on the financial performance and in what manner do they have the impact. The reason to conduct this study was basically to understand how the macroeconomic factors (inflation, exchange rates, political instability, interest rate, GDP and money supply) have an impact on the financial performance of firms in the automotive industry of Pakistan and how these may differ in terms of implications in other industries and areas. Realizing that less has been studied and analyzed regarding the specific sector, this particular study adds significant value through its findings for the same.

Significance of the Study

The automotive sector has been at highest in the past years; there is no guarantee that the country can maintain such growth especially in the light of recent times, where economies like of Pakistan are heading towards inflation and the exchange rates are getting higher. Investors are looking for a long term solution to stabilize the Pakistani rupee and stop its fall against the US dollar. The industries should reduce its imports due to the rupee depreciation.

The study is focused towards assessing the impact of macroeconomic factors (inflation, exchange rates, political instability, interest rate, GDP and money supply) on the financial performance of firms in the automotive sector of Pakistan. The findings of the study, therefore, are highly valuable and significant for academicians, practitioners and business owners who are associated with the research topic. As the study provides information regarding the macroeconomic factors and their impact on financial performance, it may become easier and clearer for the stakeholders to better understand the phenomenon and develop strategies and interventions in accordance to optimize the results and outcomes in the automotive sector of Pakistan. The Automotive sector has been used as the evidence to assess the impact of macroeconomic factors, and this provides a clear view regarding how different indicators may lead to become critical for organizations.

Structure of the Study

This particular study comprises of five different chapters, each of which provides a detailed understanding regarding the topic of research. Chapter one is of introduction, which provides a background to the study along with defining the research questions, objectives, problem statement, rationale and significance of the research. Chapter two further leads to provide theoretical information regarding the study and discusses the findings of previous researchers who have presented their studies in the relevant field. The third chapter is of research methodology which provides information regarding the method that has been selected to conduct the study on the whole along with inculcating aspects such as research philosophy, research design, research strategy, research approach, data collection method, sampling and data analysis. Chapter four is on analysis and findings where all the gathered information has been analyzed and interpreted. Lastly, chapter five provides the conclusion and recommendations.