



Analysis of the Development of Financial Management Theory to Support Financial Research

Ahmad Nur Budi Utama

Jambi University

ABSTRACT: Financial research issues and trends continue to evolve today. Financial management discusses several issues that became a financial attraction in the 1950s related to corporate funding sources. The issue is emphasized on debt funding sources, maturity period extensions, forms of financial assets, increased use of financing sources. The issue continues to grow to this day. Financial management is always concerned with the company's financial issues that address the financial aspects of the company and also the administrative side during the initial development of the company. Bookkeeping problems are related to the difference between capital and revenue, the administrative side resulting from growth and expansion, and of course financial adjustments are needed to strengthen companies that are experiencing financial difficulties. The problems raised in this study are how the development of financial management theory and the development of financial research until now, as well as how the application of financial management theory to financial research. This research uses qualitative methods. Data collection is carried out by data collection methods in qualitative research, namely observation, visual analysis, and literature study. The development of financial management theories as well as types of financial management research emerged gradually. The development of financial management theory has a history of financial thought can be grouped into several concepts that have their own developments. The foundations of modern financial theory stem from the application of neoclassical economic theory which already uses the assumption that individuals behave rationally. Until the 1970s, the application of financial theory was growing up to the current concept, namely behavioral finance.

KEYWORDS: Financial Theory, Financial Management, Financial Research, Finance, Financial Development

INTRODUCTION

Economic development is an aspect of national development as a whole. Economic development must be in line and in accordance with the capabilities of other aspects of development and must be carried out equally. One aspect that also supports development is the element of education. Education concerns the performance of research and writing as well as research development for its activists. Research plays an important role in identifying a problem that is happening, as community service, then benefit the community, and for experience itself. The results of the study explain and emphasize clearly the potential of the results of the study.

Financial research issues and trends continue to evolve today. Financial management discusses several issues that became the attraction of corporate finance in the era of the 1950s, these issues are still closely related to the company's funding sources. The issue emphasized debt funding sources, maturity period extensions, forms of financial assets, and increased use of convertible and subordinated financing sources. Research in emerging markets contributes greatly to people's understanding of corporate valuations and decisions. Research that focuses solely on the market is considered good research as it deals with clarity of theme selection and addresses issues regarding survival. Developing countries are fertile ground for high-quality research, as well as emerging issues such as corporate social responsibility and corporate philanthropy in an international context.

One area of research that is in great demand is financial decision making using the science of financial management. Financial management aligns individual motives and corporate goals with the role of the financial manager. Financial managers run companies with three main functions, namely as a funding function, investment function, and dividend policy. There are five functions of corporate finance, especially in public finance companies, namely external funding, capital budgeting, financial management, corporate governance, and risk management. In principle, the capital budgeting function is identical to the investment function, then the financial management function can be identified with the operational function or related to the management of



operating results. The next function arises as a consequence of the occurrence of violations of company management which ultimately give birth to corporate governance and risk management obligations.

Financial management is always associated with the company's financial problems. This problem starts from the financial aspect of the newly established company and also the administrative side during the initial development of the company. Bookkeeping problems related to the difference between capital and revenue, the administrative side resulting from growth and expansion, and finally financial adjustments are needed to strengthen companies experiencing financial difficulties. Financial management is part of management, and financial management deals with the duties of financial managers in the company. The term financial management relates to the efficient use of important economic resources, namely, working capital and cash. Financial management addresses funding and its effective use in business or as the application of general managerial principles to the field of financial decision making, aligning individual motives and corporate goals. Financial management can be referred to as corporate finance or business finance and is something interesting to be researched and discussed by many researchers, economists, and financial managers.

Financial management is based on financial theory built on various assumptions. Assumptions about the behavior of financial investors basically come from classical and neoclassical economic literature, where humans are seen as beings capable of making decisions based on very logical and transparent considerations. Therefore, humans are called homo economicus, financial beings who are always able to calculate and find optimal points as answers to financial economic problems that are being faced. To clarify the position of financial theory is when the theory is faced with the real situation. One of the main assumptions is the rationality of investors in every decision-making process carried out. The public is assumed to always be willing to pay attention to all available information completely and transparently, able to evaluate carefully to make the right decisions for personal interests based on rational analysis of the information. The financial theory of the organization gives some gifts nobel, and the financial theory of this organization supports the financialization of society, financial theory advocates that companies maximize the wealth of their owners/shareholders (Cardao-Pito, 2021). Therefore, financial managers in a company must know how to manage all elements and aspects of finance which are reinforced by financial management theory, because financial management is an important function in achieving company goals. If financial managers lack knowledge about the elements of financial management, various problems will arise and it will be difficult to run the wheels of the company.

Based on the explanation above, the problems raised in this study are:

1. How has financial management theory developed to the present?
2. How has financial research developed to the present?
3. How does financial management theory apply to financial research?

RESEARCH METHODS

1. Data Collection

This research uses qualitative methods. In terms of data collection, there are several kinds of data collection methods in qualitative research, namely observation, visual analysis, literature study, and interviews (individual or group). The stages of data collection and the characteristics of qualitative research conducted by researchers include:

- a. Researchers use procedures to get the right picture.
- b. Researchers limit research to the assumptions and characteristics of a qualitative approach.
- c. Researchers use qualitative approaches in research.
- d. Researchers begin research with one focus.
- e. Research contains detailed methods, appropriate approaches in data collection, data analysis, and report writing.
- f. Researchers analyze the data using separation analysis in several levels.
- g. Researchers write persuasively, so readers can feel the same experience.
- h. Research process with qualitative approach

Data collection in this study was carried out by literature studies, documents, and literature studies as well as previous research or related to the problems raised. Then researchers focus on observing aspects related to the problem, literature studies by utilizing data sources such as books or relevant journals.



1. Data Processing

The first stage carried out in data processing is data reduction. This stage focuses on the process of selecting, simplifying, abstracting and transforming raw data obtained from the data collection process which later the data will be adjusted to the needs and objectives of the study. At this stage, researchers separate important and unimportant things so that the data collected is more focused on the purpose of the study. Data reduction is carried out while the data collection process is still ongoing. Then this stage is also carried out coding, summarizing and creating partitions or parts. It is also a form of analysis that sharpens, classifies, directs, discards unnecessary and organizes data in such a way that final conclusions can be drawn and verified in the next step.

2. Data Presentation

The next step of the researcher in qualitative data techniques is the presentation of data. The presentation of data can be interpreted as a set of organized information that provides the possibility of drawing conclusions and taking action. In qualitative research, the presentation of data is carried out in the form of short descriptions, charts or flowcharts and the like. The final step is verification and drawing conclusions. The basic assumptions and initial conclusions put forward are still provisional, and will certainly change as long as the data collection process continues. If the conclusion is supported by valid and consistent evidence (data) that researchers find in the field, then the conclusion put forward is a credible conclusion. Then the researcher focuses on what comes up by relating themes, once arranged then makes a summary of the core, process and statements as a closing.

RESULTS OF RESEARCH AND DISCUSSION

1. Development of Financial Management Theory

The development of financial management theories as well as types of financial management research emerged gradually. Financial theories began to emerge since the publication of articles written by Markowitz in 1952 to 1959 discussing how investors can reduce risk through portfolio selection, and since then, a number of financial thinkers have begun to propose a number of theories about phenomena that exist in financial practice. Modigliani and Miller in 1959 proposed the theory of capital structure, and Miller and Modigliani in 1961 put forward the theory of dividend policy. Then Tobin in 1958 proposed a separation theory that was based on Markowitz's portfolio theory. Furthermore, Sharpe in 1964 issued a theory on capital asset pricing (CAPM). Fama in 1970 issued a theory on the efficiency of capital markets. In 1973, Black and Scholes issued a theory on option price valuation, known as the Black Scholes Option Pricing Model (BSOPM). Then Ross in 1976 issued the Arbitrage Pricing Theory (APT). Financial theory continued to evolve over time, then came the agency theory popularized by Jensen and Meckling in 1976. Then it was Freeman in 1984 who proposed the stakeholder theory. (Markowitz, 2009)(Pagano, 2005)(Yu et al., 2022)(Sharpe, 1994) (Fama et al., 2016)(Morel, 2020)(Tetteh et al., 2019) (Istan, 2021)(E. R. 1984 Freeman, 1984)

Corporate governance is built from a number of theories, namely agency theory, stewardship theory, stakeholder theory, resource dependency theory, the behavioral theory, and political theory. First proposed by Donaldson & Davis in 1991, stewardship theory has psychological roots designed to explain situations in which managers as stewards will act in the interests of owners. (Steinfeld, 2023) Stakeholder theory was issued by Freeman in 1984(R. E. Freeman et al., 2021), this theory argues that companies have a social obligation to consider the interests of all parties affected by their decisions. Therefore, support from stakeholders is needed so that the company can grow and survive long in the community. Resource dependency theory was pioneered by Emerson in 1962. Emerson identified the discussion (Wang & Dong, 2019), this theory is in the causality relationship between the concept of power and the concept of dependence which is assumed to consist of A and B; 'A's influence on B is based on dependence on resources'. Dependency B is balanced by the interest, B is placed above goal A indirectly, and vice versa is balanced by the usefulness of those goals on B outside the A-B relationship. Later the behavioral theory was put forward by Cyert and March in 1963. (HAX & MAJLUF, 1991)The behavioral perspective focuses on the role of learning in explaining human behavior and occurs through stimuli based that give rise to reactive relationships. While the Pound in 1993 put forward a political model of corporate governance (GORDON & POUND, 1993).

Financial theory can be divided into two major groups, namely capital markets-based theories and theories based on corporate finance or corporate finance. These two major groups are broken down into seven more sections, namely (1) stocks, (2) bonds, (3) derivatives, (4) market microstructure, (5) corporate finance, (6) financial intermediation, and (7) corporate governance. Each section covers other matters in which it is divided into several small subsections that deal specifically with aspects of financial



theory. According to conventional financial theory, the main orientation of companies rationally is to maximize wealth. However, there are many instances in which emotions and psychology influence our decisions and this causes us to behave in unexpected or irrational ways. Behavioral finance is a relatively new field that aims to combine behavioral psychology theory and cognitive theory with conventional economics and leads to providing explanations for why people make irrational financial decisions. Conventional finance is based on theories that describe people to a large extent behaving logically and rationally. People are starting to question this viewpoint because there have been anomalies that are conventional financial events and difficult to explain.

Development of Financial Research

Before the 1950s, financial literature was still descriptive, and put forward normative aspects, namely revealing more things that should be. In 1900, Louis Bachelier, an S-3 student at Sorbonne University, France, wrote a dissertation on stock price distributions and option valuations. Bachelier featured the derivation of the probability density function later known as the Wiener process with spikes. While the proposed option valuation model has many similarities with the Black-Scholes option pricing model. Unfortunately, the results of Bachelier's research received (Bernstein, 2019) little attention until the early 1950s. The writer of the field of finance who received more public attention who expressly discussed the importance of finance and corporations was Fisher in 1930. Fisher wrote about separation theory, known as Fisher Separation Theorem which suggests that individual (Tabery & Sarkar, 2015) investment decisions can be made independent of individual consumption patterns over a period of time. Then Cowles in 1932 and Working (1948) were two experts who tried to research about stock price movements over long time that showed that stock prices move randomly. What Cowles and Working did was a reflection of weak-form market efficiency testing, which became known in the 1970s. In its development, the approach used in financial research was still felt to have not changed much until the 1950s. Markowitz in 1952 wrote a dissertation that was the forerunner of modern portfolio theory. Then Markowitz in 1959 developed a model of diversification of assets in the form of a portfolio. The model developed by Markowitz theoretically explains how investors can select uncorrelated securities in a portfolio so as to reduce risk. (Gustafson, 2015)

There is no denying that Markowitz's writings have been an inspiration for a number of financial researchers. For example, Treynor in 1962 used Markowitz's findings to assess securities. Lintner in 1956 and Gordon in 1959 presented research on corporate dividend policy and valuation of company stock prices. The most significant finding of that era was Gordon's stock price valuation model known as the Constant Growth Dividend Model. Furthermore, two authors who received prizes for their writing, namely Modigliani and Miller who are considered modern financial writers whose what they put forward has become a significant stepping stone in financial research afterwards. Modigliani and Miller researched dividend policy and capital structure. They were both the first researchers to successfully prove based on the law of one price. They put forward theoretical evidence that a company's dividend policy and capital structure in a perfect market are irrelevant. In its development, several other studies revealed different phenomena. For example, Arrow and Debreu (1954) and Debreu (1959) published articles on a commodity valuation model. Tobin (1958) derived the model of efficient sides and lines of capital markets previously developed by Markowitz. The model proposed by Tobin shows that all Investors in the market, no matter Whether their differences to risk differ, will hold the same stock in the same proportion as long as they have identical expectations related to the future. Investors' portfolios will differ only in relative proportions in stocks and bonds. What we see is that the contribution of financial management science to the development of economics cannot be doubted by the marking of many financial researchers who received the highest award in economics, namely as recipients of prizes in the field of economics. From 2007 to 2016 there were at least seven financial experts who received prizes. This implies to us how significant the contribution of financial experts is in the development of the world economy (Varian, 1993).

Application of Financial Management Theory to Financial Research

Until 1970, the theoretical framework of corporate finance was, on the one hand, Fisher Separation consumption, and investment decisions that fully supported shareholders for value-maximizing decisions, at least in perfect capital markets, and on the other, Miller and Modigliani's proposition of irrelevance and its tax-adjustment model. The pure theory of corporate investment complemented by practical purpose by Miller and Modigliani's model offers a new look at the rate of return required by investors. Management science techniques such as Montecarlo analysis or decision trees are intended as a means of practical decisions, not too much effort is integrated into the framework of financial theory. So, it is still unclear, for example what discount rate will be used in calculating the present value obtained from the simulation or how the spread of the present value obtained from the simulation should be interpreted. Researchers realized that it has been widely believed that corporate valuations of investment



projects are inseparable from valuations of investor securities. At the heart of corporate securities valuation is the weak combination integration of discounted cash flow analysis, as shown, for example, by the dividend discount model which was a multi-period model and the capital assets pricing model (CAPM), which at the time was a single-period model. At this stage, Arrow-Debreu's abstract amenity model yields a new understanding of corporate finance beyond the value-adding principle used to refute the common notion that conglomerate mergers add value by diversifying companies. (Wolf, 2022)

Researchers believe that the elegance of the neoclassical world starting with Miller and Modigliani's theory, Fisher's separation theory, and the Arrow-Debreu model was a reaction to the completeness of organization in an era before financial research began to surface, as Dewing did in 1919 and the followers of the organization were actually an attempt to get back to the bottom of the problem. Dewing's attempt to emphasize on the essentials while putting organizational completeness on the ground record. The difference in views and Miller-Modigliani's decision to focus theory on valuing cash flows rather than the effect of funding on cash flows is vital, while Miller and Modigliani's proposition of irrelevance has been criticized (Jensen & Smith, Jr., 2005) by academics. The criticism that emerged of Miller and Modigliani's irrelevance proposition to the critical assumptions about the income streams to be allocated, and that certainly also adds to the development of financial research to date, What researchers can observe is that the assumptions used in modern financial theory are based on contributions made by Markowitz (1952), Kendall (1953), Modigliani and Miller (1958), among others, and Sharpe (1964). The foundations of modern financial theory stem from the application of neoclassical economic theory which already uses the assumption that individuals behave rationally.

We must know together that the application of the basic assumption of modern financial theory is the rational behavior (logical and intellectual) of human beings who in this case are investors or managers. The problem associated with this assumption is what rational behavior actually means. The second criticism of modern financial theory has to do with the assumption that a firm's goal is to maximize shareholder prosperity. Today, individual shareholders and some groups no longer have absolute control over the company. Shareholders will emerge (Butt et al., 2018) with conflicting interests that can lead to conditions where they no longer expect much to prosper. According to modern theory, it is said that humans can no longer behave rationally but this is normal, for example during the period of 2020 to 2022 where the world is being hit by covid 19 which causes various problems about inflation and investment (Main & Mustika, 2022).

CONCLUSION AND ADVICE

The development of financial management theory has a history of financial thought can be grouped into several concepts that have their own developments, starting from investment decisions and valuation which began with the thoughts of Fisher (1930) and several other experts related to investment decisions such as Markowitz and others. Then the concept of capital structure theory by Miller and Modigliani (1958) and continued by several other experts. Then the concept of factor models – CAPM and APT by Sharpe (1964), APT by Ross (1976). Furthermore, the concept of the efficient market hypothesis by Fama (1970). Then the concept of derivatives securities with the theory of option pricing model by Black and Scholes (1973). Furthermore, the concept of takeovers and corporate control was written by Weston in 1994. Then the concept of financial distress with several related fields including reorganization, high-yield securities, junk bonds and highly leveraged transactions. The next concept is short-term financial management because of its importance in financial practice, the significance of working capital management continues. When activities in other countries affect the index number used to convert nominal expected cash flows into real terms, a new perspective is needed, namely international finance. At this time investors can no longer use the same price index to express their expected monetary return, standard aggregation and asset pricing so portfolio theory will be affected. In the 1990s, much of the focus of discussion by academics shifted from econometric analysis of time series of prices, dividends and earnings to the development of models that incorporated human psychology related to financial markets. The field of behavioral finance began to develop. Researchers see so many anomalies, and too few theoretical models can explain the phenomenon.

The development of financial research follows from the development of financial management theory. In the era of 1900s financial literature was still descriptive, and put forward normative aspects and revealed more things that should be. There is no denying that Markowitz's writings have been an inspiration for a number of financial researchers. Financial research continues to develop until now in addition to being based on theories used to solve various financial problems. In its development, many researchers revealed different phenomena. The contribution of financial management science to the development of research is undoubtedly marked by the fact that financial researchers who received the highest award in economics assume that financial



research continues to develop following the need for problem solving finance.

The application of financial management theory to financial research appears as a reinforcement of various irrelevant financial problems that occur. What researchers can observe is that the assumptions used in modern financial theory are based on contributions made by Markowitz (1952), Kendall (1953), Modigliani and Miller (1958), and Sharpe (1964). The foundations of modern financial theory stem from the application of neoclassical economic theory which already uses the assumption that individuals behave rationally. In the 1970s, the application of financial theory grew to the current concept, namely the concept of behavioral finance.

REFERENCES

1. Bernstein, J. (2019). On Louis Bachelier. *Inference: International Review of Science*, 5(1). <https://doi.org/10.37282/991819.19.84>
2. Butt, B. Z., Hunjra, A. I., & Rehman, K.-U. (2018). Financial Management Practices : Theory and Application Financial Management Practices and Their Impact on Organizational Performance. *World Applied Sciences Journal, December 2010*.
3. Cardao-Pito, T. (2021). Fisher-Modigliani-Miller organisational finance theory and the financialisation of contemporary societies. *European Journal of the History of Economic Thought*, 28(4). <https://doi.org/10.1080/09672567.2020.1840604>
4. Fama, E. F., Cochrane, J. H., Moskowitz, T. J., Cochrane, J. H., & Moskowitz, T. J. (2016). The Fama Portfolio. In *The Fama Portfolio*. <https://doi.org/10.7208/chicago/9780226426983.001.0001>
5. Freeman, E. R. 1984. (1984). Freeman, E.R. 1984. *Strategic Management: A Stakeholder Approach*.
6. Freeman, R. E., Dmytriiev, S. D., & Phillips, R. A. (2021). Stakeholder Theory and the Resource-Based View of the Firm. *Journal of Management*, 47(7). <https://doi.org/10.1177/0149206321993576>
7. GORDON, L. A., & POUND, J. (1993). Information, Ownership Structure, and Shareholder Voting: Evidence from Shareholder-Sponsored Corporate Governance Proposals. *The Journal of Finance*, 48(2). <https://doi.org/10.1111/j.1540-6261.1993.tb04734.x>
8. Gustafson, K. (2015). A new financial risk ratio. *Journal of Statistical Computation and Simulation*, 85(13). <https://doi.org/10.1080/00949655.2014.918131>
9. HAX, N. S., & MAJLUF, A. C. (1991). The strategy concept and process. In *Upper Saddle River*.
10. Istan, M. (2021). PENGARUH KEBIJAKAN PERUSAHAAN TERHADAP NILAI PERUSAHAAN. *JURNAL ILMIAH AKUNTANSI DAN KEUANGAN*, 4(5).
11. Jensen, M. C., & Smith, Jr., C. W. (2005). The Theory of Corporate Finance: A Historical Overview. *SSRN Electronic Journal*. <https://doi.org/10.2139/ssrn.244161>
12. Markowitz, H. M. (2009). Harry Markowitz: Selected works. In *Harry Markowitz: Selected Works*. <https://doi.org/10.1142/6967>
13. Morel, B. (2020). Real Option Analysis and Climate Change. In *Springer Climate*.
14. Pagano, M. (2005). The Modigliani-Miller theorems: a cornerstone of finance. In *PSL Quarterly Review* (Vol. 58).
15. Sharpe, W. F. (1994). The Sharpe Ratio. *The Journal of Portfolio Management*, 21(1). <https://doi.org/10.3905/jpm.1994.409501>
16. Steinfeld, J. M. (2023). Stewardship Theory over Agency Theory. In *Public-Private Stewardship*. https://doi.org/10.1007/978-3-031-17131-4_8
17. Tabery, J., & Sarkar, S. (2015). R. A. Fisher, Lancelot Hogben, and the “competition” for the chair of Social Biology at the London School of Economics in 1930: Correcting the legend. In *Notes and Records* (Vol. 69, Issue 4). <https://doi.org/10.1098/rsnr.2014.0065>
18. Tetteh, J. E., Amoah, A., & Adenutsi, D. E. (2019). Drivers of Stock Market Returns in Sub-Saharan Africa: Evidence from Selected Countries. *Asian Development Policy Review*, 7(3). <https://doi.org/10.18488/journal.107.2019.73.191.208>
19. Utama, A. N. B., & Mustika, C. (2022). ANALISIS HUBUNGAN INDEKS HARGA SAHAM KOMPOSIT DAN TINGKAT INFLASI DI INDONESIA PADA MASA PANDEMI COVID 19 DENGAN PENDEKATAN KAUSALITAS GRANGER. *Jurnal Manajemen Terapan Dan Keuangan*, 11(03). <https://doi.org/10.22437/jmk.v11i03.20396>



20. Varian, H. (1993). A Portfolio of Nobel Laureates: Markowitz, Miller and Sharpe. *Journal of Economic Perspectives*, 7(1). <https://doi.org/10.1257/jep.7.1.159>
21. Vilks, A. (2022). On an “important Principle” of Arrow and Debreu. *B.E. Journal of Theoretical Economics*, 22(2). <https://doi.org/10.1515/bejte-2021-0074>
22. Wang, F., & Dong, Y. (2019). A power-balanced pareto-equilibrium profit allocation in supply chain. *IEEE Access*, 7. <https://doi.org/10.1109/ACCESS.2019.2899952>
23. Yu, L., Lin, L., Guan, G., & Liu, J. (2022). Time-consistent lifetime portfolio selection under smooth ambiguity. *Mathematical Control and Related Fields*, 0(0). <https://doi.org/10.3934/mcrf.2022023>