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-RESEARCH ARTICLE-

THE IMPACT OF FINANCIAL POLICY ON PROFITABILITY PERFORMANCE: EVIDENCE FROM DEVELOPING ECONOMICS

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Abstract

The paper focuses on the impact of financial policies on profitability performance, either in the company or in the startup world in general. The sample used in this paper comprises 117 Malaysian companies from 2020-2025. The information used in this paper is secondary. The positive and significant relationship between financial policy and profitability performance in Malaysian companies is significant. This importance comes from the fact that financial policy represents one of the important tools for achieving economic stability and stimulating growth, which has a direct and indirect impact on the profits of companies. The approach used in the current research was descriptive analytical in reviewing the relevant literature and previous studies. The analysis of the relationship between financial indicators and profitability indicators

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depended on this basis. The effect of financial policy on profitability will come through consumer purchasing power and, consequently, the volume of demand for the products of companies, which in turn impacts profits. Furthermore, results from multiple linear regression analysis showed that fiscal policy instruments such as government spending and direct cash transfers tended to greatly affect profit margins relative to changes in tax among SMEs participating in the experiment. Checks for robustness have equally validated stability of results by controlling structural variables such as a business's manufacturing, service, or technology, and the project life cycle stage in periods of startup, growth, or maturity; thus, conclusions are further verified. Based on these findings, the recommendation is that fiscal policies be designed considering the nature of startups, such as flexibility in short-term fiscal stimulus and linking support to measurable financial performance indicators.

Keywords: Financial Policy, Profitability Performance, Developing Economics, Fiscal Policy

INTRODUCTION

Financial policy is one of the primary tools governments use to manage the macroeconomic (Ehigiamusoe & Samsurijan, 2021). It aims to achieve economic stability, stimulate growth, and address market imbalances (Al-Busaidi & Al-Muharrami, 2021). Financial policy includes the utilization of public revenues, and government expenditures, particularly taxes to direct economic activity toward attiring desired goals (Ofori, 2025). The influence of this policy on the profitability of firms and institutions is an important topic, as the economic and financial environment directly impacts the efficient use of resources and the capacity of enterprises to generate revenues (Teixeira et al., 2020).

Financial policies, such as the extent and composition of public expenditures, stimulus policies, contractionary policies, and taxes, could help create an attractive environment in which businesses can operate. This environment would be achieved through lower costs and better infrastructure, leading to positively influenced corporate profitability (Martin et al., 2022). On the other hand, contractionary policies, such as increased taxes and less government spending, would have a negative effect on the bottom line and would seem to hamper investing (Jacob, 2022). In light of the role and relationship between financial policies and corporate profitability, the paper seeks to investigate the relationship between the two variables. This enables recommendations to be formulated to support attain a balance among the requirements of economic stability and enhancing profitability levels.

There are some issues related to high tax rates, which decrease companies' net profits and impact their competitiveness (Helcmanovská & Andrejovská, 2021). Furthermore,

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the instability of the tax system (frequent policy changes) creates uncertainty for firms and investors. Unfair taxation (discrimination between sectors or companies) leads to an imbalance in the distribution of profits and investment opportunities. Issues related to spending on unproductive sectors may decrease support for the business environment (Chu et al., 2020). A budget deficit subsequent to growing spending without sufficient resources leads to subsequent austerity policies that negatively affect profitability (Botta, 2020). Issues connected to financing and deficits. Rising public debt forces the state to impose additional taxes or reduce spending, which negatively affects corporate profits. enhancing interest rates (to finance debt or control inflation) raise the cost of financing for companies' firms, thereby reducing profitability (Hanlon & Heitzman, 2022). Problems related to inflation and economic stability: Excessively expansionary financial policies can lead to inflation, enhancing production costs and decreasing consumers' purchasing power. Weak economic stability due to unbalanced financial policies leads to a decline in investment and profits. Administrative and institutional issues the lack of coordination between financial and monetary policy weakens the effectiveness of any economic reform. Lack of transparency in budget preparation and application undermines investor confidence. Inefficient tax collection leads to financing gaps that influence profit sustainability (Cuadrado-Ballesteros & Bisogno, 2022).

Influences on economic stability: unplanned financial policies cause economic fluctuations (recession/recovery), directly affecting sales and profits. Additionally, the lack of tax exemptions or incentives reduces investment attractiveness, thereby limiting profits, limiting corporate expansion (Gasperin & Skidelsky, 2021). There are some commonly employed theories linked to financial policy. Keynesian theory holds that financial policy (increasing public spending or reducing taxes) directly affects the level of consequently, production, aggregate demand, and profits (Dullien & Tober, 2022).

In our research, we would like to combine real-world data with an economic model that has a strong foundation and adherence to economic theory. This would enable the government, in particular, to create proper economic policies using scientific knowledge on the appropriate and unbiased fiscal policies. Moreover, it has become imperative that the fiscal policies designed by experts in the field work in their favor and provide the desired positive results. In an effort to resolve the problem, a number of fiscal and economic models have been researched, and the conclusions derived provide different outlooks. Businesses would increase their output in an effort to accommodate the increased demands, and even reduced taxes could provide an increased incentive. However, increased government expenditure could potentially crowd out businesses and even hamper the increased profitability, and this has long been supported by the real business cycle theory. Increased government expenditure would even increase the cost and hamper profitability. Furthermore, the studies conducted by the International Monetary Fund highlight that fiscal policies may provide limited results and even fall short when compared to the increased government expenditure by

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some countries' government. The measures put forth in the proposed model would include grained fiscal policies, and even the dataset would hold businesses in Malaysia in the period ranging from 2020 to 2025, and even the post-Covid economic conditions and the adoption and increased use of AI technologies and even the work-from-home approach. Furthermore, the Keynesian model has also been applied in this proposed model, and even company characteristics would help in concluding the increased effectiveness in terms of increased profitability and even the types, in particular.

The paper aims to bring clarity on the pressing need for the application of the tools of fiscal policy measures and their direct contributions in terms of an improvement in corporate profitability within the framework of economic equilibrium. The important tools could be listed under government expenditure strategies, tax treatment, direct subsidies, and the like. The importance and relevance of our paper would be distinctly exaggerated, considering the numerous economic problems arising in the third decade in the 21st century and affecting the emerging economies. Thus, our paper would aim at filling the dual gap. The first gap would be on the theoretical aspect, since there isn't an understanding of the fiscal measures in terms of the impact on corporate performance, using an important institutional factor like governance. The other gap would be on the practical side, since there are few studies related to the Malaysian economy, since the fiscal policy applied in the pandemic situation was data dependent. Thus, our paper would aim at formulating the important objectives, like general and specific, together with an important package, like the following:

This research analyses the role of fiscal policy, an important variable, in the profitability of listed and operationally active Malaysian firms during the period from 2020 through 2025. The paper also examines the changes in the structures and situations that characterized this duration, such as the disruption occasioned by the pandemic. Moreover, the role that the fiscal policies employed adjusted the impact of the pandemic, addressed the issue of worldwide inflation, and the growing cost of finance, and the process through which the latter must be managed. The inquiry shall endeavor to dig much deeper than the superficial observation on the relationship that exists between the financial profitability and the process through which the latter gets driven. Therefore, fiscal policy profitability assessment and the process through which the interplay among the driving frameworks and conditions become important procedures that would either ease the process through which fiscal intervention becomes effective or become symptomatic factors. The important underlying basis here would be the adjustments in fiscal policy impact that would depend on the corporate instances both internally and externally. The internal corporate situation would be indicated by the board, and the external corporate situation would be denoted by the corporate phases.

Research Objectives

1. To determine whether board size significantly impacts firm profitability

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performance and enhance decision-making quality and strategic oversight that translates to improved profitability metrics.
2. To assess the impact of board independence on profitability performance, examining whether greater representation of independent directors strengthens corporate governance and subsequently enhances firm financial performance.
3. To investigate the relationship between financial policy decisions and profitability performance, exploring how corporate financial policies influence overall firm profitability outcomes.
4. To analyze the effect of financial leverage on profitability performance, determining the optimal capital structure that balances debt financing benefits with associated risk exposure to maximize profitability.

LITERATURE REVIEW

Financial policy is the use of revenues (taxes, fees, asset sales) and public expenditures (investment in infrastructure, education, health) to influence economic activity and achieve goals such as sustainable economic growth, reducing unemployment, controlling inflation, and enhancing social justice. Profitability performance mentions to a firm or institution's ability to make profits from its investment activities, operational, and measures its efficiency in utilizing available resources (such as assets, capital, and human resources) to make stable and growing financial returns. Startups and emerging businesses are cornerstones of the modern economy, driving innovation, creating jobs, and diversifying economic activity. A series of shocks, including volatile markets, financial crises, and most recently, a pandemic, have rocked the global economy in the last few years. These events have brought fiscal policy back into the spotlight. Policymakers and researchers increasingly view government spending, tax incentives, and direct support as tools that can cushion companies from turbulence and shore up their financial performance (Al-Busaidi & Al-Muharrami, 2021).

Malaysia provides an interesting case study because it is consciously steering its economy toward knowledge-intensive, innovation-driven activities. Through the MyDIGITAL plan and the New Investment Policy, the government wants the digital economy—which made up 15.6% of gross domestic product (GDP) in 2020 – to grow to 22.6% of GDP by 2025. In an effort to achieve the above, there are plans to create 500,000 digital jobs and encourage the adoption of digital technology among SMEs. Moreover, in 2021, there were over 489,000 micro, small, and medium enterprises using the e-commerce platform. The startup ecosystem also bears great significance in this process. The MY startup platform has registered over 4,428 Malaysian startups, and the goal of the nation is to have 5,000 active startups by the year 2025, contributing approximately 25.5% to GDP. All these plans and goals are achieved through distinct plans and strategies, such as the proposed one-off digital stimulus package in the 2019 Budget, contributing RM30 to each eligible adult in the country in an effort to promote

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the use of e-wallets.

The link here is that expanding financial policy growth corporate profitability by stimulating investment and consumption. Monetarist theory concentrates more on the role of money than financial policy but assumes that expanding government spending might cause a deficit that leads to inflationary pressures that decrease real profitability (Kantor, 2022). The financial neutrality theory suggests that the impact of financial policy on profitability may be neutral because individuals suppose that increased spending today will mean higher taxes tomorrow, and therefore their consumption behavior will not significantly change. The financial sustainability theory emphasizes that continuing financial deficits and public debt may negatively affect the business environment and decrease corporate profitability in the future. Theories linked to profitability and corporate performance, the agency theory clarifies how government policies (such as taxes) influence the decisions of managers and investors, and thus corporate profitability (Christiaens, 2020).

Stakeholder theory argues that financial policy (taxes, subsidies, exemptions) affects the interests of various stakeholders, for example investors, which is reflected in profitability performance. Efficient market theory assumes that information about financial policy is directly reflected in stock prices and corporate profitability. Business cycle theory presents that countercyclical financial policies impact profit levels based on the phases of the economic cycle. Hence, studies testing the link between financial policy and profitability performance often rely on Keynesian theory (direct impact via spending and taxes) and financial sustainability theory (the impact of deficits and debt). Firm theories such as agency and stakeholder theory clarify the effect of financial policy on management decisions and profits (Dao & Phan, 2023). Hence, this study tests the relationship among financial policy and profitability performance to fill a gap in this research and the paucity of earlier studies on this topic.

The study tested the impact of financial policies (taxes and public spending) on the profitability of industrial companies. The study concluded that growing taxes decreases profitability levels, while government investment spending stimulates economic activity and increases profits. The studied the effect of financial policy on the banking sector in Iraq and focused that the growth of public spending positively impacts banks' profitability by growing demand for financing, while the financial deficit weakens the sector's performance (Hamad & Moner, 2024). The study examined the link between financial policy and profitability in joint-stock firms and demonstrated that tax exemptions and incentives contributed to enhancing financial performance and increasing profit margins.

There are some issues related to financial policy and profitability performance. Tax volatility increasing tax rates decreases corporate net profits (Gnangnon, 2021). The

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instability of the tax system creates uncertainty and impacts investment decisions. Improved financing costs when the government resorts to borrowing to finance the budget deficit, interest rates rise, growing the cost of borrowing for firms and reducing their profitability (Mankiw, 2022). Poor targeting spending on infrastructure and main services hinders corporate development. Financial Policy-induced inflation, financing the deficit by monetary growth, leads to inflation, which raises production costs (raw materials, wages) and squeezes profit margins (Baranidharan, 2023).

Expansionary financial policies (increasing spending or reducing taxes) lead to supported economic growth, which in turn is reflected in corporate profitability, especially during periods of recession (Vergés-Jaime, 2023). It's found the financial policy (raising taxes/cutting spending) decreases the profits of firms listed on US stock markets in the short term (Norsalehe & Idris, 2023). The pointed out that multinational firms benefit from tax incentives provided by governments, which increase profitability levels by decreasing direct tax costs.

Hence, this paper suggested there is appositive and significant link between financial policy and profitability performance. Therefore, this paper clarifies this contribution by teat this link by proposed:

H1: *The financial policy is important and positive linked with profitability performance Malaysian as a developing economy*.

METHODOLOGY

Several firms suffer from weak the liquidity despite achieving accounting profits, raising questions about the connection between financial policy and profitability performance. The importance of this research lies in descriptive the role of financial policy as a key part in profitability performance. This research relies on a quantitative approach employing analytical approach and a descriptive. Financial data from firms registered on stock markets in a few developing economies will be employed to analyse the link among financial policy and profitability performance. Figure 1 present the percentages of financial policy and profitability from 2020-2025.

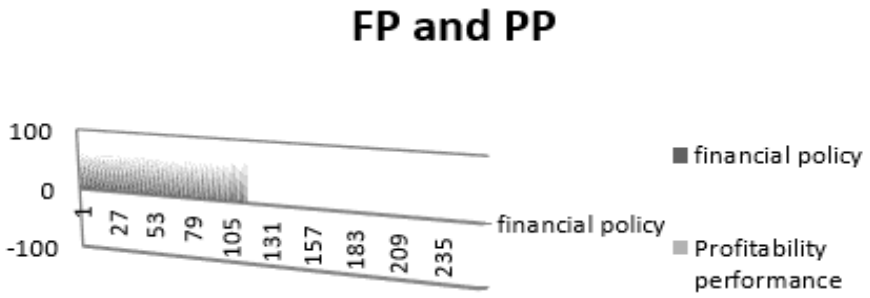

Figure 1: Present the Percentages of Financial Policy and Profitability from 2020-2025

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Data Collection and Measurement

The paper applied empirical analysis in evaluating its process and method. Financial policy was considered the independent variable, and profitability performance was considered the dependent variable. The population included 117 Malaysian firms, which belong to emerging countries. The model surveyed was estimated using the Ordinary Least Squares (OLS) regression analysis. Each financial variable indicator and measurement applied in the paper can be found in the following explanation. In the current paper, profitability performance was represented by return on equity (ROE). Financial policies are measured by their results in attaining objectives for example economic growth, financial stability, poverty reduction, and financial health, employing various methods like financial condition indices (FCIs), and the public expenditure and financial accountability (PEFA) framework (Mbodj & Laye, 2025). Board size refers to the total number of directors in attendance at the firm at any given date. Independence of the Board: The measure of the independence of the board refers to the ratio of the number of independent non-executive directors to the total number of directors presented at the firm at any date. Leverage refers to the ratio of total debts to total assets.

Econometric Equation

The current paper proposes a model that addresses both the two main variables in order to investigate how the performance as well as financial policy affects Malaysian firms. The regression of this research model under clarifies the link.

$$PP =_{it} \beta 0 + \beta 1\, FPit + \beta 2 BSIZEit + \beta 3 BINDit + \beta 3 LEVit + \varepsilon$$

RESULTS

Descriptive statistics test

The descriptive statistics regarding the sample of 117 firms in Malaysia from the year 2020 to 2025 are presented in Table 1. The mean value of the profitability performance is 11.698; mean financial policy is 61.635.

Table 1: Descriptive Statistics

Variable	Obs	Mean	Std. Dev.	Min	Max
Profitability performance	117	11.698	3.120	-2.862	20.269
Financial policy	117	61.635	1.447	60.000	64.000
Board size	117	7.365	1.916	4.000	13.000
Board independence	117	0.394	0.122	0.111	0.800
Leverage	117	0.152	0.160	0.000	0.887

Correlation Test

It can be seen from Table 2 above that the relationships studied are clear, whereby

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financial policy, size of the board, and independence of the board have positive relationships with profitability performance, and these are important. Leverage, on the other hand, has a negative relationship with profitability performance. In examining multicollinearity, the result from the association matrix shows no multicollinearity in the variables since all the correlations are less than 0.80.

Table 2: Correlation Analysis

Variables	Profitability Performance	Financial Policy	Board Size	Board Independence	Leverage
Profitability Performance	1.000				
Financial Policy	0.261**	1.000			
Board Size	0.374***	0.135	1.000		
Board Independence	0.766 ***	0.002	-0.264	1.000	
Leverage	-0.2071**	0.044	0.261**	-0.122	1.000

Regression Test

The results emerging from Table 3 above show positive and significant associations between financial policy and profitability performance (t = 0.310, p = 0.076). Board size, independence, and leverage portrayed positive significant relationships with profitability performance. These outcomes implied that an economic regulator in the development stage might have positively extended its operations to promote the process. In addition, the results emerging from this research can be applicable to determine current financial policy.

Table 3: Regression Analysis

Profitability Performance	Coef.	Std. Err.	T-Stat	Sig
Financial policy	5.900	1.932	0.310	0.076*
Board size	5.847	1.556	3.760	0.000***
Board independence	8.147	2.360	0.350	0.073*
Leverage	2.355	1.792	1.310	0.019*
Constant	-7.428	1.221	-0.610	0.544
Sample size	117			
R-squared (%)	15%			
Adjusted R2 (%)	12%			
F-value	0.009			

The consequences of this study are confirmed when compared to the economic reality in developing countries, as financial policy is the most widely used tool by governments to influence economic activity and attain a balance between growth and stability. The following observations develop the effect of taxes on profitability in most developing countries; the high tax burden constitutes an obstacle to the profitability of small and medium-sized enterprises (SMEs), limiting their competitiveness and impacting their

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expansion. This is including with the study's results that growing taxes decreases profitability levels. This reinforces the finding that public spending stimulates profitability. The heterogeneous influence in emerging countries, the consumer sectors and service are quickly impacted by indirect taxes, while export-oriented productive sectors profit from support and exemptions, confirming the differential influence of financial policy across sectors. The lack of financial and tax stability in several developing countries leads to weak confidence among foreign and local investors, limiting the chances of attaining sustainable profitability. This is consistent with the study's conclusion concerning the importance of financial clarity and stability in supporting the business environment. Business cycles and financial policy of several developing countries resort to financial growth through recessions to address unemployment and weak demand, but this often leads to inflationary pressures and improved public debt. This result reinforces the study's results on the need to balance short-run and long-run financial policies.

DISCUSSION

The results of this study examine the influence of fiscal policy on the profitability of Malaysian companies during a period of considerable economic instability, from 2020 to 2025, which includes the COVID-19 pandemic and the ensuing stimulus measures. The findings partially corroborate the initial hypothesis while exposing complexities that necessitate more profound theoretical and contextual analysis.

The average profitability performance is 11.698, the standard deviation is moderately high at 3.120, and the range of variable varies widely from -2.862 to 20.269, implying large variations in the performance among the sampled firms. This evidence confirms the findings in the related studies concerning the variability in the ability of start-ups, small businesses, and other enterprises in coping with disruption and, in a way, could be seen in the different industry sectors and the stages of development among the firms. In contrast, the fiscal policy variables appear stable with the mean value at 61.635 and standard deviation of 1.447 (Safari et al., 2024). This could be the effect of standardized fiscal policies and the structures in place when the firms are supposed to implement these policies. This is mostly the case in developing nations, where the tools available when it comes to stimulating the economy are mostly through the government (Fagbemi, 2020).

Second, the results from the correlation test reveal that fiscal policy, the size of the board, and the boards' independence are positively related and strongly correlated with the profitability performance of the firms. This reveals the important role that corporate governance could play in ensuring the effectiveness of fiscal intervention. The high positive relationship revealed in the study could help firms, especially those in Southeast Asia, better utilize fiscal incentives, such as focusing the fiscal instrument on

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investment rather than company consumption, since high boards' independence was observed. The inverse relationship between leverage and profitability performance was supported, and it revealed a strong negative relationship measured at r = -0.207, and it was justified by the negative effect of relying on leverage, particularly when interest rates fluctuate (Atshan et al., 2025).

Third, and most important, regression analysis reveals the marginal significance and positive link between fiscal policy and profitability with a regression coefficient of 5.900 and marginal significance at the 10% significance level, since the "p" value is 0.076. While the test has failed to achieve the required 5% significance level, it becomes significant because of the following reasons (Koralun-Bereźnicka et al., 2024):

1. Data context: post-pandemic period, during which the transmission of fiscal impacts was slow and unbalanced;
2. The limited variance in the fiscal policy variable as described in Table 1, reducing thereby the capability of the model to detect subtle effects;
3. The adjusted R^2 value of 12% implies that fiscal policy alone can explain just a small portion of profitability variance, which is unsurprising for emerging economies where fiscal policy interacts with structural factors such as quality of governance, access to finance, and institutional stability.

In fact, the great significance of the size of the board (p = 0.000) and its independence (p = 0.073) confirms the hypothesis that the effectiveness of fiscal policy is dependent on the best governance framework (Alnafrah & Bogatov, 2025; Shani et al., 2024), which means that the fiscal stimulus does not translate into higher profitability automatically but through effective mechanisms of internal control to ensure efficient allocation and transparent spending. It would probably also explain why some earlier research papers did not reveal a direct impact of fiscal policy, for instance, on West Africa. They were missing the institutional mediating variables (Fagbemi, 2020).

By contrast, the regression equation reveals a remarkable positive link between leverage and profitability (β=2.355, p=0.019), despite the negative relationship, and needs to be placed in proper perspective. This could be explained in relation to the role of governance quality in causing leverage, in general, in optimized companies, where the use of funds could be in the form of technology upgrade, such as digital transformation, and hence could positively impact the ROA, and in poorly performing companies, where leverage could become a negative factor. This corresponds with the "Debt and Discipline" model proposed by Jensen in 1986. Furthermore, the Malaysian scenario, where most of the economic relief packages, namely PRIHATIN and PENJANA, leaned heavily on cash and tax relief, hence impacting positively on the RA in the short term (Lim et al., 2021). Besides that, the focus on small and medium-sized enterprises, intended to make up most of the sample, is highly sensitive to changes in cash flows,

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not just to altered conditions in capital return.

The findings therefore signal not failure of fiscal policy but the need to redesign it so that it becomes more targeted and tailored to the features of corporate governance. "One-size-fits-all" policies might have only a partial effect, while their effectiveness increases once linked to governance performance indicators, such as the percentage of independent members or transparency indicators. This is consistent with the study (Alaarajy et al., 2024) This is a key practical conclusion for policymakers both in Malaysia and other emerging economies.

CONCLUSION

The financial policy can be identified as an important determinant in recognizing a firm's capability to fulfill its short-term financial requirements and, in turn, financial policy can relate closely to the profitability performance of an organization or company. After conducting an analysis, the following points can be identified. The finding of the research reveals the existence of moderate positive linkage between financial policy and profitability performance. High financial policy increases an organization or company's capability to fulfil its short-term financial requirements, hence resulting in increased profitability performance. Direct impact of financial policy on profitability, it is clear that financial policy tools (taxes, exemptions, and public spending) directly affect corporate profitability by decreasing costs or increasing financial burdens. Increasing investment spending on infrastructure and services improves the business environment, which positively influences profitability and corporate sales. Higher taxes decrease corporate profits in the short term but might contribute to macroeconomic stability if employed to finance productive projects. The significant of financial stability of the more balanced financial policy is (avoiding large deficits and sharp fluctuations), the higher the level of investor confidence, which is reflected in firm profitability. Indirect influence via aggregate demand, financial policy influence consumers' purchasing power consequently, and the demand for firm products, which is reflected in profits. Sector-deepened variation of the influence of financial policy on firm profitability varies across sectors (production, financial, and service) based on their sensitivity to taxes or government support.

RECOMMENDATIONS

This paper recommends adopting a flexible financial policy that considers economic variations and balances among stimulating, avoiding burdening companies and growth with taxes. Stimulating private investment by allowing tax exemptions or reductions to strategic sectors with high added value. Directing public spending toward infrastructure projects and main services that decrease operating costs for firms and growth their efficiency.

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This paper recommends transparent, reforming the tax system to be fairer so that it does not constitute a burden that weakens profitability or makes tax evasion. Increasing financial and monetary stability to confirm a stable business environment that helps firms plan and attain sustainable profitability. Coordinating financial and monetary policies to avoid conflicts that could limit their influence on private sector profitability. Regularly monitoring the influence through indicators and reports that measure the extent to which firm's profitability responds to financial policies and updating them according to the consequences.

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