

Systematic Risk Management and Profitability: A Case Study of Selected Financial Institutions in Sri Lanka

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Abstract

The main objective of the study is to identify the impact of Systematic risk management on Profitability, during 2007 to 2011 (05 years). In the present study, Systematic Risk Management [i.e., Degree of Financial leverage (DFL) and Degree of Operating leverage (DOL) as independent variable and Profitability (i.e., Net Profit, Return on Capital Employed (ROCE) and Return on Equity (ROE)] as the dependent variable are considered. In order to select the sample, convenience sampling techniques method is used. The study suitably used both secondary data. Operational hypotheses are formulated, results revealed that systematic risk management has a positive association ($r = 0.755$, $p < 0.05$) with Profitability. Further, Systematic risk management is enhanced by DFL and DOL in the selected financial institutions where the beneficial impacts are observed on profitability. Therefore, they have to pay more attention for tuning systematic risk management techniques. This study would hopefully benefit the academicians, researchers, policy-makers and practitioners of Sri Lanka and other similar countries through exploring the impact of systematic risk management on profitability, and pursuing policy to improve the current status of it.

Index terms— Systematic Risk Management, Profitability, Financial Institutions.

1 Background And Objectives

? To address the association between systematic risk management and Profitability ? To give some meaningful suggestions in order to enhance risk management practices in the financial institutions in Sri Lanka.

2 Literature Review and Hypotheses development

Plentiful works of early canvassers in risk management were found in the USA, UK and India [3]. The trend towards the adoption of more stylish systematic risk management created an interesting area for researchers to investigate: whether such systematic risk management performs leads to better profitability. Study [4] found that the mere adoption of systematic risk management techniques increase the performance. However, two studies proved otherwise [5,6]. Given the mix results over the years, this study seeks to provide further evidence on the degree of systematic risk management and profitability in Sri Lanka. Based on Literatures following hypotheses is formulated for the validity of the Literature. H1: Systematic risk management is positively associated with Profitability H2: Systematic risk management has an impact on Profitability Author ? : Lecturer in Accounting, Department of Accounting, Faculty of Management Studies & Commerce, University of Jaffna, Jaffna, Sri Lanka

research findings presented in the finance and accounting literatures have indicated a trend towards more keen approach in risk management by firms over time. Especially financial institutions are business. Managing the systematic risk at the optimum level is very essential to keep the performance at satisfactory level [1]. There are lots of different types like Business risk, Credit risk which are associated in a business Marcus ??2005). In

present study the following types are getting priority as per the research problem. In one sense risk can be categorized in to systematic and unsystematic risk. Unsystematic risk is a type of risk that depends on internal business factors and can be minimized through mechanism or designing an effective portfolio. It can be hedged but cannot be diversified R completely away. In fact, systematic can be thought of as diversifiable risk [2]. Financial institutions assume this type of risk whenever assets owned or claims issued can change in value as a result of broader economic conditions. As such, systematic risk comes in many different forms such as, as interest rates change, different asset have somewhat different and unpredictable value responses. Energy prices affect transportation firms' stock prices and real estate values differently. Large scale weather effects can strongly influence both real and financial asset values for better and worse. The Main objective of the study is to find out the impact of systematic risk management on Profitability in finance intuitions in Sri Lanka. To achieve main objective, the following sub objectives are considered.

3 Findings And Conclusions

According to the empirical results of this study, the researchers can drive the conclusions regarding the impact of systematic risk management on profitability. Correlation analysis revealed that there is a positive association between Net Profit and DOL and DOF (0.312 & 0.354). ROCE also has direct association with DOL and DFL at 0.519 and 0.612 and respectively. Similar, there is a moderate positive association between ROE and DOL and DFL (0.419 & 0.567). It reflects the high financial cost management leads to better Profitability.

Financial institutions in Sri Lanka mostly depend on the debt capital. Therefore, they have to pay interest expenses much. The well-developed bond market is viewed as the primary reasons for the observed relationship. The firms don't have efficient investment. Therefore, their investment not enough to increase the profitability and financial benefits. Due to this reason net profit has weak relationship with DOL and DFL.

Regression analysis revealed that R2 value is 0.57 which indicated that systematic risk management impact on 57 percentages.

4 a) Hypotheses Testing

Here the hypotheses of the present study are tested with the help of the proposed models. H 1 : Systematic risk management is positively associated with Profitability.

It is focused on the point of view of correlation between the systematic risk management and profitability ($r=0.755$, $p<0.05$). Therefore H1 is accepted. H 2 : Systematic risk management has an impact on Profitability.

It can be seen that from the regression analysis which revealed that R2 is 0.57 it means that II.

5 Research Design And Methods

6 a) Sampling Techniques

The study use data of listed companies in the Colombo Stock Exchange (CSE), Sri Lanka. In order to select the sample, convenience sampling techniques method is used. The sample size is 10 Institutions illustrated given in the table 1 systematic risk management has an impact on profitability at the rate of 57 percentage which is significant at 5 percent level. Therefore H2 is accepted.

7 b) Suggestions and Recommendations

The following suggestions are recommended to increase the institutional Profitability based on systematic risk management.

? Profitability standards should be established and communicated to the investors. This will help ^{1 2}

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Figure 1: Fig. 1 :

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Figure 2: Table 1 :

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Figure 3: Table 2 :

7 B) SUGGESTIONS AND RECOMMENDATIONS

S.No	Name of the Company	
01	Sampath Bank	
02	Commercial Bank of Ceylon Plc	
03	National Development Bank	
04	Hatton National Bank	
05	Seylan Bank	
06	Nation Trust Bank	
07	DFCC	
08	People Leasing Plc	
09	LB Finance	
10	Central Finance Plc	
Variables	Measures	
DFL	% Changes in EPS % Change in EBIT	
DOL	% Changes in EBIT % Changes in Sales	
Net Profit	Net profit X 100 Sales	
ROCE	EBIT X 100 Capital Employed	
ROE	PAT X100 Equity	
DFL		NP
Systematic		
Risk Manage-	Profitability	ROCE
ment		
DOL		ROE

Figure 4:

Figure 5: ?

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