

# 1 Systematic Risk Management and Profitability: A Case Study of 2 Selected Financial Institutions in Sri Lanka

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5 *Received: 1 June 2012 Accepted: 27 June 2012 Published: 10 July 2012*

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## 7 **Abstract**

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

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23 **Index terms**— Systematic Risk Management, Profitability, Financial Intuitions.

## 24 **1 Background And Objectives**

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

## 27 **2 Literature Review and Hypotheses development**

28 Plentiful works of early canvassers in risk management were found in the USA, UK and India [3]. The trend  
29 towards the adoption of more stylish systematic risk management created an interesting area for researchers to  
30 investigate: whether such systematic risk management performs leads to better profitability. Study [4] found that  
31 the mere adoption of systematic risk management techniques increase the performance. However, two studies  
32 proved otherwise [5,6]. Given the mix results over the years, this study seeks to provide further evidence on the  
33 degree of systematic risk management and profitability in Sri Lanka. Based on Literatures following hypotheses  
34 is formulated for the validity of the Literature. H1: Systematic risk management is positively associated with  
35 Profitability H2: Systematic risk management has an impact on Profitability Author ? : Lecturer in Accounting,  
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37 .

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

## 7 B) SUGGESTIONS AND RECOMMENDATIONS

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

### 53 3 Findings And Conclusions

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

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

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

### 65 4 a) Hypotheses Testing

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

68 It is focused on the point of view of correlation between the systematic risk management and profitability ( $r=$   
69 0.755,  $p<0.05$ ). Therefore H1 is accepted. H 2 : Systematic risk management has an impact on Profitability.

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

### 71 5 Research Design And Methods

### 72 6 a) Sampling Techniques

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

### 77 7 b) Suggestions and Recommendations

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

80 ? Profitability standards should be established and communicated to the investors. This will help <sup>1</sup> <sup>2</sup>

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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**

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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 Management	Profitability		ROCE
DOL			ROE

Figure 4:

Figure 5: ?

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