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AN ASSOCAITION BETWEEN ORGANISATIONAL GROWTH AND PROFITABILITY: A STUDY OF COMMERCIAL BANK OF CEYLON LTD SRILANKA

T. VELNAMPY, B. NIMALATHASAN[*]

The banking organizations, today, is moving towards the goal of integrated financial services because of the strong competition and quick changes of technology. In developing countries like Sri Lanka, banking organizations provide fund for other organisatinal developments. Financial system of a country is broadly the mechanism in the financial market which deals with the business or transactions in money .The financial sector in every country has become the deciding factor of the economy. The implementation and achievement of the government policies, let it be developing / developed depends on the financial market. There should be a steady financial policy of the government, further more, financial stability be maintained by the state. Today banking sector plays a significant role in the economic development of the country. The present study is initiated an association between organizational growth and profitability of virtually all of the Banks' branches of Commercial bank of Ceylon Ltd in SriLanka with last 10 years accounting period: 1997-2006.Correlation analysis shows that, Return on Average Assets (RAA), Return on Average Share holders (RAS) are significantly associated with number of advances and number of depositors and sales are correlated with all profitability ratios except ROE and ROI. Further organizational growth has a greater impact on all profitability ratios.

Key words: Banking, Organisational growth, Profitability, Advances, and Deposit.

Background of the Study

The definition of organizational performance with respect to a firm differs depending on the firm's overall goals. The chosen definition also impacts how performance is measured. When measuring the performance of a firm it is important to understand the multidimensional nature of the performance construct (Lumpkin and Dess 1996). There are pre-defined methods for measuring the performance of a firm. The difficulty in relying on these measures is that different performance measures can conflict ((Lumpkin and Dess 1996).

Measuring all of sales growth, market share, profitability overall performance and stakeholder satisfaction will provide a more accurate view of such firms performance. Throughout the entrepreneurial orientation literature,

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the performance construct is operatinalized fairly.Consistanly. Covin & Slevin (1989) use financial measures (Sales level, Sales growth rate, cash flow, and return on shareholder's equity, gross profit margin, and net profit from operations, profit to sales ratio, return on investment and ability to fund business growth) to represent performance for both the growth and financial perspectives. It is possible to regard financial performance and growth as different aspects of performance, each revealing important and unique information. A firm could, for instance, choose to trade – off long term growth for short term profitability (Zahra, 1991).Taken together these two aspects give a richer description of the actual performance of the firm than each aspect – separately.

Dess and Robinson (1984) reported strong and statistically significant relationships between the subjective comparative assessments of the 5-year performance of 18 businesses by their top management against other similar businesses in their industries, and the objective measures of return on assets and sales growth.

Literature Review

Theoretical and empirical literature on the determinants of growth and profitability are discussed in this section. Generally the profitability of the organizations depends upon its growth. In a way, Trau (1996), Sutton (1997), and Hart (2000) have reviewed the theoretical and empirical literature on firm growth. In the early empirical literature, a number of manufacturing studies find either no relationship or a positive relationship between firm sizes and growth rates. More other studies consistently find inverse size-growth relationship. MacMillan and Day (1987) considered that rapid growth could lead to higher profitability based on evidence that new firms become more profitable when they enter markets quickly and on a large scale. On the other hand, Hoy (1992) concluded that the pursuit of high growth may be minimally or even negatively correlated with firm profitability. Sexton *et. al.* (2000) found that firm profitability was correlated with sustainable growth, while Chandler and Jensen (1992) found that sales growth and profitability were not correlated. Bert Scholtens (2000) find a week association between profitability and bank concentration. Research evident that there is a substantial variation in the ability of branch offices to perform the task and substantial agreement on the identify of the branches at the bottom of the performance distribution. Profitability can be increased by the branch network (T.J. Pastor *et al.*), Velnampy and Nimalathasan (2007).

Indicated that sales are positively associated with profitability ratios except ROE, and numbers of depositors are negatively correlated to the fitability ratios except ROE, Likewise, number of advances is also negatively correlated to the ROI, and RAA.

Thus various studies on growth and profitability show different results. Whatever we have no studies in Sri Lankan context. Hence given the relative lack of research into the regularity of growth and performance measures over time we investigate the longitudinal nature.

Data Collection

Secondary data were collected for the study. Data were gathered from books, journals and annual reports etc.

Objectives

The main objective of the study is to find out the impact of organizational growth on profitability of Commercial bank of Ceylon Ltd and Specific objectives are:

1. To identify the profitability of Commercial bank of Ceylon Ltd over the last 10 years during 1997-2006.
2. To recognizes the organizational growth.
3. To find out the relationship between profitability and organizational growth.
4. To suggest the bank to keep concrete profitability.

Sample design

The present study is confined only to the Commercial bank of Ceylon Ltd as a whole. Today Commercial bank is the largest and the most admired private bank which is contributed to the development of economy of SriLanka.The bank provides the services through a network of 150 local, 269 Commercial Automated Teller machines and 7 overseas branches (Bangladesh). With an unblemished history of nearly a century in the Sri Lanka's Banking arena, Commercial Bank has been rated as the Best Bank in Sri Lanka for the 9th successive year by Global Finance magazine – New York and as Bank of the Year Sri Lanka by The Banker magazine – UK for five years. All branches are taken for the study representing the period of 1997-2006, and the average value of each item was considered for the purpose of ratio computation and analysis which are related to correlation and regression.

Methodology

Secondary data were used to measure the variables which are relate profitability and organizational growth. Here Indicators of profitability such as, net profit, operating profit, return on investment, return on equity, return on average assets, and return on average share holders were taken into account As the variables taken to measure the profitability which are most often to measure management's effectiveness is achieving profitability the following variables are considered to identify the organizational growth.

1. Number of Branches.
2. Number of Advances.
3. Number of Depositors.
4. Gross Income.

The above four items were directly extracted from the annual report of CBC.

Multiple regression analysis was performed to investigate the impact of organizational growth on profitability which the model used for the study is given below.

Profitability = *f (NOB, NOA, NOD, GI)*

It is important to note that the profitability depend upon No of branches, No of advances, No of depositors, and gross income regarding organizational growth. Since six profitability ratios (NP, OP, ROI, ROE, RAA, RAS), are considered in the study, the following six models are formulated to measure the impact of organizational growth on profitability.

$$\mathbf{NPR} = ß_O + ß_1(NOB) + ß_2(NOA) + ß_3(NOD) + ß_4(GI) \quad (1)$$
$$\mathbf{OPR} = ß_O + ß_1(NOB) + ß_2(NOA) + ß_3(NOD) + ß_4(GI) \quad (2)$$
$$\mathbf{ROI} = ß_O + ß_1(NOB) + ß_2(NOA) + ß_3(NOD) + ß_4(GI) \quad (3)$$
$$\mathbf{ROE} = ß_O + ß_1(NOB) + ß_2(NOA) + ß_3(NOD) + ß_4(GI) \quad (4)$$
$$\mathbf{RAA} = ß_O + ß_1(NOB) + ß_2(NOA) + ß_3(NOD) + ß_4(GI) \quad (5)$$
$$\mathbf{RAS} = ß_O + ß_1(NOB) + ß_2(NOA) + ß_3(NOD) + ß_4(GI) \quad (6)$$

Based on the above regression model NPR, OPR, ROI, RAA, RAS are considered as the dependent variables where as NOB, NOA, NOD, and GI are the independent variables. The detail analysis is carried out with the help of above indicators.

Hypotheses

The following hypotheses are formulated for the study.

1. Organizational growth and profitability is significantly association.
2. Organizational growth has an impact on profit.

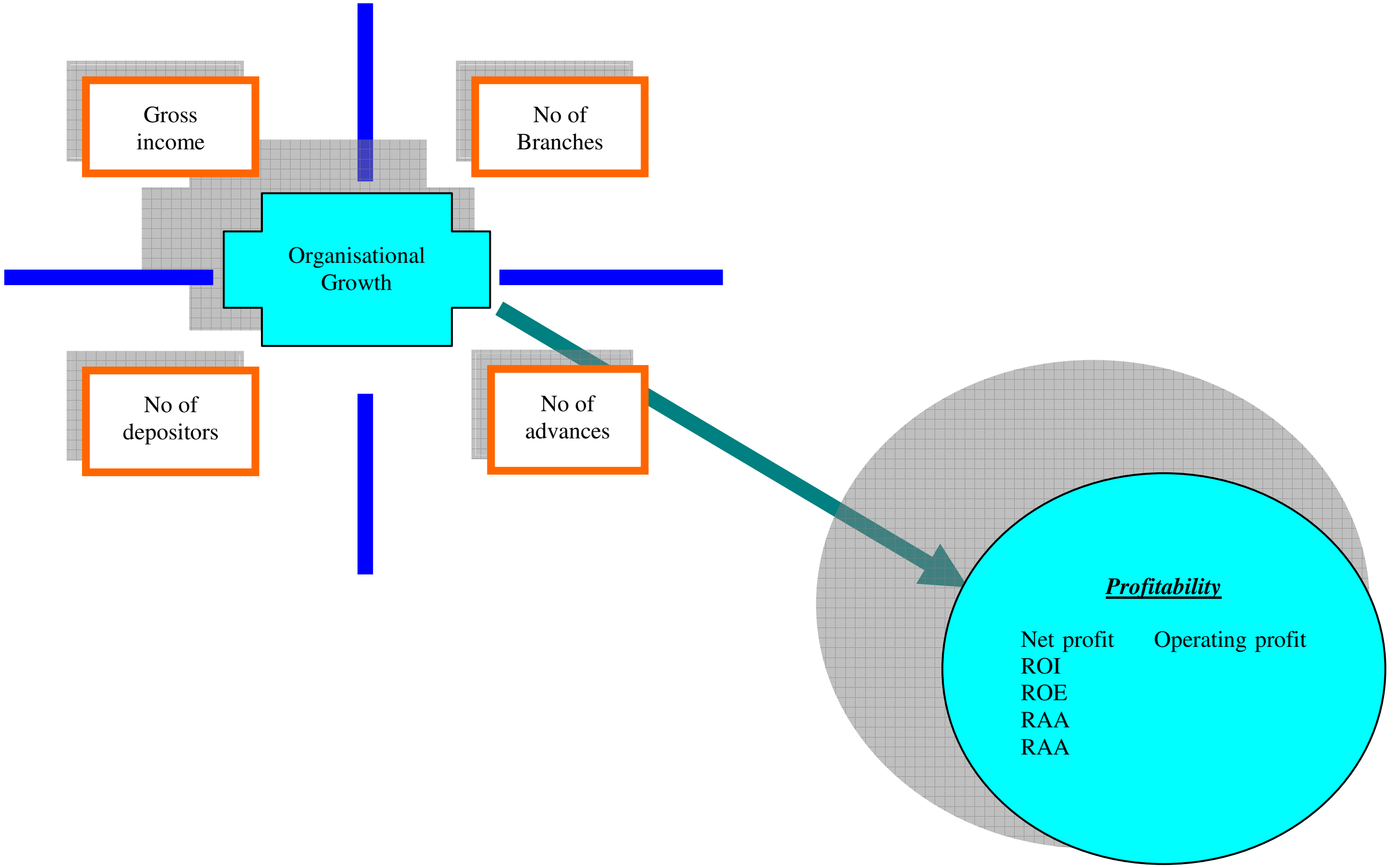
Gross income
No of Branches
Organisational Growth
No of depositors
No of advances
Profitability
Net profit
Operating profit
ROI
ROE
RAA
RAA

Fig. 1. Conceptual Model

Fig. 1. Conceptual Model

Conceptual frame work

After the careful study of literature review, the following conceptual model is formulated to depict the relationship between organizational growth and profitability.

Above conceptualization model shows the relationship between organizational growth and profitability of Commercial bank of Ceylon Ltd.

Results and Discussion

Profitability is generally depending on organizational growth (Markman, 2002, sexton .et.al, 2000) .Hence, growth indicators such as No of branches, No of advances, No of depositors, and sales should have a relationship with profitability indicators such as net profit ratio, operating profit ratio, ROI, ROE, RAA, and RAS. The correlation analysis was carried out to test the relationship and the results are summariesd in Table 1.

From the *Table 1* we can observe that sales are positively and strongly associated to all profitable ratio (RAS, RAA, NP, ROI) except ROE, OP, which means as the sales increases that profits of the CBC increases It is natural and aparant.

Number of depositors are negatively correlated with RAS, RAA, and NP; because attracting deposits from customer is not only determining factor in profitability the deposits should be used for generating profit, otherwise paying interest for deposits will decrease profitability. Meantime sufficient liquidity must be maintained by the banks for current accounts, and therefore it is better to see the relationship between deposits excluding current accounts and profitability which need to be studied further.

Similarly number of advances is also negatively correlated to RAS, RAA. It is important to note that even providing loans has a significant role in generating profit, the recovery of loan is most important.

Number of branches as a firm size, is significantly correlated with sales, and ROI. As we mentioned in methodology, six models were formulated and the results are summarized in *Table 2*.

Table 1

Correlation Matrix for Commercial Bank of Ceylon Ltd

Variables	Sales	RAS	RAA	ROE	ROI	OP	NP	NOD	NOA	NOB
Sales	1.000	– 0.670* (0.024)								
NOD	0.978** (0.000)	– 0.741* (0.014)	– 0.926** (0.000)							
NOA	0.984** (0.003)	– 0.710* (0.014)	– 0.928** (0.000)	0.332 (0.318)						
NOB	0.907** (0.000)	– 0.603* (0.050)	– 0.843** (0.001)	0.164 (0.630)	0.844** (0.001)					
RAS	0.670* (0.024)	1.000	0.871** (0.000)	– 0.013 (0.969)	– 0.693 (0.018)	0.329 (0.323)				
RAA	0.915** (0.000)	0.871 (0.000)	1.000	– 0.252 (0.455)	– 0.921** (0.000)	0.140 (0.682)	0.761* (0.014)			
ROE	0.450 (0.165)	– 0.013 (0.969)	– 0.252 (0.455)	1.000	0.532 (0.092)	0.637** (0.035)	– 0.772** (0.005)	0.309 (0.355)		
ROI	0.987 (0.000)	– 0.693 (0.018)	– 0.921** (0.000)	0.532 (0.092)	1.000	0.184 (0.588)	– 0.814** (0.002)	0.955** (0.000)	0.961** (0.000)	0.844** (0.001)
OP	0.190 (0.575)	0.329 (0.323)	0.140** (0.682)	0.637* (0.035)	0.184 (0.588)	1.000	– 0.326 (0.327)	0.129 (0.706)	0.138 (0.686)	0.010 (0.977)
NP	0.747** (0.008)	0.606* (0.048)	0.711** (0.014)	– 0.772 (0.005)	– 0.814** (0.002)	0.326 (0.327)	1.000	– 0.646** (0.032)	0.663 (0.026)	– 0.529 (0.094)

** Correlation is significant at the 0.01 level.

- Correlation is significant at the 0.05 level.

Table 2

Predictor of Profitability –- Model Summary

Details	1	2	3	4	5	6
No of Branches	0.054 (0.061)	– 0.056 (0.306)	– 0.109 (0.018)	– 0.008 (0.000)	0.000 (0.932)	0.003 (0.953)
No of Advances	0.000 (0.548)	0.000 (0.810)	0.000 (0.650)	– 0.005 (0.057)	– 0.005 (0.661)	– 0.006 (0.993)
No of depositor	0.000 (0.353)	0.000 (0.731)	0.000 (0.534)	– 0.005 (0.014)	– 0.005 (0.764)	– 0.005 (0.896)
Sales	– 0.001 (0.045)	0.001 (0.503)	0.003 (0.002)	0.000 (0.001)	– 0.005 (0.862)	0.000 (0.765)
Constant	12.288 (0.000)	– 12.234 (0.006)	8.051 (0.007)	1.538 (0.000)	2.226 (0.000)	18.642 (0.000)
R	0.925	0.516	0.996	0.980	0.930	0.728
R2	0.855	0.266	0.991	0.961	0.864	0.530
R2 Adjusted	0.758	– 0.224	0.986	0.936	0.774	0.216
Standard Error	0.9667	2.0876	1.40918	0.4663	0.14981	1.73720
F – stat	8.847	0.543	173.741	37.328	9.549	1.690

Note: Variables 1-6 are the dependent variables.

1 – Net profit **2** – Operating Profit **3** – ROI
4 – ROE **5** – RAA **6** – RAS

The specification of the four variables such as NOB, NOA, NOD, and sales in the above model revealed the ability to predict profitability (R^2 = 0.855, 0.266, 0.991, 0.961, 0.864 and 0.530 respectively i.e. 1-6). In this model an R^2 value of above six profitability ratios denote that 85.5%, 26.6%, 99.1%, 96.1%, 86.43%, and 53.0% to the observed variability in profitability can be explained by the differences in four independent variables namely, No of branches, No of advances, No of depositors, and sales. The remaining 14.5%, 73.4%, 0.9%, 3.9%, 13.57%, and 47% are not explained, because the remaining part of the variance in profitability is related to other variables which are not depicted in the model. In this model, the values of an adjusted R^2 slightly less than the value of R^2. This variance is highly significant, except ROI, as indicated by the F – values, and an examination of the model summary in conjunction with ANOVA indicates that the model explains the most possible combination of predictor variables that could contribute to the relationship with the dependent variables whatever it should be noted here that there may be some other variables which can have an impact on profitability which need to be studied.

Further, the profitability ratios such as operating profit, and Return on Average assets have a significant coefficient with No of depositors which means, that profitability decreases as the No of depositors increases.

Conclusion

This paper examined an association between organizational growth and profitability of Commercial bank of Ceylon. The analysis of Commercial bank of Ceylon Ltd. shows that sales are positively associates with profitability ratios except OP, ROE and number of depositors are negatively correlated to the profitability ratios except OP, ROE Likewise, number of advances is also negatively correlated to the RAA.

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