

A Review on Studies Relating to Profitability Performance



Commerce

KEYWORDS :

Dr. Anuradha Rajendran

M.Com., M.Phil., M.Sc(IT), Ph.D., Former Assistant Professor of Commerce (S.F), Vellalar College for Women (Autonomous), Erode-638 009

ABSTRACT

Profit is a measure of overall efficiency of business. In the words of Lord Keynes, "Profit is the engine that drives the business enterprise". It is indeed a magic eye that mirrors all aspects of the entire business operations including the quality of output.

This article presents the review of literature relating to the study carried out by various academicians, economists and researchers in the area of profitability in order to understand the research problem.

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Profits to the management are the test of efficiency and measurement of control; to owners, a measure of the worth of their investments; to creditors, the margin of safety; to employees, a source of fringe benefits; to government, a measure of tax-paying capacity and the basis of legislative action, to customers, a hint to demand for better quality and price cuts; to an enterprise, less cumbersome source of finance for growth and existence and finally to the country profit is an index of economic progress, generation of national income and rise in the standard of living of the people. Therefore, a business enterprise can discharge its obligations to the various segments of society only through profits.

This article presents the review of literature relating to the study carried out by various academicians, economists and researchers in the area of profitability in order to understand the research problem.

REVIEWS

Newmann, Bobel and Haid (1979)¹ conducted a study on "Profitability, Risk and Market structure in West German Industries" and documented mean rates of return of the period from 1965 to 1973 of 334 West German joint stock Companies by risk and market structure. They concluded that the investors were risk averters and that risk bearing was accordingly compensated by a higher rate of return. Degrees of concentration and product differentiation were closely related to profitability whereas export and import ratio exerted an adverse impact on profitability. As far as size and profitability are concerned, smaller firms tended to be more flexible, tended to take chances of growth more easily than the bigger ones. They also concluded that there was inverse relationship between growth and profitability.

Latha Arun Reddy (1983)² undertook a study entitled "Profitability and Growth - Indian Manufacturing Industries" and examined the profitability of the Indian Paper Industry with reference to the financial statistics of joint stock companies in India by the RBI during the period 1950-1951 to 1973-1974. The prime objective of the study was to look at the relationship between growth and profitability using regression models and compound growth rates. The author observed that there was a strong positive correlation between growth and profitability in the paper industry.

Deepak Chawola (1986)³ carried out an analysis namely

"An Empirical Analysis of the Profitability of the Indian Man Made Fibres Industry". He analyzed the trends in the profitability of the Indian man made fibres industry from the data collected from 17 firms found in BSE official Directory for the period 1963-64 to 1977-78. He observed that the excise duty of man-made fibres was negatively correlated with the profitability of the industry. He also observed that both concentration and vertical integration influenced the profitability. However, their impact differed for cellulosic and petro-chemical based group of fibers.

Nagarajan and Barthwal (1990)⁴ in their research work entitled "Profitability and Structure: A Firm Level Study of Indian Pharmaceutical Industry", critically examined the correlation between profitability and structure, using a sample of thirty eight pharmaceutical firms in India for the period 1970-1983. Two measures of profitability namely the ratio of net profit to total assets and the ratio of net profit to total sales revenue were used to find out the determination of profitability. The researchers showed that the most significant determinant of the profitability of the firms in this industry was vertical integration under the condition of price controls whereas the size and advertising intensity did not appear to be the major determinants of profitability. The researchers also observed that the co-efficient of growth rate of sales was positive and significant, suggesting that factors on the demand side of a firm had a greater impact on profitability than on the supply side.

Agarwal (1991)⁵ undertook a study on "Profitability and Growth in Indian Automobile Manufacturing Industry" and the study considered the performance of the companies after 1975. The key objective of this study was to find out whether the firms had been making abnormal profits when price controls were removed. The study also aimed at evaluating the impact of policy changes since 1981-82 on profitability and growth of firms in the industry using Tobin's square as a measure of profitability. The study revealed that the profitability was found to be primarily associated with vertical integration, diversification, age of the firms, and industry policy. The study also revealed that the important determinants of the growth of firms were expansion of capacities, diversification, industry policy dummy variables and gross retained profits. The author found no evidence of abnormal profits when price controls were removed.

Chandra Sekaran (1993)⁶ made a study on "Determinants of Profitability in Cement Industry". The main aim of the study was to draw inference on the impact of policy measures which led to change in price and distribution in the cement industry. The determinants of profitability were analyzed using the technique of ordinary least squares.

In order to find out whether the profitability function had shifted after the introduction of partial de-control, dummy variable was introduced for estimating the function and the test was also done to ascertain the inference. It was concluded from the study that the profitability of the company was based on the assets structure and proper utilization of the production capacity.

Vijayakumar and Venkatachalam (1995)⁷ carried out a study entitled "Profitability and Viability: Working Capital and Profitability - an Empirical Analysis", taking 13 firms from sugar industry, covering a period from 1982-83 to 1991-92. The impact of working capital ratios on profitability was determined using correlation and regression analysis. Major ratios like liquid ratio, receivables turnover ratio, inventory turnover ratio and cash turnover ratio were computed to measure their impact on profitability (PBT/TA). The study showed that inventory turnover ratio and receivables turnover ratio had positive correlation with the profitability and liquid ratio whereas cash turnover ratio had negative correlation with the profitability.

Kawal Raj Dawar (1998)⁸ in his study on "Determinants of Profitability in the Sugar Industry in Punjab and Haryana" measured the profitability of the individual mills on the year wise basis. The researcher had employed time series and cross section data to calculate multiple regressions. The author arrived at the conclusion that improvement in sugarcane recovery and avoidance of abnormal expansion can go a long way in improving profitability ratio in the sugar industry.

Mahammad Rafiqul Islam (2000)⁹ conducted a study on "Profitability of Fertilizer Industry in Bangladesh" for the period from 1985-86 to 1994-95. The prime objectives of the study were to investigate the earning capacity and to identify the key factors which affected the earning power of the selected units. The researcher analyzed a sample of five fertilizer enterprises out of the seven fertilizer enterprises in Bangladesh which are under the control of Bangladesh Chemical Industries Corporation. The study revealed that the earning capacities of the selected units were not consistent and the profits made by these units were gradually declining.

Sahu (2000)¹⁰ in his empirical study titled "Analysis of Corporate Profitability-A Multivariate Approach" analyzed the degree of relationship between the ratios by assigning different weightages corresponding to different ranges of the ratios and ranked the sample companies over the study period from 1984-85 to 1993-94. The key objective of the study was to measure the composite profitability of a firm by a single index through multivariate analysis. The study was conducted based on the secondary data from a sample of 100 non-financial non-government public limited companies in Eastern India. The researcher ranked the companies based on the score which ranged from 688 to 150.

Debasis Rej and Debasish Sur (2001)¹¹ undertook a study entitled "The Profitability Analysis of Indian Food Products Industry: A Case Study of Cadbury India Ltd". The key objective of the study was to measure the profitability of Cadbury India Ltd. The relationship among various profitability ratios and their joint impact was analyzed using multiple correlation co-efficient and multiple regression method. The study revealed that there was no correlation between the selected ratios.

Vijayakumar and Kadirvelu (2003)¹² undertook a study on "Profitability and Size of the Firm in Indian Minerals and

Metals Industry". The study focused to give a solution to the two contradictory suggestions viz., the larger firms earned a higher rate of return on its investment than the smaller firms and the counter argument that size breeds inefficiency and hence profitability may decline with size of firms. Hence it became necessary to study the relationship between size and profitability of the firms. The study revealed that size was found to be significantly associated with the profitability during the study period.

CONCLUSION

The review of literature guides the researchers for getting better understanding of methodology used, limitations of various available estimation procedures, database, lucid interpretation and reconciliation of the conflicting results. In case of conflicting and unexpected results, the researcher can take the advantage of knowledge of other researchers' published works.

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