



ORIGINAL RESEARCH PAPER

Commerce

Analysis of Profitability and Risk – A study of SME

KEY WORDS:

Dr.Vani.H

Assistant Manager, NSIC

Dr.Vandana.S

Principal, Vidya Dayini College of Management, Hyderabad.

ABSTRACT

Profitability and risk are very important to determine the financial condition and performance of a firm. Again profitability and risk have same direction; in order to have greater profitability, we need to take greater risk. But in practice a firm must accomplish a minimum risk to achieve maximum profitability. This paper makes an attempt to provide an insight into the profitability performance of SME in comparison to risk. The study is based on secondary data collected from published annual reports cover six years' period from 2010 to 2016. The available data have been analyzed by using important profitability ratios and risk factor.

INTRODUCTION:

Profit is a very good indicator of business performance; every business must earn sufficient profits to sustain the operations of the business and to fund expansion and growth. It is difficult for a business to breathe well without profit. It may be regarded as a mirror of the performance of business activities. In short, profit is the legitimate object of an enterprise form the shareholder. Accountant ascertain profits, is not only a reliable measure of efficient performance by means of production resources. But also, means of measuring the progress of the business and of indicating when and whole corrective action, if necessary shall be taken. The management of a business firm has to take some vital managerial decision like further development, raising of an additional finance and dilemma dividend payments etc. and for this purpose the management very much rely-upon the profitability of the business firm.

On the contrary risk is the "effect of uncertainty on objectives". It can be seen as relating to the profitability of uncertain future actions. Risk analysis is the technique of defining the analyzing the threats posted to businesses by adverse dealings. Financial deals which creating a proper outline to maximize profits at a given level of risk. In pursuing this balance, the firm must develop controls over the flows of funds while allowing sufficient flexibility to respond to changes in the operating environment. Thus, the firm must manage a tolerable risk so as to achieve maximum profitability.

OBJECTIVES OF THE STUDY:

- The study is being done with the following objectives:
- 1) To examine the profitability position of the SME over the study period.
 - 2) To measure the risk factor of the company during the period of study.
 - 3) To know the association between profitability and risk.

EXPERIMENTAL DETAILS:

The data was collected from SME (Balance Sheets) which is a registered unit under DIC, Hyderabad.

The study is concerned with the six years' data on SME for a period of (2010-2016). The data is of secondary in nature and is obtained from various published reports. The available data has been analyzed through various profitability ratios and drawing out the profitability position of the said company. Statistical tool correlation has been applied from observations. Further, statistical t-test has been applied to test the hypothesis and draw conclusions.

RESULTS AND DISCUSSION:

PROFITABILITY ANALYSIS:

The profitability of the enterprise is popularly measured with the help of financial ratios conveying quantitative relationship

between two variables considered for the purpose. The gross profit ratio indicates the limit beyond which sales are not tolerated to fall. A high ratio of gross profit to sales is a symbol of good management for the firm. Similarly operating ratio determines the operational efficiency of the management. Higher operating ratio indicates that the firm has got enough margins to meet its non operating expenses well as to create reserve and pay dividends. Alternatively, net profit ratio indicates the efficiency of management to operate the firm successfully in relation to earned revenues and all types of costs associated with it at a reasonable level of risk and uncertainty. The high net profit ratio ensures good return to the owners. Simultaneously return on capital employed explains the overall utilization of fund by a business. It reveals the efficiency of the business in utilization of funds entrusted to it by, share holders, debenture-holders and long-term liabilities. While Return on Net worth indicates how profitably the shareholders' fund or net worth has been utilized by the enterprise. It is an important yardstick to judge the performance of a firm for the equity shareholders. The theoretical model of Profitability analysis is given as follows.

Independent variables	Dependent variables
Gross profit ratio	Profitability performance of the company
Operating profit ratio	
Net profit ratio	
Return on capital employed	
Return on net worth	

TABLE 1: CONSOLIDATED PROFITABILITY POSITION OF SME

YEAR	OPERATING PROFIT RATE	GROSS PROFIT RATE	NET PROFIT RATE	ROCE	RONW	TOTAL					
2010-2011	2352668	23.5	5431107	54.3	1217738	12.1	4.14	4.14	0.02	2.07	96.11
2011-2012	2658793	26.5	6911552	69.1	1402956	14.0	4.11	4.11	7.27	7.2	120.9
2012-2013	6393040	63.9	9398378	93.9	852231	85.2	2.23	2.23	(0.09)	(9.9)	235.2
2013-2014	2753093	27.5	5084323	50.8	361156	36.1	1.10	1.10	(0.27)	(2.72)	112.7
2014-2015	11093212	11.09	15009714	15.0	412702	41.2	0.01	0.01	(0.38)	(3.86)	63.44
2015-2016	8555134	85.5	13821169	13.8	3772959	37.7	16.42	16.4	(0.039)	(3.99)	149.4

The ratios are ranked in order of their influence on profitability. The higher the ratio the greater is the profitability. Further, the ultimate rank has been considered from the total rank of the ratios. The ultimate ranking has been completed on the principle that the lower aggregate of individual ranks the more the profitability is the liquidity position and vice versa.

TABLE 2: CONSOLIDATED RISK POSITION OF SME

YEAR	EQUITY + RETAINED EARNINGS (E)	LONG-TERM LOANS (A)	FIXED ASSETS (F)	CURRENT ASSETS (C)	RISK FACTOR (RK) ((E+A)-F)/C
2010-2011	7272410	17122188	26064575	12764141	(0.1308334811)
2011-2012	13319848	19585282	38792530	16185451	(0.3637464288)
2012-2013	19988271	18129048	42133165	22478107	(0.1786558806)
2013-2014	15673462	17149125	37591340	23862026	(0.1998469451)

2014-2015	11279435	16231747	30398607	29533357	(0.09776826251)
2015-2016	10846395	12120583	26556435	25139094	(0.1427838648)

The above table indicates that R ik values neither closed to '0' nor closed to '1'. Hence the parameter clearly reveals a high level of risk policy; it indicates the standard profitability situation.

TRADE OFF BETWEEN PROFITABILITY AND RISK (USING CORRELATION)

YEAR	PROFITABILITY	RISK
2010-2011	96.11	-0.13083
2011-2012	120.98	-0.36375
2012-2013	235.26	-0.17866
2013-2014	112.78	-0.19985
2014-2015	63.44	-0.09777
2015-2016	149.41	-0.14278
t	-0.15(Negatively Correlated)	
T of t	-0.309	

Source: calculations are done using MS Excel

Correlations			
	profit	risk	
profit	Pearson Correlation	1	-.154
	Sig. (2-tailed)		.771
	N	6	6
risk	Pearson Correlation	-.154	1
	Sig. (2-tailed)	.771	
	N	6	6

CONCLUSION:

The overall profitability position showed mixed performance over this study period. The ranking of profitability ratios denotes that during the period 2015 the company enjoyed highest profitability and the poorest profitability was recorded in 2013. The index value of risk factor is not satisfactory over the study period. Thus, it can be said that the profitability and risk are negatively correlated

Hence, it is concluded that as the company risk is increasing the profitability is decreasing showing negative sign. T of T is calculated to check the authenticity of correlation i.e.,(-0.15) and T value -0.309 as the T of T is less than 1.196 the Null Hypothesis is accepted, alternative hypothesis is rejected.

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