

Financial Information and Strategies

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Profitability of Listed Telecom Companies in Sri Lanka: An inter & Intra Comparison of SLT PLC & Dialog PLC

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Introduction

Profit is the financial return that entrepreneurs aim to achieve to reflect the risk that they take. Given that most entrepreneurs invest in order to make a return, the profit earned by a business can be used to measure the success of that investment. Profit is also an important signal to other providers of finance to a business. Banks, suppliers and other lenders are more likely to provide finance to a business that can demonstrate that it makes a profit and that it can pay debts as they fall due. Profit is also an important source of finance for a business. Profits earned which are kept in the business (i.e. not distributed to the owners via dividends or other payments) are known as retained profits. Retained profits are an important source of finance for any business, but especially start-up or small businesses.

Profitability reflects the final result of a company's business operations. Profitability Ratios are also called Income Statement Ratios since most of the items used in their calculations are picked up from the Income Statement. Profit margin ratios and rate of return ratios are the most commonly used profitability ratios. A comparison of profitability ratios with other competitors in the same industry can reveal relative strengths or weaknesses of a business (Pandey, I.M., (1979)).

The importance of profit in a business is so they know exactly what they can spend that money on to make that business prosper and make sure that they can develop their merchandise and services to make them better to attract more customers to that business. Profits help a business spend money wisely and so they can buy in equipment which will make them perform better in their job role and so the business can run more effectively and efficiently. Well Importance of profit in business are,

1. It helps in development of the company positions in the market
2. It judge the position of their management ,working involvement of worker, proper accounting
3. It act as risk factor of the company

Profit margins can provide a comparison between companies in the same industry, and can help identify

trends in the numbers for a company from year to year. In the latter case it separates the effect on profits of growth or decline in sales from changes related to efficiency and price levels. It does not do this perfectly as margins naturally increase with sales particularly when a company has a high level of fixed costs or high sales growth or decline.

The present study is initiated profitability of listed telecommunication companies: A comparative study of Sri Lanka Telecommunication (SLT) PLC and Dialog PLC during the period from 2003 to 2008.

Objective of the study

The main objective of the study is to compare the profitability of Telecom companies. To achieve the main objective, the following specific objectives are taken for the study.

1. To identify the indicators of profitability of the Telecom companies over the 06 years during from 2003 to 2008.
2. To recognize the profitability of SLT PLC and Dialog PLC

Review of Literature

Gopinathan Thachappilly (2009) discussed the Profitability Ratios Measure Margins and Returns such as gross, Operating, Pretax and Net Profits, ROA ratio, ROE ratio, ROCE ratio. However, he determines the Gross profit is the surplus generated by sales over cost of goods sold. He also explains that the returns on resources used dividend into three categories such as ROA, ROE, and ROCE.

Maria Zain (2008), in this articles he discuss the return on assets is an important percentage that shows the company's ability to use its assets to generate income. He said that a high percentage indicates that company's is doing a good utilizing the company's assets to generate income.

Gopinathan Thachappilly (2009), in this articles he discuss the Financial Ratio Analysis for Performance evaluation. It analysis is typically done to make sense of the massive amount of numbers presented in company financial statements. It helps evaluate the performance of

a company, so that investors can decide whether to invest in that company. Here we are looking at the different ratio categories in separate articles on different aspects of performance such as profitability ratios, liquidity ratios, debt ratios, performance ratios, investment evaluation ratios.

Velnampy & Nimalathan (2007) indicated that sales are positively associated with profitability ratios except return on investment, and numbers of depositors are negatively correlated to the profitability ratios except return on equity. Likewise, number of advances is also negatively correlated to the return on investment, and return on average assets in Bank of Ceylon. Further they (2008) pointed out there is a positive relationship between Firm size and Profitability in Commercial Bank of Ceylon Ltd, but there is no relationship between firm size and profitability in Bank of Ceylon. Sexton & Kasarda. (2000) found that firm profitability was correlated with sustainable growth, while Chandler and Jensen (1992) found that sales growth and profitability were not correlated

James Clausen (2009), stated that the Profitability Ratio Analysis of Income Statement and Balance Sheet Ratio analysis of the income statement and balance sheet are used to measure company profit performance. He said the learn ratio analyses of the income statement and balance sheet. The income statement and balance sheet are two important reports that show the profit and net worth of the company. It analyses shows how the well the company is doing in terms of profits compared to sales. He also shows how well the assets are performing in terms of generating revenue. He defines the income statement shows the net profit of the company by subtracting expenses from gross profit (sales - cost of goods sold). Furthermore, the balance sheet lists the value of the assets, as well as liabilities. In simple terms, the main function of the balance sheet is to show the company's net worth by subtracting liabilities from assets. He said that the balance sheet does not report profits, there's an important relationship between assets and profit. The business owner normally has a lot of investment in the company's assets.

Weidenfeld & Nicholson (1970) considered profit as a reward to owner of capital but with the return to capital as an objective of a firm's activities. Weston (1978) mentioned that profits are the test of efficiency and a measure of control, to the owners, a measure of the worth of their investment, to the creditors the margin of safety, to the employees a source of fringe benefits, to the Government a measure of taxable capacity and the basis of legislative action; to the country profits are an index of economic progress, national income generated and rise in the standard of living. According to Pandey (1979) recent

experience in countries with totally planned economies indicates that economists are probably right in emphasizing the importance of overall profitability as a criterion for the efficient operation of an enterprise.

On the other hand, Walstedt (1980) in his book entitled "State Manufacturing Enterprises in a Mixed Economy: Turkish case" stated that profitability of an enterprise can be ascertained, if profit is analysed in terms of sales and investment. The return on sales, return on investment, and return on equity are the main measure of profitability. Schmalensee (1987) stated that to determine whether systematic changes in intra-industry profitability occurred over time so as to distinguish between an efficiency story and a collusion story about why concentrated industries had higher profit rates than other industries. Further, he found that large firms in general were more profitable than small firms within the same industry.

Based on the above review of literatures, we can say that various studies have been done on this area, but a detailed and comprehensive study has not yet been conducted in Sri Lanka context, especially in Telecom companies. Hence, the present study is initiated Profitability of Listed Telecom Companies: An Inter and Intra Comparison of SLT PLC and Dialog PLC Telecom companies with six (06) years accounting period from 2003 to 2008.

Research Methodology

1. Data collection

The secondary data was used for the present study during the six years of 2003-2008. The data was collected from the hand books of listed companies published by Colombo Stock Exchange (CSE), annual reports of the companies, journals and books.

The scope of the study is the telecommunication firms in listed companies in Sri Lanka. Now, there are two listed telecommunication firms operated in Sri Lanka. Therefore, to recognize the profitability, both of Sri Lanka Telecom PLC and Dialog Telecom PLC were taken.

2. Reliability and validity

Information was collected from annual reports and hand books of listed companies published by Colombo Stock Exchange. Therefore, the researcher was satisfied with the content and construct validity, then it was decided to continue the analysis.

3. Measurement

Secondary data were used to measure the indicators which are related to profitability. Here the indicators of profitability are as follows,

- Gross profit margin ratio = Gross profit/sales * 100
- Operating Profit Margin = Operating profits / Sales
- Net Profit margin = Net profit after tax/sales * 100
- Assets = Net profits after taxes / total assets * 100
- Return on common stock equity = Net income / Common stockholders' equity * 100

Hypothesis

Since the objective of this study is to compare the profitability of Telecom companies, the study makes a testable hypothesis.

- Dialog PLC has the higher profitability than industry average.

Results and Discussion

Profitability ratios designate a company's overall efficiency and performance. It measures the company how to use of its assets and control of its expenses to generate an acceptable rate of return. It is also used to examine how well the company is operating or how well current performance compares to past records of both telecom companies. There are five important profitability ratios that we are going to analyze: (1) Gross Profit Ratio (GPR) (2) Operating Profit Ratio (OPR) (3) Net Profit Ratio (NPR) (4) Return on Asset (ROA) (5) Return on Equity (ROE).

(1) Gross Profit Margin ratio

Gross margin is expressive of the company efficiency of raw material and labor during the working process. If any company has higher gross profit margin that company will be more efficiency to controls their raw material and labors. But a relatively low gross margin is definitely a danger signal. So it is most important for performance evaluation of Telecom companies. It can be assigned to single products or an entire company. It determines the gross profit to divide by net sales.

The gross profit margin ratio formula as following as;

Gross profit margin ratio = Gross profit/sales * 100

The gross profit margin ratios of the companies for the study period have been shown in the Table: 1.

Table: 1 The gross profit margin ratios of Telecom Companies (Ratio on percentage)

Name of the company	2008	2007	2006	2005	2004	2003	Average	SD
SLT	48.47	52.51	50.97	52.29	54.52	57.33	52.83	3.279116
Dialog	45.68	54.78	65.60	67.54	65.55	66.34	62.13	7.966629

Table: 1 shows that the gross profit of the SLT was 57.33%, 50.92%, 52.29%, 55.97%, 52.01% and 48.47% during the period from 2003 to 2008, which shows that gross profit margin has increased from 2004 to 2006. But there was a downward trend from 2007 to 2008. Similarly Dialog's gross profit was 60.24%, 65.53%, 65.54%, 65.65%,

58.78% and 45.08% from 2003 to 2008. This also shows that gross profit margin has slightly increased from 2004 to 2006. But there was a downward trend from 2007 to 2008. It is not a good sign for the companies. To increase gross profit margin they should try to decrease their cost of goods sold. As the average gross profit ratio of Dialog is 60.13% which is high compare with SLT, Dialog is the best performing than SLT.

(2) Operating profit margin

The operating profit margin ratio recognizes of the percentage of sales to exchange into all cost and expenses after remaining sales. The operating profit margin ratio is a measure of overall operating efficiency, incorporating all of the expenses of ordinary and daily business activity. A high operating profit margin is preferred. The operating profit margin gives the business owner a lot of important information about the firm's profitability, particularly with regard to cost control. It shows how much cash is thrown off after most of the expenses are met. A high operating profit margin means that the company has good cost control and/or that sales are increasing faster than costs, which is the optimal situation for the company. Operating profit margin is calculated as follows:

Operating Profit Margin = Operating profits / Sales

Table: 2 The Operating profit margin ratios of Telecom Companies (Ratio on percentage)

Name of the company	2008	2007	2006	2005	2004	2003	Average	SD
SLT	17.43	21.32	25.38	18.72	12.21	24.60	19.94	4.91012
Dialog	-1.82	29.65	42.25	40.57	38.16	35.67	30.88	16.23579

From the Table:2 Operating profit ratio of SLT decreased from 2003 to 2004, then increased from 2004 to 2006. After 2006 this showed a decreasing trend. Because that company has happened for inefficient use of operating expense. During those years the sales have increased but the ratio has failed to increase because of high operating cost. The operating profit margin of Dialog Company has suddenly decreased from 2007 to 2008 as direct cost for the company increased. This demonstrates that effort of the management to control operating expenses had been less successful. Average operating ratio of Dialog Company (30.88%) is higher than SLT.

(3) Net Profit Margin

The net profit margin is determined of net profit after tax to net sales. It argues that how much of sales are changeover after all expenses. This ratio is widely used as a measure of overall profitability and is very useful to proprietors. The higher net profit margins are the better for any Telecom company.

Net Profit margin = Net profit after tax/sales * 100

The gross profit margin ratios of the companies for the study period have been shown in the Table: 3.

Table: 3 The Net profit margin ratios of Telecom Companies (Ratio on percentage)

Name of the company	2008	2007	2006	2005	2004	2003	Average	SD
SLT	15.66	13.05	13.36	9.51	4.38	8.82	10.79	4.05065
Dialog	-7.94	27.58	39.40	38.88	35.95	38.24	28.68	18.46752

According to the Table:3 Net profit margin has increased from 8.82% to 15.66% in SLT during the period from 2003 to 2008 because the net profit and sales increased during that period. As a result this company is in standard position. There was variability in Dialog Company's net profit margin. Net profit margin ratio has slightly decreased in 2004 compare with 2003 and then increased from 2004 to 2006. Again this decreased from 2006 to 2008. Average net profit ratio of Dialog Company (28.68%) is higher than SLT.

(4) Return on asset ratio

The Return on Assets ratio is an important profitability ratio because it measures the efficiency with which the company is managing its investment in assets and using them to generate profit. It measures the amount of profit earned relative to the firm's level of investment in total assets. A return of 11% to 12% on total assets may be considered standard norm for industrial undertaking. The Return on Assets ratio can be directly computed by dividing net income by average total asset. (Kieso, Weygandt, Warfield, 2001). It finds out the ability of the company to utilize their assets and also measure of efficiency of the company in generating profits.

Return on Total Assets = Net profits after taxes / total assets*100

Table: 4 The Return on assets ratios of Telecom Companies (Ratio on percentage)

Name of the company	2008	2007	2006	2005	2004	2003	Average	SD
SLT	7.90	6.61	6.47	3.79	1.64	3.11	4.92	2.42
Dialog	-3.54	12.50	23.30	21.60	21.48	21.47	16.04	10.32

In the Table:4 we see that return on assets of SLT was 3.11%, 1.64%, 3.79%, 6.47%, 6.61% and 7.90% during the period from 2003 to 2008, which shows upward trend from 2003 to 2008. The higher the percentage, the better, because that means the company is doing a good job using its assets to generate sales. Dialog company's return on assets was 16.04%, 21.47%, 21.48%, 21.60%, 23.30%, 12.50% and -3.54% which shows a upward trend from 2003 to 2006, then a downward trend from 2006 to 2008. Average return on assets of Dialog is 16.04%, which is higher than SLT.

(5) Return on Equity

Return on Equity is computed by dividing net income less preferred dividend by average company stockholder equity. (Kieso, Weygandt, Warfield, 2001). It demonstrates how a company to generate earnings growth for using investment fund. It has some alternative name such Return on average common equity, return on net worth, Return on ordinary shareholders' fund.

Return on common stock equity = Net income / Common stockholders' equity*100

Table: 5 The Return on equity ratios of Telecom Companies (Ratio on percentage)

Name of the company	2008	2007	2006	2005	2004	2003	Average	SD
SLT	15.49	13.46	14.38	9.15	4.18	7.35	10.66	4.47
Dialog	-8.89	17.81	40.39	40.76	47.07	52.19	31.88	22.33

Table 5 shows that the return on equity of SLT has decreased in the year 2004 compare with year 2003. Then this increased from 2004 to 2008. It shows that the company is doing a good job using the investors' money. But return on equity of Dialog company decreased from 2003 to 2008. It means the company is losing efficiency in production process and also this falls in return on equity has a bad affect in common stock holder. Average return on equity ratios of Dialog Company is 31.88% which is higher than the SLT.

Table: 6 Average Profitability Ratios of Telecom Companies (in %)

Name of the company	Average GPR	Average OPR	Average NPR	Average ROA	Average ROE
SLT	52.83	19.94	10.80	4.92	10.66
Dialog	60.14	30.88	28.69	16.04	31.88
Industry Average	56.48	25.41	19.74	10.48	21.28

Table: 6 shows the average of profitability indicators for Dialog Company and SLT Company. All profitability indicators (average) are higher for Dialog PLC than SLT PLC from 2003 to 2008. On other hand SLT PLC has not been able to attain the industry average gross profit, operating profit, net profit, return on assets and return on equity. But it has succeeded to attain the standard norm for these ratios. Therefore, its profitability may be considered to some extent satisfactory. Dialog company's average profit ratios have been able to attain the industry average.

Conclusion

According to Walker (1974) the return on investment should be considered as the best measure of profitability. Further Velnamby (2005) also pointed out that Return on investment is the most suitable ratio to measure the profitability. From the above analysis we can conclude that SLT PLC has not been able to attain the industry average profit. Even though Dialog Company's net profit is low in 2008, the Dialog Company's average profit ratios are higher than the industry average.

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