The Determinants of Profitability for Kerjaya Prosepk

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Abstract

The construction industry as one of the most unsafe industry because it is highly exposed to variety of risk. An effective risk management system practise in the construction company will definitely reduce the risk exposure. The purpose of this study is to identify the relationship between the profitability performances of Kerjaya Perspek with exposure risk factor and macroeconomic factor. The second purpose of this study is to understand how the assets size of the company will affect the performance of the company as well. GDP, inflation rate and exchange rate will be utilized to see how the macroeconomic factor impact on the profitability of Kerjaya. The profitability ratio, liquidity ratio, financial ratio measured by using the financial data that obtain from annual report of Kerjaya from year 2011 to 2015. The data were analysed by using regression linear to evaluate the relationships between the variables. In this study shows only two variable which are ROE and D/E is significantly to ROA with the high impact to the profitability. However, liquidity, GDP, inflation rate, exchange rate and total assets size are not significant to ROA with the low impact to the profitability.

Keywords: Firm specific factors, liquidity risk, profitability and macroeconomic factor

1.0 Introduction

Construction sector in Malaysia was contributed large economy growth in term of gross domestic product (GDP) in the recent year and it was growing rapidly due to support by civil engineering sub sector, particularly in the transport and utilities, and oil & gas areas in year 2016. According to Department of Statistics Malaysia (2016), the value of construction grew 8.1% as compared to 2015. Construction sector was expected continue slow growth in this year due to the factor of slowing economy, property gain taxes and depreciation of ringgit Malaysia. Nevertheless, the implementation of large scale construction investment project such as Rapid in Johor, Klang Valley Mass Rapid Transit (KVMRT) and Light Rail Transit (LRT) reflect increase the modernisation method and practise in construction sector. Thus, it contributed a positive consequences to Malaysia's GDP.

Construction industry is highly exposed to variety of risk and uncertainty compared to the others industries due to its characteristics of complexity, dynamic and time consuming. In general, whole process of construction project requires enormous amounts of turnover rate, resources, expertise from different fields and skills as well as coordinate with complex activities. Due to the complexity of construction, existence of market fragmentation and competitive market, hence construction industry as one of the most dangerous industries (Einarsson, 1998) The construction sector subjected to financial risk, time risk, liquidity risk, input risk, and sensitivity to economic downturn, political and regulatory factors. The financial risk and time risk are the significant risks in the Malaysian construction sector and impact on project performance in terms of cost, time and quality. The critical effects of risks are failure to meet quality requirement, non- completion of the project within specific time period and reduce the profitability of the construction company.

Kerjaya Prospek (M) Sdn Bhd is a premium construction contractor with customer portfolio including SP Setia, Eco World and E&O. Kerjaya had achieved good performance in many property construction project especially 222 Residency. Recently Kerjaya was carried some ongoing project and expected completed on the next coming year such as Vista Residence at Genting Highlands and Gohtong Jaya, Seri Tanjung Penang and etc. The revenue of Kerjaya expected to increase over the next two years with estimated of 13 – 18%. The major revenue was contributed by construction segment and property revenue start to kick in FY17 because GDV of Gohtong Jaya project was estimated of RM150million and RM135 million respectively in year 2017 and 2018.

2.0 Literature Review

In the business environment, maximize the level of profit as the main objective for all the business to sustain and growth the business. According Wright (1970), the profitability define the function of three factors: (1) sales volume (2) the capital investment and (3) the profit was earned. The profitability used to measure the ability of the company to generate earnings compared to its expenses and costs.

In addressing the relationship between size and profitability of a company, Nguyen (1985) found that firm size and profitability have positive relationships. The profitability is largely independent of variation in size of the company, which the larger company normally will generate higher profit compared to the smaller asset size company. Spedding (1977) define that inaccurate in cash management and forecast resources needed, both being related to the high levels of uncertainty in the industry. Therefore, sometimes the larger companies may more profitable than smaller companies because of more efficiency in terms of management strategies and cash management policy. In short, the business management practice itself is the main determinant of the profitability of the companies rather than assets size of the company.

Waemustafa and Sukri (2016) found that there was no significant relationship between the credit risk and assets size of the company. The findings shows that conventional bank have negative relationships between size and credit risk, however it contrary to Islamic bank that shows positive relationship to credit risk.

Elsas et al., (2003) define the relationship between risks and return which low risks associated with low returns whereas high risk associated with high returns. However, there are no guarantee that the higher risk necessary receive the higher returns and it is a common misconception by the investor. Risks means that investor receive higher potential returns and also means assume higher potential losses. Waemustafa and Sukri (2016) found that there have positive relationship between liquidity and profitability which mean that the higher the liquidity ratio (indicate lower liquidity risk) and at the same time the profit was able to generate by using these excessively liquid assets.

In generally, the low level of profit generate by construction company is related to fierce competition in the market. According to Southwell (1970), Lenard and Heathcote (1990) have remark that there have correlation between profitability and competition. Based on standard economic theory, increase in competition should result in lower profitability of company. In the free market, it was forcing the contractors bid the tender with the lowest mark-up value in order to obtain the tender and maintain the share market. Therefore, it can conclude that it should implement a good management practise and monitoring system otherwise the competition risk will affected the profitability and even kick out of the business.

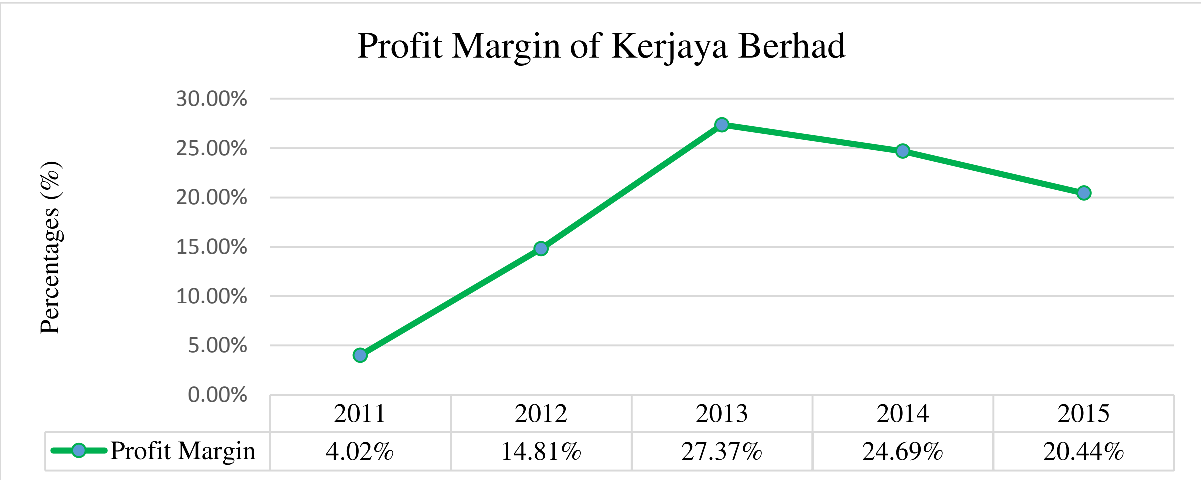
3.0 Descriptive Analysis

Table Result 1.0: Descriptive Statistics

Variable	Mean± Standard Deviation	N
ROA	0.11649±0.04417	5
Acid Test	1.2326±1.00202	5
Debt/Equity Ratio	0.53774±0.29567	5
ROE	0.17786±0.08289	5
Total Assets	120778320±24984216	5
GDP	5.288±0.53677	5
Inflation Rate	2.44332±0.66933	5
Exchange Rate	3.46000±0.49168	5
Index Score	0.55556±0.00000	5

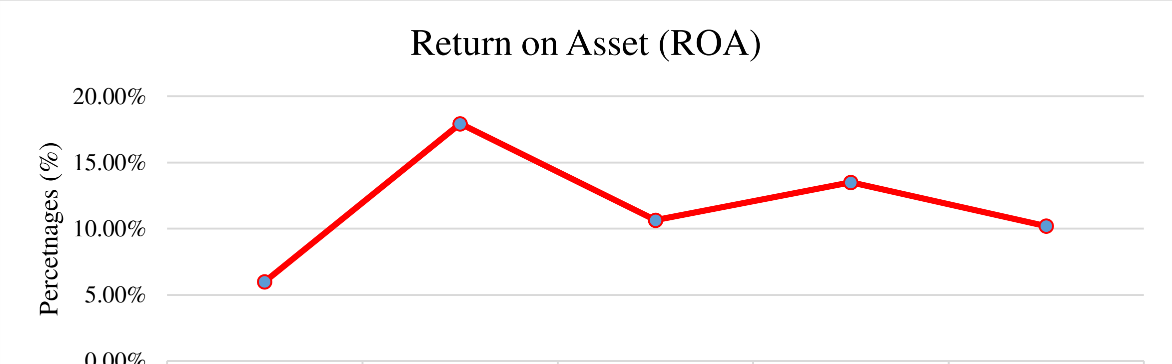
The mean of ROA and ROE of Kerjaya Company is low which is showing a bad outlook but at the same time the standard deviation of ROA and ROE also shows low of value. The standard deviation of acid test ratio was high which indicated that the Kerjaya experienced variation in term of liquidity risk exposure. The mean of the D/E ratio is 0.5 which is showing that Kerjaya adopt 50% of the capital financing to run its business operation by using debt. The study include three macroeconomic variable for Kerjaya profitability performance which GDP mean of 5.288, inflation rate mean of 2.44332 and exchange rate mean of 3.46.

3.1 Profitability



Line Graph 1.0: Profit margin of Kerjaya Berhad

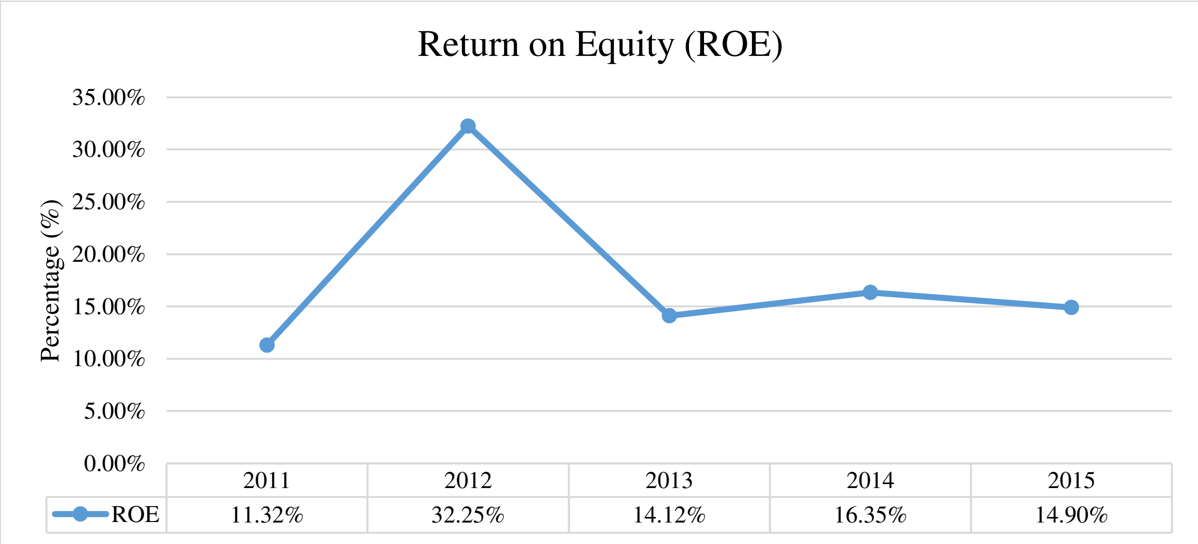
The graph 1.0 above is showing the profit margin of Kerjaya from year 2011 until 2015. The profit margin used to measure how much the gross profit earned by a company compared to the total revenue. Kerjaya Prospek Group's profit margin was increase dramatically from 4.02% in 2011 to 27.37% in 2013. This shows a good sign performance of Kerjaya in generate profit in the operating business throughout these years. However, this situation is no longer existence afterward, whereby profit margin was keeping decreased from 2013 to 2015 which from 27.37% to 20.43% respectively.



	2011	2012	2013	2014	2015
ROA	5.99%	17.93%	10.64%	13.50%	10.19%

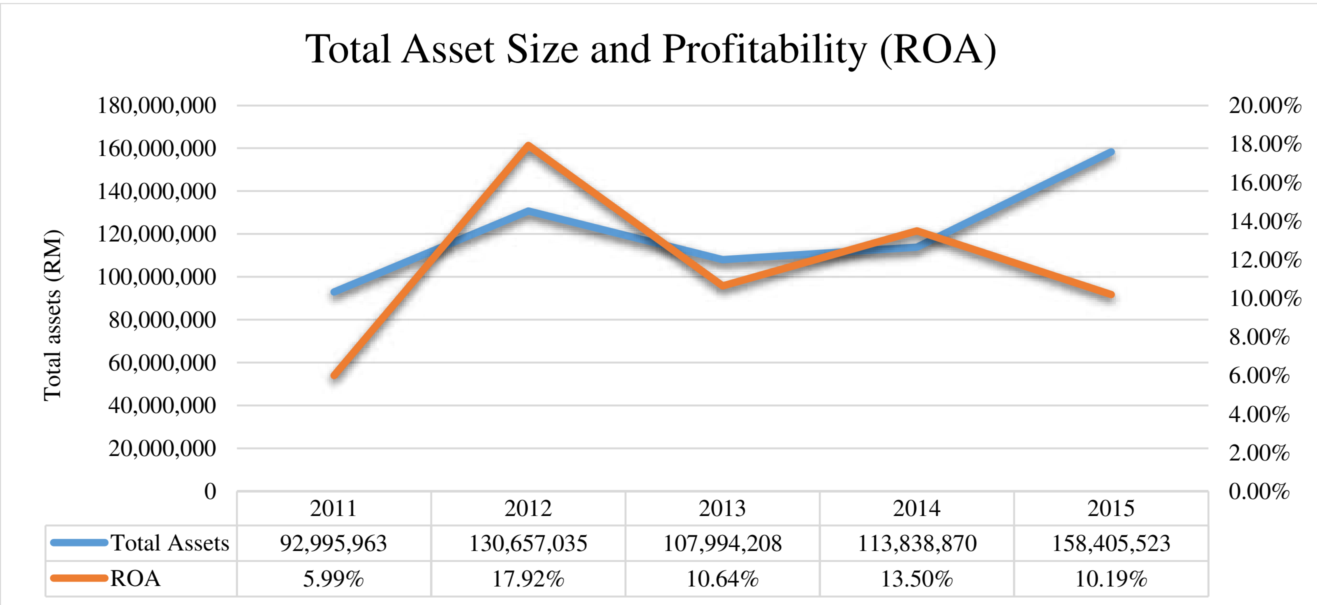
Line Graph 2.0: ROA of Kerjaya Berhad

Return on assets (ROA) is a primarily indicator of how profitable a company is relative to its total assets. ROA gives an idea as to how efficient management is at using its assets to generate earnings over a certain period of time. The higher of ROA, the more efficient in managing its assets to generate income for company. Based on the graph 2.0 above, it shows fluctuate pattern of the profitability level of Kerjaya from year 2011 to 2015. ROA has risen about 21% within 1 year from 2011 to 2012. Nevertheless, Kerjaya may have problem in converting the assets into net earnings in 2013 as compared to previous which decreased to 10.64%. In this scenario, it illustrates a very low return on the assets invested. Kerjaya manage well in their asset in 2014 as the ROA was increase to 13.5%, however it dropped again to 10.19% in 2015. From the trend of the ROA, it was fluctuate and Kerjaya may need to improve in the assets management aspect to generate some earnings from its existing assets.



Line Graph 3.0: ROE of Kerjaya Berhad

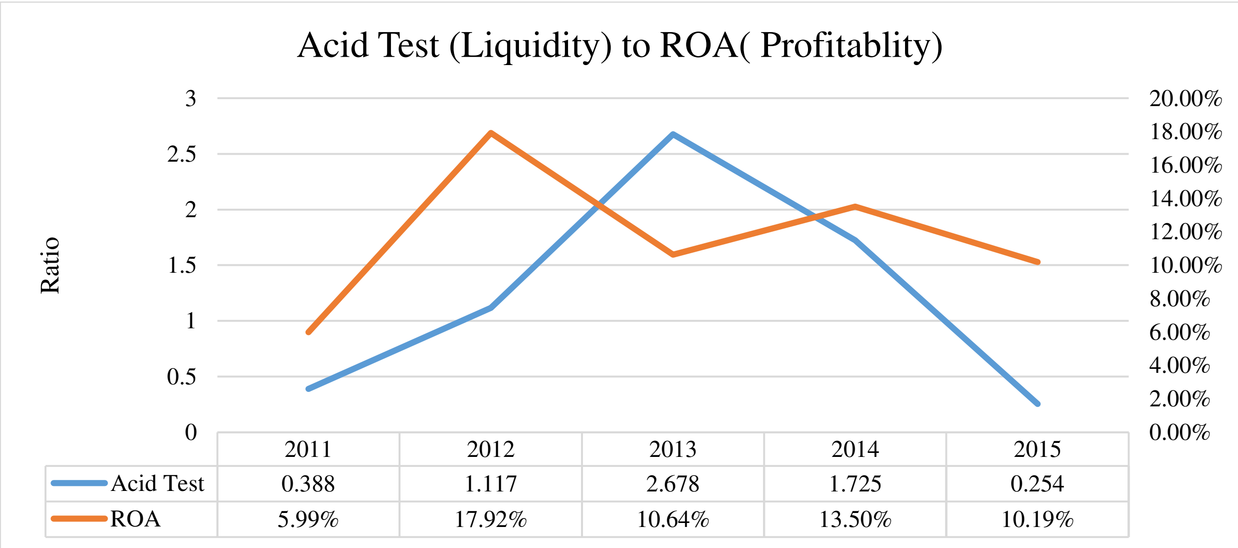
Return on equity (ROE) evaluate a company's performance by utilizing shareholders capital contributed to the company. ROE shows increase dramatically in year 2011 which is from 11.32% to 32.25% in 2012. After that, it shows gradual trend between year 2013 until 2015 in the ranging between 14.14% to 16.35%. Thus, it is mean that Kerjaya does not do its job well in protecting the value of the shareholders so that it would create the unexpected condition happens which would affected the shareholder's wealth or losses.



Line Graph 4.0: Total assets and Profitability of Kerjaya Berhad

The size of a company is determined by how much the total assets owned by a company. From the above line graph 4.0, the assets size of Kerjaya was shows fluctuated trend which from RM92, 995,963 was increased to RM130, 657,035 in 2012, decreased in 2013 and increased again afterward to amount of RM 158,405,523 in 2015. Over the year, the asset size trend to profitability was correlated to each other and both of them have same movement pattern which increase in asset size will react the increase in ROA. In other word, Kerjaya is effectively to use its assets to generate the profit.

3.2 Liquidity risk

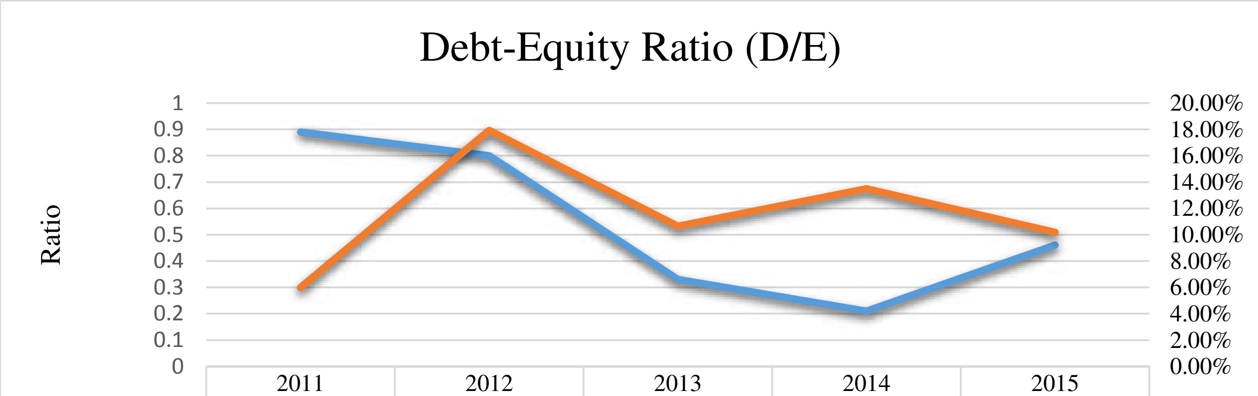


	2011	2012	2013	2014	2015
Acid Test	0.388	1.117	2.678	1.725	0.254
ROA	5.99%	17.92%	10.64%	13.50%	10.19%

Line Graph 5.0: Acid test ratio of Kerjaya Berhad

The acid test ratio is an indicator to measure the ability of a company to meet the short term obligation from its current assets. The higher ratio of current ratio means that the liquidity position of a company is better, which mean the company exposure lower liquidity risk in the operation business. Based on the line graph 5.0, it shows increase trend which the acid test ratio of Kerjaya was increased dramatically from 0.388 to 2.679 in 2013, and then dropped sharply in 2015 which posted out the every ringgit of current assets are only available for every 0.254 of current liability that owed by Kerjaya. This may shows an unhealthy sign for investor and exposure higher liquidity risk in 2015 which Kerjaya may unable to pay off the current liability by using current assets that are available in the company. However, the liquidity management of Kerjaya was improved which is current ratio was stand above the optimal ratio of 2.0.

3.3Financial risk

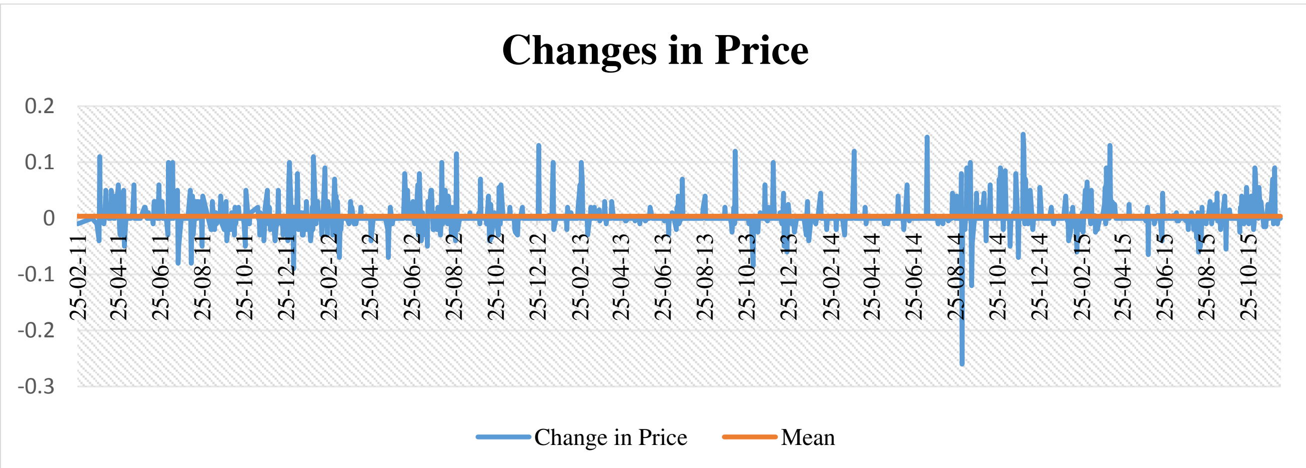


	2011	2012	2013	2014	2015
D/E ratio	0.89	0.8	0.33	0.21	0.46
ROA	5.99%	17.92%	10.64%	13.50%	10.19%

Graph 6.0: Debt-Equity ratio of Kerjaya Berhad

Debt to equity ratio is also known as financial leverage, which measure company's financial leverage (financial risk). The D/E ratio indicates how much debt a company is using to finance its assets relative to the amount of value represented in shareholders' equity. The higher ratio mean that higher financial risk of a company. The D/E ratio of Kerjaya was show decrease trends that is from 0.89 in 2011 to 0.21 in 2014 and rose to the ratio to 0.46 in 2015. It is mean that Kerjaya was gradually shift their capital structure towards from debt financing to capital financing between year 2011 until 2014. However, Kerjaya was using more debt financing to operate their business in 2015. This implied that Kerjaya will exposure higher financial risk in the event of default to make repayment to debtor compared to previous year.

3.4 Equity Price risk



Graph 7.0: Change price of Kerjaya Berhad

The above line graph 7.0 was shows the changing of the stock price of Kerjaya from year 2011 until 2015. The average changing stock price for Kerjaya along these 5 year is RM0.004 per unit stock which represent red line in the graph. We can measure the volatility of the stock price changing in respond of the changing market condition by using standard deviation. The higher value of standard deviation means higher volatility of stock. The standard deviation of Kerjaya's stock is 2.60%. From the graph 7.0 above, we can notice that Kerjaya stock was quite volatile in the respond of market movement which is showing the fluctuate trend throughout the 5 year.

4.0 Discussion and Recommendation

Table Result 2.0: Correlations Matrix Kerjaya Prospek

Pearson Correlation	ROA	Acid Test	D/E Ratio	ROE	Total Assets	GDP	Inflation Rate	Exchange Rate	Index Score
ROA	1.000								
Acid Test	.279	1.000							
D/E Ratio	-.123	-.608	1.000						
ROE	.906	.018	.302	1.000					
Total Assets	.372	-.363	-.172	.327	1.000				
GDP	.580	-.028	-.094	.451	-.048	1.000			
Inflation Rate	-.582	-.145	-.056	-.646	-.620	.300	1.000		
Exchange Rate	-.210	-.386	-.420	-.350	.760	-.224	-.090	1.000	
Index Score									1.000

Table Result 3.0 Coefficient Stepwise Regression analysis for risk of Kerjaya and Macroeconomic factor Determinant to Profitability

Variable	Beta	t	Sig.
ROE	1.037	16.427	.004
Debt/Equity Ratio	-.436	-6.900	.020

Table Result 4.0 Excluded Variable of Kerjaya Determinant to Profitability

Model	Beta	t	Sig.
Acid Test	-.008[c]	-.069	.956
Total Assets	-.051[c]	-.647	.634
GDP	.097[c]	4.344	.144
Inflation Rate	.114[c]	3580.953	.000
Exchange Rate	-.040[c]	-.447	.732

4.1.1 ROE to Profitability

ROE is an indicator to evaluate a company's profitability performance by utilizing shareholders capital contributed to the company. It also give an idea as how efficient management is using its capital to generate earnings over a certain period of time. From the table result 2.0 and 3.0, there shows ROE is the significant variables to determine the profit of company with the value of correlation 0.906 and the p value of 0.004 which is $p < 0.01$. The variation of ROE provided large influence to profitability with the t-value of 16.427.

4.1.2 Financial leverage risk to Profitability

In the result of table 2.0 shows that financial leverage (D/E ratio) have negative and significant relation to profitability with the with the p value of 0.020 which is $p < 0.01$. The negative relationships between financial leverage and profitability means that more debt financing using by Kerjaya will exposure higher default risk and the profit might decrease in value. In other words, the debt financial structure of a company will influence its overall profit performance as exposure high financial risk. This is especially relevant to the company that engage in construction industry because construction project required invest in huge amount of capital. Therefore, most the construction company will looking for external funding in the financial market in order to ensure smoothly the business operation. In addition, debt financial structure has lower impact to the profitability as compare to ROE and inflation rate with the t-value of -6.90.

4.1.3 Liquidity to Profitability

The above table2.0 shows the result of Pearson Correlation of Kerjaya's financial ratio. The result shows that liquidity (acid test ratio) have positively and insignificant relationship with

ROA because of acid test ratio with p value > 0.10. In addition, the impact of changes liquidity to profitability is not severe as compared to asset size and exchange rate with the t-value=-0.69. The positive relationship between liquidity and profitability means that increase the value of acid test ratio will lead to increase the profitability of Kerjaya. In other word, Kerjaya implement conservation liquidity management method by reserve certain amount of cash and simultaneously Kerjaya is able utiltize its own assets to generate profit. This result was consistent and supported with the previous study Ghazali (2008) who found that insignificant positive relationship between liquidity and ROA. However, finding result of Waemustafa & Sukri (2016) and Zaid, Ibrahim & Zulqernain (2014) shows positively significant relationship with ROA and liquidity.

4.1.4 Assets size to Profitability

In the study conduct by Nguyen (1985) indicate that there are positive relationship between profitability and the size of the company which the profitability is largely dependent of variation of firm size. Similarly, the result of regression in table 2.0 was consistent with the previous study. The assets size have positive and insignificant relation to the profitability with the p value > 0.1, which is 0.634. This indicated that Kerjaya was effectively in management its assets to generate the profit. To conclude that, the managerial efficiency in term of assets will affect the profit level of the company. The variation of assets size will have little influence to profitability with the t value of -0.647.

4.1.5 Macroeconomic factor to Profitability

The finding result shows that all of the macroeconomic factor was tested with the p value >0.01 which means that insignificant relation to the profitability. GDP variable shows positively insignificant relation which implied that the growth of GDP of Malaysia will positive effect on the profit of Kerjaya in the particular year. The influence of GDP to profitability is relatively high with the t-value of 4.344 as compare to exchange rate and acid test. On the other hand, exchange rate and inflation rate variables show negatively insignificant relation to profitability. In addition, the impact of changes in inflation rate bring worst severity to profitability which the t-value=3580.953. It means that in inflation economic condition will drive up the product price and resulting low demand and higher the cost of production at the same time, eventually bring negative effect on profit.

4.2 Recommendation

4.2.1 Improvement on Liquidity Management

The liquidity management is very important for each company because it might bring negative consequences such as low profit in investment, insolvent even bankrupt in the event of failure in managing the liquidity problem. Therefore, Kerjaya's financial department must ensure the company have adequate cash reserves on account frequently to meet current obligation and ensure the business operation run smoothly. Basically, the construction project was lengthy and the funds tied up in working capital, thus the cash flow management might be affected. If the liquidity ratio was lower than optimal ratio level, 2.0 then the company should take some initiative strategy to improve the cash flow and liquidity management because it shows unhealthy signal to investor and exposure higher liquidity risk. However, too high current ratio also does not necessarily indicate that company is in a state of financial well-being. Kerjaya should well manage and allocate the excess cash in purchasing advanced equipment or diversified investment portfolio in order to generate income from its current assets effectively and efficiency.

4.2.2 Optimal Capital Structure

Kerjaya Berhad adopt debt financial structure in its capital structure policy to operate their business. In the finding result shows that D/E ratio have negative and significant relation to profitability. The higher of debt financing, the lower of the profit earned by Kerjaya. Moreover, debt financial structure have quite high impact to the profitability. Therefore, Kerjaya should made an appropriate financing decision on the mixture of the equity and debt capital to develop an optimal capital structure. Kerjaya should adopt the equity financing by issue more common stock to public rather than heavily reliance on outsource funding.

4.2.3 Derivatives Instruments to Mitigate Market Risk

To reduce the market risk encountered by Kerjaya, derivative instrument is a tool that can used to hedge the risk exposure which include interest rate risk, equity price risk, foreign currency risk and commodity risk. Kerjaya can enter in the derivative market to hedge the risk and manage the fluctuation of uncertainty interest rate as Kerjaya was using debt financing to operate the business. In order to reduce such risk, Kerjaya can either utilise futures or option comtract to 'lock in' the foreign exchange rate or raw materials price. In this way, Kerjaya able to protect themselves against the risk of unfavourable those rate and price of raw materials change, this is because such fluctuation will adversely harm the cash flow of Kerjaya if it goes beyond Kerjaya's expectations. Therefore, derivative instrument is one of the tools that can used to trade-offs the risk and loss in the physical market and future market.

5.0 Conclusion

Construction is one of the industry that highly exposed to variety of risk especially financial risk and liquidity risk. This is same under the situation encountered by Kerjaya that expose to liquidity risk, market risk and financial leverage risk. All element of risk will influence the performance of the construction project as well as the company's financial wealth. Therefore, risk management must become continuing activities in each of the construction project throughout the life of the project.

Kerjaya's financial performance was out of the expectation of the shareholders with unhealthy signal which profit margin, ROA, ROE and current ratio was decrease in 2015. Other than that, Kerjaya was more focus on debt financing structure to operate their business in 2015, whereby the D/E ratio was higher than previous year. The changing of stock price of Kerjaya also more volatile in the respond of changing market condition, that Kerjaya exposure high market risk.

From the finding, ROE and D/E ratio variables have significant relation to profitability (ROA) and the rest variable was shows non-significant relationship. Exchange rate variable have the highest impact to profitability as compared to others variable. Thus, this is very important to understanding the correlation between ROA and other variables because it allow the company manage their profit performance and company's wealth as well. Liquidity management and capital structure decision should put into consideration of this company in order to improve the profitability in the future year.

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