Internal Factors Affecting the Profitability of Iranian Kosar Financial Credit Institutions Branches

Farahnaz Jangoo*

Department of Accounting, Ayatollah Amoli Branch, Islamic Azad University, Amol, Iran

ABSTRACT: This research intends to study effective internal factors and how affecting profitability of Kosar financial credit institutions branches. The research method used in this study is based on descriptive-analytical method and survey category. In terms of relationship between variables, this study is correlation type and subcategories of regression analysis. The statistical population of this study consists of 21 branches of Kosar financial credit institutions (beneficent young people) in the Province of West Azerbaijan during the years of 2011 and 2012. The data of this study is extracted from branches’ financial statements. Statistical methods for testing hypotheses included Cronbach’s Alpha, analyzing correlation and regression that were performed and calculated through SPSS software 20. According to the results of this study, variables such as: assets mix, debts mix, cost management, liquidity management, and credit risk management has positive and significant strong relationship with profitability of Kosar financial credit institutions branches.

Keywords: Financial credit institutions, liquidity management, credit risk management, costs management.

INTRODUCTION

Banks are vital arteries of each country’s economy. Banks and financial credit institutions try to increase the efficiency throughout the world. Banks should play an important role to attract and encourage people to save, deposit small capitals and invest them in manufacturing and services fields. Banks as money market besides stock market are a kind of capital market are considered as a part of country’s financial market, as the stream and circulation of blood guarantee the body life, also banks existence are considered as a guaranty for country’s economic life (Shadkam, 2001). Banks and financial credit institutions are one of the important factors in monetary politics and executives for the economic decisions of the Central Bank. Banks and financial credit institutions have an effective role in adjusting economic sectors as well as helping to stabilize economy of macro level with contracting and expanding of bank credits and directing the funds from one part to another. Since the lack of necessary development of capital market in Iran’s economy, banking is more important and practically, banks are responsible for the long-term financing (Shadkam, 2001).

Nowadays, banks and financial credit institutions provide a variety of services for their clients. The range of these services consists of deposits attraction and loan granting to the new services offered by World Wide Web. Increase in efficiency and providing a variety of services in the least possible time are the expectations that banking network of the country has faced them, in this regard, efforts such as implementation of SHETAB plan (interbank information exchange network) and electronic banking in the banking system of the country have been designed and implemented. Banking system can provide country’s growth and economic development besides making production, employment and fulfilling its social responsibilities through directing resources to the productive and service sectors. Areas for banks’ activity include three parts that are mobilizing resources, allocating resources, and providing services (Esmaeilzadeh Mogherri, 2009). Therefore, evaluating and identifying banks and financial credit institutions’ performance for implementing each mentioned responsibilities can provide a range of current strength and weakness; since banks and financial credit institutions as well as other economic enterprises are looking for profitability (Jones, 2007). To achieve this important goal, identifying effective variables is required. Factors affecting the profitability process of the banks are divided into two categories: internal factors, and external factors. Internal factors are under branches management control and external factors are out of management control and affected by macro environment.

*Corresponding Author:
Email address: university1366@gmail.com
As mentioned, internal factors are authorized by branches management and so, these factors reflect management policies and tactics that present in the areas of resources allocation and management of assets and liabilities, liquidity management, and costs management (Ouni, 2008). According to the results of Vakilian (1999), presenting financial ratios along with financial statements have informative increasing effect for users, even without providing information about industry average. Esmaeil pour (1988) in a study titled “limitations of using the financial ratios for evaluating “firm performance” suggests that financial reporting necessity comes from requirements and user’s informative demands of financial statements somehow follow interests in the firm. Also, Irvani (2002) concluded that the ratios of profitability and activities are related to returns at 95% confidence level, and therefore, they can change the stock prices. On the other hand, Sasan Miar (2006) concluded that ratios based on the statement of cash flows have informative increasing effect on the ratios based on balance sheet and statement of profit and loss. Reza nejad (2011) has conducted another study titled “financial ratios of performance in the banks”. The results of his study show that financial ratios are the figures’ communicative tongue in the financial statements of the banks that disclose lots of inexpressible for financial analysts by creating significant relationship between information.

Goudarzi (2008) studied the effect of electronic banking expansion on the profitability of Iran’s commercial banks and results showed that increasing the number of ATM of each bank has positive effect on the profitability of that bank and this impact has increased after joining the banks to the SHETAB system. Kordestani (2006) concluded that profits and cash flows observed aren’t useful for predicting cash flows of most firms under study, but adding profit as an independent variable to the model of the cash flows prediction has additional information. The Baghersi’s findings (2011) show that among the internal factors, efficient management of the costs, assets, liquidity management and capital and among the external factors, economic growth have positive and significant relationship with profitability, and the rate of inflation has an inverse effect on the profitability by low insignificant.

The results of Hoseini (2012) show that the amount of profitability has direct relationship with profit margin and the rate of economic growth and an inverse relationship with the rate of inflation. The results of Atansagloo et al (2008) suggested that variables of capital, productivity growth, and costs management have positive relationship with profitability. Meanwhile, there is a positive relationship between the predicted inflation variable and profitability because of applying reduction of deposits interest rate before reduction of loan interest rate and size and bank ownership variables don’t have significant impact on bank profitability. The results of Kasmeydo (2008) indicate that capital quality factor has positive and significant effect on the bank profitability, and size factor has positive and insignificant but slight effect on it, if we only enter special banking variables, and positive and significant effect, if we enter macroeconomic and financial market structure variables. Also, the results of Kabir and Bashir (2004) suggest that profitability scale is directly related to capital proportion increase and inversely to loan proportion increase. Also, the results of Ramlal’s study showed that capital impacts positively and significantly on profitability that’s because of banks’ further ability to increase the power of crediting and finally, gain profit.

Meanwhile, West Azerbaijan province is one of the boarder and tourism provinces of Iran and it’s a place for major industries such as cement, agriculture, mining, steel etc. need to support in crisis situations financially. Many institutions and funds exist in West Azerbaijan province that can absorb capital better and be considered as a rival for the banks since they don’t have banks limitations. On the other hand, existence of state banks has created a serious threat for private banks. According to the above, studying and evaluating clients’ preferences for selecting banks as well as identifying the most important factors affecting profitability of the credit institutions are necessary. Therefore, in this study, it has tried to evaluate the internal factors affect financial credit institutions’ profitability to make step to resolving problems related to the advancement of financial credit institutions, realizing the clients’ demands, preferences and meeting them. And this study seeks to answer this question that what are the internal factors affecting profitability of Kosar financial credit institution?

**METHODOLOGY**

**Research hypothesis**

- There is a significant difference between the amount and type of deposits and branches’ profitability.
- There is a significant relationship between the amount and type of facilities and profitability of institution branches.
- There is a significant relationship between liquidity management and profitability of institution branches.
- There is a significant relationship between costs management and profitability of institution branches.
- There is a significant relationship between the management of granted funding collection and profitability of institution branches.
- There is a significant relationship between the size of branches and profitability of institution branches.
- There is a significant relationship between the employees’ education and profitability of institution branches.
Research method

The present study is applicable in terms to objective and to do so, the method of descriptive-analytical research and survey category are used. In terms of variables’ relationship, this study is of correlation type and subcategories of regression analysis. To collect data, branches’ financial information is received completely.

Data collection

Library method: to collect research data that in this part, a part of our work is done theoretically that in this part books, articles, treatises and researches, and also reference to Documentation Center of Iran and computer searching are used for achieving to abroad articles and treatises. Field method: financial statements and extracted statistics from the reports of Kosar financial credit institution branches (the former beneficent young people) in the province of West Azerbaijan.

Research variables

To evaluate factors affecting the profitability of institutions branches, returns of assets (profit ratio before taxes to overall assets ROA) is used as a dependent variable, and indices of type and amount of payable facilities, type and amount of deposits, liquidity management, costs management, credit risk management, size, education of employees are used as independent variables.

Variable measurements

The bulk of bank assets comprise facilities granted to the clients. The ratio of total granted facilities value to overall assets is a measure for evaluating liquidity of the bank’s credit sources so that the higher this ratio in banking system, the higher the bank’s liquidity. In this study, to evaluate the type and amount of each one for profitability, the ratio of tasking facilities, non-tasking facilities, funds managed to the assets and facilities capitation (total remained facilities to the number of branch employees) are used as indexes of assets management.

Non-tasking facilities

Internal banks sources is a financial supplier of these credits that is payable in the framework of bank’s internal regulations by using available resources.

Tasking facilities

Its financial resources supplier is the credit that is specified in line with the specific objectives of annual budget law to be allocated for different parts of economy every year and that announced by the Central Bank to performing to the operative banks.

Type and amount of deposits

Deposits are considered as the major banking network resources by which the power of branches’ lending will be strengthened. Since institution is a private bank, the greater amount of gathered resources from deposits, the better management of the liabilities. Thus, in this regard, in the present study the balance ratio of current, saving, short-term, long-term (long-term and general special securities) and public account to total assets is used to evaluate the type and amount of these debts impact on bank profitability.

Indexes of liquidity management

One of ratios used in liquidity management is self-reliance ratio. This ratio is obtained by dividing the balance of branch’s total granted facilities to the total public deposits. Whatever it’s less than one, it will represent desirable situation, and if it is more than one, it indicates an increase in bank borrowing (Rashidi et al, 2010). Given that borrowing from the Center indicates improper management of liquidity in branches and thereby, financing costs are imposed to the branches, so the ratios of self-reliance, financing costs to the overall assets, and Center account balance to the overall assets are used to evaluate and examine how liquidity management affects the profitability. It is expected that, proper liquidity management has a positive impact on bank’s profitability.

Indices of cost management

One of the main components of total costs in banking system is interest expenses. Interest expenses are paid by the bank to the clients because of public interest-bearing deposits. The ratio of total interest expenses value to the overall assets is used to evaluate and test the impact of interest expenses on bank’s profitability and it’s expected to have a negative effect on profitability. Given that administrative and personnel costs and depreciation included in the bulk of branches expenses and amount of these expenses represents the quality of costs management through the bank’s branches, therefore, the ratio of total administrative and personnel costs value and depreciation to the overall assets are used as a measure of cost management, and it’s expected to have a negative effect on profitability.
Indices of credit management

The amount of credit risk is one of the most important and effective indicators in credit risk, and it’s obtained from the sum ratio of past maturity, accrued and bad debt dues on total facilities balance. When resulting number is closer to the zero, it represents improvement in the branch’s collection situation and suggests average period of desirable collection and fund flow in the bank and proper facilities payment by the branches (Rashidi et al, 2010). Given that branch of the bank can decrease its credit risk indicator by increasing the fraction denominator mentioned and but actually, their dues aren’t reduced. The collection ratio and bad debt expenses ration to the assets are used as another index of credit management. The higher collection ratio and the lower the credit risk and the less the ration of bad debt expenses to the assets, the better the credit risk management.

Size

Total assets of an institute consist of its common and virtual valuable belonging. These assets are classified into two general categories of tangible assets (real estate, machinery, equipment etc.) and intangible assets (goodwill, product patent etc.). It’s noteworthy that banks’ total assets represent their size, and it’s obvious that the greater the total assets value, the larger the so-called bank size. To evaluate the effect of institution’s branches size on their profitability, logarithm of total assets is used in this study because of this variable’s value compatibility to the other financial ratios in the regression model. Bank’s major assets include granted facilities, receivables from state, fund and banks’ account, movable and immovable property, and intangible assets.

Branch size = Log (sum total assets)

Employees’ education

In this study, the employees’ average education of each branch is used as an independent variable. To calculate the average education of employees, the number of persons having a certain degree in each branch is multiplied to the coefficient of that grade importance and the sum is divided by the number of branch’s employees. Coefficient of employees’ importance of education is considered as followings:
Diploma (1), A.D (2), B.A (3), M.A (4)

\[
\text{Average of employees education} = \frac{\text{Total score for employees' education per branch}}{\text{The number of employees per branch}}
\]

RESULTS

Table 1. Correlation coefficient of deposits types with profitability of financial credit institution.

<table>
<thead>
<tr>
<th>Variable</th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current account ratio to asset</td>
<td>0.041</td>
<td>0.187</td>
<td>0.034</td>
</tr>
<tr>
<td>Saving deposit ratio to asset</td>
<td>-0.148</td>
<td>-0.152</td>
<td>-0.176</td>
</tr>
<tr>
<td>Short-term ratio to asset</td>
<td>-*0.387</td>
<td>-*0.388</td>
<td>-*0.397</td>
</tr>
<tr>
<td>Long-term ratio to asset</td>
<td>0.291</td>
<td>0.261</td>
<td>0.245</td>
</tr>
</tbody>
</table>

*Significant level at the probability of 0.05%

Correlation Coefficient of deposits types with profitability of credit institution are presented in table 1. Therefore, during the studied years of Pearson correlation coefficient, there isn’t a meaningful relationship between currents deposits ratio to the asset and profitability, saving deposits ratio to the asset and profitability, and also long-term deposits ratio to the asset and profitability, but there is a negative and significant relationship between short-term saving deposit ratio to the asset and profitability at the probability of 0.05 %. So, according to the results, the research hypothesis based on existence of relationship between the amount and type of deposits and branches profitability is confirmed.

Table 2. Correlation coefficient of paid facilities types with profitability of credit institution.

<table>
<thead>
<tr>
<th>Variable</th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>Non-tasking facilities ratio to assets</td>
<td>0.325</td>
<td>-0.243</td>
<td>0.185</td>
</tr>
<tr>
<td>Tasking facilities ratio to assets</td>
<td>-*0.423</td>
<td>-*0.323</td>
<td>-*0.317</td>
</tr>
<tr>
<td>funds managed ratio to asset</td>
<td>-*0.224</td>
<td>0.276</td>
<td>-*0.245</td>
</tr>
<tr>
<td>Paid facilities capitation ratio to asset</td>
<td>0.079</td>
<td>0.205</td>
<td>-*0.383</td>
</tr>
</tbody>
</table>

*Significant level at the probability of 0.05%
Correlation coefficient of paid facilities types with profitability of credit institution is presented in table 2. Therefore, during the studied years of Pearson correlation coefficient, there is a positive and significant relationship between non-tasking facilities ratio to the asset and profitability at the probability of 0.05% in 2010, but there is not a significant relationship during the years of 2011-2012. There is a meaningful relationship between the asset tasking facilities ratio and profitability at the probability of 0.05% in every three years. Also, there isn’t a meaningful relationship between managed funds facilities ratio of the asset and profitability, but there is a negative and significant relationship between paid facilities capitation ratio and profitability at the probability of 0.05% in 2012; however it was insignificant during the years of 2011-2012. So, according to the results, the research hypothesis based on existence of relationship between the amount and type of facilities and profitability is confirmed.

### Table 3. Correlation coefficient of different liquidity management types with profitability of credit institution.

<table>
<thead>
<tr>
<th>Variable</th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total facilities ratio to the total public deposits</td>
<td>-0.083</td>
<td>-0.142</td>
<td>-0.423</td>
</tr>
<tr>
<td>Financing costs ratio to the overall assets</td>
<td>-0.189</td>
<td>-0.375</td>
<td>-0.467</td>
</tr>
<tr>
<td>Center account balance to the total asset</td>
<td>-0.067</td>
<td>0.079</td>
<td>-0.345</td>
</tr>
</tbody>
</table>

*Significant level at the probability of 0.05%

Correlation coefficient of liquidity management with profitability of financial credit institution is presented in table 3. Therefore, during the studied years of Pearson correlation coefficient, there isn’t a significant relationship between total facilities ratio to the total public deposits and profitability at the probability level of 0.05%, but there is a significant relationship between financing costs ratio to the total assets and profitability at the probability level of 0.05% in 2011; however it was insignificant in 2010 and 2012. Also, there is a negative and significant relationship between Center account balance ratio to the total asset and profitability at the probability level of 0.05% in every three years. So, according to the results of the research hypothesis, existence of relationship between liquidity management and profitability is confirmed.

### Table 4. Correlation coefficient of costs management types with profitability level of credit institution.

<table>
<thead>
<tr>
<th>Variable</th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total interest expenses ratio to asset</td>
<td>-0.047</td>
<td>-0.327</td>
<td>-0.411</td>
</tr>
<tr>
<td>Administrative and personnel costs ratio to asset</td>
<td>-0.176</td>
<td>-0.453</td>
<td>-0.417</td>
</tr>
</tbody>
</table>

*Significant level at the probability of 0.05%

Correlation coefficient of costs management types with profitability of financial credit institution is presented in table 4. Therefore, during the studied years of Pearson correlation coefficient, there isn’t a significant relationship between total interest expenses ratio to the asset and profitability, and also between administrative and personnel costs ratio and to the asset and profitability in 2010, however it was significant at the probability level of 0.05% during the years of 2011-2012. So, according to the results of the research hypothesis, existence of relationship between costs management and profitability during the years of 2011-2012 is confirmed, but rejected in 2010.

### Table 5. Correlation coefficient of management types of granted funds collection with profitability of credit institution.

<table>
<thead>
<tr>
<th>Variable</th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bad debt costs ratio to asset</td>
<td>-0.773</td>
<td>-0.076</td>
<td>0.526</td>
</tr>
<tr>
<td>Collection ratio</td>
<td>0.391</td>
<td>0.332</td>
<td>0.362</td>
</tr>
<tr>
<td>Credit risk ratio</td>
<td>-0.254</td>
<td>-0.079</td>
<td>0.344</td>
</tr>
</tbody>
</table>

*Significant level at the probability of 0.05%

Correlation coefficient of management types of granted funds collection with profitability of financial credit institution is presented in table 5. Therefore, during the studied years of Pearson correlation coefficient, there is a significant relationship between bad debt costs ratio to the asset and profitability at the probability level of 0.05% in 2010 and 2012; however it was insignificant in 2011. There is a significant relationship between collection ratio to the total assets and profitability at the probability level of 0.05% in every three years, but not a significant relationship between credit risk ratio and profitability in every three years. So, according to the results of the research hypothesis, existence of relationship between collection management of granted funds and profitability is confirmed.
DISCUSSION AND CONCLUSION

The main purpose of the study is to examine the effective internal factors on profitability of Kosar financial and credit institute. The research’s results indicate that there is a significant relation between the amount and type of deposit and the profitability of the branches. These findings are correlated with Homels et al (2004), Hugez (2001), Vi fio et al (2000) and Chen and Strong (2005) and Irotes (2007) researches. The obtained result from the analyzing the second hypothesis demonstrated that there is an association between the amount and payment facilities and the profitability of the branches. Regarding assets analyzing, the results indicated that the bank should focus on loans and facilities and prefer them to direct investment and civil partnership. The obtained result is correlated with Balentien et al (2006) and Vi Fio et al (2000) researches. Also, the obtained results from analyzing the third hypothesis demonstrate that there is a relation between liquidity management and the profitability of the branches. These findings are correlated with Hassan Bagheri (2006) and Fariba Rostami (2011) researches. Hence, it is suggested that the available financial resources are used to improve the accountability, and effective and proportional application. On the other hand, the obtained results from the fourth hypothesis demonstrate that there is an association between costs management and the profitability of branches. The above results are correlated with Davidson and Divita (2011), Balentien et al (2009), Grocchi et al (2012), Hugez (2002) and Vi Fio et al (2000) and Rostami (2011). It is recommended that the institute continues to their activities with the minimum manpower and lessens the negative effects on profitability with the help of costs saving. Ultimately, the obtained results from analyzing the fifth hypothesis showed that there is a relation between credit risk and the profitability of the branches. The above result are not correlated with Tills (2003) results, but it is not correlated with Comannor and Wilson (2005), Jones et al (2007), ower (1996), Nakaow (2011), Graham and Franklin berger (2000), Han and Manrey (2004) and Li (2002). Therefore, it is recommended that the bank persuades the borrower to pay his loans using regular rules and regulations and taking reliable guarantee. According to the obtained results from research hypotheses, it is necessary that executives consider the following points: 1) Specify the area of employees’ responsibilities and grouping so that employees have specific units and management in order to receive information from each part in minimum time. 2) Spread and create supportive network in the form of financial reward in a workplace. 3) Regular use of rules and regulations. 4) Improve executive rules so that employees of each unit have more freedom. 5) Elect and appoint individuals proportionate to the jobs. 6) Create and develop interpersonal communication networks in all organizational units for better budgeting implementation. 7) Effective and appropriate use of budget to improve accountability.

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