

## **Impact of Promotional Expenditures on Financial Performance of Banking Sector in Pakistan.**

### **A Case Study of Conventional and Islamic Banking**

Sarah Sehar, Tahir Ali

Karachi University Business School, Pakistan

[Sarabsiddiqui93@gmail.com](mailto:Sarabsiddiqui93@gmail.com), [tahirali@uokedu.pk](mailto:tahirali@uokedu.pk)

#### **Abstract**

Core aim of that paper is to identify and mention various aspects that relate to costs of promotion and their significant impacts on business performance and in this regard it has been determined that banking entities intend to invest towards promotional activities with an aim to generate business profits and enhance market share. Apart from that such study will also target any dissimilarity in investments made in relation to define legal spectrum of banking companies. Under that paper concern will also be towards potential on part of private equity participants that urge them to inject more financial resources. Such study has been conducted with a random sample of near 40 companies in 2019 and achieved results depict that promotional expenditures pose significant impacts on profits of banking entities and there appears no major difference between profitability mechanism and relative legal structure of banking entities.

**Key words:** Profitability, promotional costs, size and legal structure of companies

#### **Introduction**

It is detrimental to mention here that business environment has strong relationship with technology and innovation and various other factors indeed contribute towards competition and stiff market

and economic conditions. These include empowerment of customers, privatization mechanism, merger and annexation of various industries, business takeovers, acquisitions and regulations. Such scenario indeed leads towards the fact that these must target customer satisfaction and also win confidence of investors and other stakeholders. To remain sustainable, competitive and prominent various corporate entities move for business promotion activities in view of customers and shareholders so that strategic aims and objectives can be accomplished. During tough economic conditions indeed policy makers adopt compromising policies in terms of budgets and time to be devoted towards business promotion activities and thus diminution appears towards promotion activities in terms of investment and vice versa.

Regulators also consider that promotional costs are admissible expenses for tax purposes and same appear in financial statements of entities. All of these aspects in relation to economy of Pakistan and applicable tax laws here are dealt under Companies ordinance 1984, Income Tax Ordinance 2001 and other applicable accounting standards as devised by ICAP for corporate environment. At overall level owing to these aspects various objectives for current study have been determined like

- I. To mention and highlight various determinants of promotional costs.
- II. To assess impact of these costs towards business profits.
- III. To assess and critically evaluate differences in investments towards promotion and publicity of business with its legal status and relative business size in a dynamic manner.

### **Literature Review**

Purpose of that section is to present a comprehensive overview in terms of Islamic and conventional banking and relative differences that exist between the two. Apart from that it also signifies role of advertisement and publicity expenses towards enhancement of

financial performance of banks that offer traditional and Islamic banking at large. Apart from that review of other relative studies have also been taken in the context of comparative financial performance of both banks I-e MEBL and HBL that offer services under conventional and Islamic banking and adhere towards determinants of profitability, sales, cost, research, training and development to assess financial performance and profitability at large. Under Islamic mode of financing aspects like Aqidah, Sharia'a and Akhlaq have been given due significance at all under role model guidance from spiritual and holy personalities from time to time.

Islam is of the view that money holds status of asset backing and has no value in itself and it leads to enhanced purchasing power. As per Islam it becomes only capital when same is invested at productive place. Islamic banking emerged in 1971 as compared to other Islamic countries into the world and it is detrimental to mention here the fact that with the passage of time numerous Islamic banks emerged like Faysal and Bank Islami and many other conventional banks like Askari Bank and Bank Alfalah are also offering separate Islamic banking branches. It is interesting to mention here the fact that annual Islamic finance news poll was held in 2008 where State Bank of Pakistan ranked as second that offered and took interest in promotion of Islamic banking in the country at large (Khan, I., Rahman, W., Jan, S. and Khan, M., 2017). Such study also covers aspects that relate to profitability, performance and cost assessment in terms of promotion and advertisement expenses and significance of such aspects have been enhanced during last couple of years in Pakistan. Under concepts of both Islamic and conventional banking both banks I-e HBL and MEBL will provide a deep insight in terms of impact of advertisement and promotional expenses on financial performance and in this regard so far indeed annual reports statistics

for last 10 years have depicted lot for both of these. It differentiates itself from traditional mode of banking in terms of secular position of the same and also concepts of halal and haram have also been given due significance from Islam. Annual reports of both banks have revealed the fact that same are pocketing enormous and appreciable response from potential customers but in the context of conventional mode of banking still there is a need of lot to be done on part of HBL. Such network although enjoys a sound reputation among largest banking networks but at the moment it has been assessed that people in Pakistan are giving due attention towards Islamic mode of financing so as to secure their both materialistic and spiritual needs. Various modes of Islamic banking like Salam, Ijarah, Murabaha, Istisna, Takaful and Mudarabah offer incentives and other aspects in terms of profit and loss sharing added value and services to customers and contracts on the basis of pre-determined prices and quality specifications. All of these determinants can produce sound impact on financial performance of banks and same have been assessed in the context of both of HBL and MEBL in both short and long run as per information in annual reports at large.

It has been admitted at all hands across the corners of the world that banking industry plays vital role in terms of business stability and also for producing sound impacts on various business dynamics at substantial level. Today concepts of Islamic and conventional banking are imparting their ways in developing countries like Pakistan and their significance can be judged from the fact that now across the corners of country many banks like Meezan Bank Ltd, Dubai Islamic Bank Ltd, Summit Bank Ltd and Muslim Commercial Bank Ltd are offering business under Islamic concepts (Yao, H., Haris, M. and Tariq, G., 2018). Such aspect has caught attention of the masses and now concern and

interest of millions of people in Pakistan towards such mode can be easily judged and fast-growing expansion and popularity of Meezan Bank Ltd have justified such aspects at large. Data that will be used for that study will be extracted from annual reports of both MEBL and HBL and in this regard impact of promotional and advertisement expenditures on financial performance of a company need to be assessed at large. Various statistical approaches will also be used under that study that highlight strong relationships of various parameters and to what extent these are posing impacts on financial performance of banks both in short and long run and vice versa.

### **Bifurcation of promotional costs and related theoretical perspectives**

As per marketing domain it can be determined that promotion is related to such type of communication in business world that ensures dissemination of information and realizing people about product, service, innovation, idea or an investment that relate to specific corporate business. Contrary to that regulations and other legal guidelines are unable to support any conclusive definition for promotional expense. It can be considered that it relates to informing customers and insisting them towards products or services of company. Income Tax Ordinance 2001 has mentioned in a comprehensive manner that promotional expenditures do not cover entertainment costs and these target only marketing of goods or services of business towards customers.

In terms of VAT promotional costs are also categorized in accordance with the provision of a value and apart from that as per ITO 2001 such do not lead towards increase in tax base owing to various domains like owing to use of electronic or print media, flyers, telops, costs of prize distribution and those costs that are incurred to promote business customers identity. Mostly it happens that

promotional expenditures are related to current period and as per tax laws these can be fully tax deductible and apart from that laws also present certain other categories of promotional costs like those goods or services that do not come under long term durability and also in this respect a certain value has also been mentioned in ITO 2001.

As a whole it can be determined that laws and regulations have mentioned numerous categories for promotional expenditures and these are mentioned in the following manner:

- ❖ Costs of promotions that are paid towards media and these may be paid and impersonal and able to deliver message to massive customers.
- ❖ Cost of promotional materials like catalogues, leaflets and brochures that are provided to customers without any charges.
- ❖ Sales promotion activities that urge customers towards business products and services.
- ❖ Sponsored donations and other programs under which through intermediary functions customers are urged towards business brands and services.
- ❖ Entertainment costs but these are not always assumed as of promotional feature for an organization and also owing to tax consideration in terms of partial recognition towards expense it appears must to demarcate the same from normal promotional costs respectively.

### **Analysis of previous research**

There exist numerous studies that are related to impact of promotion on company's business performance. Promotion produces sound impacts on sales and leads towards business efficiency, and other studies have determined that business promotion can never be considered as an independent variable and same is contingent towards price factors and technological mechanism.

Various studies during last 40 years have concluded that impact of promotional costs cover varied purposes. Researchers conclude that promotional costs also promote performance and asset management and one of studies has indicated that relationship among promotional costs and performance are determined on the basis of return on assets have no statistical significance and thus defined direction leads to negative effect.

However further breakup into non-interest and interest based returns and concern for promotional costs lead towards statistical significance with positive mindset. Another study has devised that owing to marketing business profits are not reduced even during critical time periods. On the basis of VAR model for banks and data collected for banks during last 10 years relationship of investment in parts with sales has been determined in an effective manner. On the basis of these aspects and results it has been concluded under that study that promotion produces positive and accumulated effects on revenue from corporate brand of bank on long term basis.

In the context of Pakistan research on these areas exist randomly and under another study impact of promotion on efficiency and effectiveness of banks has been determined. Under simple linear regression model it is assumed that with income from sales as dependent variable and cost of promotion as independent variable accelerated profits can be determined and thus results determine hypothesis.

## **Sampling and Research Methodology**

### **Hypothesis**

Promotional expenditures of conventional and Islamic banking during the past 10 years have created an impact on profitability/ROI/financial performance.

### **Problem Statement**

Promotional expenditures of Islamic banking is not up to the mark due to which its profitability is decreasing.

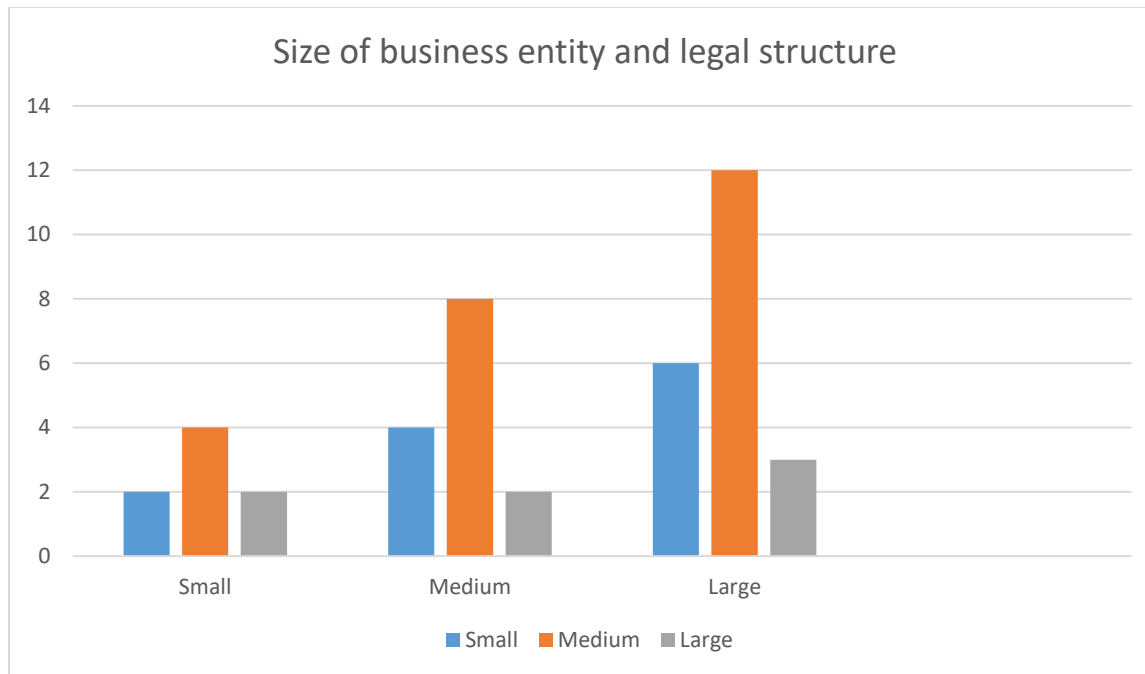
In accordance with subject of research, mentioned problem covering relevant background and previous researches research hypothesis can be underpinned in the following manner:

H: Promotional expenditures of conventional and Islamic banking during the past 10 years have created an impact on profitability/ROI/financial performance

The sample size we took is 4 and instruments were questionnaire and interview. Simple random sample was applied for the questionnaire inputs were obtained as the organizations were reached through email. For the interview two renowned banking organizations from Karachi was selected.

On random basis sample of 40 companies has been established in 2019 in accordance with the needs of a companies in banking industry. These include both private and public owned limited companies and financial statements of companies were gathered from available register with SECP (Securities and Exchange Commission of Pakistan) of companies. These include 22 public limited companies, 8 as medium, 4 as large companies, 3 in small category and 3 in medium category.





Above aspects cover size and legal structure of companies that have been covered in the study in a comprehensive manner. Various steps are involved under that like defining of variable on the basis of a problem, subject of research, profitability, and share in promotional costs and also size of an organization. For profitability relative return on assets has been used and its equivalent from the group of cash flow that indicate profitability section of an organization. Return on asset indeed determines ability and efficiency of management of an organization in view of profit and in relation to its equivalent it also targets ratio of operating cash flow to average total assets. Value added edge of that return on assets is related to its ability to indicate about an ability of an organization to pay return on assets but also it falsifies provisions for coming investments and also liabilities at large.

Second variable determines level of investment in promotion that is expressed by relative cost of promotion. As per aim of relativization such indicator has respective role towards total cost of a company. Legal structure of companies has also been mentioned in a comprehensive manner as

per Companies Act 2017 and for the purpose of that study sample comprises of both public and private limited companies. Relative size of a company as per share capital, annual turnover and number of employees has been mentioned in that corporate law in a descriptive manner.

### **Conclusion**

It is detrimental to mention here that managers and business strategists always aim for reduction in cost during critical times but owing to it also sometimes marketing expenses get affected. Owing to that question arises that highlights as to whether owing to that there appear any negative impacts on profitability and business performance. Owing to that under such study concern was towards assessment of promotional costs towards profitability of banks and also their interrelationship with legal structure of banks and also respective size.

It has been determined under results that positive and sound relation exist among profitability and promotion and legal status and size of banks are not much substantial towards injected financial resources. In view of all such business strategists may be devised under that study to determine impact of reduction in cost of promotional expenses towards business profits on the basis of decisions that they made.

Moreover researchers of the issues as highlighted have presented quite descriptive facts for banking industry and same can be recommended for subject of the research in terms of non - deductible expenses of promotional costs. Above all subject of the research can be extended towards contribution and role of promotional activities for profits, effects on business performance at universal level, industry and respective factors and vice versa.

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