CHAPTER II

REVIEW OF LITERATURE
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This chapter presents a review of previous studies relating to the research problem selected for the present study and enables the researcher to have an in-depth knowledge over the various concepts of research problem. A review of the important empirical studies and different concepts relating to the financial performance has been presented. In this regard, the researcher has referred to various academic journals, magazines, books, etc.

Marcus (1969)\(^1\) in his study “Profitability and Size of the firm: Some Further Evidence”, has made an attempt to re-evaluate the hypothesis that the rate of return increases with the size of the firm, against new data within an improved analytical framework. He has arrived at the conclusion that the hypothesis did not perform uniformly in all the industries and that it cannot, therefore be viewed for having general validity.

Subramanian and Papola (1971)\(^2\) in their work “Profitability and Growth of Firms: The Case of Indian Chemical Industry” have attempted to study the influences of financial policy variables, assuming that profitability is a major determinant of growth. The study has employed growth as the dependent variable and has analysed it through various indicators namely, profitability, size, retention ratio and liquidity. The study has been made from a sample of 27 companies quoted in the stock exchange in Indian chemical industry during the period 1960-1969. The authors have observed that there is a strong positive relationship between profitability and growth in the chemical industry.
Agarwal (1978)\textsuperscript{3} in his work "Size, Profitability and Growth of some Manufacturing Industries", makes an attempt to examine the relationship between profitability measured as profit / net worth and net profit / net assets and size expressed as total sales for the period 1962-1972, by taking into account seven Indian manufacturing industries viz., sugar and brewing, jute textiles, cotton spinning and weaving, ginning, cement, paper and pulp, and aluminium. Agarwal has observed that there is relationship between size and profitability in sugar and brewing industry, jute textiles industry, cotton spinning and weaving industries and aluminium industry while no such relationship exists among the remaining industries.

Neumann, Bobel and Haid (1979)\textsuperscript{4} in their research work entitled "Profitability, Risk and Market Structure in West German Industries", have explained mean rates of return of the period from 1965 to 1973 for 334 West German joint stock companies by risk and market structure. The researchers concluded that investors are risk averters and that risk bearing is accordingly compensated by a higher rate of return. Degrees of concentration and product differentiation are positively related to profitability while export and import ratio exerted an adverse impact on profitability. As regards size and profitability, smaller firms tend to be more flexible and tend to take chances of growth more easily than the bigger ones. The researchers also concluded that there is inverse relationship between growth and profitability.

Mahalingam, (1980)\textsuperscript{5} who carried out a study on “Financial Performance of Indian Sugar Industries” has critically examined the operation of sugar mills and actual benefits derived from the cooperative sugar mills. He had observed that the benefits include rise in remuneration and the consequent change in their cropping pattern, additional employment opportunities and the development of their industrial and business activities in and around cooperative sugar mill.
Asha Jain (1981) in his study “Price-Cost Margin in Indian Manufacturing Industries: An Econometric Analysis” has analysed the price cost margin over time in the Indian manufacturing industries. Price-cost margin is used as a measure of profitability. Cost factors emerge as significant determinants of profitability while the structural variables like concentration ratio, capacity utilization and growth and capital intensity show mixed pattern. He has observed the different results for different industries.

Bothwell, Cooley and Hall (1982) in their work “A New View of Markets Structure-Performance Debate” have used a sample of 156 large U.S. manufacturing firms over a period 1960-1967 for determining the relationship between profit rate and other variables like seller concentration, advertising intensity, firm growth, profit variability, leverage, absolute capital requirements, firm size and market share. They have observed that a positive correlation exists between seller concentration, market stock and growth of demand, business risk, profit rate and advertisement expenses. Profit rates are found negatively correlated with the extent of economies and capital requirement.

Latha Arun Reddy (1983) has conducted a study on “Profitability and Growth-Indian Manufacturing Industries” with the main objective of examining the relationship between growth and profitability using regression models and compound growth rate. Her study covers a period of 24 years from 1950-1951 to 1973-1974. The author observes that the paper industry exhibits a strong positive correlation between growth and profitability.

Mahanti (1984) in his study “Paper Industry’s Looming Crisis” has examined the Indian Paper Industry’s overall capacity utilization. He observes that capacity utilization of paper and paper board has gradually deteriorated. He has also found that capacity utilization has declined from 96.4 per cent in 1951 to 74.6 per cent in 1981 due to inadequate supply of power.
Nizam Mohammed (1985) in his study entitled “Indian Paper Industry: Heading for a Bright Future” has analyzed the causes for low capacity utilization during the 1970s. He observes that the major problems which cause the relatively low capacity utilization include the shortage of raw materials, inadequate supply of power, coal and transport bottlenecks. He has also observed that the capacity utilization in paper industry is influenced by several factors.

Deepak Chawola (1986) in his work “An Empirical Analysis of the Profitability of the Indian Man Made Fibers Industry”, has analyzed the trends in the profitability of industry during the period 1963-1964 to 1977-1978. He has observed that the excise duty of man-made fibres was negatively correlated with the profitability of the industry.

Arun Ghosh (1987) in his article entitled “Education and Environment Contribution the Paper Industry” has reported that the growth of the paper industry was impressive and that the annual growth rate over the period 1951-1986 was 8.7 per cent for capacity and that of production, 7.4 per cent. He has observed that the overall capacity utilization had declined from 96 per cent in 1951 to 60 per cent in 1986. He has also observed that the capacity utilization was not in accordance with the growth of capacity of the paper industry.

Thangavelu (1987) in his study entitled “A study of the working of paper industry with special reference to Sri Venkatesa Paper and Board Ltd., Udumalpet”, has analyzed the cost efficiency and financial performance of Sri Venkatesa Paper and Board limited, from the years 1977-1978 to 1985-1986. The relevant data were collected from the annual report of the mill and have been filled to a regression model. He has concluded that the co-efficient of output and raw material was significant at 1 percent level. The study also reveals that the cost
has increased by 2.67 times, the profit ratio has shown a declining trend and the operating cost has gone up ranging to 48 percent on sales.

Kulkarni (1989)\(^{14}\) in his article entitled "Paper and Paper Board" has examined the capacity utilization of the Indian paper industry during the two decades. He has observed that the capacity utilization declined very sharply from 82.3 percent to 66.4 percent during the first decade and to 60.41 percent during the second decade of the study. He has further found the installed capacity was increased to 28.51 lakh tonnes per annum during the year 1988 as against the installed capacity of 9.54 lakh tonnes in the year 1971. The production of paper and paper boards was also increased in a similar manner as from 7.75 lakh tonnes to 17.20 lakh tonnes during the same period. Thus it is noted that the capacity utilization of the paper industry has an inverse relationship with the installed capacity and production.

Sivarami Reddy and Mohan Reddy (1989)\(^{15}\) in their article "Indian Paper Industry: Problems and Prospects" evaluate the capacity utilization of the paper mills in India. They have observed that a fairly high degree of capacity utilization was maintained in the earlier years. However, it had declined every year from the year 1971 and the decline in ratio of capacity utilization was found to be severe during the five years from 1981 to 1986. The researchers have concluded that the installed capacity of the industry has been gradually increasing and the capacity utilization has been coming down.

Nagarajan and Barthwal (1989)\(^{16}\) have conducted a study on "Profitability and Size of Firms" and observed that the size of the firms and profitability were positively correlated. The researchers have found that large firms would be in a position to take advantage of technical know how and economies in manufacturing, marketing, supervision and in raising capital.
Nagarajan and Barthwal (1990) under took a study on “Profitability and Structure: A Firm Level Study of Indian Pharmaceutical Industry”, and have critically examined the correlation between profitability and structure, using a sample of thirty eight pharmaceutical firms in India for the period 1970-1983. Two measures of profitability i.e., ratio of net profit to total sales revenue and the ratio of net profits to total assets have been used to find out the determination of profitability. The analysis demonstrated that under the conduction of price controls the most significant determinant of the profitability of the firms in this industry was vertical integration. They observed that the co-efficient of growth rate of sale was positive and significant, suggesting that factors on the demand side of a firm have a greater impact on profitability than on the supply side.

Khan and Mohammed Tufail Khan (1990) in their study on “Paper Industry: An Appraisal”, have pointed out that the paper industry is a highly capital intensive industry. They have conducted the study with the selected companies for a period of six years from 1980-81 to 1985-86. They have found that the industry was unable to function vigorously due to rise in the cost of inputs, heavy overheads, paucity of power and adverse impact of control orders over the industry. They have concluded that the profitability of the selected companies was hampered because of controls over prices and production of printing paper. The researchers have suggested that the control over price and production of printing paper should be removed.

Kallu Rao (1991) has made a study on “Inter Company Financial Analysis of Tea Industry: Retrospect and Prospect”. An attempt has been made in this study to analyze the important variables of tea industry and projected future trends regarding sales and profit for the next ten year period, with a view to help the policy makers to take appropriate decisions. The various financial ratios have been calculated for analyzing the financial health of the industry. The forecast of sales
and profits of tea manufacturing companies show that the Indian tea industry has bright prospects. According to him, the recent changes in the Indian economic policies will boost up the foreign exchange earnings, which will benefit those companies, which are exporting to hard currency areas.

Jagdish Lal (1992) in his article “Sugar and Sugarcane Production, Trends and Policies”, studied the production of sugar and its consumption trend. He has also examined the impact of sugarcane and sugar pricing and distribution policies. He observed that there was an increasing trend in the case of production and consumption of sugar during the period 1950-51 to 1990-91.

Jagan MohanRao (1993) have made a study on “Financial Appraisal of Indian Automotive Tyre Industry”. The study was intended to make an in-depth study of the financial condition of the Indian tyre industry. He has made an attempt to measure and evaluate the financial performance through intercompany and inter-sectoral analysis over a given period of time (1981-1988). The findings are that fixed assets utilization in many of the tyre undertakings was not as productive as expected and inventory was managed fairly well. The overall profitability performance of the tyre industries was subjected to inconsistency and ineffectiveness.

Vijayakumar and Venkatachalam (1995) have undertaken a study entitled “Profitability and Viability: Working Capital and Profitability - An Empirical Analysis”, taking 13 firms from sugar industry, covering a period from 1982-83 to 1991-92. Major ratios like liquid ratio, receivables turnover ratio, inventory turnover ratio and cash turnover ratio were computed to measure their impact on profitability [PBT/TA]. The study has revealed that inventory turnover ratio and receivables turnover ratio had positive correlation with the profitability.
and liquid ratio whereas cash turnover ratio had negative correlation with the profitability.

Kim and Kunchul (1996)\textsuperscript{23} has undertaken a study entitled “Profitability, Growth and Risk Optimization”. An attempt was made to understand the profitability differentials in terms of inter-relationships among profitability, growth and risk. The authors focused on the process of production and investment decision making, which was the main activity for firms’ profit maximization. The major objective of the investment and production decision is to choose optimum levels of profitability, growth and risk. They found out that these variables were endogenous in a firms’ profit maximization and it is simultaneously interrelated.

Pari and Vijayakumar (1997)\textsuperscript{24} have carried out a study entitled “Productivity and Profitability of the Paper Industry: A Case Study of Seshasayee Paper and Boards Limited, Tamilnadu” analyzed the growth in production, sales and profit of the company for a period of twelve years from 1981-82 to 1993-94. They have also examined the factors determining the profitability of the company and have concluded that the ratio of debt to total assets, inventory turnover ratio, current ratio and operating expenditure ratio are permanent variables in determining the profitability of Seshasayee Paper and Boards Limited.

Vijayakumar (1998)\textsuperscript{25} in his study entitled “Determinants of Corporate Size, Growth and Profitability: The Indian Experience” measured that the growth has been found to be significantly associated with profitability. The study covers the period from 1980-81 to 1995-96. The technique of average, correlation and linear and multiple regression analysis has been used in this study. The researcher has observed that the growth is positively and significantly associated with the size in all the industry groups except textiles.
Kuldip Kaur (1998)\textsuperscript{26} in this study entitled "Size, Growth and Profitability of Firms in India-An Empirical Investigation", has analyzed the size, growth and profitability of firms in India by undertaking 235 firms for the period from 1970-71 to 1989-90. Growth pattern of the firms showed that majority of the firms recorded growth rate from 10 to 20 per cent. Two measures of profitability have been used in the study: First measure, the profitability margin (operating profit as percentage of net sales), and the second measure, the profitability rate (gross profit as percentage of net sales). He has revealed that there was no systematic tendency for average profitability to increase or decrease as the size of the firms changed.

Chandrasekaran (1999)\textsuperscript{27} in his study on "Financial Performance of Indian Sugar Industry" covers the period from 1990-91 to 1995-96. The researcher has employed various ratios like profitability ratios, leverage ratios, liquidity ratios, and turnover ratios. He has observed that financial performance of the sugar industry had been moderate to poor except during 1993-94. He has also observed that the industry was affected mainly by high stocks of finished goods, average to low coverage ratios due to high variability of earnings, and difficulty of controlling cost structure. The researcher concluded that there was no significant improvement in the financial position of Indian sugar industry.

Soumyendra Kishore Dutta (1999)\textsuperscript{28} has conducted a study on "An Analysis of Profitability Trend in Indian Cotton Mill Industry" and concluded that the disadvantageous situations of a large number of mills get reflected in loss. Loss of market share of mill made cotton cloth to synthetic substitutes, uncertainty in supply of raw cotton, under utilization of capital and high capital cost added to fluctuations in profitability. Lower base of the profitability ratios and the warning financial position of the majority of the mills have left them with resources to undertake renovation and modernization.
Mohammad Rafiqul Islam (2000) in his study on "Profitability of Fertilizer Industry in Bangladesh" has examined the profitability of fertilizer industries in Bangladesh from 1985-86 to 1994-95 with a sample of five fertilizer companies, operating under the control of Bangladesh Chemical Industries Corporation. The author has revealed that the earning capacity of the fertilizer industry and the factors influencing that earning power offer some suggestions for improvement of the profit earning capacity of fertilizer industry.

Debasis Rej and Debasish Sur (2001) have conducted a study on "The Profitability Analysis of Indian Food Products Industry: A Case Study of Cadbury India Ltd." and attempted to measure the profitability scenario of Cadbury India Ltd. The researchers have analysed the relationship among various profitability ratios and their joint impact using multiple correlation co-efficient and multiple regression method. The study on the inter-relation between the selected ratios regarding the company’s position and profitability has revealed both negative and positive association.

Sahu (2002) in his article titled "A Simplified Model for Liquidity Analysis of Paper Industry" has examined the liquidity of paper industry. The model developed by him has been based on the assumption that the liquidity management of a company in a particular year is effective if its’ earnings before depreciation is positive and not effective if its’ earnings before depreciation is negative. The findings have revealed a very high predictive ability of the estimated discriminant function.

Nand Kishore Sharma (2002) in his work "Financial Appraisal of Cement Industry in India" has made an attempt to study important tools and techniques which have been used for appraisal of financial position of cement industry in India. He has observed that the prevailing ratios of six companies are higher than
the average of industry and that of four companies are lower than the average of industry. He has further recorded that on comparing the financial assets to the total debt ratio of industry, three companies have higher ratio while rest of the companies have lower ratios. The study has also revealed that the overall financial performance of the cement industry has been satisfactory.

Padmaja Manoharan (2002)\textsuperscript{33} in her work “An Analytical Study on Profitability of Cement Industry in India”, has revealed that the variation in profitability of Indian Cement Companies depends on age, size and region. The study has identified that quality of earnings depends on cost management, asset management and leverage management. The researcher has concluded that the profitability and quality of earnings is influenced by the liquidity factor.

Sudarsana Reddy (2003)\textsuperscript{34} undertook a study on “Financial Performance of Paper Industry in Andhra Pradesh” for the period from 1989-90 to 1998-99. The primary objective of the study was to analyze the investment pattern and utilization of fixed assets, ascertaining the working capital condition, reviewing the profitability performance and suggesting measures to improve the profitability. He had concluded that the introduction of additional funds along with restructuring of finances and modernization of technology are needed for better operating performance.

Vijayakumar and Kadirvelu (2003)\textsuperscript{35} undertook a study on “Profitability and Size of the Firm in Indian Minerals and Metals Industry”. The authors have suggested that the larger firm may be in a position to earn a higher rate of return on its investment than the smaller firm. Similarly a counter argument that size breeds inefficiency and hence profitability may decline with size of firms. The study reveals the relationship between size and profitability of the firms where the
size is found to be significantly associated with the profitability during the study period.

Sukhder Singh and Gill (2003)\textsuperscript{36} undertook a study entitled “Status and Growth of Paper and Pulp Board Industry in Northern India - A Case Study”. The study has revealed that due to the availability of raw materials and labour, 80 per cent of the mills are running with the optimum capacity utilization. The authors have observed that more than 3000 people have got employment in 10 paper and paper board mills with a proportion of 1800 skilled workers and 1200 unskilled labours. The authors have found out that the major problem faced by the industry is frequent breakdown of paper production especially during the summer season due to scarcity of power supply.

Sanjay J.Bhayani (2004)\textsuperscript{37} carried out a study on “Working Capital and Profitability Relationship - A Case Study of Gujarat Ambuja Cements Ltd.” and has analyzed the impact of working capital on its profitability during the period 1993-94 to 2002-03. The statistical techniques like multiple correlation and multiple regression analysis are employed in this study. The study has revealed that the increase in the profitability of the company is less than proportionate to decrease in the working capital.

Amit K.Mallik, Debasish Sur and Debdas Rakshit (2005)\textsuperscript{38} in their article entitled “Working Capital and Profitability: A Study on their Relationship with reference to selected companies in Indian Pharmaceutical Industry” was studied for the period from 1990-91 to 2001-02. They have assessed the influence of working capital on its profitability. The authors have found out no definite relationship between liquidity and profitability. The study has revealed the favourable influence of inventory management on profitability in the Indian Pharmaceutical Industry during the period of study.
Hamsalakshmi and Manickam (2005)\(^{39}\) undertook a study on “Financial Performance Analysis of Selected Software Companies” for the period covering from 1997-98 to 2001-2002 in which the structure of liquidity position, leverage position and profitability position were analyzed. In this study, it is found that the liquidity position and working capital are favourable during the period of study. The study has revealed that the overall profitability position of selected software companies regarding return on investment and return on equity has been increasing gradually.

Gitanjali Chaturvedi, Jain, Singh and Kulkarni (2006)\(^{40}\) carried out a study on “Indian Paper Industry-Growth and Prospects” and highlighted the existing status of the Indian paper Industries with respect to the key market indicators. They have also discussed the basic issues and challenges confronting the industry with possible strategies to address the same. The authors have revealed that issues and concerns of the industry include raw material availability, scale of operation technological obsolescence and environmental issues. It is concluded that there is ample scope for growth in many segments of the paper industry.

Jain, Singh and Roy (2007)\(^{41}\) have conducted a study on “Indian Paper Industry Raw Material Scenario, Growth Prospects and Pathways” and have made an attempt to analyze the issues before the industry particularly with reference to raw material and the response of the paper sector in addressing the same. The authors have concluded that efforts are required to develop the then available waste lands to be wood banks for the Indian paper industry so as to tide over the inevitable high demand of quality raw material in the times to come.

Sam Luther (2007)\(^{42}\) in his article titled “Liquidity, Risk and Profitability Analysis – A Case Study of Madras Cements Ltd.” has examined the adequacy of current assets as well the level of risk posed by current liabilities. He has also
observed that the company had achieved adequate liquidity, minimization of risk and maximization of the profitability. The main objectives of the study were to measure and evaluate the liquidity position of Madras Cements Ltd., to assess the correlation between liquidity and profitability, to assess the tradeoff between profitability, and risk. An attempt has also been made to test whether the computed value of the correlation coefficient is significant or not by using 't' test. It is concluded that the high degree of aggressive policy adopted by MCL has made a negative impact on its profitability.

Ahmed Arif Karim Almazari (08-09) in his research work entitled “Analyzing Profitability Ratios of the Jordanien Phosphate Mines Company (2001-2007)” has evaluated the profitability ratios of Jordan Phosphate Mines company (JPML). The author has found that there was a statistical relationship between gross profit margin ratios, operating profit margin, net profit margin and return on equity ratios (independent variables) during different business cycles and the performance of the company (dependent variable). However, there was no statistical relationship between earnings per share ratio, return on total assets ratios (independent variables) during different business cycles and the performance of the company (dependent variable). He has observed that the overall performance of JPMC, in terms of profitability has been good, the company market has been growing, not shrinking, and that the company has been earning an acceptable return on invested capital and it has good opportunities.

Sudipta Ghosh (2008) undertook a study entitled “Liquidity Management: A Case Study of TISCO Ltd.” and analyzed the liquidity management of TISCO Ltd., one of the leading iron and steel manufacturing companies in India for the period 1996-1997 to 2000-01. The objectives of the study were to examine the liquidity position of the company, to study the overall liquidity position of the company more precisely by a comprehensive test and to measure the association.
between liquidity and profitability of the company. The author had observed that the degree of association between liquidity and profitability of the company was positive, and the degree of influence of liquidity on its profitability was low and insignificant.

Venkat Janardhan Rao and Durga Prasad (2009)\textsuperscript{45} in their research work entitled “Z-score Analysis - A Tool to Predict Financial Health”, have critically examined the possibility of the failure of the firms with reasonable accuracy by using statistical tool Z-score, developed by Altman which is a measure of a company’s health and which utilizes several key ratios for its formulation. The model incorporates five weighted financial ratios into the calculations of the Z-score. Making use of this Z-score, the authors have examined the overall financial performance, to predict the financial health and viability of Mahindra and Mahindra Limited and Eicher Motors. They have observed that after comparing the financial performance of both companies, performance of Eicher motors is better than Mahindra and Mahindra limited.

Sudershan Kuntluru and Mohd. Akbar Alikhan (2009)\textsuperscript{46} undertook a study entitled “Financing Pattern of Foreign and Domestic Owned Pharmaceutical Companies in India” and have made an attempt to examine the financing pattern of foreign and domestic owned pharmaceutical companies in India. The study has covered a period of 15 years i.e. from 1991 to 2005. The financing pattern has been analyzed, based on traditional methodology such as common size statement, trend analysis and ratio analysis. The researchers have observed a significant difference between the financing pattern of domestic and foreign owned companies in Pharmaceutical Industry. The null hypothesis has been rejected. The authors have found that the results and analysis indicated that domestic companies are highly levered than foreign owned companies in Pharmaceutical Industry.
Anuradha Rajendran (2009) undertook a study on “Performance Appraisal of Private Sector Sugar Companies in Tamilnadu” for the period from 1997-98 to 2006-07. The main objectives of the study are to access the production and sales performance, to analyze the financial performance and profitability analysis of select sugar mills. Financial analysis techniques like ratio analysis and trend analysis are used to analysis the financial data. The correlation analysis revealed a positive correlation between return on total assets and inventory turnover ratio during the study period. The analysis of the operational efficiency using Altman’s model reveals that the financial health of the selected sugar industry falls in the healthy zone.

Rajendran and Nagarajan (2010) in their research work entitled “A Study on Solvency Position of LIC of India” have intended to evaluate the solvency position of LIC during the study period from 1988 to 2008. Financial analysis techniques like, ratio analysis and trend analysis are executed to analyze the financial data. The researchers have observed that correlation analysis revealed a positive correlation between the equity share capital and total current liability in the firm during the study period. The analysis reveals that LIC proportionally distributed its profit to equity share capital as well as to liabilities, which vary due to the needs of the company. The analysis has found that there is more variation in current liabilities due to heavy competition.

Conclusion

Research studies carried out by eminent persons in the areas of industry’s growth, profitability, liquidity and overall performance has been reviewed. The researcher has understood the gaps in the various studies and hence the present study has been undertaken.
References


