CHAPTER - VI

SUMMARY, CONCLUSION AND SUGGESTIONS FOR FURTHER RESEARCH
6.1 INTRODUCTION

Objective of every business organisation in the modern competitive world is considered to be the maximisation of the wealth of its shareholders. For the fulfillment of this objective every business organisation must run its operations in the most efficient manner and appraise its performance on periodical intervals. The manner in which the operations of a business are carried on is reflected in its financial results stated in terms of earnings or profits. Earnings or profits earned by a business is considered as one of the indicator of its success or failure. Having regard to importance of earnings every effort should be made to measure the earnings in an objective manner. However, the reported earnings of an enterprise are significantly influenced by the accounting policies and practices adopted for their measurement. Therefore, to understand the true financial results of a business organisation, the analysis of its accounting policies and practices should be made with a view to find out whether or not they conform to benchmark accounting policies and practices.

After having computed its earnings in a fair manner a business organisation must proceed to manage its earnings in the best possible way. The earnings of a business can be put to two uses; (i) earnings may be used for further expansion of the business; and (ii) payment as dividend to shareholders as a reward on their investment. The first use of earning considers the growth of the business as the primary objective whereas second use gives importance to the interests of shareholders. However, an enterprise should consider both the objectives simultaneously, namely, ensuring growth in the business and keeping the shareholders satisfied. A business organisation which does not give due importance to any of the two objectives, may find it difficult to expand and grow in future.

Having regard to the importance of the measurement and management of earnings, it was decided to empirically examine the practices and policies relating to measurement and management of earnings. For this purpose a sample of ten companies promoted by PSIDC was selected. The sample consisted of five companies in the public sector (PTL, PACL, PNFC, Punwire and ESPL) and five in the joint sector (ADIL, MFPL, GNA, Japson and PSWML). All the companies selected in the public sector have operated for more than six years. While selecting the companies in the joint sector, only those companies were selected which had a track record of more than six years upto 1997-98.
The study covered a period of six years from 1992 to 1998. The main objectives of the study were as follow:

1. To examine the accounting policies concerning measurement of earnings in the companies under study.
2. To examine the pattern of income earned and expenses incurred by the companies under study.
3. To study the depreciation policies of the companies under study and the effect of depreciation policies on the funds generated.
4. To study the dividend policy/retention policy of the companies under study and the factors affecting such policies.
5. To study the considerations governing the capitalisation of earnings through the issue of bonus shares by the companies under study.

For the purpose of fulfillment of these objectives of the study, the requisite data was collected both from primary as well as secondary sources. Secondary data was collected from the Annual Reports of the companies under study and other published and unpublished documents of Punjab State Industrial Development Corporation and Government. For collecting primary data, two questionnaires one each for measurement of earnings and management of earnings were prepared. These questionnaires included the questions concerning different aspects of measurement and management of earnings. With the help of these questionnaires, the requisite information was collected from the members of Board of Directors and others managers of the companies under study. Personal interviews were also conducted wherever required, to cover some qualitative aspect. The information so collected was suitably classified and tabulated to make the analysis possible.

For the analysis of data the use of both financial and statistical analysis techniques was made. In addition, the use of diagrams and charts was also made to highlight major findings. The financial analysts techniques used in the present study included ratio analysis and analysis of funds from operation. The statistical analysis techniques included average, coefficient of correlation and T-test. The findings of the study were reported in five chapters stated as below:

1. INTRODUCTION
2. APPROACHES TO MEASUREMENT OF EARNINGS.
6.2 MAIN FINDINGS OF THE STUDY

The major findings of the study have been reported as below:

6.2.1 INTRODUCTION

The Chapter-I was devoted to introduction of the study. It consisted of review of literature, main findings of review of literature, need for the present study, objectives of the present study, scope of the present study, and the research methodology used in the present study. The main findings of various studies conducted on Measurement and Management of earnings i.e. Income expenses pattern, dividend declaration, depreciation provision, retained earnings, bonus issue etc. in India and abroad can be stated as follows:

1. There are large number of factors which had adversely affected the overall profitability of the concerns. In order of importance, these are; under capacity utilisation, agitation and go-slow tactics by employees, current profitability, pay-out ratio and the shareholder's and management's attitude.

2. The studies conducted both in India and abroad revealed that the depreciation rates always keep on changing from time to time, so it has become a debatable issue in the concerns.

3. No general agreement on the set of factors influencing dividend policy is found. Different authors have been using different combinations of variables for explaining dividend behaviour. However, the profitability and investment needs are the common explanatory variable of dividend policy, and have been used in almost all studies.

4. Various studies do not have a consensus on Modigliani and Miller's hypothesis. Some studies support the MM hypothesis, whereas there are studies which do not support this hypothesis and report that there is a
The relationship between dividend policy and the value of a firm. The value of a firm depends solely on its earnings power.

5. The bonus issues are the ad hoc decisions, as they are dependent upon the amount of earnings to be capitalised, and retained earnings are largely a by product of dividend actions.

6. Regarding statistical research methodology, majority of the researches conducted in India use statistical methods of tabulation, analysis, partial correlation and regression equations. Ratios and percentage have been worked out to analyse the trends. But the researches conducted in Foreign countries, apart from regression analysis, have also used other tools of analysis like earnings expectation life cycle, finite-growth model, simultaneous equation model, single equation model and Neyman-Pearson likelihood ratio test's etc.

6.2.2 APPROACHES TO MEASUREMENT OF EARNINGS

The second chapter of the study was devoted to the discussion of various approaches to the measurement of earnings. It was observed in this chapter that traditionally earnings are measured according to accounting concepts and policies by matching revenues and expenses. This approach has been criticised due to its dependence on realisation principle, cost allocation methods and historical cost accounting. As an alternative to accounting concept of earning, economic concept of earning is suggested which is measured in real terms and results from changes in value of assets. Economic concept is theoretically sound but difficult to measure accurately.

Earnings measurement focuses on capital maintenance concept on financial and physical basis. Financial Accounting Standard Board favoured financial concept while some other favoured physical concept. Since, physical concept is useful for users in predicting amounts, timing and risk associated with future cash flows and understanding enterprise performance in real terms, Earnings measurement is discussed at structural level and behavioural level. Structural concept of earnings relates to transactions (both internal and external) and activities approach. Transaction approach involves recording of changes in asset and liability valuations only as these are the result of transactions. Activities approach focuses on a description of activities of firm rather than on reporting of transactions. Behavioural concept of earnings relates to decision processes of investors and creditors, the
reaction of securities prices in organised markets to earned reporting, the capital expenditure decisions of management, and the feedback reactions of management and accountants.

6.2.3 ACCOUNTING POLICIES AND REPORTING PRACTICES ADOPTED FOR MEASUREMENT OF EARNING BY COMPANIES UNDER STUDY.

The Chapter-III of the study was devoted to the valuation of accounting policies and practices adopted for measurement of earnings by the companies under study. These policies were evaluated by comparing them with international accounting standards and accounting standard issued by Institute of Chartered Accountant of India. This chapter was also devoted to discuss the reporting practices for measurement of earnings used by the companies under study. The major finding of this chapter are stated below.

1. All the companies under study do not fully comply with the requirements of AS-2 and IAS-2. Both AS-2 and IAS-2 require that inventories should be valued at lower of historical cost and net realisable value but all the companies under study do not use this basis for the valuation of inventories. However, cost flow basis used by the companies under study for the determination of the cost of their inventories has been consistent with the requirements of both AS-2 and IAS-2 because companies under study either use FIFO method or weighted average cost method for this purpose. All the companies under study do not compute the cost of inventories of finished and semi-finished goods according to the requirements of AS-2 and IAS-2. These standards require that cost of inventories should be arrived at by including costs of purchase, costs of conversion and other costs incurred in bringing them to their present location and condition. Two of the companies under study viz.; ESPL and Japson do not follow this requirement as they include cost of purchase only in the cost of inventories. Companies having inventories of by-products do not follow the requirements of AS-2. However, all companies having inventories of reusable and non-reusable waste follow the requirements of AS-2.

2. All the companies under study have valued their fixed assets at historical cost in accordance with the Accounting Standard-10 and International Accounting Standard-16 except MFPL which shows some of its fixed assets at revalued
amount. This company follows a very consistent approach for the valuation of its fixed assets.

3. None of the companies under study except Alpha Drugs India Limited changed the method of providing depreciation during the period under study.

4. The companies under study do not review the useful lives of the depreciable assets periodically as required by IAS-4 and AS-6. Consequently there was no question of adjustment of depreciation rates to consider the change in the lives of depreciable assets. It is therefore advised, that these companies should formulate and implement a policy for the review of lives of major assets and adjustment of depreciation rates.

5. Some of the companies under study amortize their intangible assets over a period of ten years whereas others do so over a period of six years. Still some companies are not amortizing their intangible assets as they are suffering losses. Due to the adoption of different approaches by the companies for amortization of intangible assets their financial results cannot be compared in an objective manner.

6. Accounting policies in respect of treatment of research and development cost followed by the companies under study are in accordance with the requirements of IAS-9 and AS-8.

7. All the companies under study except GNA and Japson fulfill the requirements of IAS-18 and AS-9 for revenue recognition from sales. None of the companies under study are rendering services. For recognizing revenue from interest and dividends, the companies which have investments follow the requirements of IAS-18 and AS-9 i.e. they recognize interest on a time proportion basis and dividends when the right to receive payment is established.

8. All the companies report prior period items separately as required by AS-5. Only PTL has reported extraordinary items during the period under study as per the requirements of AS-5. Changes in accounting estimates are also dealt with in accordance with AS-5 by the companies under study.

9. IAS-21 and AS-11 dealing with effect of changes in foreign exchange rates requires that a foreign currency transaction should be recorded on initial recognition in the reporting currency by applying the foreign exchange rate as at the date of transaction. Three companies under study viz. PACL, ADIL and GNA Udyog Limited do not follow this requirement as these companies
record the transaction at the exchange rate applicable on the date of making payment. All the companies under study having foreign currency transactions deal with foreign exchange denominated monetary assets and liabilities as per IAS-21 and AS-11. The treatment of increase in liability on account of exchange rate changes in respect of acquisition of fixed assets followed by the companies under study is consistent with AS-11 which states that exchange differences arising on repayment of liabilities incurred for the purpose of acquiring fixed assets, which are carried in terms of historical cost should be adjusted in the carrying amount of respective fixed assets. However this treatment is not consistent with the benchmark treatment recommended by IAS-21 which states that exchange difference arising on the settlement of monetary items should be recognised as income or expense in the period in which they arise.

10. PTL and GNA Udyog Limited value their long term investments on market value basis and lower of cost or market value basis respectively. This treatment is not however consistent with the benchmark treatment recommended by IAS-25 and AS-13 dealing with accounting for investments. None of the companies under study value their current investments as per AS-13 which requires that current investments should be valued at the lower of cost and fair value determined on an individual investment basis or by category of investment but not on an overall (or global) basis.

11. During the period under study the format of reporting of various items in the income statement (profit and loss account) differed amongst the companies under study. The differences include the method for classification of incomes and expenses, the procedure for appropriation of profits, computation of profits to be carried to the balance sheet and the number of schedules supporting the profit and loss accounts of the companies under study.

6.2.4 ANALYSIS OF EARNINGS AND FUNDS FROM OPERATION OF THE COMPANIES UNDER STUDY

After having discussed the accounting policies and practices and reporting practices for the measurement of earnings in Chapter-III; Chapter-IV was devoted to analysis of normalised income statements profitability ratios, funds from operations,
share of non-cash expenses like depreciation and amortisation in the funds from operation of the companies under study. The main findings of this chapter are as follow:

1. In respect of profits earned by the companies under study the position of PTL is praise worthy followed Punwire, PACL and GNA. PNFC incurred losses during the period under study except 1993-94. ESPL also incurred losses during the period under study except 1992-93 and 1994-95. PNFC, ESPL, MFPL, Japson and PSWML have been declared sick units under sick industrial companies (special provisions) Act, 1985 and the cases for their rehabilitation have been sent to Board for Industrial and Financial Reconstruction (BIFR) whose approval is still awaited. ADIL and MFPL are running in losses.

2. The cost of goods sold as percentage of net sales varied between 29% to 305% during the period under study. The minimum range of variance was denominated in case of PSWML as this percentage varied between 88.31% to 93.76% during the period under study. PTL was the other company which experienced a narrow variation in this ratio (69.98% to 75.40%) during the period under study. Three companies namely ESPL, MFPL and Japson reported this ratio at more than 100% of net sales. This means these companies were incurring gross losses which resulted into poor performance of these companies. Cost of good sold consumes a major part of the revenue of most of the companies under study. Therefore, the profitability of the companies under study is not very encouraging.

3. PTL was the only company which could control its operating expenses within desirable limits as the percentage of its operating expenses varied between 15.04% to 18.64% during the period under study. In the case of PSWML, the ratio varied between 10.38% to 23.41%. In respect of PACL, PNFC, Punwire, ADIL and GNA Udyog Limited this ratio varied between 22.87% to 35.24%, 32.67% to 49.30%, 29.39% to 39.97%, 36.72% to 52.26% and 25.12% to 36.43% respectively. In the case of three companies namely ESPL, MFPL and Japson this ratio was very high. Sometimes even more than 100 percent. Consequently it has been reflected in their poor profitability.

4. Two out of five public sectors companies and four out of five joint sector companies under study revealed negative net profit to sales ratio. It implies that majority of the companies under study do not have good performance in
terms of profitability. It were PTL and Punwire only which reported positive net profit to sales ratio during all the years under study. The remaining companies incurred losses in one or the other year during the period under study. Following the behaviour of net profit to sales ratio, net profit as percentage of paid-up capital was reported to be positive in case of three public sector companies namely, PTL, PACL and Punwire and one joint sector company, namely GNA Udyog Limited. Remaining Companies under study reported negative net profit to paid up ratio. The behaviour of net profit as percentage of net worth is similar to that of net profit to sales and net profit to paid-up capital ratio.

5. Only three out of ten companies under study, namely, PTL, Punwire and GNA Udyog Limited reported positive funds from operation in all the years during the period under study. Remaining companies had to lose funds in business operations in one or the other year during the period under study.

6. The amount of depreciation as percentage of internal funds generated / lost in case of all the companies under study is very significant. It implies that funds from operation are significantly influenced by the amount of depreciation provision in these companies.

7. PTL and GNA Udyog Limited did not amortize any intangible or fictitious assets during the period under study. PNFC, ESPL, MFPL, Japson and PSWML reported funds lost in business operation during the period under study. Therefore the question of amortisation of fictitious and intangible assets did not arise in their case. Overall in all the companies under study except Punwire, the proportion of amortisation of intangibles and fictitious assets remained insignificant during the period under study.

6.2.5 MANAGEMENT OF EARNINGS

The Chapter-V of study was devoted to analyse and evaluate the management of earnings by the companies under study. The main findings of the study are as follows:

1. Earnings after interest and taxes but before depreciation has shown a rising trend in case of public sector companies under study during the entire study period except 1996-97. During the year 1996-97 the raw material shortages along with erratic power supply led to cost increases, thereby lowering the profitability of these concerns. In joint sector companies under study, earnings
after interest and taxes but before depreciation was positive only in 1997-98 (Rs. 228.08 lacs). In the remaining years joint sector companies reported negative earnings after interest and taxes but before depreciation.

2. There is no agreement amongst the companies under study regarding the order of importance of retention or distribution of earnings decision. PTL gives equal importance to both distribution and retention decisions. PACL and ESPL give more importance to retention decision than distribution decision. The remaining companies under study give more importance to distribution decision than retention.

3. In the primary survey of companies under study regarding the analysis of factors affecting dividend policy, it was found that stable rate of dividend on face value of share influences the dividend decision of PACL and ESPL. Market value of share is considered important by Punwire and ADIL for this purpose. Stable / Constant payout ratio is considered by PTL, PACL, and PSWML while deciding about their dividend policy.

4. The primary survey also reveals that only five out of ten companies are dividend distributing companies. Remaining five could not pay dividend because of continuing losses. Four out of five dividend distributing companies viz; PTL, PACL, Punwire and GNA aim at maintaining stable rate of dividend. PTL agrees that it strives for a long run rate of dividend where Punwire is against long run rate. Four out of five companies paying dividend consider lagged dividend while taking dividend decision for the current year.

5. PTL ranked first in terms of earning power of the companies under study. EPS in case of Punwire showed a very inconsistent trend. As compared to other companies under study Punwire ranked second, next only to PTL. GNA was on top as compared to other companies in joint sector companies under study in terms of earning power of firm. In case of Japson EPS was negative during the entire period under study. The EPS was negative in seven of the ten companies under study as they reported losses during most of the years under study.

6. The comparison of inter-company payout ratio gives misleading results. Punwire by declaring a modest dividend at a rate of 15 percent (excluding 10% tax on dividend) had 32.63 percent payout ratio in 1997-98 as compared to PTL whose payout ratio was 28.82 percent with the rate of dividend being 125 percent (excluding tax on dividend) in the same year.
7. PTL, PACL and Punwire have been able to retain a part of their profits in the form of different reserves after paying out dividends for all the years under study.

8. PTL can be identified as leader in the matter of rate of dividend paid during the period under study. Punwire was also enjoying this honour virtually up to 1995-96, after that it declined. PACL maintained rank number three in companies under study for dividend distribution. The position of remaining seven companies under study deteriorated, as they reported losses during most of the years under study.

9. Only two companies under study, namely PTL and Punwire issued bonus shares in the year 1992-93 and 1996-97 respectively during the period under study. While the remaining companies under study did not issue the bonus shares throughout the period under study. From the total cases of three bonus issues made from 1992 to 1998, the rate of dividend increased after the bonus issue in both PTL and Punwire. Both of these companies earning good profits in the year following the years in which bonus issues were made.

10. Retained earnings as percentage of internal funds generated during the period reveals the same position as was observed in the case of retained earnings as the percentage of net earnings.

11. Out of the ten companies under study PTL and Punwire are the only two companies in respect of which retained earnings as gross asset expansion ratio could be reported for all the years under study. The position of PTL was more praise worthy as compared to Punwire. Seven out of the ten companies under study could not depend upon retained earnings for expansion of their assets as they reported losses during most of the years under study.

12. Net earnings and dividend paid by the dividend paying companies under study viz.; PTL, PACL, Punwire, ESPL and GNA are positively correlated. They were significantly correlated at 5% level of significance in case of PTL and Punwire. It implies that companies base their dividend decision primarily on the level of their earnings.

13. Retained earnings and gross asset expansion of eight out of ten companies under study were positively correlated. These were significantly correlated at 5% level of significance in case of PTL, PNFC and GNA. In the case of Japson and PSWML retained earnings and gross asset expansion were negatively correlated. It implies that these companies kept on expanding
their business of mounting losses, which is not a prudent financial and commercial practices. However the remaining companies finance their assets partly from retained earnings and partly from other sources.

6.2.5 SUGGESTION FOR THE IMPROVEMENT OF THE COMPANIES UNDER STUDY.

The financial performance of most of the companies under study has generally remained very bad during the period under study. The performance of public sector companies has been better as compared to joint sector. In the public sector two companies, namely PTL and Punwire recorded profits during the entire period under study. PACL recorded profits in all years under study except 1997-98. The remaining two public sector companies viz; PNFC and ESPL incurred losses in most of the years under study. In the case of joint sector companies all the companies under study except GNA Udyog Limited incurred losses in most of the years under study. The poor performance of these companies may be ascribed to lack of proper management of their financial and operative activities. PNFC, Japson and PSWML could not operate efficiently because of working capital position. ESPL had to face a still completion from other companies supplying computer components. The position of ADIL remained bad during the period under study because the demand for its product was not as per its supply. Added to these reasons some of the companies under study did not follow prudent financial policies, for example Japson and PSWML kept on expanding the investments in their assets inspite of mounting losses. The poor performance of the companies under study may also be ascribed to lack of professional practices adopted by PSIDC. It was observed in certain cases that PSIDC took undue time in sanctioning projects and providing financial assistance especially in the joint sector companies. Consequently these companies could not perform efficiently.

As reported earlier, accounting policies and practices followed by these companies for the measurement and reporting of their earning leave much to be desired. The practices differ to such an extent that the comparison of earnings of various companies under study cannot be made objectively.

Based upon the above observations, following suggestions can be made for the improvement of the practices of measurement and management of earnings in the companies under study.
1. Effort should be made to ensure that accounting policies followed conform to the requirements of Accounting Standards issued by Institute of Chartered Accountant of India (ICAI). It may be mentioned here that now it has been made compulsory under the Companies Act, 1956 to use accounting standards issued by ICAI for the preparation and presentation of financial statements. It is hoped that in the coming years, the accounting policies and practices of companies under study would be more comparable.

2. PSIDC as a promoter company should design model formats of financial statements to be followed by companies promoted by it. This will help in fair and ready comparison of financial performance of various enterprises.

3. As a promoter, PSIDC should adopt a professional approach to ensure the efficient functioning of companies promoted by it. It was noted that PSIDC delayed the corrective measures for avoiding worsening situation. Consequently the problems which could be solved became beyond control due to lapse of time. Therefore PSIDC should develop a mechanism to take timely action to correct the worsening situation before it becomes chronic.

4. PSIDC is refinanced by IDBI in respect of financial assistance given by it to various projects in Punjab. There were cases when PSIDC could not get refinance from IDBI at proper time. Consequently it could not provide financial assistance to various companies promoted by it. Therefore, it is recommended that mechanism should be developed to have better coordination between PSIDC and IDBI in the matter of financing and refinancing.

5. Five out of ten companies under study kept on incurring losses from one year to another during the period under study. The rehabilitation scheme for their revival were delayed due to one reason or the other. For example the cases of the revival of PNFC, ESPL, MFPL, Japson and PSWML were referred to BIFR but after considerable delay. Therefore it is recommended that PSIDC should initiate rehabilitation programmes for the loss incurring companies well in time.

6. Some of the companies under study did not follow the prudent financial practices during the period under study, which resulted into accumulation of losses. For example, Japson and PSWML kept on increasing the investment in their business assets inspite of mounting losses. Therefore, it is recommended that PSIDC should ensure that unnecessary expansion in the assets of the companies under study is avoided.
6.4 SUGGESTIONS AND AREAS OF FURTHER RESEARCH

In the present study, an effort was made to evaluate the policies and practices relating to measurement and management of earnings by PSIDC promoted companies in the public sector and joint sector. PSIDC has also promoted companies in the assisted sector. For further research companies promoted by PSIDC in the assisted sector can also be considered for analysing the measurement and management of earning.

The focus of the present study was mainly on measurement and management of earnings considered separately. No effort in the present study has been made to establish a relationship between measurement and management of earnings. This is due to the fact that most of the companies under study were incurring losses. There was no question of management of earnings in their case except to convert their losses into profits. Therefore, a study could be taken up to establish a relationship between the practices of measurement and management of earnings by taking up the case of those companies which consistently earn profits and distribute dividends.