CHAPTER II

REVIEW OF LITERATURE
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It is mandatory to review the literature available for the research study. Measuring the performance of the corporate sector has always been an area of controversies from the point of view of the government, shareholders, prospective investors, creditors, employees and other stakeholders. Several studies have been undertaken to analyse profitability in the corporate sector. This chapter presents excerpts of some of the studies conducted by financial analysts.

Indra Doraiswamy (1968) in her study on “Financial Performance – An Interfirm Comparison”, analyzed the financial performance of 73 member mills of South India Textile Research Association (SITRA) during the year 1965-1966. The interrelationships between profits, capital, productivity, raw material cost and yarns selling price were studied. The study also covered the influence of number of counts spun, inventory, age and size of the mills on profit of count. The study found that raw material cost is not associated with profit and does not show any significant effect on production per spindle and labour productivity. The profit per spindle and return does not show any appreciable difference between old mills and mills started during the period 1948 to 1954.
Samuels and Smith (1968)² in their study on "Profits, Variability of Profits and Firm Size", have analysed the relationship between profitability (profit after tax on net assets) and size of the firm (net assets) and have found that they were inversely related to each other during the period from 1954 to 1963.

Indra Doraiswamy, Ratnam and Rajamanickam (1970)³ in their study on "Financial Performance- An Interfirm Comparison", presented the return on capital, profit and production costs and also analysed the factors responsible for the variation in profits. The influence of pattern of production on profits and the reasons for the fall in profits in some mills were also examined. The study found that the production patterns have a significant effect on profit variability. Labour cost and machine productivity are the two major factors influencing profit variability. The study suggested that the mills should ensure that the salaries and wages do not exceed 18 per cent of the yarn sales and machine productivity index to be not lower than 90.

Roger Cossaboom (1971)⁴ in his study, "Let's Reassess the Profitability–Liquidity Trade off", has found out the significant relationship in the profitability–liquidity trade–off. To reduce the firm’s vulnerability to further liquidity squeeze, he has stated that the
liquidity, flexibility, sensitivity, innovation and segmental financing should be examined by the firm. For future liquidity management, he has identified financial flexibility and innovation as the best approach.

Subramaniyam and Papola (1971) in “Profitability and Growth of Firms: The Case of Indian Chemical Industry”, expressed that there are a number of determinants of profitability in India. They studied the relationship between profitability and growth of firms in Indian chemical industry during the period 1962-1969 with the data of 27 companies quoted in stock exchange. They found that most of the firms want to grow with differing intensities and those of profitable firm continue to grow faster.

Indra Doraiswamy (1972) in her study “Financial Performance – An Interfirm Comparison (5th survey)”, analysed the financial performance of 85 member mills of SITRA during 1961-1970. The factors responsible for the variation in profits and the influence of pattern of production on profit were also studied. During this period, the sales turnover, current assets, current liabilities and interest charges have been doubled and fixed asset showed a marginal decrease.
Chakraborthy (1973)\(^7\) has made a study on the use of operating cycle concept for better management of working capital. He has examined the working capital as a segment of capital employed. He has found that excessive working capital would lower the capital turnover ratio and bring down overall return on capital employed. The study has proved that though a very small working capital would yield an immediate higher return on capital employed, it would reduce the earning capacity of the fixed capital employed.

Valliappan (1973)\(^8\) in his study, "Performance Evaluation of the Management of Finance in Textile Mills – A Ratio Analysis Approach", attempted to find the causes for the variation in profits and the reasons for the better financial performance of the mills. Six mills were selected for the study during the period from 1964 to 1970. Based on the return on total capital employed, they were divided into three groups as higher profit, average profit and lower profit groups. The study concludes that the profit per spindle, for the higher profit group (Rs.71) was almost 2 ½ times that of the average profit group (Rs.28) and 5 times that of the lower profit group (Rs.15). The average return on capital employed were, 24 per cent, 15 per cent and 5 per cent respectively for the three groups. The study identified high cost of production, non profitable trading on equity, lower volume of sales, lack of liquidity in working capital, over trading, over capitalization, high geared capital schedules, lack of protection for creditors funds, absence of long term financial
planning and inadequate plough back of profits as the reasons for the fluctuations in profits and financial performance of lower profit earning mills.

**Smith’s (1974)**\(^9\) was related to “Profitability versus Liquidity Trade–off in Working Capital Management”. He has suggested that the role of finance managers lies in achieving a trade off between liquidity and profitability.

**Indra Doraiswamy and Ranganathan (1976)**\(^10\) in their study on “Financial Performance – An Interfirm Comparison (6\(^{th}\) Survey)” analysed the financial performance of 106 mills for the year 1974. The influence of labour cost, machine productivity, raw material cost and yarn selling price and pattern of production on profit variability have been investigated in the study. The study found that the mills with high capital do not attain a much higher rate of production per spindle than mills with below-average capital.

**Barthwal (1976)**\(^11\) in his study on “The Determinants of Profitability in Indian Textile Industry” has examined the factors which influence the profitability. The variables used for the study are profitability, size of the firm, age of the firm, past growth, capital–output ratio and changes in average cost of production. Among them,
past profitability and changes in the average cost of production over
the previous years have been found to be significant determinants of
profitability of the firms in the industry, in different region of the
country. The other factors like capital–output ratio, size and age of
the firm and past growth have less than 25 per cent of the variation
in the profitability and were considered as insignificant.

Rao (1976)\textsuperscript{12} had found that good mills managed their fixed
assets efficiently, which was evident from the uniform rate of
investment. Good mills held a lower percentage of current assets and
high profitability while in other mills he found that it was erratic
over the period (1962-1971). He also asserted that the low current
ratio in mills indicated poor financial management.

Chakraborthy (1977)\textsuperscript{13} has conducted a study to investigate
debt-equity ratio with total assets, retained earnings, profitability and
capital intensity. He found that retained earnings and profitability
were negatively correlated, while total assets and capital intensity
were positively related to debt-equity ratio.

Agarwal (1978)\textsuperscript{14} in his study entitled “Size, Profitability and
Growth of some Manufacturing Industries” studied the relationship
between profitability and size. The study was made for seven Indian
manufacturing industries (cotton spinning and weaving, cement, cotton ginning, jute textiles, paper and pulp, sugar and aluminum) during the period 1962-1972. The relationship between the size and profitability was observed in cotton spinning industry, jute textile industry, sugar and brewing industry and aluminum industry, but there was no relationship in the cement and cotton spinning and ginning industry.

Lambrix and Singhvi (1979)\(^{15}\) in their study, pointed out that a firm can shorten the working capital cycle and improve cash flow by reducing the time between receipt of raw materials and by minimizing the time involved in paper work. The cash flow can also be increased by improving the terms on which a firm buys and sells goods and also by improving the effective receipt or disbursement of cash. The researchers have suggested that the predetermined decision level of working capital must be examined in relation to profitability measured by the return on net assets.

Rajamani (1979)\(^{16}\) in his study on, “Behavioral Pattern of Financial Ratios of Textile Mills in Tamilnadu,” analysed liquidity, profitability, turnover, investment and structural positions for a period of ten years from 1965-1966 to 1975-1976. The study indicated that the management with rare exception has been showing little concern about long term sources and their uses. Cotton Textile
Industry was a poorly paid sector compared to sophisticated Synthetic Textile Industry.

**Bhave and Patel (1980)**\(^\text{17}\) in their study, “Finances of Textile Processing House Companies-An Interfirm Comparison” analysed cost and profitability based on 24 textile processing companies for 3 years (1976-1978). The study found that the return on capital employed was fairly satisfactory, but return on equity was not adequate. An examination of the cost structure revealed that the top rank cost element was direct material (41 per cent), followed by wages and salaries (18 per cent) and power and fuel (14 per cent). The companies were found relying largely on borrowings for raising capital.

**Kulshrestha (1980)**\(^\text{18}\) in his study on “Corporate Liquidity – X Rayed” has established that excessive liquidity would result in lower profitability and deterioration in managerial efficiency.

**Singh (1981)**\(^\text{19}\) has found that the size of the units has a significant role in the capital structure of a cement industry. His study has revealed that the returns and profitability can be increased by increasing the size from small to big.
Vishu Kanda Purohit (1982) estimates the analyzing trends of profitability of the manufacturing industries in the corporate sector during 1950-51 to 1970-71. The analysis relies upon the ratios. Variation in profitability has been analysed with the help of co-efficient of variation calculated over the period of time. The profitability has recorded an upward trend in most of the industries over the period.

Bhabatosh Banerjee (1982) in his study on “Corporate Liquidity and Profitability in India”, has identified the relationship of liquidity with profitability by analyzing the trend of liquidity position of medium and large public limited companies in India covering the period 1971-78. His study reveals that the industrial groups belonging to publishing, ferrous and non-ferrous products and shipping, have a direct relationship between the liquidity and profitability and vice versa, but tobacco, silk and rayon textiles have an indirect relationship.

Sarojini Rajkumar (1983) in her study on “Retrospect and Prospects of Indian Textiles Exports”, examined the problem encountered in the textile production and exports and also forecasted the textile exports. The study found that the percentage share of cotton fibre production to the total fibre production showed a
declining trend. During the 1970’s the overall production of mill made cotton cloth showed a decreasing trend.

Myers (1984)\textsuperscript{23} made an analysis on the theory of debt-equity structure and Myers called it the pecking order theory of capital structure. Two important empirical implications of the pecking order theory are:-

i) Most profitable firms tend to borrow the least, and

ii) Less profitable firms have a higher debt-equity ratio.

Indra Doraiswamy (1984)\textsuperscript{24} in her study on, “Financial Performance in Boom and Recession – An Interfirm Comparison (7\textsuperscript{th} survey)”, analysed 97 member mills of SITRA for five years from 1977 to 1981. The return on capital, profit per spindle and other related indices have been analysed. The effect of boom and recession on high and low profit mills have been dealt with. The return on capital was used for ranking the performance of individual mills in different years. The study concluded that in high profit group, 12 per cent of mills showed consistent increase in profits, and the remaining mills showed varying degrees of profits. In above average and below average groups, 50 per cent of the mills showed varying degrees of profits. The study identified two major factors, increase in sale value every year and steady reduction in wages, power and interest, which enabled some mills to rise to higher profit group.
Modi, Deshpande, Padmanabhan, Ranganathan, Srivastava and Trivedi (1985) evaluated the financial performance of the cotton textile industry for a period from 1962 to 1981. They examined the profit performance of spinning and composite mills. They also analysed trends in the levels of fixed assets, current assets, sales, profits and return on capital. They emphasized the need for prior feasibility studies in sick textile mills for rehabilitation.

Pandey (1985) in his study on financial leverage in India, found that there was no definite structural relationship between the degree of financial leverage and profitability and growth. Though profitability and growth improved over time, so had the degree of leverage.

He also found out through his study (1985) on “The Financial Leverage in India” that Indian companies follow a high levered capital structures. The size of the companies are highly associated with leverage and as the leverage increased, the profitability and growth also increased.

Kumar (1985) in his study on “Corporate Growth and Profitability in the Large Indian Companies”, has examined the relationship between profitability and growth in 83 large companies.
in Indian corporate sector during 1969-79. The study revealed a significant inter-industry differences in the growth of firms under study. The study showed that the growth of only a few firms in Indian corporate sector has been influenced by profitability.

**Gopalakrishna Pillai (1986)** in his study, “Growth and Profitability of Diversified Companies” has found that the growth rates and profitability of diversified group of companies were higher, compared to non-diversified group. The study concluded that the diversification strategy helps a company to attain its goals of profitability and is a recommendable policy for growth strategy.

**Gopalam and Minraj (1987)** in their study on “Financial Management of Co-operative Sugar Mills”, analysed the financial performance of co-operative sugar mills and found that owned funds were more than that of borrowed funds.

**Chalam and Chintha Rao (1988)** confined their study to the finances of the cotton textile industry. To highlight the poor performance of the cotton textile industry, they used the profitability ratios and dividend ratios. The study also examined the sources of financing in cotton textile companies in India. The study found that, this sector could not generate adequate internal funds for financing
or expanding its activities mainly because of low profitability and fall in reserves and surplus. The study observed the increased reliance on trade dues and other current liabilities. The study expressed concern about the health of the industry.

**Pandey and Bhat (1988)** have analysed the pattern of financial ratios in Indian manufacturing industries, by taking 612 companies from Reserve Bank of India data source for the period from 1965-66 to 1984-85. They identified three groups of profitability ratios to analysis the performance of manufacturing and processing industries. Their study observed a declining trend in profitability in relation to sales, shareholder’s equity and total investment and the impact of which increased with the increasing interest burden. It was also found that these groups of ratios of profitability showed a consistent declining trend across most of the firms.

**Sharma (1988)** had made a study on the management of working capital in a single business enterprise. The study points out that mismanagement of working capital and misuse of bank credit in unauthorized and undesirable channels are the important reasons for the failure or sickness of the textile mills.
The regression results have evidenced that only inventory turnover ratio has negatively influenced the total profitability and the other ratios have witnessed a positive influence on profitability. The working capital leverage of the company had recorded that the increase in the profitability of the company was less than the decrease in working capital.

Jane Cote and Claire Kamm Latham (1999)\(^{48}\) in their study, have revealed that lack of attention on working capital management would ultimately lead to the demise of a profitable organization.

Rajamanickam and Chandramohan (2000)\(^{49}\) have made a study on “Higher Productivity- key to Sustaining Profitability in Spinning Mills”. The study brought out the need for higher productivity through investment and modernisation as a means to ensure sustained profitability in spinning mills. The various cost structure, cost control and sickness recovery measures were also studied. The study revealed that the cost differences between the mills were due to variation in productivity. The study also found that the raw materials, salaries and wages are the major contributing cost to the total cost. They also suggested long and short term financial, productivity, technical and maintenance measures to control the cost.
Sahu (2000)\textsuperscript{50} has made a study on, "Analysis of Corporate Profitability a Multivariable Approach" based on the sample of 100 non-financial non-government public limited companies, in Eastern India for a period of ten years from 1984-1985 to 1993-1994. He has chosen profitability ratios and interest coverage ratio for the analysis. Spearman rank correlations of the profitability ratios for all the companies have been used for selecting the ratio for analysis. He has arrived at a single index to measure the composite profitability of a firm and ranked the companies based on the overall score.

Mohammed Rafiqual Islam (2000)\textsuperscript{51} has made a study on "Profitability of Fertilized Industry in Bangladesh" for a period from 1985-1986 to 1994-1995. Five out of seven fertilizer enterprises in Bangladesh under the control of Bangladesh Chemical Industries Corporation have been taken for the study and he had examined the earning capacity of the selected enterprises. He has identified the factors which affect the earning power of such units. Ratio analysis has been used and he has found that none of the selected units' return was consistent and all the units were affected with declining profits. Higher cost of production, poor investment policy, defective capital structure, industrial unrest and frequent disruption of process due to power cuts were found to be some of the reasons attributable for the inconsistency.
Ganesan (2001)\textsuperscript{52} in his study identified the determinants of profits and profitability in the selected State Bank group (8 units) and 19 Nationalized banks. The empirical examination of profit function shows that interest cost, interest income, other income, deposits per branch, credit to total assets, proportion of priority sector advances and interest income loss are the significant determinants of profits and profitability of Indian public sector banks. The study has found that the banking sector reforms and individual bank's policies towards direct investments and direct credit programmes have played a significant role in improving the profits and profitability of the banking sector.

Joseph, Ananthaswamy, Jade and Desai (2001)\textsuperscript{53} in their study on "An Approach to Global Benchmarking for Indian Spinning Industry", focused on quality, production, raw material procurement, warehousing and distribution. According to the study to optimize the cost of production of yarn, each cost element should be viewed separately and benchmarking are to be done. They highlighted the measure to achieve the optimization of manpower for spinning. They also discussed work practices adopted in leading Indian Mills. They used benchmarking as a vital part of the overall response for rapid changes driven by both internal and external pressures in the competitive scenario.
Revathy (2001) in her article “Financial Crisis in Textile Industry – A Case Study of Weavers Co-operative Societies (WCSs) in Tamilnadu” analysed the working capital structure of WCSs in Erode district, Tamilnadu. All Powerloom Weavers Co-operative societies (PWCs) and Handloom Weavers Cooperative Societies (HWCSs) were chosen for the study. The study covered five years, from 1990-91 to 1994-95. She found that the HWCSs are highly dependent on external borrowings. The profitability of HWCSs had been low. The working capital investment per meter production of cloth in HWCSs is nearly ten times higher than that of PWCs. Requirements of working capital are higher in HWCSs than that of PWCs, due to their high cost of production which is one and a half times of powerloom cloth. The correlation between production and working capital of PWCs is not so high as in HWCSs.

Rajamanickam, Shanmugananandam and Ratnam (2002) made an attempt “To Assess the Financial and Operational Strengths and Weaknesses of Spinning Mills for Rehabilitation of Potentially Viable Spinning Mills”. The study was based on the 77 spinning mills in southern region and covered the financial performance of mills during the period 1990-91 to 2000-01. The low profitability of spinning mills during the last few years has severely affected the working of 65 per cent of the mills and most of them have working capital shortage and some even have accumulated losses.
Shanmuganandam and Ratnam (2002) in their study on “Measures for Sustaining Profitability of Spinning Mills”, analysed the financial performance of 140 spinning mills in Tamilnadu during 1994-2000. The mills were classified as high and low profit mills. The financial performance of the spinning mills during the six years was found to be poor.

Sankaran and Krishnaveni (2003) in their article “A Study on Funds Management in Spinning Mills” studied the financial status of the Non-SSI Textile Mills. The study covered thirty member mills of The Southern India Mills’ Association (SIMA) situated in Tamilnadu, over a period of 1990-2000. The study identified the consistent and inconsistent performers based on their fund position and also analysed the long term and short term fund position. The correlation coefficient of total debt-equity ratio and current ratio on profit before tax in respect of best consistent units were significant, in case of least consistent companies, it was insignificant.

Cotton Textiles Export Promotion Council (2003) made a study on, “Benchmarking Production Cost of Textile Products”, to identify the competitiveness of Indian exporters for specific textile products in export markets relative to exports of some product from a selected competing countries and analyse the inherent reasons for
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Tirmazi, Sarah Hasan (1987)\textsuperscript{69} dealt with the structure of the Pakistan’s cotton textile industry and analysed the importance and contribution of prices and domestic government policies in the structure and growth of textile exports. The results of this study indicate that Pakistan’s textile exports are dependent on foreign demand.

Stalhammar, Nils - Olov Henrik (1988)\textsuperscript{70} examined the relationship between market structure and market performance and found that seller’s concentration is negatively influenced by the share of exports in total sales, and the wage level by the share of female workers in the labour force.

Nolle, Daniel E (1989)\textsuperscript{71} in his study examined the interdependence of market structure, profitability and trade performance and concluded that industry’s import share, export share, seller concentration and profitability are interdependent.
Kassaee, Massoud (1992)\textsuperscript{72} compared high performers with low performers cost leadership strategy and differentiation strategy. Based on the eighty eight broad woven cotton fabric mills chosen for study, it has been found that the high performers reported linkage between their business strategies and selected manufacturing strategy variables.

Kilvington, Kenneth W. (1992)\textsuperscript{73} examined the development of a textile spinning and weaving industry in South Africa and concluded that the decentralised structure hampered international competitiveness.

Eletr, AMR (1993)\textsuperscript{74} focused on the relationship between congruence and profitability in U.S. electronics industry. The study found that there was no relationship between the level of congruence and profitability for firms using traditional manufacturing systems but there was positive relationship for firms using just-in-time manufacturing. The study also revealed many of the management accounting methods and quality measure that are being used along with different types of manufacturing technology / methods.
Nachrowi, Nahrowi Djalal (1994) studied the relative cost efficiencies between government and private enterprises as well as between foreign and domestic enterprises in the textile industry in Indonesia. The empirical results suggest that government establishment are not less cost efficient than private establishment in Indonesia’s spinning and weaving industries because they are operating in a competitive market environment. Foreign spinning plants are neither cost efficient nor less cost efficient than domestic spinning plants.

Labyak, Gregory John (1994) examined the progress of cotton textile manufacturing in the South Carolina piedmont between 1880 and 1940 and also assessed the attractiveness of the state’s piedmont to textile manufacturing interests. Spearman correlation co-efficient values revealed the changing relationship between Cotton Textile Development and three of the locational factors in palmetto state countries during the study period.
Machado, Carlos A.P. (1995) in their study on exports and firm performance, examined the relationship of foreign market dependence and firm performance with the help of regression for 336 manufacturing firms in Portugal during 1987. They found that, it was positive on the productivity measure but negative on the financial indicator.

Abbott, S. Ardis (1997) reviewed the beginning of textile manufacturing in Connecticut. The study also examined the relationship of the factory community to the industry.

Ussahawantichakit, Weerachai (2002) examined the determinants of export performance and also attempted to find resources and export performance relationships in U.S. ISO and non-ISO certified firms. The United States and Thailand firms were considered for the study. The results indicate that ISO certification is significant for Thai firms, but it is insignificant for U.S. firms. The study found that all non-financial resources have significant roles in explaining the level of export performance and indicates that quality improvement resources are more influential on export performance than other resources.
Chiang, Jiunn-Chiou (2002) examined the financial and operating performances in various hospitals after the implementation of National Health Insurance (NHI). This study utilized financial ratios, chi-square tests, ANOVA and multiple regression to assess Taiwan hospital financial performance. The results showed that the hospital’s capability to meet short-term liability in Taiwan is better than that in the United States. However, the hospitals’ profitability in Taiwan is lower than those in the United States.

U-on, Vichit’s (2003) research was to identify the exporting development activities of the firms. The study examined the relationship between two groups of firms at internationalization stage. Tests of the hypotheses were conducted by using personal interview data collected from 300 Thai exporting manufacturers that produce one of the products in the thirty principal export products. Analysis of variance (ANOVA) and multivariate analysis of variance (MANOVA) were used for analysis. There are significant differences in the ratio of annual export sales to total sales between firms at different stages of internationalization and found that the internationalization stage was more useful to the main exporting activity than the firm sizes of Thai’s exporting firms.
Khaemasunun, Kamol (2005) examined the family firms in terms of profit, risk and the probability of their survival in developing countries (Thailand). Regression results showed that the single-family managed firms and corporate-style firms have significant relationship than family-partnership. According to the total return variance, the CAPM, and the Fama French three-factor model, family firms are riskier than the other two styles of management. The study results suggest that family companies and partnership companies have a lower likelihood of filing for bankruptcy than corporate-style firms.
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