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FINANCIAL MANAGEMENT IN COTTON INDUSTRY

- A Case Study

The cotton industry is the largest contribution of exchequer to the central government as well as state government by way of excise duty, income tax, purchase tax, etc. It has also made significant contribution to the foreign exchange earnings of the country. Though the cotton industry is providing more employment opportunities to the workers, earning much exchequer to the central and state governments, many cotton mills are running in losses and some other mills have closed down due to various problems.

- Mr. M.A. Dhandapani, Research scholar, Dept. of Commerce, S.V.U., Tirupathi.
- Prof. K. Jayachandra, Dept. of Commerce, S.V.University, Tirupathi.

Introduction:

Cotton is one of the important crops of India and plays a vital role in the country’s economic growth by providing substantial employment and making significant contributions to export earnings. Cotton is one of the principal crops of the country and is the major raw material for the domestic textile industry. Since 2008, the textile industry has been facing challenges due to an increase in the price of material, depressed global demand for textiles, and infrastructure problems.

The Suryalatha spinning mills Ltd., started in the year 1983 located in Munchala of Mahaboobnagar District of Andhra Pradesh state. Suryalatha spinning mills Ltd., has performed very well up to 2006. But recently the firm’s financial statements show negative results like low level of sales, poor performance in profitability and imbalance in the assets and liabilities.

The Suryalatha spinning mills limited has to improve the management of fixed assets and profitability. The spinning mill has very good record in cash management and performance of inventory management at satisfactory level.

India was recognized as the cradle of cotton industry for over 3000 years (1500 BC to 1700 AD). India produces finest and beautiful cotton fabrics since time immemorial. India, being the earliest country in the world for domesticated cotton production and manufacture of cotton fabrics has led today’s first in cotton cultivated area and second in production among all cotton producing countries in the world next to the China.

India is the 15th largest economy in the world with a GDP of USD 3.319 trillion and a GDP per capita of USD 2,900. In 2008, the textile sector contributed about 14 percent industrial production, 4 percent of the GDP and provided direct employment to over 33 million people. The textile sector is the second largest provider of employment after agriculture. Cotton is one of the principal crops of India and plays a vital role in the country’s economic growth by providing substantial employment and making significant contributions to export earnings. The cotton cultivation sector not only engages around 6 million farmers but also involved another about 40 to 50 million people relating to cotton cultivation, cotton trade and its processing. The textile industry accounted for 14.4 percent of the country’s export earnings. Consumption of cotton has gone up by about 2 percent i.e. 4 million tons in 2009-10.

Financial performance of many mills is not satisfactory and leads to incurring heavy losses. Financial management is very essential element for any organization. In the present article an attempt is being made to study the financial management of cotton industry. For this purpose the Suryalatha spinning mills Ltd., Mahaboobnagar district of Andhra Pradesh was selected.

Objectives of the Study:

- To study the fixed assets management.
- To analyse the inventory management
- To examine cash management and
- To evaluate the profitability of the industry.
**Data Base:**

This study is based on the primary data. The primary data covering all financial aspects of the factory was collected through the help of a structured questionnaire specially designed for this study.

**Tools and Techniques**

The data drawn from the structured questionnaire is analysed with the help of various tools and techniques such as ratio analysis, funds flow analysis, averages and percentages.

**Fixed Assets Management**

**Value of Fixed Assets:**

While investing funds in fixed assets, management must examine the various methods which give higher rate of return on investment. According to the chief accountant of cotton mill, they are adopting discounted cash flow method.

The values of fixed assets in the year 2005-06 were Rs.60.56 crores. The value of fixed assets abnormally increased during the years 2006-07 and 2007-08 and finally increased to Rs. 90.42 crores in 2009-10. The reason is modernization programmes undertaken by the cotton mill. The average fixed assets during the study period were Rs. 81.97 crores. (Table 1)

It is observed from the Table I, the value of fixed assets in the cotton mill increased abnormally in the year 2006-07. The reason may be modernization programmes undertaken by the cotton

<table>
<thead>
<tr>
<th>Year</th>
<th>Fixed Assets</th>
<th>Total Assets</th>
<th>Percentage</th>
<th>Sales</th>
<th>Times</th>
</tr>
</thead>
<tbody>
<tr>
<td>2005-06</td>
<td>60.56</td>
<td>91.89</td>
<td>65.90</td>
<td>181.14</td>
<td>2.99</td>
</tr>
<tr>
<td>2006-07</td>
<td>103.53</td>
<td>141.07</td>
<td>73.39</td>
<td>205.57</td>
<td>1.99</td>
</tr>
<tr>
<td>2007-08</td>
<td>78.75</td>
<td>104.75</td>
<td>75.18</td>
<td>175.69</td>
<td>2.23</td>
</tr>
<tr>
<td>2008-09</td>
<td>76.60</td>
<td>106.59</td>
<td>71.86</td>
<td>158.41</td>
<td>2.07</td>
</tr>
<tr>
<td>2009-10</td>
<td>90.42</td>
<td>121.49</td>
<td>74.43</td>
<td>169.69</td>
<td>1.88</td>
</tr>
<tr>
<td><strong>Average</strong></td>
<td><strong>81.97</strong></td>
<td><strong>72.15</strong></td>
<td><strong>2.23</strong></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

The fixed assets turnover ratio decreased from 2.99 times in 2005-06 to 1.99 times in 2006-07 and increased from 1.99 times in 2006-07 to 2.23 times in 2007-08.

The values of total assets in the year 2005-06 were Rs.91.89 crores and abnormally increased to Rs. 141.07 crores in 2006-07. The value of total assets decreased in the year 2008-09 to Rs. 106.59 crores and in 2009-10 Rs. 121.49 crores. The percentage was increased during the years 2006-07 and 2007-08 and decreased in the year 2008-09.

The percentage of fixed assets to total assets in the year 2005-06 was 65.90. The percentage was increased during the years 2006-07 and 2007-08 and decreased in the year 2008-09. Finally the percentage was increased to 74.43 in the year 2009-10. The average percentage of fixed assets to total assets worked out to 72.15 percent. (Table 1)

**Fixed Assets Turnover Ratio:**

Maximum utilization of Fixed Assets is one of the ways of increase profitability. Efficient management of fixed assets serves this purpose. The efficiency depends upon the fixed assets turnover ratio.
in 2007-08. Further the fixed assets turnover ratio decreased from 2.23 times in 2007-08 to 1.88 in 2009-10. The average fixed assets turnover ratio is 2.23 times. During the study period the fixed assets turnover ratio is less than the standard ratio. The lowest time indicates the poor utilization of fixed assets. This may also be a sign of fact that funds are not being employed fully or they are not being utilised properly.

Inventory Management:

Inventory Turnover Ratio:

Inventory turnover ratio is also known as stock turnover ratio, establishes a relationship between the cost of goods sold during a period and the amount of inventory. This ratio acts as an indicator of the liquidity of the inventory. A higher turnover indicates efficient inventory management of a firm. This ratio helps in judging the efficiency of inventory management.

Inventory turnover ratio and percentage of inventory to current assets is presented in table. 2. The inventory turnover is 26.10 times in 2005-06. This ratio decreased from 26.10 times in 2005-06 to 11.67 times in 2007-08. Further this ratio increased from 11.67 times in 2007-08 to 18.86 times in 2008-09 and decreased from 18.86 times in 2008-09 to 10.40 times in 2009-10. The average inventory turnover ratio during the study period is 17.42 times.

Normally the inventory constitutes a major percentage in current assets. But in the sample cotton mill the percentage of inventory to current assets varies from 17.14 percent to 39.78 percent. The percentage of total inventories to total current assets in 2005-06 is 17.14 percent, in 2008-09 23.66 percent and in 2009-10 39.47 percent (Table 2). The increase of inventory to current assets in 2007-08 and 2009-10 is due to higher purchase of inventory.

<table>
<thead>
<tr>
<th>Year</th>
<th>Sales</th>
<th>Inventory</th>
<th>Turnover Ratio</th>
<th>Current Assets</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>2005-06</td>
<td>181.14</td>
<td>6.94</td>
<td>26.10</td>
<td>40.49</td>
<td>17.14</td>
</tr>
<tr>
<td>2006-07</td>
<td>205.57</td>
<td>10.24</td>
<td>20.08</td>
<td>48.16</td>
<td>21.26</td>
</tr>
<tr>
<td>2007-08</td>
<td>175.69</td>
<td>15.05</td>
<td>11.67</td>
<td>37.83</td>
<td>39.78</td>
</tr>
<tr>
<td>2008-09</td>
<td>158.41</td>
<td>8.40</td>
<td>18.86</td>
<td>35.50</td>
<td>23.66</td>
</tr>
<tr>
<td>2009-10</td>
<td>169.69</td>
<td>16.31</td>
<td>10.40</td>
<td>41.32</td>
<td>39.47</td>
</tr>
<tr>
<td>Average</td>
<td></td>
<td></td>
<td>17.42</td>
<td>28.26</td>
<td></td>
</tr>
</tbody>
</table>

Cash Management:

Cash management is one of the important aspects of financial management. Cash is the most liquid asset that a business owns. It includes money and instruments such as cheques, money orders or bank drafts, which banks normally accept for deposits and immediately credit to the depositors account. Cash management has mainly two objectives: (1) liquidity and (2) profitability. It is the starting point as well as the end of the operating cycle of a manufacturing concern. It is the basic input needed to keep the business running on a continuous basis and it is also ultimate output expected to be realized by selling the product.

Current Ratio:

Current ratio indicates the quality coverage of current assets over current liabilities. It indicates the
ability of the company to meet its maturing current obligations. It is also the reflection of a static condition and a relationship on one date between two variables.

The current ratio is computed as,

\[
\text{Current ratio} = \frac{\text{Current Assets}}{\text{Current liabilities}}
\]

This ratio can be expressed as:

\[
\text{Quick Ratio} = \frac{\text{Quick Assets}}{\text{Current liabilities}}
\]

The cotton mill maintained the standard ratio during the study period. The average quick ratio worked out 3.3:1. The ratio is very high when compared to standard ratio.

\[\text{Net Cash Flow Coverage Ratio}:\]

The computation of actually liquidity attempts to measure the potentiality of the firm in meeting the current obligations on the basis of cash flow coverage operations (Net profit plus Non-cash expenses / current liabilities). In the sample cotton mill the percentage of net cash flow coverage to current liabilities has remained positive. On an average the percentage worked to 4.80 percent. The net cash flow coverage ratio increased from 3.88 times in 2005-06 to 5.36 in 2007-08. The ratio decreased from 5.36 times in 2007-08 to 4.98 times in 2008-09 and finally increased to 5.22 times in 2009-10. If there is any demand from sundry creditors, the sample cotton mill in a position to pay the amount. Even sometimes the sample cotton mill may invest the excess funds in other profitable project or short term securities.

Table 3: Current Ratio, Quick Ratio and Net Cash Flow Ratio

(Rs.in crores)

<table>
<thead>
<tr>
<th>Year</th>
<th>Current Assets</th>
<th>Current liabilities</th>
<th>Current Ratio</th>
<th>Quick Ratio</th>
<th>Net cash flow ratio</th>
</tr>
</thead>
<tbody>
<tr>
<td>2005-06</td>
<td>40.49</td>
<td>9.18</td>
<td>4.41</td>
<td>3.65</td>
<td>3.88</td>
</tr>
<tr>
<td>2006-07</td>
<td>48.16</td>
<td>10.63</td>
<td>4.53</td>
<td>3.57</td>
<td>4.57</td>
</tr>
<tr>
<td>2007-08</td>
<td>37.83</td>
<td>11.84</td>
<td>3.58</td>
<td>1.92</td>
<td>5.36</td>
</tr>
<tr>
<td>2008-09</td>
<td>35.50</td>
<td>5.51</td>
<td>6.44</td>
<td>4.92</td>
<td>4.98</td>
</tr>
<tr>
<td>2009-10</td>
<td>41.32</td>
<td>10.25</td>
<td>4.03</td>
<td>2.44</td>
<td>5.22</td>
</tr>
<tr>
<td>Average</td>
<td>4.52</td>
<td>3.30</td>
<td>4.80</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Evaluation of Profitability:

Profitability implies profit-making ability of a business enterprise. For the successful management, profits are to be evaluated and compared with the previous year’s figures. The profitability of cotton mill depends upon the cost of production.

The profitability of cotton mill is analysed with reference to capital as well as sales. The return on investment in sample cotton mill varies between 5.53 percent and 16.86 percent. The average return on investment worked out to 10.55 percent (Table 4).

The percentage of cost of goods sold to sales in sample cotton mill increased from 94.70 percent in 2005-06 to 98.29 percent in 2007-08 and decreased from 98.29 percent in 2007-08 to 87.93 percent in 2009-10. It is the highest in the year 2007-08 and lowest in the year 2009-10. The cost of goods sold is high in the mill in the year 2007-08 due to rise in prices of raw materials. In 2009-10 the mill earned a net profit of Rs. 1.25 crores. But in the year 2007-08 the cotton mill incurred a net loss of Rs. 0.32 crores. During the year 2009-10, the net profit was increased to Rs. 1.25 crores due to decreasing in selling and distribution expenses. The average percentage of net profit to sales worked out to 0.28 percent.

Table 4: Return on Investment, Sales, Cost of goods sold and Gross and Net operating profit/loss

(Rs in crores)

<table>
<thead>
<tr>
<th>Particulars</th>
<th>2005-06</th>
<th>2006-07</th>
<th>2007-08</th>
<th>2008-09</th>
<th>2009-10</th>
<th>Average</th>
</tr>
</thead>
<tbody>
<tr>
<td>Return on Investment</td>
<td>10.45</td>
<td>7.06</td>
<td>5.53</td>
<td>12.86</td>
<td>16.86</td>
<td>10.55</td>
</tr>
<tr>
<td>Sales</td>
<td>181.14</td>
<td>205.57</td>
<td>175.69</td>
<td>158.41</td>
<td>169.69</td>
<td>178.10</td>
</tr>
<tr>
<td>Cost of goods sold</td>
<td>171.54</td>
<td>195.61</td>
<td>172.69</td>
<td>144.7</td>
<td>149.21</td>
<td>166.75</td>
</tr>
<tr>
<td>Gross operating profit/loss</td>
<td>2.74</td>
<td>2.55</td>
<td>0.03</td>
<td>0.96</td>
<td>3.38</td>
<td>1.93</td>
</tr>
<tr>
<td>Net profit/loss</td>
<td>0.26</td>
<td>0.14</td>
<td>-0.32</td>
<td>0.08</td>
<td>1.25</td>
<td>0.28</td>
</tr>
</tbody>
</table>

Findings and Suggestions:

- The sample cotton mill not concentrated on sales as much as on fixed assets. They have to improve a lot in the sales department then only the fixed assets turnover ratio will improve. They must utilize the fixed assets like plant and machinery and land and building at full capacity.

- The average percentage of inventory to current assets is 28.26 crores. It is very low when compared to other cotton mills. So it is suggested that the cotton mill should set up purchase committee to take decisions and adopt an appropriate inventory control system.

- The current ratio and quick ratio showed that the cotton mill has maintained more than required funds. Though the mill has more than standard ratios regarding to current ratio and quick ratio, they have paid interest unnecessarily towards idle funds invested in the shape of current assets as well as quick assets. Therefore, the management has to decrease current assets by way of investing idle funds into short-term securities.

- The average of cost of goods sold and sales is 166.75 crores and 178.10 crores respectively. The average percentage of cost of goods sold to sales is 93.63. Moreover it has an increasing trend. So the mill should plan the level of operations through the estimated cost of production.

Conclusion:

The performance of the Suryalatha spinning mills limited has been satisfactory except in fixed assets management. The inventory turnover ratio is also good during the study period. As far as concerned to the liquidity ratios, the company maintained more than the standard ratio. The company has to control the cost of production and utilize the fixed assets at maximum level.

Business Vision: October
December 2012

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