CHAPTER-I
INTRODUCTION

1.1 Introduction to Study

The Indian Iron and Steel industry contributes significantly to the overall growth and development of the economy. As per the estimation of the ministry of steel, the industry today directly contributes to 2% of India’s GDP and its weightage in the official index of Industrial Production (IPP) is 6.2%. The industry has been able to shape out a niche for itself globally. From a country with a production of one million tonnes at the time of independence, it has now become the world’s 4th largest producer of crude steel preceded behind China, Japan and the US. Crude steel production grew by 4.6% to 81.2 million tonnes and steel demand grew by 1.8%. India’s GDP growth has slowed down to 5% in 2013 on account of rising inflation and tight monetary controls. This has led to weak domestic steel demand, which grew by 3.3% in 2013, in spite of a rise in demand in the last quarter.

Due to infrastructure creation and urbanization emerging as key growth enabler, the Indian economy is witnessing rising import of steel in recent times. This has resulted in India becoming the big exporter of steel in Financial Year 2013-14 after a gap of six years. Total steel exports by India during the Financial Year stood at 5.59 million tonnes, as against imports of 5.44 million tonnes as per the report issued by the Joint Plant Committee (JPC), a unit of the steel ministry. India's GDP is expected to grow by 5% and steel demand is expected to grow by 3.3% in 2014. However, in the past three years, growth in this sector has been just 5%. Observed with the market trend, the National Steel Policy 2012 is being set in place to facilitate rapid growth of the domestic steel sector by ensuring more rapid capacity addition. At
the same time, India is committed to reduce GHG Emission Intensity of its GDP to 20-25% by 2020 over the 2005 level, through pursuits of proactive policies. There is a need to transform the technological face of the Indian steel industry to achieve international benchmarks as a long-term strategy. The present study makes evaluation to identify the financial strength and weakness of select steel companies in India.

The study evaluates the profitability level of selected steel companies to know their financial strength and weakness, it will lead to increase financial tactic to compete with international steel producers. Profitability involves profit-making ability of business. Profitability is defined as the ability of invested capital to earn a return from its uses and it is the relationship of the earnings to total capital of the company. Profitability is an overall indication of the strength and weakness of the company. Therefore, profitability is the main sign of the efficiency and effectiveness of a business enterprise in achieving its goal of earning profit. Profitability as a relative measure enables the management to make prompt changes in the financial and production policies in the beam of the past performance. The important managerial decisions are pertaining to such issues, expansion of plant, implementation of modern technology, raising of additional funds, and also payment of bonus and dividend are depending on profitability of the firm.

Further, with the evaluation of dividend progress of steel companies to identify how the companies are retaining their existing investor and attracting new investor to keep its market share position in stable level because the investor is the major key player to start and run a business and keep this position, the company has to fulfil investor’s financial needs through the issuing of dividend and other financial benefits. Dividend decision is one of the three major important decisions of financial
management. The financial manager has to choose between the distribution of earnings and retention of earnings. The choice would depend on the effect of the decision on the shareholder wealth. For this, the payment of dividends should be preferred to maximize shareholders wealth. Otherwise, the company should retain the profit. The financial expert has to take a decision for dividend payment based on dividend policy of firm’s determinants and the proportion of retaining earnings that are reinvestment purpose.

**Profit and Profitability**

Not only profit, but also income changes in operational efficiency and financial performance of the company show the complete position. It is very difficult and confused to interpret the absolute figures of profit in case of past or inter-firm comparisons due to variation in the size of investment and volume of sales, etc. Such problem handled by relating level of profit moreover with the volume of sales or with the level of investment. This quantitative relationship measures in the form of ratios or percentages, mainly by using of profitability ratios. The profitability is a relative term measurable in terms of profit and its relation to other factors that can directly influence the profit.

The primary objective of business is to earn profits. The amount of profit earned measures the efficiency of a business. The higher level of profit indicates the higher efficiency of the company. Profitability is the ability to earn profit from all the activities of the company. It indicates the efficiency of company earning generation by using all the resources of the company. Profitability is the combination of two words profit and ability. The word profit represents the absolute figure of profit or otherwise of increase or changes in performance of income and expense as shown in the financial statement of the company and the word ability indicates the power of an
enterprise to earn profits called earning performance. Earnings are the very important obligation to continue the business. Therefore, a healthy company is that which has good profitability. Weston and Brigham define profitability as "the net surplus of a large number of policies and decisions". According to Hermenson Edward and Salmonson “profitability is the relationship of income to some balance sheet measure which indicates the relative ability to earn income on assets employed.”

Profit and profitability are strongly related and mutually interdependent. Profit of an enterprise means reports about the financial and operational efficiency of the business; also, profitability interprets the term profit in relation to other factors likely to affect these profits in order to help in financial decision-making.

Profit is regarded as an absolute connotation as against profitability, which is regarded as a relative concept. Where profit is the excess income left after meeting all manufacturing, administrative expenses; it indicates the amount of earnings of a business during a specific period. At the same time, profitability denotes whether these profits are constant, increased, or decreased, and it shows degree profit can be improved. Profit in two separate business concerns may be equal; it usually happens in the profitability varies when measured in terms of size of investment. It has been rightly remarked that the role played by profits and profitability in a business is very important to the function carried out by blood and pulse in the human body.

Concept of Profitability

1. Accounting concept

Profitability is a measure of evaluating the overall efficiency of the business. The best possible course for evaluation of business efficiency may be input-output analysis. Profitability can be measured by relating output as a proportion of input or matching it with the results attained in the different periods. The profitability of a firm
can be evaluated by comparing the amount of capital employed, i.e. the input with income earned and the output popularly known as return on investment or return on capital employed.

This method is mainly accepted as an indicator of performance and capability. This is the reason for viewing operational and financial performance in relation to the scale of resources of funds required for operation. That is a given amount of profit return should be evaluated in terms of the percentage profit return on the investment. Moreover, the return on investment used to indicate the effectiveness of all the financial decisions from the routine to the critical, made by the management in all functional areas of the organization.

2. Social concept

Along with the primary economic objective of earning profits, a business is also required to fulfil a large number of social objectives like above and beyond providing better quality of goods and services, provides good employment opportunities to the people, better work environment, fulfils people need, conserves resources and so on. Mean Cardiner rightly observed, "the darkness of greediness has been dispelled by the light of a new kind of social responsibility". Social objectives may prove profitable as well as expensive concern. As some objectives aids in enhancing profitability by attracting customers like in case of providing quality goods. Whilst others may be counteractive such as elimination of pollution may cost the company and reduce its profitability, but it creates social profitability. Earnest Dale, these social objectives appear to urge the executive to assume an infinite broad-gauge burden of responsibilities to all the various public with whom he clears. That makes it an obligation on the part of the company to disclose its financial, marketing,
personnel and social objectives in a simple and short form to all the members of the concern so that they can judge the influence of these objectives on their jobs.

3. Value Added concept

Wealth generation is essential for every company. Value added profitability indicates the wealth generated as a result of the manufacturing process during a specified period. Wealth generation is the very essence for survival or growth of a business. An enterprise may survive without making profit, but would cease to do so without adding value. If the enterprise is not making profit, it will bound to become sick, but not adding value may cause its death over a period of lime.

Profit forms a part of value added. Thus, value added is a broader concept. Value added at a particular level of operating capacity and claims should be determined and it can represent the efficiency and inefficiency of a business. The concept of value added can be related to the concept of social profitability of an enterprise. The investment of an enterprise comprises of the investment of shareholders, debenture holders, creditors, financial institutions, etc. If an enterprise fails to generate growth or add anything as value added, it would simply mean that the enterprise is misusing public funds. This concept represents the wealth distribution in a proper manner besides suggesting how productivity can be increased when reducing the consumption of resources produces same or better outputs.

Analysis and Measurement of Profitability

The importance of analysis and measurement of profitability has been stated by Hingorani, Ramanathan and Grewal, “a measure of profitability is the overall measure of efficiency”. The most effective tool of analysis of profitability is ratio analysis. Ratios revealing profitability are generally called profitability ratios. Profit
may be derived either from operating or from non-operating activities. However, profits alone cannot state the concept of profitability. Thus, there arises a need to establish relationship between profit and other variables. Present study-highlighting the position of profits is resulting from business activities of selected steel companies by using following financial ratios.

I. Profit Margin

The profit margin is a measure of overall profitability. These measures also refer to the net income percentage or the return on sales. The profit margin is the return generated by the company's assets and represents the difference between total income and total expenditure. In a manufacturing concern, the profit margin results from sale of goods, also it is the key figure in the income statement or profit and loss account.

1. Operating Profit Margin

It is the ratio of profit made from operating sources of the sales, usually shown as a percentage. It shows the operational efficiency of the firm and is a measure of the management’s efficiency in running the regular operations of the company.

\[
\text{Operating Profit Ratio} = \frac{\text{Operating Profit}}{\text{Sales}} \times 100
\]

\[
\text{Operating Profit} = \text{Gross Profit} - \text{Operating Expenses}
\]

Operating expenses include administrative, selling and distribution expenses, except financial expense.
2. Gross Profit Margin

The gross profit ratio shows the percentage of profits generated by the company from the sale of products or services before selling and administrative expenses. It is also known as gross margin or trading margin ratio. The operating profit ratio shows the ability of a business to produce products in a cost-effective manner. This ratio is very important to track on a trend line of sales and income.

\[
\text{Gross profit ratio} = \frac{\text{Gross Profit}}{\text{Net Sales}} \times 100
\]

The gross profit margin higher ratio is preferable and it is indicating higher profitability.

3. Net Profit Margin

As pointed out by Hingorani, Ramanathan and Grewal, “Net profit margin indicates the net margin earned on a sale of Rs. 100.” Van Home states that “the net profit tells us the relative efficiency of the firm after taking into account all expenses and income taxes, but not extra-ordinary charges”. Thus,

\[
\text{Net Profit Margin} = \frac{\text{Profit after tax}}{\text{Sales}} \times 100
\]

\[
\text{Net profit} = \text{Gross profit} - (\text{Operating Expenses + Interest and Taxes})
\]

The net profit margin shows that the efficiency of the company is related to manufacturing, financing and selling, also states the portion of income that is available for shareholders after all charges, costs and expenses.
II. Return on Investment

The most commonly used measure of profitability is related to input and output relationship of capital invested in the business, popularly known as rate of return on capital. This rate or ratio is the series of quantitative variables representing different factors of business which are interdependent and interconnected. Profitability on the basis of return on investment can be studied under following ratios:

1. Return on capital employed
2. Return on Net worth
3. Return on assets
4. Return on long term funds

1. Return on Capital Employed Ratio (ROCE)

Return on capital employed ratio measures the capability of profit in relation to the capital employed in business and it shows that the company’s profitability efficiency on capital employed. Return on Capital Employed (ROCE) ratio expressed as follows:

\[
\text{ROCE} = \frac{\text{Earnings Before Interest and Tax (EBIT)}}{\text{Capital Employed}}
\]

\[
\text{Capital employed} = (\text{Shareholders Equity} + \text{Total Debt Liabilities})
\]

\[
\text{Or}
\]

\[
= \text{Total Assets} – \text{Current Liabilities}
\]

A higher Return on capital employed ratio shows the efficient use of capital amount and it is preferable to be higher than the cost of capital. The lower ratio indicates improper utilization of the capital amount.
2. Return of Shareholders Equity/Net Worth

In the words of Clifton, the return on equity relates net to shareholder's equity. After obtaining of profit maximisation the company can concentrate on shareholders’ wealth maximisation because shareholders are all more interested in knowing the amount of return from their investment. Return on shareholders' equity measures the profitability of an owner's investment and this ratio, expressed with the following formula:

\[
\text{Return on Net Worth} = \frac{\text{Net Profit after Interest and Taxes}}{\text{Total Shareholders’ Equity}} \times 100
\]

\[
\text{Shareholder’s equity} = (\text{Equity Share Capital} + \text{preference share Capital} + \text{Share Premium} + \text{Reserve and Surplus})
\]

A higher rate of return indicates the efficiency of the management in utilisation of owner's funds. A lower rate of return shows the company’s inefficient and ineffective uses or misuse of shareholder's funds and it indicates unfavourable business conditions. For manufacturing companies, the standard rate of return on owner's fund is 10-15 percent.

3. Return on Assets

Return on assets is the ratio of expressing the relationship between the annual net revenue to average total assets of a business during the financial period. It measures effective and efficient uses of assets to generate optimum income.

\[
\text{Return on Assets Ratio} = \frac{\text{Net Profit After Tax}}{\text{Total Assets}} \times 100
\]
4. Return on Long Term Fund

The return on a long-term fund ratio is used to measure the ability of a firm that earned by using of long-term fund such as total equity fund and long term debt during the financial year. This relationship is expressed as follows

\[
\text{Return on Long Term Fund} = \frac{\text{Earnings After Tax}}{\text{Total equity fund and Long term debt}} \times 100
\]

The term total equity refers to equity share capital, reserves and surplus, profit and loss account, the term long term debt refers to debentures, bonds and long-term loan.

To analyse the profitability efficiency of selected steel companies along with the profitability ratios discussed above, the following solvency and turnover ratios are taken into analysis. This analysis studied under following ratios.

1. Current Ratio

Current ratio or working capital ratio indicates the relationship between current assets and current liabilities which shown in balance sheet of company. In addition, it measures the liquidity or short-term financial position of a company. A high current ratio is favoured to company because of company regular operation is managing effectively and in efficient manner. The low ratio indicates unfavoured to company and it shows poor management of regular operations, it is a danger signal to the management.

For manufacturing companies, the standard current ratio should be 2:1

\[
\text{Current Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}}
\]
2. Quick Ratio

The quick ratio measures the relationship between quick assets to current liability of balance sheet components, the main important of quick ratio is to judge the strength and weakness of liquidity position of the company, because the current ratio does not indicate the absolute quick position of current assets, it measures overall position of working capital. The working capital components of inventories and prepaid expenses fail to fulfil the quick financial obligation, which cannot be converted into immediate cash. The quick ratio shows the original solvency position of company is better than the current ratio. When the quick assets are higher than or equal to current liabilities, the solvency position of the company is considered satisfactory. It also indicates the ability of the business to meet its short-term financial commitments. For manufacturing companies the standard ratio is 1:1 as the yield will be adequate to meet current liabilities.

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

Quick assets consist of Current assets - (Inventories + Prepaid expenses)

3. Debt Equity Ratio

The debt equity ratio is one of the best measures to identify the long-term solvency position of the company; it shows the ability of the company to meet its long-term financial obligation. The debt equity ratio is the relationship between total debt or borrowed funds and shareholder’s fund. It also reflects the relative claims of creditors and shareholders against the assets of the company.

\[
\text{Debt Equity Ratio} = \frac{\text{Total Debts}}{\text{Shareholder’s Fund}}
\]
Total Debts = Bonds, Debenture, and Long-term loan

Shareholder’s Fund = Equity share capital, Preference share capital, Credit balance of Profit and Loss Account and Reserves and Surpluses.

4. Interest Coverage Ratio

The interest coverage ratio is a very important measure to identify the ability to pay interest charges periodically for its debt; it is based on the profit earned by a company for a specific period. The interest coverage ratio shows the number of times interest charges covered by profits. The minimum ratio is favoured to company and high interest coverage ratio may not be good for company. This ratio expressed as follows:

\[
\text{Interest Coverage Ratio} = \frac{\text{EBIT}}{\text{Fixed Interest Charges on Debt}}
\]

5. Financial Charges Coverage Ratio

The financial charge coverage ratio is upgraded of interest coverage ratio. This ratio is used to measure a company’s ability to pay all its financial charges on lease payments, insurance payments, and preferred dividend payments etc.

\[
\text{Financial Charges Coverage Ratio} = \frac{\text{EBIT} + \text{Fixed Charges Before Taxes}}{\text{Fixed Financial Charges Before Taxes} + \text{Interest}}
\]

6. Inventory Turnover Ratio

Inventory turnover ratio measures the relationship between sales and inventory. It depicts the number of times inventory replaced for a specific period. The high ratio shows good signal to company, so far, a very high ratio leads to careful
analysis because it may bring the highest level of cost which associated with maintenance and carrying of inventory

\[
\text{Inventory Turnover Ratio} = \frac{\text{Net Sales}}{\text{Inventory}}
\]

7. Debtors Turnover Ratio

The debtor’s turnover ratio measures the relationship between Net credit sales and sundry debtors, it shows the number of times that the average debtors replaced during the period, it shows that the credit sales position related to debtor and bills receivable for daily movement, it is normally to consider 360 days in a year instead of 365 days in a year. The higher ratio shows the more efficient in managing of debtors and the lower ratio indicates inefficient Management of debtors.

\[
\text{Debtors Turnover Ratio} = \frac{\text{Net Credit Sales}}{\text{Closing Sundry Debtors}}
\]

8. Investment Turnover Ratio

The investment turnover ratio indicates the relationship between the total revenues and total fund invested in the business, it measures the ability of the company to produce revenue from its total investment, which borrowed from equity and total debt. The higher ratio is more favour to company because the investment is properly utilised to generate income efficiently. The lower ratio shows the inability or misuse of investment in the business because it fails to produce reasonable income. This ratio can be expressed as follows:

\[
\text{Investment Turnover Ratio} = \frac{\text{Revenues}}{\text{Shareholders Equity} + \text{Total Debt}}
\]
9. Fixed Assets Turnover Ratio

The fixed assets turnover ratio shows the relationship between sales and fixed assets used in business. This ratio measures ability to generate sales from various financial resources committed to fix assets in business also it measures the efficiency with which the fixed assets are employed and discloses under investment or over investment in fixed assets during the period. The standard fixed asset turnover ratio is 5 times. But in capital-intensive industry likes steel Industry, the normal ratio is in between 4 to 5 times. The high ratio shows good trend in the generation of sales by utilising of fixed assets efficiently. The low ratio indicates inefficient management and underutilization or no utilization of fixed assets. This ratio can express as follows

$$\text{Fixed Assets Turnover} = \frac{\text{Sales}}{\text{Fixed Assets}}$$

10. Total Assets Turnover Ratio

The total assets turnover ratio is the relationship between sales and total assets employed in business. This ratio measures the efficiency of management in using total tangible assets for generating earnings. The standard total assets turnover ratio is 2 times, but for steel Industries being of capital intensive in nature, it’s standard between 1.5 and 2 times. The high ratio indicates a good sign of effective uses of tangible assets. The lower ratio is undesirable, it shows inability of firm because no utilization or underutilization of assets leads to low income generation

$$\text{Total Assets Turnover} = \frac{\text{Sales}}{\text{Total tangible assets}}$$
Dividend

The word ‘dividend’ derived from the Latin word “dividend” which means that divided. According to the Institute of Chartered Accountants of India, “dividend is a distribution to shareholders out of profits or reserves available for this purpose.”

Also, it means that the portion of net profit distributed to shareholders, the profits after deducting all expenses, provision made for taxation, and transferring some portion of amount to reserve from the total income of the company. If the company desires to pay dividends to the shareholders, it should have sufficient profit; it should get approval from the Board of Directors and acceptance of the shareholders at the annual general meeting.

Types of Dividends

The dividend can be declared in the following forms or modes:

1. Cash Dividend

The Indian companies have practice to pay dividends in cash mode normally. For payment of dividend in cash, the company should have adequate cash resources, majority of shareholders are interested in cash dividend and according to sec. 205 (3) of the Companies Act dividend is also payable in cash mode only.

2. Stock Dividend

In Stock dividend mode, the company can pay dividend as bonus shares. The bonus shares may be allotted by the capitalisation of reserves and surplus of a company. Such shares may issue to the equity shareholders in proportion to their holdings of the equity shares of the company. However, in India issue of stock dividend is not permitted. The dividend has to pay in cash mode only. According to
SEBI’s guidelines for issue of bonus shares, “bonus shares cannot be issued in lieu of can issue bonus shares frequently in addition to cash dividend.”

3. Scrip Dividend

The dividend given in the form of promissory notes to pay the amount at a specific future date is known as scrip or dividend certificates. The company can go for this mode of dividend when there is a shortage of cash. The scrip may or may not be interest bearing.

Dividend Policy

According to Weston and Brigham, “dividend policy determines the division of earnings between payments to shareholders and retained earnings.”

The dividend policy of a firm greatly influences the dividends and retained earnings proportion decision. As discussed above, the dividends are payable in cash mode by the company to its shareholders. The Retained earnings should be a part of business surplus remaining earning should kept as reserve for financing firm’s long term growth or it reinvest in the business, also the dividend policy of a firm affects shareholders wealth as well as firm's long term financial position. Financial experts shall adopt a usual dividend policy in order to bring consistency for better investment. The experts also suggest that the company should not pay dividends in the beginning of business operation. That should pay after evaluation of past performance and predicted of future performance.
Types of Dividend Policies

1. Stable Dividend Policy

The stable dividend policy means the company paying dividend as fixed rate in regular payment. It may consider two different ways, such as constant amount per share and consent pay out ratio, the consent amount per share is the policy to pay a fixed amount of dividend per share regularly and constant payout ratio policy describes a fixed percentage of net profit paid as dividend every year.

2. Policy of No Immediate Dividend

In this dividend policy, the company suggested to pay no dividend even it generates high profit in the beginning of business operation. Instead of dividend payment the net profit completely retained and it uses for company growth and expansion, if desire to pay dividend, it may issue bonus share or it can split its outstanding shares.

3. Policy of Irregular Dividend

The company does not follow the fixed dividend payment regularly, but make changes for every year and the dividend payment decision made based on companies continues profit generation, liquidity and other future financial requirement.

4. Policy of Regular Dividend plus Extra Dividend

This policy provides the regular fixed dividend payment for its shareholders, after retaining of sufficient fund for future requirements, and it provides additional policy to pay extra dividend along with regular dividend payment. It is based on the excess fund available in the company or necessity of payment to satisfy shareholders of the company.
5. Policy of Regular Dividend plus Stock Dividend

In this policy the company pays regular dividend along with extra stock as bonus share. The policy follows when a company generates high continues profit for long periods. The purpose of the payment dividend in stock form instead of cash, the company wants to increase its outstanding share in the market and retaining its profits for expansion of business. It is only preferable for some specific periods and not preferable for long period of business.

Factors Affecting Dividend Policy

The following important factors should be considered by the board of directors when taking of dividend decision, the factors are discussed below.

1. Preference of Shareholders

It is one of the factors to take dividend decision, commonly the majority of retail investors are very much interested to get a dividend, but there are some shareholders, especially a high net worth investor like to get capital gains and benefits for capital appreciation that increases net worth. In such a case, the policy is decided by the dominating group of shareholders of a company.

2. Current Year’s Earnings

The payment of dividend fixed based on the company’s earnings level. The company has to determine the amount of dividends from the actual earnings of the current year only. Based on dividend policy, the whole earnings cannot distribute as dividends.
3. Past Dividends

Before deciding the current dividend payment the board of directors should take account of past dividend, because the majority of shareholders are expecting to get dividend more than what the company paid past periods and that leads to satisfy the shareholders.

4. Management Control Motive

The existing shareholders or management’s control motive also influences the dividend policy of a firm. When the management wants that the existing shareholders should continue to retain control over the firm but it does not raise finance through issues of new shares, because the control is diluted into the hands of new shareholders.

5. Liquidity Position

Dividend payment is made only in cash mode. The liquidity position of the firm affects its dividend decisions. Even the firm earned good profits, it should have enough cash to pay dividend. Also it shows capacity of liquidity position of company.

6. Future Financial Requirements

The payment of dividend is portion of profits that is after detecting of all financial obligations, the excess fund is used for dividend payment. When taking of dividend decision, the finance manager has to consider the company’s future financial requirement in the aspect of short term and long term. That support to expansion of business and modernisation of industry. It leads to retaining a maximum of its earnings and minimum dividend payout ratio.
7. Access to Capital Market

The dividend policy of the company should make easy access to capital markets, because it helps to raise additional fund with minimum cost. It can afford to adopt suitable dividend policy. Otherwise the company may meet struggle to raise additional fund in the capital market. It has to depend more on retained earnings of funds required for its expansion programmes. This also affects the dividend policy of the companies.

8. Contractual Restrictions

The contractual restriction is one of the major factors that affects dividend policy of the company, when the company raise funds from external sources the company restricted by certain specific conditions in loan agreements by the creditors to exempt themselves from possible insolvency of the firm.

9. Taxation Policy

The corporate taxes affect the rate of dividend of the company. The profit after tax only takes account for payment of dividend. High rate of taxation on profit reduces profits available for distribution to shareholders of the company. In addition, the government levies additional dividend tax on distribution of profits beyond a certain limit.

10. Inflation

Inflation is one of important factors that affect the dividend policy of a company. With rising prices, funds generated by depreciation may fall short in order to replace obsolete assets. The firms have consequently to rely on retained earnings for this purpose. The company has to retain the greater part of earnings for replacement.
11. Stability of Earnings

The stability of earnings has a significant impact on dividend policy decision. If a company generates stable earnings over a long period, it will be more moderate in its dividend policy decision. Otherwise, the company can avoid the dividend distribution to shareholders; it leads to a company’s insolvency position to generate profit.

12. Legal Restrictions

The company should follow legal procedure for taking a dividend decision; it has to fulfil so many legal obligations related to investor, company, stock market and the economy. The legal procedure plays an important role in company’s dividend policy.

Measurement of Dividend

In order to analyse the dividend position of selected steel companies, the researcher has undergone detailed discussion in the study with the following four ratios, namely the Dividend Payout ratio, Dividend per share, Earnings per share and Earnings retention ratio.

1. Dividend Payout Ratio

The dividend payout ratio indicates the relationship between the earnings per equity share and dividends paid to them. This ratio measures managerial ability and status of the company. Also, it clearly depicts the amount of retained in the business and payment of dividend to the shareholders. The higher ratio may lead to favour to shareholders to stay long period in company. This ratio is expressed as follows

\[
\text{Dividend Payout Ratio} = \frac{\text{Dividends per Equity Share}}{\text{Earnings per Share}} \times 100
\]
2. Dividend Per Share

Dividend per share (DPS) expresses the company’s total dividends paid out during a year for its equity shareholders. The sum of declared dividends for every ordinary share issued. For this purpose, annual dividend and interim dividend take account for calculation except special dividend declared by the company. The Dividend per share might be calculated by using the following formula.

\[
\text{Dividend Per Share} = \frac{\text{Total Dividend Amount Declared}}{\text{Total Number of Equity shares}}.
\]

3. Earnings Per Share

The earnings per share (EPS) shows the relationship in profitability of the firm on per equity share basis. It measures the profit allowed to the equity shareholders on per share basis. By analysing the movement of earnings per share over a period, we can understand the changes in earning power of the firm on per share basis during that period. It is an important and commonly used ratio to identify original shareholders benefits. This ratio can be expressed as follows

\[
\text{Earnings Per Share} = \frac{\text{Net Profit after Tax Interest and Preference Dividend}}{\text{Number of Equity Shares}}.
\]

4. Earnings Retention Ratio

The earnings retention ratio refers to the percentage of net income of the company that retained to grow through expansion etc., rather than paid out as dividends to shareholders. Simply, it is the proportion of earnings kept back in the business as retained earnings. The earnings retention ratio measures the percentage of
earnings paid out to shareholders as dividends. It is the opposite of the dividend payout ratio. The retention ratio changes year to year by depending on the company’s earnings stability and dividend payment policy. This ratio can be calculated as follows:

\[
\text{Earnings Retention Ratio} = \frac{\text{Net income} - \text{Dividend}}{\text{Net income}}
\]

(Or)

\[
= \frac{1 - \text{Dividend}}{\text{Net Income}}
\]

(Or)

\[
= 1 - \text{Payout Ratio}
\]

1.2 Need of the Study

The profitability entails the process and methodology of identifying company’s all operational income and expenditure value drivers at a transactional level, and aggregating to translate their workings into financial results. It is providing operational managers to use their resources in an optimal way. In addition, to get insight into the financial consequences of their operational business and it guides to increase financial control and predictability of financial results. The purpose of profitability makes the good and permanent business environment. It should create goodwill and increase value of the firm, not only for the benefit of one individual, but also for the benefit of all consumers, suppliers, employees and the community at large. Businesses can be a catalyst to transform benefits to society and nations for serving as the engine of the economy.

Once a company makes a profit, management must decide to utilize profits. In order to retain the profits within the company for the purpose of expansion and
modernization, or it could pay out its surplus profits to the shareholders in the form of dividends. If the company decides to pay dividends, it may formulate a permanent dividend policy; this policy creates a good impact on the company’s value in the financial markets to fulfill investor’s expectation. It depends on the present and future situation of the company and its financial planning. It also depends on the management decision and preferences of retail and potential investors. Therefore, that the company needs to concentrate on dividend policy and dividend declarations to retain their existing shareholders or investors and attracting new investor.

The purpose of present study makes an attempt to identify the financial strength and weakness through profitability analysis and to identify the dividend progress that increase shareholders wealth of the company.

1.3 Scope of the Study

The present study aims to make an evaluation of profitability and dividend progress of select steel companies in India. Hence, the present study is being appropriate to select steel companies. The study has used the financial facts of the select companies from 2003-2004 and 20012-2013. The financial performance of the sample companies is evaluated in terms of profitability, liquidity and dividend. The scope of financial appraisal of the company is very wide and this study is based on accounting and financial information only.

1.4 Statement of the Problem

In the present scenario, companies are facing so many problems to generate profit, due to high competition in domestic and international level. The production companies are struggling to maintain to reduce costs, increase production, and
constant profitability. Here, profitability is the primary goal of all business. Without profitability, the business will not survive for a long period. Therefore, measuring current and past profitability and predicting future profitability is very important to identify the success of the business during the period. Conversely, the highly profitable company has the ability to reward its shareholders with a high return on their investment. Profitable and continuous growth only suggests itself when all operations and financial control things deep inside the business are running well.

Payment of dividend is desirable because the shareholders contribute in the capital of the company to earn higher returns from their investment and to maximize their wealth. In this, retained earnings are the major sources of internal finance for financing future requirement such as expansion and modernisation of the company. Hence, both business growth and dividends are desirable. On the contrary, higher dividend leads to less provision of funds for growth and higher retained earnings leads to low dividends which majority of shareholders dissatisfies from return on investment. Therefore, both decisions are complementary to each other and no decision can be taken independent of the other, the finance manager has to formulate a guidable dividend policy to fix the proportion of dividend payment and retention that can retain the existing shareholders and attract new investors. Increasing profitability and dividend declaration are most significant tasks of the business managers. Hence, finance managers constantly investigate possible ways to change the business to improve profitability and shareholders wealth. These possible changes can be analysed in the present study and attempt to make the evaluation of profitability and dividend progress of select steel companies in India.
1.5 Objectives of the Study

1. To analyse various measures of profitability of select steel companies in India.
2. To estimate growth rate and forecast the values of profitability and solvency position of select steel companies in India.
3. To examine the impact of various financial factors on the profitability of select steel companies.
4. To identify the difference between the overall performance of profitability and solvency position of select steel companies in India.
5. To determine the dividend progress and growth rate of select steel companies in India.
6. To identify the various financial factors that influence for dividend payment of select steel companies in India.

1.6 Hypotheses of the Study

1. There is no significant difference in the mean Operating Profit Margin among the large cap and mid cap companies.
2. There is no significant difference in the mean Gross Profit Margin among the large cap and mid cap companies.
3. There is no significant difference in the mean Net Profit Margin among the large cap and mid cap companies.
4. There is no significant difference in the mean Return on Capital Employed among the large cap and mid cap companies.
5. There is no significant difference in the mean Return on Net Worth among the large cap and mid cap companies.
6. There is no significant difference in the mean Return on Long Term Funds among the large cap and mid cap companies.

7. There is no significant difference in the mean Return on Assets among the large cap and mid cap companies.

8. There is no significant difference in the mean Current Ratio among the large cap and mid cap companies.

9. There is no significant difference in the mean Debt Equity Ratio among the large cap and mid cap companies.

10. There is no significant difference in the mean Quick Ratio among the large cap and mid cap companies.

11. There is no significant difference in the mean Interest Coverage Ratio among the large cap and mid cap companies.

12. There is no significant difference in the mean Financial Charges Coverage Ratio among the large cap and mid cap companies.

13. There is no significant difference in the mean Inventory Turnover Ratio among the large cap and mid cap companies.

14. There is no significant difference in the mean Debtors Turnover Ratio among the large cap and mid cap companies.

15. There is no significant difference in the mean Investment Turnover Ratio among the large cap and mid cap companies.

16. There is no significant difference in the mean Fixed Assets Turnover Ratio among the large cap and mid cap companies.

17. There is no significant difference in the mean Total Asset Turnover Ratio among the large cap and mid cap companies.
18. There is no significant difference in the mean Dividend Payout Ratio among the large cap and mid cap companies.

19. There is no significant difference in the mean Dividend Per Share among the large cap and mid cap companies.

20. There is no significant difference in the mean Earning Retention Ratio among the large cap and mid cap companies.

21. There is no significant difference in the mean Earning Per Share among the large cap and mid cap companies.

1.7 Limitations of the Study

The main limitations of the study are related to the period of time, availability of data and the size of the sample covered by the study.

1. The present study is based on financial data collected from official websites of selected steel companies, NSE, BSE and company’s annual report. Hence, the quality of the study purely depends on the accuracy, reliability and quality of secondary data.

2. The study could not be extended to a longer period due to the problem of resources/data availability.

3. The companies are chosen for the study was restricted to a small number due to limitation such as lack of continuous profit earning, non-availability of data of select companies.

4. The present study is largely based on ratio analysis, which has its own limitations also.

5. There are different methods to measure the financial performance of a company. In this connection, views of experts differ from one to other.
6. This study has focused only selected steel companies in India. Therefore, the analysed results and the findings are applicable to the selected steel companies in India and not applicable to other companies.

1.8 Chapterisation

The report consists of six chapters. The first chapter deals with introduction, need, scope of the study, statement of the problem, objectives of study, hypotheses formulated and limitations of study. The second chapter presents the profiles of Indian steel industry and selected steel companies. The third chapter reviews the literature relevant to profitability and dividend under various aspects. The fourth chapter explains various aspects of methodology such as research design, data collection, sampling, framework for analysis, tools for analysis and period of study have been dealt with in this chapter. The fifth chapter depicts the profitability analysis, dividend analysis and interpretations. The sixth chapter summarises the findings from profitability and dividend analysis, conclusion, suggestions, managerial implication and scope for further study.

1.9 Chapter Summary

This chapter has dealt with various important aspects of profitability and dividend evaluation. The theoretical perspectives of profitability, dividend measurement are the important content of this chapter. The significance of carrying out this research work is also highlighted here. The next chapter provides the profile of Indian steel industry and selected steel companies.