CHAPTER - II

REVIEW OF LITERATURE
2.1. Introduction:

The researcher after discussion with various experts, industrialist, and academics had also gone through the work carried out by different stalwarts in this field which are summarized below:

Bierman and Thomas (1975) attempted to relate the working capital and the capital structure decisions. They showed that working capital is used not only as a cushion to avoid ruin but also to offset sales. They found that working capital affects the expected earnings and leads to variations in the earnings.

Barthwal (1976) studied on "The Determinants of Profitability in Indian Textile Industry" and identified the factors which cause variation in profitability. The variables used are past profitability, size of the firm, age of the firm, capital output ratio and changes in average cost of production. According to the studies Past profitability and changes in the average cost of production over the previous years have been found to be significant determinants of profitability for the firms in the industry, in different regions of the country.

Richard and Howard (1977) studied that the pre-tax profit to total liabilities, current assets to total liabilities and current liabilities to total assets are the significant ratios which can explain the corporate failures more accurately than others.

Altman et al. (1977) developed a zeta model, using financial ratios. The Multiple Discriminant Analysis is used along with linear and quadratic structure.

Bhattacharya and Raghavachari (1977) have conducted a study to determine the effectiveness of working capital taking 72 large companies, 14 banks and financial institutions. They used 11 ratios namely, current ratio, quick ratio, average finished stock as number of days sales, average raw materials as
number of days raw material consumption, average receivables as number of
days sales, cash flow as percentage of sales, creditors as per cent of raw material
consumed, profit after tax as per cent of sales, sales as number of times of total
assets, profit after tax as per cent of total assets and debt as percent of equity.

Chakraborty (1977) investigated debt equity ratio in the private corporate
sector in India. He studied the relation of debt equity ratio with age, total assets,
retained earnings and profitability were negatively correlated while total assets
and capital intensity were positively related to dept equity ratio. He showed the
regional patterns of dept of equity ratio in different industrial centres in India
and also attempted a prediction equation for dept ratio for each industry and also a
very simple methodology for calculating cost of capital. He showed calculation
of cost of capital for 22 firms.

Ramamoorthy (1978) stresses that profitability and solvencies are the twin
goals of working capital management. He states that the firm's survival and
growth depend greatly on its ability to achieve these goals. If liquid assets can
pay off the current liabilities, financial strength can be created and it can sustain
its reputation.

Gupta (1979), worked on "Financial Ratios as Forewarning Indicators of
Sickness," has made an attempt to study 41 Indian textile companies. He has
applied 63 financial ratios and concluded that 2 ratios, viz., earning before
depreciation, interest and taxes to sales and operating cash flow to sales are
significant.

Kulshrestha (1980)" studied on "Corporate Liquidity: X Rayed". He found
that excessive liquidity would reflect lower profitability and deterioration in
managerial efficiency exhibited through inappropriate decisions taken in the spheres of expansion, credit policies and dividend policies.

Singh (1981) has stated that the size of the units has a significant role in the capital structure of the cement industry. He emphasized that increasing the size from small to big can increase the returns and profitability.

Banerjee (1982) studied "Corporate Liquidity and Profitability in India" and showed the trend of liquidity position and its association with the profitability, taking medium and large scale public limited companies from 1970-71 to 1977-78. He has found that in certain industry groups, a rise in liquidity has led to a rise in profitability and vice versa, whereas in other industry groups, the association between liquidity and profitability is negative.

Purohit (1982) in his article entitled, "Profitability in corporate Sector", showed trends of profitability of the manufacturing industries in the corporate sector. Profitability of the industries over the period of twenty four years has shown upward trends in most of industries. Returns over a period of time have been many fluctuations.

Myers (1984) studied the debt-equity structure and he has called it the pecking order theory of capital structure. The pecking order theory has two important empirical implications: most profitable firms tend to borrow the least and less profitable firms have higher debt-equity ratio.

Pandey I.M., (1984), studied about "Financing Decisions; A survey of management undertaking" the corporate manager's attitude by using a sample of 62 companies from engineering industry towards use of borrowings in India revealed that practicing managers generally preferred to borrow instead of using
other sources of funds because of low cost of debt due to the interest tax
deductibility and the complicated procedures for raising the equity capital.

Sharma and Reddy (1985) have identified the factors influencing liquidity,
by conducting a study on the liquidity position of Nigam Sugar Limited, during
the period 1974-75 to 1981-82. They have concluded that government policy
with respect to input and output has significantly affected the liquidity.

of Aluminium Industry in India" was aimed at analyzing the complex financial
situation in which the Indian aluminium industry had sailed during the period of
study from 1973 to 1983 He analyse the financial statements of aluminium
companies in India and attempted to find out the financial problems of different
units engaged in the industry.

Peddina Mohan Rao (1985) studied the "The impact of debt equity ratio
on profitability-An exploratory study of Engineering Industry in India", in which
he revealed that profitability had negative association to debt- equity ratio.

Industrial Development Bank of India Review (1984-85) on the financial
performance of the companies has brought out the striking features of the cement
industry during the Sixth Plan period. A significant point is the growth in the
after tax profits at 33.8 per cent per annum over the Plan period. The industry
recorded higher growth rates in gross value-added compared to the overall
industry rate. Growth in net assets is also higher than industry average.

Pandey (1985) studied on "The Financial Leverage in India". He showed
that there is no definite structural relationship between the degree of financial
leverage, profitability and growth and reveals that Indian companies follow a high-leverage capital structure.

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 India's corporate sector during 1968-69 to 1978-79. The study reveals the significant inter-industry differences in the growth process of firms under study. The very low value of R Square in all the cases shows that only a small fraction of the growth of firms in Indian corporate sector has been caused by profitability.

Arthur et al. (1985) studied on "Basic Financial Management" and explains that managing of firms' liquidity, investment in current assets and managing of current liabilities are the important problems of working capital management. He showed that investing in current assets, a firm could reduce its risk of liquidity but the lower overall rate of return on its investment would be lower.

Mukerjee (1986) in his study on "Management of Working Capital in Public Enterprises" in respect of Central Government undertakings and covering a period from 1974-75 to 1978-79, has identified that the current assets have increased due to the accumulation of inventories and current liabilities have increased due to increase in payables. The overall size of the working capital has been significantly influenced by the size of sales and output.

Srivastav and Yadav (1986) developed a multivariate model to establish the determinants of effective working capital management, taking 78 companies, which include 39 sick units. A discriminant model consisting of 4 variables, namely cash flow from operations to total tangible assets, current ratio, net sales
to total tangible assets and defensive assets to total operating expenses have been employed as the best discriminating function in determining the effectiveness of working capital management. In their opinion, 95% of the companies are non-effective in working capital management.

Thomas et al. (1987) in their study titled "Empirical Measurement of Operating Leverage for Growing Units," studied the relationship between the degree of operating leverage and the ratios between total assets and net sales, depreciation and net sales, fixed assets and total assets and depreciation and total assets. There has been a very low degree of negative correlation between them.

Ganga Prasad (1987) explained the working and management of Uttar Pradesh State Cement Corporation during 1984-85 to 1986-87. According to him, efficiency in the production front and better management practices were the reasons for the continuous success of the corporation.

Gupta (1988) analyzed the profitability of the cement industry with special reference to the cement units in Rajasthan. He showed that profitability of the units had been consistently good due to partial decontrol of cement.

Sharma R.P (1988), presented a research report on “Corporate financial structure and analyzed financial structure so as to assess the automobile companies in making sound financial decisions. He also suggested ways to increase profitability without additional financial obligation and sources from which additional funds can be obtained and the uses which can maximize the welfare of the concern in particular and society.

Pramod Kumar (1988) explained the financial statements of the cement industry in India since 1979, based on a sample of 23 cement units in the private
and public sectors. He explained that investment in the private sector has registered significant growth in sales compared to the public sector. A comparison of these sectors shows that utilization of investment in augmenting sales is better in the private sectors than in the public sectors.


Brealey and Myers (1991) have emphasized that according to trade off theory, high profit should mean more debt servicing capacity and more taxable income to protect resulting in a higher optimal debt-equity ratio.

Bhanu (1992) explained the capacity utilization, investment and inventory behaviour of the Indian cement industry during 1980s. She has found that underutilization of capacity is attributed to the infrastructural bottlenecks, and the effect of liberalization has diluted the investment in coal and power.

The Industrial Credit and Investment Corporation of India (1993) carried out a study on the cement industry and concluded that unless a bag of cement was sold at Rs.120, the industry would not have reasonable return on its investment. It has been pointed out that currently the industry is suffering from three vital factors: liquidity, growth in the market, and substantial cutback.

Sinha (1993) investigated the debt-equity ratio of the private sector companies in India. His showed that there is a negative correlation between the debt-equity ratio and profitability in the case of public limited companies but in
the case of private limited companies, the margin on sales has a negative correlation with debt-equity ratio.

Hyderabad (1995), in his studies "Capital Structure Planning: A New Approach", explained the financial risk and risk on account of non-employment of debt capital and the trade off between the financial risk and risk on account of non-employment of debt capital. He has concluded that the firm should arrive at a trade off between the two extremes and balance the financial risk and risk on account of non-employment of debt capital by minimizing the total risks/costs and follow an optimum capital structure.

Aramvalarthan (1996) applied regression analysis and operating cycle for estimating working capital requirements. In the regression analysis, inventory and sales as dependent variables were used.

Vijayakumar (1996) assessed the corporate liquidity with the help of discriminant analysis. He showed that industries with lower current and liquid ratios are in the high-risk group and the industries with higher current and liquid ratios are in the low risk group where the standard current and liquid ratios are 2:1 and 1:1 respectively.

Suresh Katariya (1996) analyzed the published statements of accounts of cotton textile industry in Malwa Region. He explained the profitability and financial position of the select cotton textile units. He suggests that loss-making units require the judicious combination of efficient financial administration and skilful people management.

Hyderabad (1997) in his article titled "EPS Management: An Analysis" explained that earning per share is linearly related to the amount of earning
before interest and tax, amount of debt and preferred stock. An increase in these determinants increases earning per share, other things being equal. Tax rate, cost of debt and preferred stock affect earning per share negatively. All these determinants change simultaneously and in different directions.

Beaumont Smith and Begemann (1997) showed measure the association between working capital and return on investment and to find out whether the more recently developed alternate working capital measures show improved association with return on investment to that of traditional working capital ratios.

Hyun Han Shin and Luc Soenen (1998) studied "Efficiency of Working Capital Management and Corporate Profitability" of 58,985 firms, covering the period of 1975-1994, on a composite sample, have identified that there is a strong negative relationship between the length of the firm's net trade cycle and its profitability.

Jane Cote et al. (1999) have showed that lack of attention to the working capital management would ultimately contribute to the demise of a once profitable organization.

Carol Lancaster et al. (1999) analyzed the incremental explanatory power of cash flow over the accrual income in explaining differences in measures of liquidity, for a large sample of firms. They explained the relationship between the cash flow, accrual income and liquidity are sensitive to the sample period and the measure of liquidity.

Germen Beer (1999) in his article on "Managing the Cash Gap" has emphasized the fact that cash gap affects profits directly as it has cost of financing which should be kept at low level.
Sakthivelmurugan (1999) showed the indicators for the efficient management of working capital. He studied the several indicators of efficient management of working capital is maintenance of adequate liquidity. The Z test used in this study reveals that any organization maintains above 3 points for all the years taken for the study. He has concluded that the company is maintaining adequate working capital by investing sufficient funds in its current assets and it is able to meet the current obligations without inviting the risk of bankruptcy.

Siddhanti (1999) has studied the financial health of Indian Farmers Fertilizers Corporation (IFFCO) using Z score analysis. He has observed that the financial health of the IFFCO was excellent during the year 1992-93 while in the rest of the period it was not satisfactory since Z scoring had declined from 2.72 to 1.74.

Desai (2000) studied the capital structure and the causes for business failure. The study reveals that sickness might have been caused by non-accounting factors.

Sahu (2000) studied "Analysis of Corporate Profitability: A Multivariate Approach" has made an empirical analysis based on the secondary data from a sample of 100 non-financial non-government public limited companies, in Eastern India, for a period of ten years from 1984-85 to 1993-94. He showed the Cross Sectional Spearman's rank correlation of the profitability ratios for all the companies have been calculated and applied for selecting the ratios for analysis.

Hrishikes Bhattacharya (2001) explained the capture the essence of natural business year and translated it into operating cycle. According to him, if logical natural business year is followed, then the true operating cycle of a
business should be either the days of current assets or current liabilities, whichever is higher.

Ganesan (2001) has selected State Bank of India Group and 19 nationalized banks as sample to show the determinants of profits and profitability. The empirical examination of profit function shows that interest cost, interest income, other income, deposit 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.

Shanmugam and Poornima (2001) studied the crucial role of working capital in the success of a business firm. The top management of a firm spends most of the time on working capital management. According to him the market for raw material as well as the finished product is a key factor in determining the working capital requirements.

Navdeep Agarwal and Singla (2001) developed a single index for the appraisal of financial performance. They have analyzed eleven ratios in distinguishing profit making and loss making units. Only four ratios, namely, net profit to assets, interest coverage ratio, earning per share ratio and inventory turnover ratio are significant as the discriminatory variables.

Mahesh et al. (2002) studied the determinants of capital structure in India. The study reveals that assets composition, collateral value of assets, life of the company and the corporate size have significantly influenced the capital structure.

Balaji. V (2005) in his Ph.D., Thesis, entitle "A Comparative study of Capital structure management of TNPL and SPBL" emphasized that both the
public sector as well as private sector should maintain consistent capital gearing ratio; else the firms may go out of their control in the long run.

Achilleas Zapranis et al. (2006), explained "Forecasting Corporate Failure with Neural Network Approach: The Greek Case," have stated that the recent developments in the field of nonparametric statistical analysis have established neural networks as an efficient approach to identify the complicated relationships in multidimensional data sets, without making a prior assumption regarding the nature of these relationships.

Maria Zain (2008), explained the return on assets is an important percentage that shows the company’s ability to use its assets to generate income.

Gopinathan Thachappilly (2009), explained the Financial Ratio Analysis for Performance evaluation. He explained the relationship between the different ratio categories such as profitability ratios, liquidity ratios, debt ratios, performance ratios, investment evaluation ratios.

James Clausen (2009), stated that the Profitability Ratio Analysis of Income Statement and Balance Sheet Ratio analysis of the income statement and balance sheet are used to measure company profit performance. He showed the relation between ratio analyses of the income statement and balance sheet. The income statement and balance sheet are two important reports that show the profit and net worth of the company. He also shows how well the assets are performing in terms of generating revenue.

Gopinathan Thachappilly (2009), explained the Profitability Ratios Measure Margins and Returns such as gross, Operating, Pretax and Net Profits, ROA ratio, ROE ratio, ROCE ratio. He determines the Gross profit is the surplus
generated by sales over cost of goods sold. He explains about the operating profit margin. Operating Profit Margin = Operating Profit/Net Sales or Revenue. - The denominator is the average total assets employed during the year.

Gopinathan Thachappilly (2009), explained that Liquidity Ratios help Good Financial. He knew that a business has high profitability, it can face short-term financial problems and its funds are locked up in inventories and receivables not realizable for months. He explained that current assets include Cash, Cash equivalents, Marketable securities, Receivables and Inventories. Current liabilities include Payables, Notes payable, accrued expenses and taxes, and Accrued installments of term debt). Current Ratio = Current Assets / Current Liabilities. Similarly, Quick ratio excludes the illiquid items from current assets and gives a better view of the business' ability to meet its maturing liabilities.

Gopinathan Thachappilly (2009), showed that the EPS is computed by dividing the company's earnings for the period by the average number of shares outstanding during the period. He discuss that Stock analysts regularly estimate future EPS for listed companies and this estimate is one major factor that determines the share's price. Price/Earnings (PE) Ratio = Stock Price per Share / Earnings per Share (EPS). Hence, many investors prefer the Price/Sales ratio because the sales value is less prone to manipulation. Price/Sales (PS) Ratio = Stock Price per Share / Net Sales per Share. The Dividend Yield, the dividend yield ratio annualizes the latest quarterly dividend declared by the company Dividend Yield = Annualized Dividend per Share / Stock Price per Share.

James Hutchinson (2010), He realizes that about the long term debt to equity ratio of a Business.

Jo Nelgadde (2010), debt collection and debt recovery tools a company guide to using debt solution tools for effective debt collection: credit insurance, a
solicitor or debt attorney or a debt collection agency. Moreover, collection of accounts receivable, debt collection or debt recovery is an important source of a company’s cash flow and business finance. As such, learning about credit management and debt recovery can prove vital for entrepreneurs.

Munya Mtetwa (2010), in this article he short propose that about the fixed asset. He define that fixed assets are assets that are used in production or supply of goods or services and they are to be used within the business for more than one financial year. Consequently, fixed assets represent the company's long term income generating assets and they can either be tangible or non tangible. It includes land and buildings, plant and equipment, golf courses, casinos, football players, machinery and hotels depending on the nature of the business under consideration. *Fixed asset turnover = Sales / Net fixed asset.*