CHAPTER 6

SUMMARY AND CONCLUSIONS
Cotton Textile Industry is one of the oldest and the biggest industries which provides direct employment to more than 11 lakh people. It also provides indirect employment to millions of people in India. This industry consists of three different categories (a) Spinning Mills (b) Coarse and medium composite mills and (c) Fine and Super fine composite mills.

The Cotton Textile Industry in India has been growing year after year. The total mills in India has increased from 805 (525 spinning mills and 280 composite mills) in 1983 to 1,062 (781 spinning mills and 281 composite mills) in 1991; with a capacity of 26 million spindles and over 2 lakhs looms. Inspite of this tremendous growth, this industry has been facing several problems such as inadequate supply of raw material, short supply of power, increasing production costs, low capacity utilisation, unhealthy industrial relations etc. These problems have greatly affected the profitability position of the industry.

The Precot Mills Ltd. is one of the cotton processing mills in India. It has a built in capacity to produce both synthetic and cotton yarn, which is used as raw-material in textile mills. It has set up three units at Kanjikode (Tamilnadu), Kodigenahalli, Hindupur (Andhra Pradesh), and at Walayar (kerala). The central office of
the company is situated at Coimbatore in Tamilnadu State. Since its inception the company has grown both in terms of production and sales. The value of production has increased from Rs.719.54 lakhs in 1983 to Rs.4,689.10 lakhs in 1992, registering a growth rate of about 652 percent and the value of sales has increased from Rs.933.23 lakhs to Rs.5,240.25 lakhs during the same period, registering a growth rate of about 562 percent. The amount of net profit has increased from Rs.104.4 lakhs in 1983 to Rs.268.7 lakhs in 1992. Though the net profit showed an increasing trend, the rate of increase was not constant.

In spite of the growth in several spheres, Precot Mills Ltd. has been facing several problems, such as, under utilisation of capacity, labour unrest, power handy caps, scarcity of raw material etc. In addition to these general problems, it has also been facing several financial problems, such as, excessive investment in inventory, decreasing fixed assets turnover ratio, high operating ratio etc. Apart from other reasons, adoption of unsound financial principles, policies, also might have been responsible for these problems in Precot Mills Ltd.

The present study is undertaken to make a financial appraisal of Precot Mills Ltd. The areas covered are working capital management, Fixed Assets management, capital structure and profitability.
The specific objectives of the study are

(1) To analyse the efficiency of working capital management in Precot Mills Ltd.
(2) To study the capital structure and longterm financial position of Precot Mills Ltd.
(3) To study the fixed assets management in Precot Mills Ltd.
(4) To analyse the profitability position in Precot Mills Ltd.

The important observations of the study in these four key areas of Financial Management have been presented in this chapter.

WORKING CAPITAL AND SHORT TERM FINANCIAL STRENGTH

Working capital management is the most important area of financial management the efficient management of which will contribute to both liquidity and profitability. Most of the Financial Managers time in a company is spent on the management of different components of current assets. With a view to analyse short term financial strength and the management’s efficiency in bringing about a trade off between liquidity and profitability in Precot Mills Ltd. the size, structure, liquidity, efficiency aspects of working capital have been analysed. Finally the relationship
between liquidity and profitability ratios has been analysed by using the technique of correlation.

The analysis of the size and structure revealed that current assets constituted a large portion of total assets in the company during the period of study. On an average 43.40 percent of total assets in the company was committed to current assets alone.

The analysis of the structure of working capital in Precot Mills Ltd. during the study period revealed that the inventory constitutes the highest share of current assets. On an average it constituted 53.89 percent. Loans and advances had occupied second place and constituted at an average 31.29 percent. The share of Debtors to the total current assets had occupied third place and on an average it worked out at 7.52 percent cash and other current assets occupied the lowest share among the components of current assets. On an average it worked out at 5.97 percent and 0.70 percent respectively.

Analysis of liquidity has been done by using current ratio and quick ratio as they are the two important measures of liquidity in any company. The generally accepted norms for these ratios are 2:1 and 1:1 respectively. The current ratio is Precot Mills Ltd. compares favourably as it is above the standard in most of
the years of the study. The average current ratio of the company stood at 2.38 times. The quick ratio in Precot Mills Ltd. which has registered an average of 1.05 times also compares favourably with the standard. Thus liquidity position of Precot Mills Ltd. was considered sound.

The efficiency of working capital management has been measured by computing inventory turnover ratio, Debtors turnover ratio and working capital turnover ratio. The average inventory turnover ratio in Precot Mills Ltd. was 3.94 times. The ratio was above the average in most of the years of the study period, which indicates better utilisation of inventory in Precot Mills Ltd.

Debtors turnovers ratio and Average collection period measures the efficiency in credit management. The debtors turnover ratio registered an average of 36.03 times. The average debt collection period during the study period was 11 days. It is clear from this that the business is mostly transacted on cash basis and the credit policy of the company is very rigid. Working capital turnover ratio reduced from 5.54 times in 1983 to 3.32 times in 1992 and registered an average of 3.95 times respectively. As the company's liquidity position is sound and there was no situation of any working capital deficit such a rigid credit policy is not justified. Hence it is important for the company to consider the competitive environment and
liberalise its credit policy to achieve further growth in its sales.

To study of the analysis of working capital and short term financial strength of the company during the study period revealed that though the liquidity of the firm is sound, the decreasing turnover of working capital indicates decreasing efficiency of management. It only points to the high amount of investment blocked up in various current assets. This is reflected in increasing operating cycle period during the study period. Efforts should be made to reduce the operating cycle period by reducing raw material storage period which was found to be the highest. This can be done by carefully planning the material requirements, developing new sources of supply and improving negotiations with suppliers.

CAPITAL STRUCTURE AND LONG TERM FINANCIAL STRENGTH

Capital structure is one of the most important functional area of Financial Management which influences the cost of capital and value of the firm. By combining Debt and Equity capital in optimum proportions a firm can minimise cost of capital and maximise the value of the firm.

The capital structure of Precot Mills Ltd. is comprised of equity share capital (43.70 percent) and Loan
funds (56.30 percent). The capital structure of Precot Mills Ltd. has been analysed from the point of view of creditors, owners and the company. Both debt equity ratio and interest coverage ratio are intended for creditors. They indicate the margin of safety and debt servicing capacity. Both these ratios in Precot Mills Ltd. are not favourable to creditors. The average debt equity ratio was 1.32 times, which is above the generally accepted norm of 1:1. This high debt equity ratio led to decrease in interest coverage ratio. The interest coverage ratio shows a fluctuating trend and on an average it stood at 2.82 times during the study period. It has not reached the usual norm of 6 to 7 times in any year of the study period. It indicates that the debt servicing capacity of the company is not good. Thus the creditors interest is not well protected in Precot Mills Ltd. From this it is clear that the company has adopted aggressive approach of financing. This is not considered a desirable approach in view of fluctuating and low profitability of the company.

The ratio of debt to total capital reduced from 70.52 percent in 1984 to 40.03 percent in 1992 and on an average it is 62.12 percent. However, the ratio of fixed assets to long term funds indicates the adequacy of long term funds not only to cover the investment in fixed assets but also a portion of working capital. It can also be said
that the financial structure of the company is not sound as the investment of networth in assets is less than borrowed funds. Hence it is suggested that the company should increase equity capital to have a sound financial structure which will strengthen its longterm solvency position and provide sufficient cushion to creditors.

**FIXED ASSETS MANAGEMENT**

Analysis of the size of total assets in Precot Mills Ltd. during the study period reveals that fixed assets constitute the major investment up to the year 1988 and current assets form major investment in the latter years of the study period. The investment in fixed assets varied between 47.98 percent in 1989 to 71.01 percent in 1984. Gross block showed an increasing trend up to 1988 and thereafter it showed a declining trend. As fixed assets are long term in nature their investment should come from proprietors funds. To examine the financing pattern of fixed assets in Precot Mills Ltd. Ratio of fixed assets to networth and fixed assets to long term funds were calculated.

Fixed assets to networth ratio varied between a minimum of 1.21 times in 1990 to a maximum of 2.36 in 1984. The average ratio registered during the study period was 1.58 times. The ratio indicates that the firm could not reach the ideal norm of financing all its fixed assets out
of networth. Thus the company used borrowed funds to invest in fixed assets.

Fixed assets to long term funds revealed that long term funds are sufficient to finance fixed assets during the study period. The ratio varied between a minimum of 0.55 times to a maximum of 0.83 times during the study period. The average ratio is 0.67 times.

To measure the efficiency in utilising its investment in fixed assets, fixed assets turnover ratio is calculated. It denotes contribution of fixed assets to sales. Fixed assets turnover ratio of Precot Mills Ltd. during the study period varied between a minimum of 0.99 times to a maximum of 2.62 times with an average of 1.80 times. It is below the standard norm of 5 times. It indicates that the fixed assets in Precot Mills Ltd. have not been efficiently utilised in all the years of the study period. Thus the investment in fixed assets is excessive when judged in the context of sales.

Profitability of the company is influenced by the quantum of investment in fixed assets. To measure the impact of gross block on sales and operating profits, the indices of gross block, sales and operating profit of Precot Mills Ltd. during the study period have been calculated. This analysis revealed that there was an increasing trend in
both the gross block and sales. But the operating profit margin is marked with more fluctuations. Thus in Precot Mills Ltd. even though the rate of increase in gross block showed a corresponding increasing trend in sales it has no positive impact on operating profit margin. This analysis reveals that the operating income Precot Mills Ltd. is not sufficiently relative to the investment in fixed assets during the study period.

Provision of adequate depreciation is very important for the successful operations of a company. It not only helps in timely replacement of fixed assets but also is a source of working capital until the expiry of the life of concerned fixed assets. To know whether there is adequate provision of depreciation or not in Precot Mills Ltd, the trend of depreciation is compared with the trend of gross block. The index numbers calculated for this purpose indicate that the rate of increase in depreciation is more than the rate of increase in gross block. So it is evident that depreciation provided by the company is adequate.

The study of fixed assets management in Precot Mills Ltd. revealed that the company has invested huge amounts in fixed assets and relied mostly on borrowed funds for financing them. The fixed assets have not been efficiently utilised as revealed by fixed assets turnover ratio.
PROFITABILITY ANALYSIS

Profit is the ultimate test of the operating efficiency of a company. Profitability of Precot Mills Ltd. was analysed in relation to sales and investment.

Gross profit ratio fluctuates between a minimum of 9.96 percent in 1989 to a maximum of 22.50 percent in 1990. The average ratio was 15.50 percent. The ratio was above the average level in most of the years of the study period. It indicates the increasing trading efficiency of the company. The highest and the lowest Net profit ratio recorded during the study period was 13.03 percent and 2.30 percent in 1990 and 1989 respectively. The average ratio during the study period was 7.04 percent. The ratio was less than the average in five out of ten years of the study period.

The comparison between gross profit margin and net profit margin of Precot Mills Ltd. has a positive relationship. However, the rate of decrease in net profit margin in some years is more compared to the gross profit margin, indicating companys inability in controlling the operating expenses debitble to profit and loss account.

The operating ratio of Precot Mills Ltd. showed a fluctuating trend during the period of study. The average
ratio during the study period was 87.41 percent. However, the ratio was less than the average level in five years of the study period and was below hundred throughout the period of study. It indicates that the operating efficiency of Precot Mills Ltd. on the basis of sales has been satisfactory.

Profitability of Precot Mills Ltd. is also analysed on the basis of return on investment. This is analysed in terms of investment in assets, capital employed and shareholders equity. The average ratio of return on assets was 10.76 percent during the study period. The ratio was below the average in most of the years of study. Eventhough the situation has considerably improved towards the end of study period it cannot be considered satisfactory.

Return on capital employed showed a fluctuating trend during the study period. The average ratio was 13.26 percent. The ratio was below the average level in most of the years of the study. Return on shareholders equity of Precot Mills Ltd. during the study period showed a fluctuating trend. It has fluctuated between 5.63 percent in 1989 and 38.14 percent in 1990. The average ratio for the period was 18.45 percent. The ratio was below the average in most of the years of the study period which indicates poor operating efficiency.
The financial appraisal of Precot Mills Ltd. on the basis of various parameters led to the conclusion that the company should adopt a strategic approach in Debtors management rather than sticking to the present credit policy which is very rigid as Debtors turnover ratio is very high. This is particularly important from the point of view of improving the liquidity and turnover as the share of debtors in current assets at present is found to be very low. The company's financial strength and long term financial solvency can be improved by issuing equity shares rather than relying on debt capital heavily. There is great scope for improving the earning power of the company by concentrating more on the components of net profit margin rather than on the components of investment turnover.