CHAPTER - V
SUMMARY AND CONCLUSIONS

Iron and Steel Industry is one of the few basic and core industries and it is the backbone of the economic growth of any country. It is a key industry for the development of several other industries and provides basic raw-materials. Development of Iron and Steel Industry and per capita consumption of steel is regarded as an achievable index of the economic development of a country. In India, both the private and public sectors have been making good efforts to set up and expand the steel plants from the early years of the present century. Much progress has been, however, made by the public sector only from the Second Five Year Plan.

The performance of the Iron and Steel Industry is not satisfactory. This is evident from the fact that India continues to be net importer of steel. This is inspite of the fact that it has all favourable factors, like, low cost of labour, abundant availability of iron ore resources etc. Though certain external factors, such as, shortage of power, obsolete technology, inadequate transport facilities are the reasons attributed for low capacity utilization which is
reasons for poor performance; lack of proper managerial skills also might have affected the performance. Among the different managerial skills which effect the performance of an industry, financial management is vitally significant.

The present study is intended to bring out the deficiencies and inadequacies of financial management function in Navakarnataka Steels Ltd., a mini steel plant located in Bellary city of Karnataka State. This company whose performance was impressive before 1985-86 became sick and was declared by the BIFR as a sick unit. As such, an elaborate rehabilitation scheme is being implemented by the unit. Consequently, the company is now on its revival path. The findings and suggestions of the present analytical study are presented in this chapter.

FINANCIAL MANAGEMENT :: AN OUTLOOK

Finance function is the basis of all other functions like production, marketing etc. It deals with acquisition and efficient management of capital funds. It provides relatively infallible yardstick for judging most of the enterprises operations and projects keeping in view the goals of wealth maximisation of the owners.
Hence, efficient controlling and management of finances is the key to success of any business enterprise. In the present days of complex industrial environment, the subject of financial management has become an important branch of Business Administration.

For realising the objective of wealth maximisation, financial management involves three major decisions, namely (i) investment decision, (ii) the financing decision and (iii) the dividend decision. Investment decision deals with the allocation of funds for investment in fixed and current assets. Financing decision concerns itself with best financing mix of capital structure. It is related to the choice between the owned funds and the borrowed funds of different types. The dividend decision is concerned with the allocation of Firm's profits between the distribution to shareholders and retained earnings for reinvestment.

A judicious and careful exercise of these three functions enable the Firm to achieve the objective of wealth maximisation.

Some of the major findings of the present study in the areas of working capital management, capital structure and profitability are presented here.
CHAPTER - II : ANALYSIS OF WORKING CAPITAL AND LIQUIDITY

Working capital usually refers to that part of total capital which is available and used for carrying out the routine or regular business operations. Hence, the management of working capital is viewed as an integral part of overall financial management. It is concerned with the problems that crop-up in managing the current assets, current liabilities, and the inter-relationship existing between them. A satisfactory level of net-working capital is required to be maintained to ensure both liquidity and profitability of the Firm.

In this chapter, the size and structure of working capital, need for working capital operating cycle period and financing of working capital in Nava-karnataka Steels Ltd., are discussed. The liquidity position is analysed by applying various liquidity ratios. The adequacy of working capital is examined with the help of certain ratios, like working capital to sales, working capital turnover ratio, inventory turnover ratio, debt collection period. Financing aspect of working capital has been analysed on the basis of the norms of Tandon Committee Report as per the first two methods.

This analysis has led to the following observations.
1. The size of the working capital was found to be very high. This is clearly revealed by the high ratio of current assets to total assets and high proportion of current assets relative to the fixed assets.

2. The structural analysis of the working capital has revealed that the inventory forms major component of current assets in Navakarnataka Steels Ltd. Out of the inventory, the non-saleable inventory like stores, spares, graphite electrodes, scrap etc., is more than the finished goods inventory causing blocking up of excess funds, leading to lower liquidity.

3. Other current assets in the form of accrued interest on deposits and receivables, which are less liquid, amount to 25 per cent of the total current assets. They are even more than debtors which are only 20 per cent of current assets. This has further affected the liquidity of the Firm.

4. Except during the two years of the study-period (1989-90 and 1990-91), the net-working capital showed an increasing trend, showing that the company followed conservative approach of financing of assets, indicating more reliance on long-term funds for the working capital needs. Though this situation may not create liquidity problems, yet profitability will
be affected as cost of long-term funds would be higher than short-term funds. But, the situation in Navakarnataka Steels Ltd., is different. The liquidity position is not satisfactory inspite of the increase in the net working capital. This shows that the net working capital is not, always in tune with the relative measure of liquidity position.

5. The operating cycle period in Navakarnataka Steels Ltd., is more, showing an increasing trend. This indicates delay in recovering capital invested. Funds are excessively blocked-up in current assets, particularly in raw-materials which is evident by high raw-materials storage period which is due to scarcity of raw-materials and high lead time.

6. Since the working capital funds were used to be blocked-up for a long period, the company had to raise excess borrowings from Banks to meet other operating expenses. This is substantiated by applying the norms of the first and second methods of the Tandon Committee Report. Such excess borrowings beyond the limits are not cost-effective for a company like Navakarnataka Steels Ltd., which is under heavy losses.

7. The fluctuating trend of the working capital turnover ratio and also the increasing trend of inventory to current assets indicated that, but for few years, the working capital was not utilised efficiently.
The liquidity position of the company as revealed by the liquidity ratios appears to be precarious and highly depressive. However, the company borrowed heavily from KSIIDC, KSFC and Canara Bank who have given consent to extend co-operation in carrying out the rehabilitation scheme. As such, there is no immediate threat. However, the company should make efforts to improve its liquidity, mainly by improving operating results.

The preceding analysis of the size, structure efficiency and liquidity of working capital of Navakarnataka Steels Ltd., reveals that the inventory constitutes a major component of current assets in Navakarnataka Steels Ltd. In order to reduce the investment in non-saleable inventory like stores and spares, raw materials and other consumables, selective control ought to be exercised by classifying the items into A, B, C categories. This would lead to optimising investments in these components of inventory. Effective demand-forecasting is necessary to control the investment on the finished goods inventory.

Though the size of the net-working capital in Navakarnataka Steels Ltd., is high and has showed increasing trend during the study-period, the liquidity position
is not quite satisfactory. This shows the diversion of the working funds to finance the expansion programmes ought to have been carried out by long-term sources of funds. Such diversion of funds should be stopped in future especially when the expansion programmes are not commercially feasible.

The liquidity position can be improved by improving the sales through improved capacity utilization.

CHAPTER - III : ANALYSIS OF THE CAPITAL STRUCTURE

The left hand side of balance sheet is represented by total liabilities and is called financial structure of the Firm. Thus, the financial structure refers to the way how the Firm's total assets are financed. It includes both long-term and short-term sources of funds. Capital structure, on the other hand, is the permanent financing of the company represented mainly by long-term debt and shareholder's funds. Hence, the capital structure is only a part of the financial structure.

While planning for capital structure to raise funds, the Firm must bear in mind the impact of various sources of capital on the cost of capital and value of the firm and the long-term financial soundness. Every Firm should aim at 'judicious mixture of debt and equity'
that minimises the cost of the capital and maximises the value of the Firm.

This chapter aimed to measure the long-term solvency deals with the structure of long-term sources of funds, sufficiency of these funds to finance the fixed assets and the quantum of debt used in Navakarnataka Steels Ltd. This analysis has led to the following observations.

1. Long-term loans from KSIIDC, KSFC and Canara Bank were extensively employed in the capital structure of the company. Long-term loans are more than short-term funds and thus constitute, on an average 72 per cent of the total funds. Such high doses of long-term loans, as is evidenced by high debt-equity ratio has caused high interest charges which is a fixed obligation.

2. Net-worth was not sufficient to cover investment in fixed assets as it generally should be. However, the long-term funds were sufficient to cover not only fixed assets but also to finance part of the working capital requirements.

During the study-period, term loans increased at a high rate but the increase in owned funds was only marginal. The preference share capital was also redeemed.
Due to sickness, the company could not raise share capital; past undistributed profits were completely depleted. As a result of this, the net-worth was not at all sufficient to cover fixed assets.

3. Long-term debt to the total capital ratio in Navakarnataka Steels Ltd., is much more than the accepted norm of 33½ per cent, showing that the firm is highly leveraged and is risky from the solvency point of view. This is also supported by the high capital gearing ratio. Debt Equity Ratio is very high, indicating a low margin of safety for creditors. The high ratio of long-term funds to fixed assets also indicates insufficient security to creditors' claims.

4. The Interest Coverage Ratio of Navakarnataka Steels Ltd., is very low and even negative indicating the profits are not at all sufficient to cover high interest charges caused by high doses of debt.

5. The proprietary Ratio also showed decreasing trend, indicating that the new assets are acquired with borrowed funds only, in the absence of operating profits.

The analysis of financial structure, capital structure, long-term debt to capital, interest coverage ratio etc., reveals that the interest-coverage ratio is very low because of high losses. In order to have
comfortable interest coverage ratio the company should improve the operating profits or redeem some debt by issuing equity shares.

The company should increase its capacity utilisation with the help of owned funds rather than resorting to borrowed funds as the existing debt has already been out of proportion.

At this juncture, when the company is declared sick and is in the process of carrying out the rehabilitation scheme, it may, however, be difficult to raise equity share capital. The Management need not yet bother as the company is slowly recovering the losses. In this changed condition, it is useful to take the underwriting services of Canara Bank or other financial institutions and try to raise equity share capital.

CHAPTER - IV : ANALYSIS OF EFFICIENCY AND PROFITABILITY:

The success of the Firm mainly depends upon the efficient utilization of both fixed and current assets. Hence, the Management must be wise enough in having a proper blend of fixed and current assets. The efficiency with which assets are managed directly effects the volume of the sales.

In this chapter, the efficiency in utilising the fixed assets is measured by applying some efficiency
ratios, like Total Assets Turnover Ratio, Fixed Assets Turnover Ratio, Capital Employed Turnover Ratio.

1. The sales volume is not fairly relative to the total investment in fixed assets, indicating the existence of idle assets and improper use of tangible assets.

2. The Fixed Assets Turnover Ratio has been fluctuating up to the time of rehabilitation programme, indicating inefficient utilization of the fixed assets. Capital employed turnover ratio also indicates that the capital is not efficiently utilised.

Profitability:

Profit is the primary objective of any business enterprise. Every business organisation must earn sufficient profits for its survival and growth. Profitability expresses the profit-making ability of the company. It can be ascertained and analysed by computing profit either on the basis of operating-profit or net-profit or either.

In this chapter, an attempt has been made to analyse the profitability of Navakarnataka Steels Ltd., by using gross-profit Ratio, Net-profit Ratio, Return on Investment, Return on the capital Employed etc. This analysis has resulted in the following observations.
1. The company has miserably failed to control the operating costs upto 1990-91, indicated by low and negative gross profit margin. Another important reason for the low gross-profit margin is the selling price, the increase of which is not proportionate to the increase in the operating costs. Further, power consumption also constitutes more than 50 per cent of production expenses. One of the reasons for the high operating ratio and the consequent low gross-profit margin was the use of the obsolete Arc furnace which consumed more power and other consumables like graphite electrodes etc. However, the replacement of a new Induction Furnace in the place of the obsolete Arc Furnace in 1992 has ensured the control in power and some other raw-materials consumption.

2. Because of the high operating expenses, the net-profit ratio also shows negative, indicating high net losses, particularly upto 1990-91. This has resulted in the abnormal erosion of the net worth.

3. Both the gross-profit margin and net-profit margin, moving in the same direction with declining tendency and turning to negative, showed that the Firm did not show its ability to control the operating expenses and the financial charges.
4. The negative trend in the ratio of return on capital employed also shows that the company has not utilised the capital productively.

The preceding analysis of efficiency in fixed-assets utilization and profitability in Navakarnataka Steels Ltd., has revealed that the fixed assets are not utilised effectively and some assets were kept idle. The company could not make use of cancast machine purchased by investing Rs. 90 lakhs of borrowed funds showing poor investment planning. The company must take steps either to use it or dispose it off immediately. Because non-using of such heavy capital invested asset causes more financial burden like high interest and opportunity cost of such funds.

The mounting prices of inputs which exerted more strain on the mini-steel plants like Navakarnataka Steels Ltd., have resulted in the inflated operating ratio. The need of the hour is, therefore, to control effectively the operating costs. Adoption of profit planning and controlling techniques like marginal costing, standard costing and budgetary control system would undoubtedly help in controlling the operating costs.

One of the besetting problems faced by mini-steel plants is modernisation. Unless modernisation is
taken-up on a large scale, the present gradual deterioration in the capacity utilisation and the operating income can not either be checked or improved. So, the Management of Navakarnataka Steels Ltd., is advised to initiate steps, without loss of time, in this direction. The Government should also come forward to finance on very liberal terms such mini-steel plants.

Timely implementation of these suggestions, based on observations and analysis, drawn on the thorough high-profile study, would go a long way to make such sick mini iron and steel plants to a profit earning enterprises.