CHAPTER IX
SUMMARY OF FINDINGS AND SUGGESTIONS

INTRODUCTION

The Indian Sugar Industry, is a major processing industry on the industrial map of India. It has been facing several problems in the functional areas like production, marketing, personnel and finance both in the pre and post-independence periods. The present study is specifically designed to bring out the inadequacies and failures on the part of the financial management in seven selected factories belonging to three sectors viz. co-operative, private and public in Andhra Pradesh. The findings based on the empirical analysis are presented in this chapter along with the appropriate suggestions.

1. Sugar Industry in India and Andhra Pradesh

Sugar Industry, being a major industry in India, made a significant contribution, to the economy on the whole and has assumed national importance by virtue of its size, investment, output and employment. The industry produced a wide range of products to serve the specific needs and variegated tastes of consumers. Apart from its conventional use today sugar is used for producing plastics, alcohol, hormones, ethanol and others.

India is one of the largest sugar producing countries in the world in terms of area of cultivation, cane
crushed, sugar produced, investment made and employment provided. The industry contributes a major share to the industrial production and provides direct and indirect employment to 25 million cultivators comprising seven per cent of rural population in India. The work force employed directly by the sugar factories includes sizeable number of technical and administrative staff. In India, there were 392 sugar factories with 9.14 lakh TCD installed capacity in 1992, contributing to a large extent to the economic development of our country.

The sugar industry has been experiencing a severe set back during the last few decades from the viewpoint of the lower capacity utilisation and lower profit earnings. The sugarcane shortage, sugar controls and levy, labour unrest, power handicaps, and transportation bottlenecks are the main causes. Besides, more often the industry has been facing odds and crisis due to imprudent financial management. With a view to assessing the financial performance of the sugar factories in Andhra Pradesh an empirical evaluation of their working during 1981-92 is made.

II. THE DESIGN OF THE STUDY

The studies which have been already carried out on financial management in Indian industries in general and sugar industry in particular could focus on a few aspects of
financial management not viewing the finance function as an integral part of overall management. The present empirical study on financial management in select sugar factories covering all the three sectors in Andhra Pradesh is an attempt in this direction with the objectives like examination of capital structure, evaluation of fixed assets, assessment of working capital and analysis of profitability.

For the present study covering the period from 1980-81 to 1991-92 the number of sugar factories being 36 in Andhra Pradesh at the end of 1980-81 has listed out in each sector viz., co-operative, Private and Public. From the list of 18 units in co-operative sector and 7 units in private sector, 3 units of each are chosen by applying random sampling technique. In the case of public sector, the Nizam Sugar Factory (NSF) comprising of 8 units is purposively selected for the study, as no other unit is available in this sector. Accordingly, the seven factories viz., Chittoor, Kovur, Venkateswara, Jeypore, K.C.P., Sarvaraya and Nizam constitute the sample. The study is organised into nine chapters.

III. FINANCIAL MANAGEMENT : AN OVERVIEW

Finance is the key for the successful operation of any organisation. The efficient utilisation of resources depends upon proper planning and control of business
finance. Financial management, therefore, performs a crucial role in the survival and success of a business undertaking. Financial policy decisions such as risk and profitability determine the value of the firm. The planning, raising, controlling and administering the funds in the business are the four core areas of financial management. The principal objective of financial management is to maximise wealth or net present worth. A judicious and cautious planning of investment, financing and dividend decisions enable a firm to achieve the objective of value maximisation. Investment decision relates to the allocation of long-term funds and short-term funds for investing fixed and current assets. Financing decision is concerned with the best financing mix or capital structure. The dividend decision is concerned with the allocation of profits.

IV. PROFILES OF SELECT FACTORIES

1. The Chittoor Co-operative Sugar Factory Limited

The Chittoor co-operative sugar factory limited was registered in 1955. It is located at T.Chavatapalle near Chittoor of Andhra Pradesh. The installed capacity which was 1,000 TCD has been increased to 1,600 TCD in 1970. The factory had a sales of Rs. 1,515.39 lakhs and earned a net profit of Rs. 23.45 lakhs in 1992.
2. The Kovur Co-operative Sugar Factory Limited

The Kovur co-operative sugar factory limited was registered in 1974 and started its operation in 1979. It is located at Pothireddypalem of Nellore district of Andhra Pradesh. The installed capacity was 1,250 TCD and remained unchanged during 1981-92. The factory has a sales of Rs. 1,178.88 lakhs and a net profit of Rs. 42.95 lakhs in 1992.

3. Sri Venkateswara Co-operative Sugar Factory Limited

Sri Venkateswara co-operative sugar factory limited was registered in 1972 and started its operation in 1978. It is located at Gajulamandyam village of Chittoor district of Andhra Pradesh with an installed capacity of 1,250 TCD which remained constant during the period of study. The factory had a sales of Rs. 1,480.50 lakhs and a net profit of Rs. 62.55 lakhs in 1992.
4. The Jeypore Sugar Company Limited

The Jeypore sugar company limited was incorporated in 1956 and started its operation during 1961. It is located at Chagallu of West Godavari district of Andhra Pradesh with an installed capacity of 800 TCD which was expanded to 1,250 TCD, 3,000 TCD and finally to 3,800 TCD in 1992. The factory had a sales of Rs. 4,539.08 lakhs and a net profit of Rs. 233.96 lakhs in 1992.

5. The K.C.P. Vuyyuru Sugar Factory Limited

The K.C.P. Vuyyuru sugar factory limited was registered in 1941 and started its operation during 1942. It is located at Vuyyuru of Krishna district of Andhra Pradesh with an installed capacity of 800 TCD and expanded to 6,000 TCD by 1992. The factory had a sales of Rs. 5,292.13 lakhs and a net profit of Rs. 660.71 lakhs in 1992.

6. The Sarvaraya Sugars Limited

The Sarvaraya sugars limited was incorporated in 1956 and started its operation during 1959. It is located at Chelluru of East Godavari district. The initial licensed and installed capacity of the factory was 1,000 TCD and it was expanded to 1,500 TCD in 1969 and finally stood at 2,500 TCD in 1992. The factory had a sales of Rs. 2,754.29 lakhs and a net profit of Rs. 47.60 lakhs in 1992.
7. The Nizam Sugar Factory Limited

The Nizam Sugar Factory Limited was first established as a single unit in 1937 with 1,200 TCD installed capacity at Shakkarnagar of Nizamabad district and finally it expanded to eight units viz., Shakkarnagar, Madhunagar, Amurthnagar, Sudhanagar, Muthyampet, Bobbili, and Medak comprising of 11,950 TCD installed capacity during 1991-92. During the study period of eleven years the installed capacity of the factory was increased from 9,250 TCD in 1981 to 10,700 TCD in 1985 and 11,950 TCD in 1986-87. The factory had a sales of Rs. 12,604.89 lakhs and a net loss of Rs. 169,52 lakhs in 1992.

V. CAPITAL STRUCTURE AND COST OF CAPITAL

Capital structure is composed of owned and borrowed funds. In other words it comprises of long term sources of funds viz., equity share capital including retained earnings, preference share capital and debentures. In other words the judicious mix of debt and equity maximises shareholders' wealth in the long run. The inclusion of fixed interest bearing securities in the capital of a firm will lower the overall cost of capital and also increases the rate of return to equity shareholders which is generally known as financial leverage or trading on equity. Financial leverage has to be used carefully so as to maximise returns to the equity shareholders which in turn will push up the value of the firm.
This chapter deals with the capital structure, financial leverage and cost of capital besides the structure of long term sources of funds and sufficiency of these funds to finance the fixed assets and permanent current assets, and the justification for the use of debt and the effect of leverage on cost of capital of select sugar factories belonging to co-operative, private and public sectors.

A. Findings

The main sources of capital in Chittoor, Kovur and Venkateswara in the co-operative sector and Nizam in public sector was "other loans" as against reserves and surpluses in the case of K.C.P. and Sarvaraya and equity share capital in the case of Jeypore in private sector.

In all the three factories in the co-operative sector and in Nizam in public sector the second major source was equity share capital where as it was in 'other loans' in K.C.P. and Sarvaraya and reserves and surpluses in Jeypore in private sector.

There was no preference share capital and debentures in all the three factories of co-operative sector. On the whole the source of capital in the order of preference was from other loans followed by equity shares, reserves and surpluses, preference shares and debentures. Thus, other long term loans and equity share capital constitute the major source of financing the assets in select sugar factories.
Preference share capital is not popular as a source of finance in select factories as only three out of seven factories employed it and that too at a meagre level.

In Kovur and Venkateswara the item reserves and surpluses shows a negative balance as the accumulated losses were deducted from the reserves and surpluses.

The long term funds were sufficient to meet the fixed asset requirements in Chittoor, K.C.P., Nizam, Jeypore and Sarvaraya in the order of preference and insufficient in the case of Venkateswara and Kovur. Even the permanent current assets could not be met by the long term funds in the case of Venkateswara and Kovur.

The long term debt comprising long term loans and advances and retained earnings formed about 3 times to the net worth in the overall position of the select sugar factories. In Venkateswara the ratio was nil as against 20.85 times in Kovur and 2.26 times in Chittoor of co-operative sector. In private sector the debt-equity was 0.48 times in Sarvaraya, 0.68 times in K.C.P. and 0.70 times in Jeypore. In public sector the ratio was 0.93. Not even a single unit has the ratio below the norm of 0.50 times. As such the proportion of debt is abnormal to equity. Where in long term borrowed capital, thus, is much higher than desirable. As a result the sugar factories have become top heavy, bearing high interest burden, thus increasing the cost of capital.
The overall position of debt-equity ratio in all the sugar factories in all the sectors recorded at 4.37 times is much higher than the ideal norm of 1 : 1 (When short term loans and advances are taken into account). The position of co-operative sector is worse when compared to private and public sectors. In only Sarvaraya the ratio is nearer to norm at 1.19 times. It shows that all the factories have failed to maintain debt-equity ratio at a reasonable level.

The analysis of interest coverage ratio reveals that the overall position of the factories which stood at 3.29 times is below the ideal norm of 6 to 7 times. In co-operative sector it is much worse as it is at 1.54 times. Except K.C.P. in private sector all others are below 3.49 times revealing that more interest is paid from the profits due to heavy loans.

The impact of leverage on cost of capital made through the regression co-efficients shows a negative (inverse) relationship between leverage and cost of capital in Nizam and a positive relationship in all other six factories in co-operative and private sectors. However, the analysis of variance reveals a significant impact of leverage on cost of capital in the combined position of the sugar factories.
The management of the select factories was not serious of the effect of financial leverage, changes on cost of capital. As such they have simply mobilised whatever funds that are available in the capital market irrespective of their impact on the financial position of the factories.

B. Suggestions

In view of the prevailing situation of major source being 'other loans' in co-operative sector, it can be suggested that the share capital, in the form of government contribution, is to be increased. However, as the performance of co-operative sector is poor on several fronts it is an appropriate time to consider the privatisation of co-operative sugar factories.

In the case of private sector, though the situation is comfortable as the main source of finances for them is 'reserves' there is a need to improve debt capital by issuing preference share capital and debentures.

In the case of public sector, it has to improve its financial position by improving the reserves and surpluses by ploughing back of profits and increasing through the contribution in the form of equity from the government.
VI. FIXED ASSETS MANAGEMENT

Fixed assets are the assets which are permanent in nature and are incidental to production. They are consumed slowly in the production process over a long period and replaced periodically. They are not meant for sale. They cover the tangible assets like land and buildings, plant and machinery, furniture and fixtures and intangible assets consisting of patents, copy rights and goodwill. Efficient allocation of financial resources for the acquisition of fixed assets will enable an enterprise to achieve the objectives of profit maximisation and wealth generation. The generation, evaluation, selection and execution of capital expenditure projects are carried out through the process of capital budgeting. Capital budgeting involves the investment of current funds most efficiently in the long term activities keeping in view of such criteria as urgency, liquidity, profitability and risk sensitivity in anticipation of an expected flow of future benefits.

The overall and individual structure and growth of fixed assets of the select factories during 1981-92, the financing pattern of fixed assets, utilisation of fixed assets, investment in fixed assets, impact of gross block on sales and profit margins and the provision of depreciation are the issues of this chapter.
A. Findings

The analysis of the overall position of the fixed assets investment in select factories reveals that the size of investments has improved considerably during the period of study. The fixed assets investment trend of overall position was also reflected in all the factories except Kovur and Venkateswara. However, the proportion of fixed assets investment was less than the current assets in the earlier years than in the latter years of the study in select sugar factories. In absolute terms fixed assets were lower than the current assets in Chittoor, Venkateswara, Jeypore, K.C.P., Sarvaraya and Nizam and vice-versa in Kovur factory. The expansion programme was considerably very active from 1986 to 1992 as can be observed from the expanded gross block in consolidated position. This can also be confirmed from the large scale expansion and modernisation of plant and machinery during these years.

In Gross block, plant and machinery occupied the primary position of all the components in the select factories. The investment in land and buildings as a percentage of total assets had declined over the period of study with a few fluctuations. In the case of Jeypore it has declined in the first eight years and increased in the last three years.
All the factories in all the sectors have recorded a positive average annual growth in their gross block. The gross block recorded was the highest in Nizam and the lowest in Venkateswara and Chittoor. In net block there has been an increase in all the factories recording the highest of Rs. 227.03 lakhs in Nizam and a negative of Rs. -13.52 lakhs in Venkateswara.

In the overall position for all the factories the owners' funds were inadequate to finance fixed assets as the ratio of fixed assets to net worth was more than 1 : 1 recording at 3.09 times except in K.C.P. and Chittoor recording at 0.41 times and 0.82 times respectively. In Kovur it was at maximum of 21.08 times. In Venkateswara the net worth was nil.

In the overall position the fixed assets ratio of select factories reveals that the long term funds were insufficient to finance the fixed assets. The long term funds were adequate in five factories and inadequate in 2 factories. They were not available to finance permanent current assets in the case of Kovur and Venkateswara. Hence, short-term funds have been employed to meet the long term needs.

In the overall position of select sugar factories the average fixed assets turnover ratio reveals that the fixed assets utilisation was at about the general norm (5
times) at 4.90 times indicating normal utilisation of fixed assets. In the case of K.C.P., Chittoor and Jeypore the ratio was higher than 5 times indicating good performance. The remaining four factories are in a bad position as the ratio is below the norm. Out of them Kovur is in a very bad state recording at 0.84 times.

The investment in fixed assets was higher than the overall average per 100 tonnes of installed capacity in Kovur, Venkateswara and Sarvaraya and lower in K.C.P., Chittoor, Jeypore and Nizam revealing that there is a modernisation in the former block and modernisation as well as expansion in latter block. The investment in land and building was higher in public sector and co-operative sector except Chittoor and less in private sector. In the case of plant and machinery also the investment was more in all the factories with an exception of Chittoor. In the case of investment in furniture and fixtures the highest was in Sarvaraya, Kovur and Nizam and lowest in other four factories.

The investment in other fixed assets per 100 tonnes of installed capacity was more in private sector and less in Venkateswara in co-operative sector. The private sector factories made investment in other subsidiary and ancillary units to earn other income from investments. The investment in land and buildings, plant and machinery,
furniture and fixtures and other assets, however, was not properly controlled and regulated resulting in unprofitable investments.

The gross block and sales have registered an increasing trend in the overall position and also in the factory-wise position. In co-operative sector the sales in absolute terms was very low in the first year of study. As such the indices of sales have shown highest growth in co-operative sector than all other sectors. The operating profit has shown a constant growth in private sector except in Sarvaraya in three years. The operating profit which was on the negative side in co-operative and public sectors in the first five years of the study has turned in to positive side and started earning profits in the latter years.

The depreciation to gross block was low in the case of co-operative sector than public and private sectors. The amount of depreciation seems to be inadequate for all factories in the context of inflationary trend as all factories were following the method of historical cost basis. The ratio of depreciation to sales in individual factories shows variations signifying a conservative policy by some factories and liberal policy by some other factories.
B. Suggestions

Keeping in view of the findings drawn on fixed assets management, the following suggestions are made. Investment in fixed assets is to be made from the ownership and long term funds by increasing equity and long term borrowings in the case of Venkateswra and Kovur in co-operative sector.

All the private and public sector factories (Jeypore, K.C.P., Sarvarya and Nizam) and Chittoor in co-operative sector should expand their installed capacity to 2500 TCD or more as these factories had a reasonable margin in long term funds to meet the permanent current assets so as to enable them to enjoy the economies of scale.

In order to overcome the problem of fixed assets turnover the investment in fixed assets is to be increased by raising equity and long term funds in Kovur, Nizam, Sarvaraya and Venkateswara. This measure would also enable these factories to expand their installed capacities and thereby reap the economies of scale.

The investment in land and buildings, plant and machinery, furniture and fixtures and other assets must be rationalised so as to reduce the excess investment to the reasonable limit so as to avoid the assets being and add idle investment on fixed assets where ever necessary.
The excessive and unutilised long term funds available at K.C.P. and Chittoor may be utilised for diversification purpose or investment in secured scripts of other companies.

In Chittoor, K.C.P. and Nizam, where there is a margin amount in the long term funds even after meeting the requirement of the fixed assets and the permanent current assets, the excess amount may be used for redeeming some of the current liabilities. On the other hand in Venkateswara and Kovur factories where the long term funds could not meet even the requirement of fixed assets, the long term funds may be mobilised by the issue of equity, preference and debentures, as already suggested.

The enhancement of net worth and increase in installed capacity would rectify deficiencies in the factories where in the debt-equity ratio is high and interest coverage ratio is low. Besides, the ratio of inventory to total current assets is to be brought down so as to avoid the locking up of working capital and reducing the interest burden there upon.
VII. WORKING CAPITAL MANAGEMENT

The objective of working capital management is to manage the current assets and current liabilities in such a way that an acceptable level of net working capital is maintained so as to protect and maintain liquidity and profitability of a firm.

The structure of working capital factors determining working capital, utilisation of current assets, analysis of investment in inventory and evaluation of liquidity are the important aspects for empirical investigation.

A. Findings

The indices of current assets and current liabilities of select sugar factories reveal that the increase in current assets surpassed that of current liabilities in all the factories. But in absolute terms there was negative working capital in Kovur and Venkateswara in co-operative sector. The working capital position as per indices reveals the highest growth was in Chittoor, Jeypore, Nizam and K.C.P. whereas it could not be calculated in the case of Kovur, Venkateswara and Sarvaraya as they have shown negative figures for all the years and in the first year of study in Sarvaraya.

The investment in current assets was increasing while that of the fixed assets was decreasing in all the factories. Inter-factory-wise analysing reveals that in