Chapter-8

SUMMARY OF CONCLUSION AND SUGGESTIONS
INTRODUCTION

The Indian cement industry is a mature and world class industry in terms of production, technology, process efficiencies and product quality and variety. Unlike most other cement producing countries, it has recorded a sustained 7 to 8 per cent annual growth rate over the past two decades and this rate is likely to continue with the same vigour in the next century.

The State of Andhra Pradesh (A.P) is rich in limestone reserves which enabled it in the setting up of quite a good number of cement plants. A.P occupies the top position in Indian cement industry, but the industry in A.P is confronted with varied problems such as shortfall in coal supplies and power shortage causing production interruptions, transportation costs posing a heavy burden, declined demand and sales and consequently cement production. But the recent initiations for stepping up of investments in building roads, developing ports, setting up of irrigation projects and hydro-power generating plants, spurt in housing activity would
provide necessary impetus for the industry to utilize installed capacities and to create new capacities in the state.

Although the fundamentals of most cement companies are sound, the industry in general has been working under cost constraints affecting its profitability. But increasing statutory imposts and mounting input costs coupled with unremunerative prices of finished cement made it difficult for the industry to earn plausible rates of return on capital employed. The ultimate result is that the investments in the industry have become unattractive.

In this context the present study proposes to undertake a detailed evaluation of financial performance of select cement companies in A.P through inter-firm and intra-firm comparison.

The sample for the study consists of 8 cement companies covering both large and mini categories. The study covers a eight-year period from 1997 to 2004. Both primary and secondary data gathered for the study are presented in tables and analysed by applying various financial and statistical techniques. Besides these, statistical tests are used appropriately.

CONCLUSIONS

The present analytical study, "Financial Performance of Cement Industry in Andhra Pradesh" has brought to light the financial strengths and weaknesses of the industry as represented by the sample units. The conclusions that emerged from the study are briefly summarized hereunder.
1. An imbalanced financial structure is evident in Andhra, Panyam and Priyadshini, whereas moderately balanced financial structure is observed in Pena, Deccan, Kakatiya and Sagar. The financial structure of Suvarna, unlike other sample enterprises, is conservative. Overall, an uneven relationship exists in cement industry in A.P. between long term and short term funds. The industry is heavily banking upon long term funds, that too on borrowed funds to finance its assets requirement.

2. The abnormal rise in the use of debt - long term plus short term - was to cover up the losses in some of the sample units, which implies that the use of debt was not due to any preference, but to absolute compulsion. The extent of owners' funds as against the longterm borrowed funds was marginal in the industry. There exists no sufficient cushion for longterm creditors from equity funds. The industry has imbalanced capital structure with dwindling financial strength.

3. In a majority of the years under study; the industry could not meet its current interest commitments fully. As such there exists no justification for further use of debt capital in the industry in A.P. The continuation of such a situation will surely land the industry in deep financial crisis. This is true in the case of Andhra, Panyam, Suvarna, Priyadshini and Sagar in which no justification exists for the enhanced use of debt capital. Further, in the other units too the continuation of debt demands improvement in their interest coverage ratio through better profit performance.
4. The increasing use of debt in all the sample cement units did not result in enhanced returns on shareholders' funds, because of either continuing losses in some of the units or very thin profit margins in some others. They look like prospective insolvents, the exceptions being Penna, Deccan and Sagar. Therefore, the shareholders, the residual claimants, became the worst sufferers due to exposure to the highest degree of financial risk.

5. Excluding Deccan, all sample units have highly geared capital structures. But the situation observed is dangerous in Andhra and Panyam and worrying in Suvarna and Priyadarshini. The capital structures of these enterprises would be financially burden some for them in the wake of their poor profit performance. Overall, the industry is highly geared, which is not conducive to its healthy growth.

6. Trading on equity from the banker's point of view, in Andhra, Panyam, Priyadarshini and Suvarna, is totally unsatisfactory and worrying. It is relatively lower in Penna, Kakatiya and Sagar. Deccan had opted to trade on thick equity. The industry trading on thin equity with excessively used borrowed funds coupled with recurring losses and falling profits, became a glaring example of bad financial planning.

7. The major component of investment in cement industry in A.P is in fixed assets. The pace of expansion programme gained impetus after 2000 in the industry. As regards the sample units, significant expansion in fixed assets took place in Andhra, Penna, Priyadarshini and Kakatiya.
8. Owners' funds were insufficient to finance fixed assets in majority of the sample units. The industry in A.P is starved of owners' funds because of unabating losses. Hence the extent of fixed assets financing by these funds is nominal.

9. Shortage of longterm funds to finance fixed assets is quite evident in Andhra and Panyam. Diversion of working funds to finance fixed assets on a permanent basis threatened the longterm solvency of these enterprises and caused liquidity crisis. In rest of the enterprises, longterm funds were not only adequate to finance their fixed assets but also core current assets. By and large, longterm funds were adequate to finance fixed assets in the industry in A.P.

10. All the sample enterprises have underutilized their fixed assets, reflected in poor capacity utilization. The capacities created were not used aptly in generating sales. Power shortages, labour problems, transport bottlenecks on the one hand and demand stagnation on the other were the reasons attributed to poor capacity utilization.

11. Kakatiya, Deccan, Penna and Sagar were able to generate increased sales with the expanding gross block. In others, no positive impact of fixed assets expansion on sales is evident. But, productivity of expanding fixed assets was not realized in the form of sustainable and enhanced profits in the industry in A.P. Hence, no justification for existing level of fixed assets.

12. The depreciation policy followed was uniform in all the sample units except Priyadarshini. But the depreciation provided was inadequate in Andhra, Priyadarshini, Deccan and Kakatiya. Thus, the industry
followed consistent depreciation policy, but the depreciation amounts were found inadequate.

13. The investment in current assets came down significantly in the industry in view of low output and sales. Of the current liabilities the proportion of loans and advances was maximum, reflecting the increased dependence of the sample units on this source to finance their working capital needs.

14. The working capital condition of Andhra, Panyam and Sagar is precarious and threatening. Penna, Priyadarshini, Deccan and Kakatiya too presents a gloomy picture, but the condition was relatively better in later than the former. Suvarna’s working capital condition is volatile. By and large, the working capital efficiency of the cement industry in A.P was low and far from the desired level.

15. With the exception of Kakatiya, all sample units had stocked inventory below the usual norm of 3-4 months' value of production, implying underinvestment in inventory. Hence, there was no overstocking of inventory in the industry but there could be imminent danger of stock outs.

16. All the sample units, leaving Andhra, Kakatiya and Suvarna, had high inventory turnover. Penna, Deccan and Sagar tried to do more business with insufficient investment in inventory – a symptom of overtrading. Contrary to this, Suvarana reported a low inventory turnover, reflecting that this enterprise had undertraded. Overall the industry indulged in overtrading in A.P.
17. The raw materials storage period of all the sample units is within Tandon Committee norm of 45 days. No overstocking of raw material inventory is identified in sample units. It is so because the sample units are located within the vicinity of sources of raw materials. Hence, no need to stock them in larger quantities as the inventory carrying cost will be more.

18. With the exception of Suvarna, all other units had carried on with reasonable conversion period. No overstocking of finished goods was reported in the sample units barring Kakatiya.

19. In majority of the cement enterprises, stores and spares from the principal component of aggregate inventory. High positive correlation was found between stores and spares purchased and store and spares consumed with the exception of Andhra and Panyam. As such, there was no overstocking of stores and spares inventory in the industry.

20. The sample units – Panyam, Andhra, Suvarna and Sagar- pursued liberal credit policy, whereas the others strict credit policy. Effective credit collection methods were adopted in Penna, Deccan, Kakatiya and Priyadarshini. Overall, the industry showed better collection efforts.

21. In between the sample units, there exists significant difference in the debtors' collection period and creditors payment period. But, in between the years no significant variations are found in these two variables.
22. The debtors' collection period was far less than the creditors' payment period in the industry. It ought to have helped the sample units to reduce the pressure on working capital. But the debtors' collection period tended to increase along with creditors payment period in the sample units. Thus, an increase in creditors payment period coupled with an increase in debtor's collection period did not reduce pressure on working capital in many of the sample units. The increasing creditors payment period reflects the inability of these enterprises to mobilize enough cash funds from internal sources to discharge dues to creditors within the reasonable period of time. Obviously, these units are becoming victims of overtrading.

23. Andhra and Deccan had large cash balances not supported by the level of business operations undertaken by them. An opposite situation prevailed in Suvama, Panyam and Penna. Further, the industry is characterized by volatility in cash balances.

24. Excepting Deccan, in all the sample units, the current ratio was not only less than the ideal norm of 2:1 but also gradually declining signaling falling liquidity. The quick ratio made it clear that with the exception of Deccan and Penna, all other sample enterprises are characterized by technical insolvency as they are unable to repay to current debt out of their liquid resources. The observations made out of the analysis of current ratio and liquid ratio are further confirmed by the cash flow coverage of current liabilities. Without ambiguity, it can be said that the liquidity of sample enterprises, with the exception of Deccan and Penna, is threatening and their short term financial
strength is very weak and bleak. Henceforth, the liquidity of the industry in A.P. is critical.

25. Penna, Deccan and Kakatiya pursued conservative policy of financing working capital, whereas all others followed an aggressive policy. Aggressive working capital financing policy pursued by the industry is highly risky in the context of its critical liquidity and unfavourable profitability.

26. Expansion of capacities took place in the industry in a significant way requiring investment of huge capital. But the expansion of assets did not result in commensurate sales activity in the industry. Hence, rate of capital turnover fell significantly as the sales generated were inadequate and the profit margin earned thereon was also narrow. The combined effect of these two resulted in low return on capital employed. The prime reasons attributed for this state of affairs were: (i) intense competition in the industry, (ii) mismatch between demand and supply, (iii) cost escalation of various inputs used in the manufacture of cement, (iv) no spurt in infrastructure projects taken up by the government, thereby impinging on the level of demand for cement, (v) excess capacity created in the industry because of expansion in the existing units coupled with the establishment of new units, (iv) high rates of import and excise duties levied by the government on the inputs and capital goods of the industry, and (v) escalating transport costs relating to inputs and output. On the whole it can be said that the cumulative effect of all these factors resulted in
declining sales and falling profit margins leading to declined overall profitability in the sample units.

27. Barring Penna, Deccan and Kakatiya, in all others the growth in sales was either negative or not upto the desired level. The pace of increase in the indices of operating expenses outstripped that of the sales. As such, the extent of profitability has come down substantially in the cement industry in A.P.

28. The gross profit performance reported by Penna, Priyadarshini and Kakatiya was relatively better than that of other sample units. Panyam, Suvama, Sagar and Andhra were unable to make high gross profit on their sales for varied reasons. The declining gross profit margin is indicative of falling profit margin on sales in the cement industry in A.P.

29. The sample enterprises, excluding Penna and Kakatiya, are characterized by increasing operating inefficiency, for their profits were quite insufficient to cover interest, taxes, dividends and need for retained earnings.

30. It is disturbing to note that the operating ratio of the industry exceeded 100 per cent in 2003, indicating that the industry had to bear the losses. The operating profit performance of the industry in A.P was disappointing.

31. Enterprise-wise, Panyam, Andhra, Priyadarshini and Suvama reported losses during the period of study. In the rest of the sample enterprises, the net profit margin was positive. But, this profit
performance too was not encouraging. Overall the industry’s net profit performance in A.P is distressing.

32. The shareholders funds in the sample units, with the exception of Penna, were unable to make any earnings worthy of their presence.

33. These funds became almost worthless in the industry in terms of earnings made.

34. Andhra, Panyam, Penna and Suvarna did not pay dividends during the period under study. In Andhra and Panyam, the question of paying dividend did not arise as they had not made profits during the period under examination. Suvarna made some profits in a few years but it was not large enough to pay any dividend to shareholders. Penna, though made adequate profits, did not pay any dividends to its shareholders. It retained the entire profits in order to finance expansion activity. Sagar paid dividends intermittently. The dividend payment behaviour of sample units was disappointing and the productivity of their share holders funds abysmal.

In the light of the conclusions drawn from the study, the following observations are made with regard to various issues addressed in the study.

- The sample enterprises did not use appropriate mix of debt and equity in their capital structures.
- The Debt-equity mix did not enable the units to maximize returns to the share holders.
- The expansion activity did not lead to increased sales/profits.
Overall, the working capital management in the sample units is ineffective.

The aggressive approach of financing working capital needs pursued by majority of the sample units did not conform to their requirements.

Diversion of working funds to finance fixed assets is evident.

No proper relationship exists between debtors velocity and creditors velocity.

Understocking of inventories and overtrading is evident.

The liquidity and solvency of the most of the sample units is not only critical but also threatening.

The pace of increase in operating expenses was more than the rate of increase in sales.

Return on capital employed in sample units is totally disappointing.

Earnings made were not adequate enough for paying dividend in sample units.

Self-financing is absent due to either recurring losses or poor profit margins.

SUGGESTIONS

The cement industry in A.P in general, and select sample companies in particular have been considerably exposed to the financial stress and strain due to imprudent management of their finances. Inadvertently, the industry slowly has entangled in a financial web. It would be very difficult to come out of this self made financial impasse, unless it
awakes and initiates concerted efforts to bring back its finances on right track. Henceforth, the individual cement companies should manage their finances productively inducting innovation and pragmatism into their financial management so as to facilitate steady progress of the industry. The following are some of the suggestions offered for improving the financial performance of not only the select cement companies but also the industry in general in Andhra Pradesh.

1. First of all the sample units need to establish even relationship between longterm and short term funds so as to make their financial structures balanced. To this end, the cement companies may use more longterm funds to finance not only their fixed assets and but also core current assets, instead of short term borrowed funds as is now done.

2. In order to strengthen longterm solvency, the size of longterm funds need to be expanded. In mobilizing longterm funds, due care should be taken to avoid longterm debt, represented by debentures and other longterm loans. The reason for this being that the practice of trading on equity in many of the sample cement companies has neither increased earnings to shareholders nor have the earnings provided adequate coverage to interest norm. Under these circumstances it is better if a part of the existing longterm debt represented by debentures and longterm borrowings is allowed to be converted into equity shares. Further, while financing new expansion programmes in the industry, it is desirable to opt for
additional equity share capital by issuing new equity shares. In addition to this, a major part of short term loans and advances, particularly those represented by short term creditors, should be allowed to be converted into redeemable preference shares.

3. Yet other alternative is to resort to internal financing. But many of the sample units as they are not run profitably. Hence they should adopt innovative methods of improving sales on the one hand and improving operating efficiency on the other to improve future profits so as to facilitate not only better returns to the owners but also to allow internal financing of expansion programmes.

4. To provide greater coverage to fixed assets, the proportion of long term funds has to be increased considerably. Further, as already explained long term funds in these units should be made adequate enough to finance both the fixed assets and core current assets. It enables these units to overcome the problems of deficit working capital.

5. Fixed assets should be utilised more effectively so as to generate more sales because the quantum of sales in relation to the size of investment in fixed assets is mismatched at present. At the same time the operating costs should be controlled and kept at the minimum possible level so that the increased sales due to better use of fixed assets may result in higher operating profit.

6. The technology in the cement industry is fast changing. As a result, the existing physical assets are becoming obsolete. Modernization of the industry should fall in line with latest technology available and
it should be carried out, no matter what it means cost-wise. Funds required for this purpose may be met either through fresh issue of equity or preference or both besides using internal funds.

7. Depreciation provided in the industry on historical cost basis is inadequate to replace the fixed assets. As such under the present inflationary conditions it becomes a difficult task to replace the fixed assets with the existing depreciation reserve. Therefore, the cement enterprises should create replacement fund in addition to normal depreciation in order to ensure adequate funds for replacing the fixed assets when they are worn out.

8. Expansion should be undertaken only when there exists scope to raise additional funds through equity issue. Otherwise it should be confined only to the extent of internally available funds.

9. Sample enterprises have experienced shortage of working capital resulting in liquidity crisis. Persistence of this situation hampers the free working capital flow and endangers the very survival of these enterprises in the longrun. The situation, therefore, demands immediate attention of the management of these enterprises to set right this predicament. In order to attain comfortable working capital position, measures should be initiated either for improving the current assets or reducing the current liabilities or both.

10. The individual units can make use of operating cycle concept in estimating future working capital requirements. The effective use of this concept avoids, to a greater extent unnecessary blocking up of funds in different stages of the cycle and components of current
assets. Further, it enables to have advance planning in procuring required working funds at the right time.

11. The policy of diverting short term funds for acquiring longterm assets in expansion programmes should be done away with as this policy result in inadequate working capital leading to a financial catastrophe. Besides, expansion programmes should be scheduled so as to augment working capital requirements to back up larger production requirements.

12. Enterprises suffering from deficit working capital are in the dire need of raising longterm funds either through the issue of shares or obtaining longterm loans from financial institutions to overcome the impending financial crisis. The best policy for financing the growing working capital needs is to augment internal resources. Further, the size of working funds should be improved in the chosen enterprises to avert over-trading.

13. The variable component of working capital may be financed by cash credit arrangement with banks. The enterprises should also try to tap the savings of the public by accepting public deposits as this is a cheaper source and moreover, will not create any charge on the assets of the company. Steps should be taken by the enterprises to match the extent of trade credit with trade debt.

14. Scientific planning and monitoring of cash flows presupposes the availability of accurate and dependable data as well as a system of feedback. It is, therefore, necessary for these concerns to develop
suitable financial information systems especially for the purpose of
cash flow planning and control.

15. In each and every select enterprise, there is a need to establish an
Integrated Inventory Management Department with the following
functions:

- Material planning and programming
- Purchasing and sub-contracting
- Receiving and warehousing
- Storekeeping
- Inventory controls
- Scrap and surplus disposal
- Value analysis

16. Efforts should be made by the enterprises to create a systematic
and reliable inventory information system to take rational inventory
decisions.

17. Periodical review of inventory levels shall be made to ascertain the
stock position and to avert the risk of being run out of stocks as well
as cost of carrying excess stock. Minimum and maximum levels of
inventory and consumption norms should be laid down on scientific
basis and in no case should they be violated in practice.

18. Non-moving items should be identified and proper steps should be
taken to dispose them off in order to avoid loss of obsolescence.
Stores and spares as far as possible should be purchased from
nearby markets. Norms for consumption and fixation of different
stock levels are also needed. It is desirable to have a system of
selective control of stores and spares in the sample enterprises. VED analysis, FSN analysis, ABC analysis help a lot in this regard. Over and above, the enterprises should establish Stores and Spares Planning Cell to carry out long and short term planning for stores and spares.

19. Enterprises shall have an exclusive department for credit and collections under the control of Finance Manager or Marketing Manager. This department should be entrusted with the task of developing a viable credit policy, formulating procedures for collection of debt, developing methods for evaluating the creditworthiness of a customer and finally, taking necessary follow-up action for collecting dues from longstanding customers. Not only care is needed in the formulation of policies, but due caution is to be exercised for their efficacious implementation.

20. Enterprises should establish and maintain good credit control systems as they not only realize cash earlier from operating cycle, but also greatly reduce the amount of working capital needed. Control can also be exercised through Debtors Budget, which takes account of budgeted sales and reckons cash inflows with credit terms offered.

21. Efforts should be made by the enterprises to step up efficiency in collection of accounts receivables. Firms can greatly reduce the investment in accounts receivables if they ensure adhering to their prior credit terms agreed upon and embark on collecting the debts accordingly.
22. The aggressive policy of financing of working capital by many of the sample enterprises should be dispensed with as such a policy is highly risky and unwarranted in the contest of critical liquidity and unfavourable profitability in the industry.

23. Cement is subjected to heavy doses of taxation. A scaling down in the tax incidence on cement would bring down the cost of production, which helps the cement industry in making more profits.

24. Over a period of time, returns in the cement industry have been declining. The rising input prices without a corresponding rise in cement prices had a serious strain on profit margins and resulted in inflated operating ratio. Proper monitoring of costs and effective cost reduction measures undoubtedly enhances profitability. Transport cost constitutes 10 to 25 per cent of the total cost of cement. To mitigate this cost, augmentation of railway wagon supplies in critical sections, introduction of wagons with special rakes for quick loading, bulk transportation of cement, usage of multi-modal movement of cement and development of coastal transportation are need of the hour and support from the Government is sought for in this aspect. Establishment of washeries is required to convert the inferior quality of coal into superior quality of coal, which is required by the cement industry. For uninterrupted operation of rotary kiln, captive generation sets should be established by the sample enterprises without any delay.
25. The shooting prices of inputs have put a severe strain on the cement industry resulting in inflated operating ratio. Therefore, the need of the hour is the effective control of operating costs. Adoption of profit planning and control techniques such as marginal costing, cost-volume-profit analysis, standard costing and flexible budgetary control systems may in fact enable the units to push down the operating costs and boost up the profits.

26. The enterprises should utilize their installed capacities to the maximum extent in order to reap the benefits of economies of scale and consequently, to obtain higher returns on capital employed by the enterprises.

27. The Marketing Departments of the enterprises should introduce innovative marketing methods like bulk transportation of cement, supply of ready mix concrete and introduction of 1 kg pockets to create new demand for the cement. Increase in quantum of sales certainly impinges on the capital turnover and rate of return favorably.

28. Exports offer a challenging alternative to the cement industry to cope with the problem of overproduction compared with demand. The industry, therefore, should make sustained marketing efforts to cultivate markets abroad.

29. Since returns on equity is dismal, investors may not come forward to subscribe to the new issue of the cement companies. Hence, efforts should be made to convince the investing public that the industry is earnest in improving its profitability in future.
To conclude, the cement industry in A.P should design and develop a balanced financial structure, use fixed assets efficiently, provide depreciation adequately, optimize the inventory investment, adopt sound credit policy, strengthen the degree of liquidity and control operating expenses effectively in order to improve its financial efficiency.