CHAPTER VIII

SUMMARY AND CONCLUSIONS

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(A) In Regard to DER

(B) Employment of Proprietorship Funds and Non-Proprietorship Funds.

(C) Use of Proprietorship Funds.
   (i) Paid-up share capital
   (ii) Reserves

(D) Use of Non-Proprietorship Funds
   (i) Secured loans
   (ii) Unsecured loans

(E) Trade Credit and Provisions

(F) Inter-Corporate Investment and Loans

(G) Provision for Depreciation

(H) Suggestions

* * *
(A) In Regard to DER

The theory of debt-equity ratio is of prime importance from the viewpoint of the study of pattern of financing adopted in the cotton textile mills of Ahmedabad. It helps one also in knowing the use of proprietorship funds and non-proprietorship funds. An attempt has been made by me to study the financial structure of fifty composite cotton textile mills of Ahmedabad for a period of ten years. This period of study is divided into two equal parts, i.e., 1966 to 1970 and 1971 to 1975, so that a comparative analysis of the financial patterns could be made.

The generally accepted norm of DER, i.e., 2 : 1 was suggested by the study group on DER headed by Dr. B. K. Madan. The present study indicates that the cotton textile units of Ahmedabad had not reached their debt capacity throughout the period of the ten years of this study. Yes, some units had tried to do so during the latter period.

The number of textile mills conforming to the standard norm of 2 : 1, i.e., five, had remained unchanged during both the periods of this study. At the same time, the number of units with exceptionally low DER, i.e., even less than 1 : 1, had increased from 20 during the former period to 26 during the latter. Some of these units had repaid a major part of their long term borrowings and ploughed back a portion of their profits.
The average DER for all the fifty cotton textile mills of Ahmedabad together had remained unchanged at 98 : 100 during both the periods. This means that they had not reached their debt capacity. In future, they can certainly make increasing use of debt, particularly, of institutional borrowings. The financial institutions working in Gujarat State, too, have a role to play in the financing of these units. The average DER of 98 : 100 also indicates that the debt and the equity had been equally utilised as a source of finance. These units do not seem to have used the principle of trading on equity to their benefit.

Excessive use of debt coupled with an unsatisfactory record of profitability seems to have been one of the most crucial factors contributing to and resulting in the 'sickness' of some of the textile units of Ahmedabad.

The DER prevalent in the cotton textile units of Ahmedabad - 98 : 100 - was higher than the corresponding All-India All-Industries figure of 35 : 100, whereas it was lower than that prevalent in the entire Indian cotton textile industry, i.e., 113.60 : 100.00.

(B) Employment of Proprietorship Funds and Non-Proprietorship Funds

The non-proprietorship funds had played a marginally higher role as compared to the proprietorship funds in financing the cotton textile units of Ahmedabad during
the second period in comparison with first. The proportion between proprietorship funds and non-proprietorship funds had remained unchanged at 31:69 in the former period, and 30:70 in the latter. The sources of finance like short term loans and current liabilities and provisions had played a significant role in financing these mills during both the periods.

The share of proprietorship funds in the financing of cotton textile mills of Ahmedabad (29.80%) was very low, when compared with the figure for All-India All-Industries (53.30%). These mills seem to have relied on debt and short term borrowings to a larger extent and failed in ploughing back as much profit as had been done by all the industries, in general, working in this country. An unsatisfactory record of profits, increasing burden of corporate taxes on profits, declaration of dividend at rates which could not be justified by the rates of profitability in case of some of the units, unfavorable conditions prevailing in the share markets, and comparative ease of securing short term loans were some of the important factors contributing to the dependence of these mills on the non-proprietorship funds during both the periods of this study.
(C) Use of Proprietorship Funds

(i) **Paid-up share capital**: The share of proprietorship funds in total funds was around 30.00% during both the periods.

The average share of paid-up capital in total funds had declined during the latter period by 25.20%. In other words, the importance of paid-up capital as a source of finance had declined fairly, during the latter period of study.

The share of equity capital in total funds had also declined by 24.78% during the latter period. Even as a source of proprietorship funds, the importance of equity share had declined during the latter period. Its share in total share capital had increased only marginally during the latter period, viz., by 1.8%. It may be noted that the decline in the role of equity share and total paid-up share capital in the case of cotton textile mills of Ahmedabad was in no way different from the situation that prevailed in all the Indian industries, including the entire Indian textile industry.

The share of preference capital in total funds (2.08%) as well as in proprietorship funds (10.20%) was very meagre in both the periods of
this study; and, as such, it had declined during the latter. Even the share of preference capital in total paid-up capital (20.00%) had declined during the latter period. This can be construed to mean that preference shares as a source of finance had played an insignificant role in the financial structure of these units. They seem to have been unpopular not only with the investors but also with the managements of these units. The absence of good record on dividend payment, lack of capital appreciation and poor response to public issue were the basic reasons for their unpopularity.

(ii) Reserves: The average share of reserves in total funds (16.20%) as well as in proprietorship funds (50%) of the textile units of Ahmedabad under study had increased marginally during the latter period. It may be noted that the retention policies of these units were not uniform during both the periods. However, a decline in the variability factor during the latter period suggests that the retention policies and dividend policies adopted by these units were more uniform during that period.

On the whole, these units had adopted a less liberal dividend policy during the latter period. This study of the Profit and Loss Accounts
and Balance Sheets has revealed that 29 of the 50 units had earned profits at the rate of 10% or more on their net worth. The number of units with negative profit before tax had declined by 50% during the latter period. In the absence of heavy taxation, these units would have been able to add larger amounts to reserves. The number of textile units providing for taxes to the extent of more than 50% of their PBT had increased from 9 during the former period to 12 during the latter.

The companies under group management had issued more bonus shares as against the individual units. They were also more consistent than the latter in regard to the bonus issues. Restrictions under the Companies (Temporary Restrictions on Dividend) Act, 1974, did not seem to have much affected the working of the cotton textile mills of Ahmedabad. There were only two units which had declared deferred dividends during the period of this study. The number of companies with a dividend payout ratio of over 100% of PAT had declined from 14 during 1966-70 to 10 during 1971-75. In order to pay dividend, as in the past, some of the textile units had depended on bank loans and institutional loans.
(D) Use of Non-Proprietorship Funds

(i) Secured loans: The share of secured loans consisting of funds raised through the issue of debentures, secured borrowings from banks and financial institutions, and under DPG Scheme in total funds (31.20%) as well as non-proprietorship funds (45.40%) had declined marginally during the latter period. The financial policies adopted by the textile units were more or less uniform during both the periods.

Debentures had contributed in very small measures to the total funds (2.04%), non-proprietorship funds (3.30%), and total secured funds (7.00%). It may be noted, however, that their contribution had increased marginally during the latter period. Only five units in the former period and six in the latter had raised funds by issuing debentures. The basic reason for nonutilisation of this source on a large scale seems to be the poor public response to such issues—which was an all-India feature. The costs of issue including underwriting commission were also fairly high. The absence of organised stock exchange activities was another contributory factor. Again in the case of the textile units of Ahmedabad, managements seem to have relied on banks and financial institutions as a policy matter. On an average, the rate of interest of debentures paid by the units was lower than the RBI rate.
The share of secured bank loans in total funds (28.60%), in non-proprietorship funds (41.80%), as well as in secured loans (87.20%), had declined marginally during the latter period. A marginal change in the variability factor suggests that the policies in regard to financing through banks adopted by the textile units of Ahmedabad were more or less uniform during both the periods.

Though bank loans constituted an important source of finance for cotton textile units of Ahmedabad and though they were the single largest component of secured loans, the dependence on bank borrowings was not as great in the case of these units as was found in the case of the entire Indian cotton textile industry. Again, it is worth special mention that the heavy reliance on bank borrowings was found only in cotton textile industry. Insofar as All-India All-Industries were concerned, the bank borrowings had accounted for 18.13% of total funds raised.

The amount of assistance provided and disbursed to the cotton textile units of Ahmedabad by the eight specialised financial institutions and agencies had increased marginally during the latter period. The share of such secured loans in total funds (3.30%) as well as in non-proprietorship funds (4.30%) had increased marginally during the latter period. The financial policies of these textiles
units in respect of securing institutional assistance were more or less uniform during both the periods of this study, and the level of uniformity had improved during the latter period.

It may be noted that the share of institutional loans to these units had increased from 3.30% to 4.00% of total funds, whereas the loans to the cotton textile industry of India as a whole had declined from 16.30% to 4.00% of total funds, during the latter period, and the decline in the case of textiles was sharper than that in the case of other industries (Viz., from 10.68% to 7.35% of total funds). It may also be noted that the assistance provided by the specialised financial agencies had accounted for only 3% to 4% of the total funds raised by the textile units of Ahmedabad during 1966 to 1975. It seems that these units used to meet their working capital needs mainly through bank borrowings. It is felt that institutions like GSFC, GSTC, etc., can play an increasing role in the development of the textile industry of Ahmedabad. The fact that only 15 units in the former period and 18 units in the latter had taken the benefit of institutional loans proves that this source of finance had remained unexploited. The policy of the textile units to rely on bank borrowings, the delays in sanctioning and disbursing loans, and the imposition of special and cumbersome conditions
for loans by financial institutions seem to have been responsible for this. The impact of 'Convertibility Clause' depends on the degree, the timing and the duration of this clause. During 1966-1975, not a single textile unit of Ahmedabad was granted an assistance exceeding Rs. 25/- lacs. Hence, the study of the impact of this clause on their capital structure has not been made.

The average share of secured DPG funds in the total funds (1.56%) as well as in non-proprietorship funds (2.10%) of textile units of Ahmedabad was very small during 1966-1975. However, it had increased significantly during the latter period. The number of units getting the benefit of this scheme had increased from 23 during the former period to 25 during the latter. The cotton textile units of Ahmedabad had not taken as much advantage of this scheme as done by the other industries. (The DPG funds had accounted for 4.49% of total funds in case of All-India All-Industries).

(ii) Unsecured loans: It was believed in the past that public deposits made a significant contribution to the total funds obtained by the cotton textile units of Ahmedabad. My study has revealed that their share in total funds (4.90%) as well as in non-proprietorship funds (6.90%) was very insignificant throughout the period of this study. Moreover, their average share had declined during the latter
period. The policies in relation to the acceptance of deposits from public adopted by these units were not uniform throughout the period of this study. The policy of relying on bank borrowings, lack of prestige of loss-making units, and some government regulations constraining the acceptance of deposits were the chief factors responsible for such a trend.

The system of accepting deposits from the directors of companies seems to be the legacy of the managing agency system. In the past, they had been dominating the financial policies and practices of companies under their management. With the abolition of the system in India, the deposits from directors have lost their importance as a source of finance. This study has revealed that such deposits had formed a very insignificant portion of the total funds (1.56%) as well as of the non-proprietorship funds (1.84%), during both the periods and that their share had declined during the latter period. The policies adopted by individual units under study in regard to the acceptance of directors' deposits were highly non-uniform during both the periods of the study.

Loans from banks and financial institutions for a short period of time, usually not exceeding
twelve months, were obtained by the cotton textile units of Ahmedabad on the basis of personal guarantees given by the directors. My study reveals that the share of institutional short term loans in total funds (6.60%), non-proprietorship funds (8.90%), and total unsecured funds (45.40%) had declined during the latter part. (It may be stated that the proportion between secured loans and unsecured loans had not changed during this period). The textile units of Ahmedabad had relied much less on such institutional loans (6.60% of total funds) as compared to All-India All-Industries (18.66% of total funds). It seems that banks as well as financial institutions were very cautious in regard to the grant of unsecured loans to the former.

The share of unsecured DPG funds in total funds (1.29%) as well as in non-proprietorship funds (1.92%) was insignificant throughout the period of this study, although it had increased during the latter part. On the whole, DPG funds had played a very minor role in the financing of the textile units of Ahmedabad. The policy of relying on bank borrowings even for replacing the gross fixed assets and lack of adequate plans for modernisation seem to be important factors responsible for this.
(E) Trade Credit & Provisions

Trade credit & provisions have been defined to include Trade creditors, Bills payable, Unclaimed dividends, etc., and provisions for taxation, depreciation, provident fund, etc. This source of finance had contributed to the extent of 24.60% and 30.20% of total funds of the cotton textile units of Ahmedabad during 1966-70 and 1971-75 respectively, which exhibited a growth. Most of these units had adopted uniform financial policies in regard to its use.

In the same manner as above, the share of trade credit and provisions in the total funds had showed an upswing in the case of the All-India All-Industries, the figures being from 22.30% to 30.53% of total funds. It had increased by 23% during 1971-75 in the case of cotton mills of Ahmedabad, whereas it had remained unchanged in the case of the entire cotton textile industry (56.50% of total funds). It may be concluded that the fifty cotton mills of Ahmedabad had relied less on trade credit and provisions than either the cotton textile industry in general or the All-India All-Industries.

(F) Inter-Corporate Investments and Loans

The present study has revealed that only eight out of the fifty textile units of Ahmedabad had borrowed funds or accepted investments from other textile units of the city. The inter-corporate investment in equity shares and preference shares had increased by 14.50% whereas, in the
case of debentures, it had declined by 80% during the latter part of the study. The inter-company investments and loans had played a very minor role in the financing of the borrower textile units of Ahmedabad. Even the share that was negligible at first had further declined during the latter part of the study.

(G) Provision for Depreciation

The study has revealed that provision for depreciation had made a significant contribution to the total funds of the cotton textile units of Ahmedabad during the ten-year period. The policies followed by these units were fairly uniform during both the periods of this study. Yes, there was a very marginal decline in its share in total funds during the latter part. On the whole, the annual rate of growth in the provision for depreciation on plant and machinery had improved marginally from 10.10% during the former period to 11.90% during the latter. A similar marginal increase in the annual growth in plant and machinery (9.40% during 1966-70 and 10.20% during 1971-75) was also visible.

It may be noted that the rates of depreciation on plant and machinery had remained unchanged during both the periods. One of the important causes of sickness in the case of some of the textile units of the city was found in the lack of adequate provision for depreciation on fixed assets. Very few units had adopted even moderate plans for replacement and modernisation. The inflationary
escalation in prices further aggravated the situation. On the whole, the provision for depreciation was a major source of finance for the cotton textile units of Ahmedabad.

**Suggestions**

The financial structure of the fifty cotton textile units of Ahmedabad revealed by this study on an overall basis, showed features that did not support popular beliefs in several respects.

It was found that many successful cotton textile units were having low-geared capital structure. With a record of stable earnings such units could certainly have been able to earn the benefit of the principle of trading on equity.

As against this, some of the unsuccessful units - NTC units, in particular - were having a high-geared capital structure. It would have been a sound financial policy for them to adopt a low-geared capital structure in cases where earnings were inadequate and unstable. Theirs was the case of misapplication of the principle of trading on equity, as it could not be justified in the presence of a high debt-equity ratio and very low profits or losses.

There is a need to protect the interests of equity shareholders, who are too widely dispersed to organise themselves effectively. The relevant provisions of the Companies Act need to be implemented vigorously.
particular, the provisions relating to special Government audit and inspection & investigation should be enforced. The recommendations made by the Sachar Committee in this respect need to be seriously considered.

There should be a separate provision for the deduction of dividend income out of gross total income for the purpose of determining total taxable income of an assessee. Any dividend earned up to that limit should also be exempted from deduction of tax at source. The amount of dividend for the purpose of this deduction and exemption may be kept around Rs. 3000/-, unclubbed with the other items, as at present.

Legally and in an accounting sense, preference share capital is capital and should be treated rather than as debt at any stage. A legal reform is necessary to ensure that preference dividends are paid compulsorily in the event of sufficient profits. Skipping of any dividend should be reported and justified by the auditors of the respective companies. The issue of convertible preference shares, as in the U. S. A., may be experimented with in our country. The preference to equity ratio of 1 : 3 as now permitted should be reduced to 1 : 5 or 1 : 6.

There is a case for reducing the already heavy burden of corporate taxes to increase the ploughing back capacity of these units. Again, on their part, the dividend policy and retention policy need to be co-ordinated, and growth oriented policies need to be adopted.
While debentures have not been a popular source of industrial finance, convertible debentures as an element of capital structure offer several attractive features and possibilities which need to be carefully explored. They are suitable even in the case of those mills where debt limit is reached. The market for them can develop in course of time.

It is suggested that since the Tandon Committee norms have created difficulties, their application to the cotton textile industry may be suspended till special revision is decided upon by the Government. Credit for working capital may be increased on the basis of the cash flow of each unit and margins for advances may be reduced. The term loans may be given with a first charge on the fixed assets which are unencumbered or partially encumbered.

The recommendations of the Bhide Committee on co-ordination between SFCs and banks should be implemented immediately.

The cotton textile units may be classified into three categories for the purpose of grant of assistance:

(i) Banks may revise cash credit limits for units experiencing difficulties on account of increase in costs.

(ii) Units which are in a stage of incipient sickness may be granted assistance to purchase raw materials, and cash credit limits may be fixed on need basis.
(iii) Sick mills should be granted a moratorium for the payment of interest charges for a specific period.

The loan agreements of the cotton textile mills with the specialised financial institutions should be audited. The statutory auditor should ensure that all provisions and conditions comprised in the agreements have been complied with. The internal auditor should keep close watch on the company's transactions to ensure that no violations occur. This must, in fact, be a continuous exercise until all loans are fully repaid.

All deposits from public should be canalised through a special account in a nationalised bank, comparable to the share application moneys. The proposed utilisation of the deposits should be specifically described, unlike the current practice of making a general remark that the proposed utilisation is for the operations or expansion of the activities of the company, which does not convey anything. It is earmarking of funds collected through public deposits that is a vital issue. The Income-Tax Rules should be amended to allow interest paid as eligible for deduction at 100% in the case of selected companies and 60% in the case of non-selected companies. Regularity in payment of interest & repayment on maturity should be the major factors to be considered while selecting such companies.

Inter-corporate investments and loans were a very minor source of finance for the fifty cotton textile units.
of Ahmedabad. I am one of those who subscribe to the view of the Sachar Committee in that they should be restricted to the following:

(i) Promoting a new company independently,
(ii) Taking over a sick unit, and,
(iii) Taking over an existing company after making an offer to buy shares from all the shareholders of such a company on terms and conditions equally applicable to all of them and after obtaining the approval of the Company Law Board.

As suggested by the Chokshi Committee, the reducing balance method of depreciation should continue. The average rate of annual growth in depreciation fund on plant and machinery of the cotton textile units under study had remained unchanged for 10 years during 1966-75. There is a case for increasing the rates of depreciation adequately keeping in mind the future replacement needs. It may be suggested that the basis for calculation of depreciation should be changed from historical cost to current replacement cost. Insofar as the cost escalations for the past years are concerned, a phased plan of annual provisions will have to be thought of. And, still the problem of sudden and heavy inflationary price escalations will have to be taken care of, at times, through special additional provisions. The additional provision for the replacement made in order to cover the gap between the amount of depreciation based on historical cost and that based on current replacement cost should be invested in
earmarked securities and should be treated as admissible deduction for the purpose of computing taxable profits.

The cotton textile units of Ahmedabad should utilise effectively the schemes of assistance for modernisation made available by the specialised financial institutions.