CHAPTER - IX

DIVIDEND POLICY OF THE CORPORATE
SECTOR SUGAR INDUSTRY IN KARNATAKA

INTRODUCTION

We have examined the dividend and the dividend policy in Chapter III in general. Now we have attempted in this chapter the dividend policy followed by the corporate sector sugar mills in Karnataka during the period 1975-76 to 1979-80. It may be recalled that all the units were in red except the Ugar Sugar Works Limited, which maintained a continuous flow of profit, which cannot by any standard be considered either stabilised or steady. However, it is pertinent to note that, these seven units surveyed by us have a tendency to recover themselves from the losses and show the profits, to give some return atleast (if not a fair), on the capital employed in the production.

Dividends as stated earlier can be paid:

a) out of the profits of the current year, and

b) out of the undistributed profits of proceeding several years.
All the seven units surveyed by us have carried forward the accumulated losses, except one, after providing for the depreciation and the reserves. Before we examine the dividend policy of the sugar unit in the private sector to declare dividend continuously, we will first analyse the reasons for the low profits and/or losses.

CAUSES FOR LOW PROFITS AND/OR LOSSES

We administered a question to ten captains of industry on the possible causes for the low profits and/or losses of the concerns under their control and the answers were very revealing.

One of the questions asked in the questionnaire issued to the management was: 5. What are the reasons for the low profits earned and/or the losses incurred by your unit? It is due to the:

a) High price of the cane,
b) Low recovery,
c) High indirect taxes (Excise and Purchase tax),
d) High transport expense,
e) High marketing cost.
f) Less availability of 'free' sale sugar,
g) High cost of operation,
h) High wages,
i) Less utilisation of installed capacity,
j) Non-utilisation of the by-products,
k) Any other reason/s.

All the ten respondents have answered the question. Nine of them have said that high price of cane was the prime reason for the low profits. As a consequence, less cane was used for crushing by the mill. So the installed capacity of these units remained under-utilised. Seven respondents have attributed under-utilisation of the capacity as yet another reason for falling profits or for incurring the losses. Four each respondents have attributed the losses or fall in profits to:

a) Low recovery of sugar per tonne of cane crushed, and

b) Less availability of free sale sugar.

The 'free' sale sugar available for sale was 35% of the production, 65% being reserved for the 'levy' sugar
to be lifted by the Government for distribution through fair price shops. Yet another four respondents attributed the falling profits of their units to the non-utilisation of the by-products in their units.

It is true that there are various by-products generated in the process of manufacturing sugar. Unless all the by-products are fully utilised, it is not possible to maximise the profits as cost cannot be distributed over the joint product. The units must take note of this factor and try to utilise the by-products to the maximum. The managements of only three units have said that the low profits are due to the high wages. Thus, high wages, according to us, is one of the reasons for low efficiency as examined by us in the Chapter XIII. The managements of the Corporate sector units in Karnataka do not think high wages to be an important reason for the fall in profits. That only shows that this problem of high wages is affecting other units in the country than the units working in Karnataka, where the wages and the working conditions have not proved a real threat to the efficient working of the mills.
Since the respondents have separately answered on the taxation affecting their industry, there is only one management which has attributed falling profits to the high rate of indirect taxes like excise and purchase tax. Again only one management has a complaint against the high cost of transport. This is so because, the cane supplier has to make his own arrangements to supply the cane at the gate of the mill. It is he who has to procure the transport, carry it to the gate, get it weighed and return home with cash paid to him.

However, the most interesting and important reasons are in the 'any other reason/s'. Excepting two respondents, all the remaining eight have given their own reasons for the fall in profits or for the losses incurred by their unit. Their analysis is very important as they are the persons on the spot, who are better able to review the situation with the actual data in hand and the day-to-day administration to observe.
One of the respondents has observed as under:

'The most important reason for the loss incurred by the sugar factories in the last few years has been the unremunerative price fixed by the Central Government for the 65% of sugar taken over as 'levy' for public distribution. Eversince July, 1975, when the Government brought about a change in the method of computation of levy sugar price, by taking into account the higher price realised from sale of sugar in the open market and adjusting it in the levy sugar, the factories have been incurring losses year after year. The fixation of unrealistic levy prices left no option to the sugar factories, but to challenge such prices by filling writ petitions in High Courts in most of the States and Karnataka in particular. It was only in November, 1980 that the Government reverted to the old methodology of price fixation. But even under this method, the conversion cost allowed is inadequate and does not cover all the items of cost fully'.

"Apart from the inadequacy of conversion cost that is allowed in the levy price, factories are also obliged to pay prices for the cane purchased much
higher than the statutory prices notified by the Central Government for each factory. Though the fixation of cane price is a statutory function of the Central Government, invariably the State Governments interfere and put pressure on the factories to pay higher prices in order to satisfy the demand of the farmers. Another common reason for loss is under-utilisation of capacity and consequent reduced production of sugar on account of non-availability of adequate quantity of sugarcane. Cane supply to sugar factories is adversely affected by diversion of cane for manufacture of jaggery as well as for production of Khandasari sugar, especially in years, when the manufacturers of jaggery and Khandasari are in a position to pay attractive prices for their raw material. It must also be remembered that jaggery and Khandasari are not subject to any control, like sugar.

Yet another respondent finds fault with the 'less utilisation of capacity, consequent upon non-availability of adequate cane supplies, coupled with high price for cane. Moreover, the pricing policy
announced from time to time (by Government) has been one of the reasons."

A third respondent while agreeing with major reasons listed in the questionnaire, attributes the losses to the "incapacity to process the by-products, which are easily available out of the sugar industry."

Another respondent agrees with all the reasons given in the questionnaire for the low profits of the unit, with a provision that "the above factors (reasons) contribute for the losses but only it may differ from year to year. Due to drought, cane is not available, sometimes recovery is low, and the main reason for the loss is non-availability of free quota sugar for sale."

One of the respondents attributes to the fall in profits to the heavy burden of interest payment. He is not specific. The same point is stressed by another respondent when he says under any other reason/s that "the cost of acquisition of working capital is very high and heavy amount is locked up in holding stocks as the release of stocks is controlled by the Government".
The same view is voiced by still another when he says that "interest payable to the Government institutions and creditors and financial institutions is heavy. Company is unable to pay such high cost of working capital."

Yet another holds a view that the Government should have a long term policy for the sugar industry. The cane price is fixed every year. The diversion of cane for jaggery and other sweetening agents is too much when the price of jaggery is high. This can be avoided only if the Government can fix up an attractive and remunerative price of sugarcane to the growers for at least three years at a time.

Thus, we see that the reasons by and large for falling profits and/or losses are crystallised around high price of cane and the dual pricing policy of the Government for the sugar produced.

We put another question to our respondents, namely: What is the dividend paid by your unit in the last five years for the equity holders?
Do you think this to be an adequate return on the capital investment?

If not, what suggestions do you make to make it more attractive in the Capital Market?

The replies to be above first question from the managements of six units in the corporate sector units in Karnataka and the other experts was that no dividend was paid by their concerns during the last five years beginning from 1975-76 to 1979-80 for the simple reason that they were running at a loss. The profits made by 2/3 units for 2/3 years was set off against previous losses as well as carried forward. Only one unit, the Ugar Sugar Works Ltd., Ugar Khurd made continuous profits and also declared dividend for all the five year period though the rate of dividend was varying every year.

The opinion of the Secretary, South Indian Sugar Mills Association, Bangalore is worth noting. He says that 'most of the sugar factories, particularly in South India, have not been able to either make any profit or pay dividend for the five year period ending 1980. It is only in 1981 that some of the units may be
able to report profitable working and declare dividends. It is too early to say whether the industry would be able to work profitably in 1981."

"It has been the unfortunate experience of the sugar industry that it has been deprived of a fair return in the last several years. This has been proved from the studies published by the Reserve Bank of India, according to which sugar industry occupies the lowest place from the point of view of profitability. In no other industry is the percentage of gross profit to total capital employed so low as in the sugar industry, the average in the last two decades being only 9.2%. This shows the deplorable position in which the sugar industry finds itself, due to reasons beyond its control."

Yet another respondent says on the subject that "Sugar industry in India is now generally making losses, especially due to the Government's restrictions on selling prices. The return on Capital investment is not, therefore, adequate. Removal of Government strong holds on this industry and free commerce (trade) might make the industry more attractive in commercial market."
The reply of another respondent exhibits his anger and disappointment at the return on the investment in sugar units. He says "there is no return for the shareholders. Hence no shareholder buys sugar factory shares. Unless there is adequate return in the form of dividends on the shareholdings, there cannot be any boom for sugar industry in the capital market as the establishment companies and public sector undertakings are paying 15% interest on the capital and/or on advance to them as loans".

Two units expect the dividend to be declared in 1981-82. Whereas one unit has stated that the "last dividend paid was 10% in 1974 and then for the last several years no dividend is paid". Besides it is pointed out very aptly by the management of the same unit that "its share value is quoted in the share market around Rs.4.00 (Face value Rs.10.00). This indicates that there is no adequate return on the capital employed. In fact, there is erosion of the capital". Yet another respondent says that "no dividend is declared since there are no profits. In our opinion, investment in shares of sugar industry is a dead investment".
The only unit which has paid dividend for the past five years beginning from 1975-76 to 1979-80 feels that the returns are not adequate when compared to other industries. Even this unit has to complain of the low returns on the capital investment which is a serious matter worth looking into.

TAXATION AND DIVIDEND

Before we analyse the dividend policy of this lone unit, we would like to examine the replies to another question which was put to the various units and the experts. The question referred to was: Do you think that taxation has anything to do with the dividend to be declared? Which tax is more harmful for the dividend distribution?

The answers to the above questions were not specific. Majority of the respondents have replied that since the companies are not making profits, the question of paying the taxes, does not arise. However, some of the answers are specific and worthy of reproduction for the sharp reaction of the management on the vexed question of taxation of the profits.
One of the respondents has pointed out that
"the direct and indirect taxation generally affect
declaration of dividends, though in the present
juncture of national economy, declaration of dividends
would affect even the very survival of the units.
While indirect taxation cannot be avoided, the units
generally get the benefit of non-payment of direct
taxes, in view of the various allowances like,
depreciation, investment allowance, etc."

Two of the respondents have a sound suggestion
to make on this issue. One of them pointed out that
"it is understood that coffee and tea industry are
getting considerably favourable treatment under direct
taxation. Similar concession could be extended to the
sugar industry also, considering that it is an agro-
based and consumer oriented industry."

Similarly, another respondent replied saying
that "Indirect taxation has direct bearing on dividend.
Dividend declaration arises only when there is profit.
Under the present circumstances no company can make
profits unless all direct and indirect taxes are totally
removed just like coffee industry or plantation".
Another suggestion is for "simplification of the taxation without frequent changes year in and year out". Yet another respondent envisages no "prospects of the sugar industry making profits in the near future as to declare dividends, with the present policy of the Government on the pricing of cane and sugar and with rising expenditure on wages".

Even the unit which is paying the dividend regularly feels as under:

"In our factory, the tax is burdensome as we have declared dividends. The levy of 55% plus surcharge and sur-tax is burdensome, and corporation taxation is harmful for dividend distribution".

The opinions expressed by the management on the subject of profits and the subsequent dividends are worth taking into consideration for the formulation of a fiscal policy for the sugar industry which is an agro-based industry.
RETURN ON THE CAPITAL EMPLOYED

It is of vital importance to study here the capital employed by various units surveyed by us and to examine the return of the said investments so that capital is attracted to this industry to get going. In a capitalistic society, it is needless to say that there has to be an adequate return on the capital employed. Then alone capital will be forthcoming, leave apart the risk capital, for the growth of the industry. Besides, profits are necessary, as a source of internal finance, in other words, for self financing. For this very purpose, we posed a direct question on the adequacy of the return on the capital investment, calling forth the suggestions for attracting the capital to this industry from the capital market of the country.

We have to point out the grave situation on the question of the return on capital. However, we have given below in Table No. IX. 1 the total amount of the capital employed by the sugar units in the corporate sector in Karnataka during the five year period beginning from 1975-76 to the year 1979-80 for a clear analysis.
Capital employed is the aggregate of the following amounts as on the first day of the previous year relevant to the assessment year:

1) Paid up capital,

2) Reserves reduced by the amount of the dividend proposed and, if any provisions for taxation,

3) Development rebate reserve and/or Investment Allowance Reserve.

Since the companies have not made profits, we are not going into the rules for computing the chargeable profits. Suffice it to say that the return is to be calculated on the capital employed as per the rules of the Income Tax Act. We have seen that the gross profits of most of the concerns as compared to the capital employed is very low resulting, in many cases, in losses. This we have already analysed in Chapter V, which we have noted was due to reasons such as poor sales returns, high wages or operational expenses, etc. Suffice it to say here that from our analysis, the return on capital employed is very poor. However, the return on capital employed can be worked out by the following equation:
The return on the shareholders equity is not worth trying as all the units are running at a loss, excepting the Mysore Sugars Ltd., for two years and the Kotharis Sugar and Chemicals Ltd., for two years during the five year period of 1975-76 to 1979-80. We have, therefore, confined ourselves to the study of the dividend policy more exclusively to the Ugar Sugar Works Ltd., only as the above equation does not help, there being no profit to distribute in respect of other units.

DIVIDEND POLICY

Dividend policy mainly aims at two important issues:

(i) How much is to be retained out of the earnings, for the unit for its self sustained growth, and

(ii) How much is to be distributed in the form of dividend.

Dividend decision is both a long term financing decision as well as a wealth maximisation decision. Without going into the greater details of these aspects
of dividend policy of a firm, we will consider the practical approach usually adopted by the profit making firms. It is needless to recall here that only the Ugar Sugar Works Ltd., has made continuous profits and hence declared the dividends.

The practical consideration of a dividend policy are:

(i) What is the choice of the shareholders expressed at the general body meeting? What do they generally prefer - Dividend income or Capital gains?

(ii) What are the financial requirements of the concern? Does it want more liquid cash? Does it require more long term Capital? Does it find any difficulty in raising loans from the financial institutions for its working capital requirements? Does it require capital replacement or financing of another more profitable project?

(iii) How much should be paid out as dividends and how much is to be retained only to be paid later on in kind as a bonus share?
(iv) Is it desirable to follow the stable dividend policy to avoid speculation on the stock exchange?

(v) What should be the form of the dividend?

It is not necessary that all companies should pay dividend if the shareholders do not desire it so. There is a case of a sugar mill in a Co-operative Sector in Karnataka State, which pays the highest price for cane in the entire State, always more than the statutory price fixed by the Government, for the shareholders but never pays the dividend. Besides, the shareholders are given, on the basis of the shares held by them, a predetermined quota of sugar for home consumption and a bonus every year of either a steel cupboard or an electric pumpset, etc., at a concessional rate. The shareholders have never demanded the dividend so far. Of course, this is an extreme case which is possible only in a co-operative sector. In a corporate sector, this is not possible. Profitability has to be measured in terms of the returns on the capital invested. That is the only important yardstick to measure the efficiency of the concern.
The Ugar Sugar Works Ltd. whose working condition is analysed in the following Table No. IX.2 from its balance sheet for the last five years, has continued to make profits, due to better management, better utilisation of the capacity and the best use of the by-products:

(See next page)
<table>
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<tr>
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<tbody>
<tr>
<td>Preference Share Capital</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>--</td>
</tr>
<tr>
<td>Equity Share Capital</td>
<td>1,00,89,600</td>
<td>1,00,89,600</td>
<td>1,00,89,600</td>
<td>1,00,89,600</td>
<td>1,00,89,600</td>
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<tr>
<td>Reserves</td>
<td>97,88,064</td>
<td>1,09,58,264</td>
<td>1,15,44,253</td>
<td>1,09,17,788</td>
<td>40,78,051</td>
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<tr>
<td>Loans Secured</td>
<td>1,25,73,584</td>
<td>2,26,54,935</td>
<td>5,66,25,946</td>
<td>3,17,21,595</td>
<td>65,719</td>
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<tr>
<td>Unsecured</td>
<td>35,24,237</td>
<td>33,43,184</td>
<td>34,70,273</td>
<td>36,81,617</td>
<td>35,32,784</td>
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<tr>
<td>Stock-in-trade</td>
<td>4,02,87,710</td>
<td>5,71,67,922</td>
<td>9,14,23,689</td>
<td>7,76,49,828</td>
<td>3,79,42,667</td>
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<tr>
<td>Interest</td>
<td>19,74,340</td>
<td>24,90,135</td>
<td>63,42,291</td>
<td>81,66,308</td>
<td>51,12,910</td>
</tr>
<tr>
<td>Depreciation</td>
<td>29,46,300</td>
<td>46,65,573</td>
<td>41,71,277</td>
<td>34,12,018</td>
<td>28,76,903</td>
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<tr>
<td>Cane Crushed</td>
<td>3,70,465</td>
<td>4,87,235</td>
<td>5,83,250</td>
<td>4,31,085</td>
<td>3,78,455</td>
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<tr>
<td>Output</td>
<td>4,28,987</td>
<td>5,40,538</td>
<td>6,52,450</td>
<td>4,85,735</td>
<td>3,46,783</td>
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<tr>
<td>Recovery</td>
<td>10.60</td>
<td>66</td>
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</table>
The above table is presented graphically on the next page for comparative understanding. The Table No. IX.2 clearly gives us the net profit earned by the Company. We have worked out the return on the capital employed which is as under:

**TABLE NO. IX. 3**

**STATEMENT SHOWING THE RETURN ON SHAREHOLDERS CAPITAL FOR 1975-76 TO 1979-80 FOR UGAR SUGAR WORKS LTD.**

<table>
<thead>
<tr>
<th>Year</th>
<th>75-76</th>
<th>76-77</th>
<th>77-78</th>
<th>78-79</th>
<th>79-80</th>
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<tr>
<td>Return on the Shareholders Capital (Paise per Rupee)</td>
<td>17.4%</td>
<td>21.3%</td>
<td>10.4%</td>
<td>9.2%</td>
<td>10.5%</td>
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<tr>
<td>Dividend paid</td>
<td>15%</td>
<td>15%</td>
<td>10%</td>
<td>9%</td>
<td>10%</td>
</tr>
</tbody>
</table>

The return on the shareholders capital has matched with the earning per share. In 1975-76 when the Company earned 17.4% on the shareholders capital, it paid 15% retaining a bare balance of just 2% only. It was only during 1976-77 that a substantial amount of the earned profit was retained. As for the remaining three years, whatever was earned on the share capital was distributed in the form of dividend.
Graph showing the return on share holders capital 1970.
Thus, the Ugar Sugar Works Ltd. did not follow the practical considerations in determining the dividend to be paid to the shareholders. This was so because, the profits earned were not very impressive to leave any choice for the management to take a decision but to disburse the little that was earned.

When the average returns on the capital employed in all other industries is above 15% it is only in sugar industry, as per the study undertaken by the Reserve Bank of India, that the returns are around 9%. This return being very low, the industry must distribute the profits that is earned to the shareholders in order to keep them satisfied. This analysis clearly points out, how the sugar industry is in a desperate position and, therefore, needs a separate and special treatment if it has to grow as an agro-based industry, with all its benefits accruing to the primary producer.