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# Financial Performance of Cotton Mills - A Special Case in Andhra Pradesh

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**ABSTRACT**

*A subjective measure of how well a firm can use assets from its primary mode of business and generate revenues. This term is also used as a general measure of a firm's overall financial health over a given period of time, and can be used to compare similar firms across the same industry or to compare industries or sectors in aggregation. There are many different ways to measure financial performance, but all measures should be taken in aggregation.*

*The objectives of this study are two analyse the liquidity position, profitability position and the effectiveness of asset utilization in Pioneer spinning and weaving mills Ltd. For achieving objectives, annual reports of the company are collected from 2000-01 to 2009-10 and analysed by using the ratios, percentages and averages. The firm has maintained very good liquidity position. Current ratio and quick ratio are more than the standard. Therefore it is advised to deposit idle cash in marketable securities. The profitability position also good except in 2007-08 and utilsed fixed assets and current assets effectively.*

*The efficiency ratios like stock turnover ratio, debtors turnover ratio and fixed assets turnover ratio are also static during the study period. Therefore, the firm must try to improve the performance by making various forms of internal reconstruction like alteration of share capital, reduction of share capital, writing off lost assets. The firm should also follow strategies like right person in right job to improve the productivity and overall financial performance.*

**KEYWORDS : Liquidity position – Profitability – Asset utilization - Evaluation**

## INTRODUCTION

Financial performance means measuring the results of a firm's policies and operations in monetary terms. These results are reflected in the firm's return on investment, return on assets, value added, etc. A subjective measure of how well a firm can use assets from its primary mode of business and generate revenues. This term is also used as a general measure of a firm's overall financial health over a given period of time, and can be used to compare similar firms across the same industry or to compare industries or sectors in aggregation.

The performance of a company can be viewed in many ways. The view taken will determine the measures used to assess performance. For example, a human resource manager might look at staff retention or productivity measures. A marketing manager might be interested in market share. A sales manager might be interested in sales volume, while an accountant might look at cost of sales and margins. Cost of sales and margins are financial measures and can be derived from a company's financial statements.

There are different ways to measure financial performance, but all measures should be taken in aggregation. Line items such as revenue from operations, operating income or cash flow from operations can be used, as well as total unit sales. Furthermore, the analyst or investor may wish to look deeper into financial statements and seek out margin growth rates or any declining debt.

A ratio is the relationship between two numbers and is calculated by dividing one by the other. As we will see, sometimes the two numbers come from the same financial statement. Some other ratios require a number from the P&L Account and a number from the Balance Sheet. Financial ratios are widely used by managers, analysts, and investors for assessing the performance of a business. We will use some vital financial ratios to examine the performance of the Pioneer Spinning and Weaving Mills Ltd.

## REVIEW OF LITERATURE

The Ahemadabad Textile Industry's Research Association (1985) has observed that income is the single most important determinant of textile consumption expenditure. International trade in textile is becoming increasingly competitive and India holds competitive advantages in yarn and cloth manufacture. The study suggests a greater attention to machinery maintenance and a commitment to extract a best out of installed technology by way of quality and productivity.

Gradie (1985) in his study has observed that the modernization gap is large due to poor profitability of the mills which in its turn is a part of a vicious circle of poor profits less expenditure on machines. He suggests through his study that detailed discussions and dialogues will have to take place within and between the management and labour for crystallizing the action plans such as achieving an adequate level of profitability for survival and growth of the industry.

Lokande made an attempt to analyse the performance of Cooperative Spinning Mill of Jalna of Maharastra State. He also made an attempt to examine the problems of spinning mill. The researcher adopted ratio analysis tool to evaluate the performance of cooperative spinning mill. The study revealed that profitability and liquidity of the firm had been very poor since the inception of the firm and concluded that the ailing firm was leading to sickness.

## NEED AND IMPORTANCE OF THE STUDY

The finance is the scarcest resource in India, needs to be utilized optimally. The sound performance of a firm depends on the well planning of capital structure, invest and distribution. Any firm that fails to apply the sound principles of capital structure like cost, control and flexibility and the firm that fails to adopt scientific tools of investment and distribution in managing funds will not survive in long run. Further, the firm should apply the wealth maximization as criteria in taking financial decisions like financing, investment and distribution. Since, the finance is the lifeblood and nervous system of an enterprise, the importance of the timely appraisal the performance of the firm should not be overemphasized. In addition, it is clear from the review of earlier literatures that there has been no study on financial performance of the Pioneer Spinning and Weaving Mills Ltd., Puttur.

## OBJECTIVES OF THE STUDY

- To analyse the liquidity position of Pioneer Spinning & Weaving Mills Ltd.
- To assess the profitability position in Pioneer Spinning & Weaving Mills Ltd.
- To know the effectiveness of asset utilisation of Pioneer Spinning & Weaving Mills Ltd.

## RESEARCH METHODOLOGY

### Data

The present study is purely based on the secondary data i.e., Annual reports of the Pioneer Spinning & Weaving Mills Ltd., Puttur. The data extracted from the annual reports of the mill from 2000-01 to 2009-10. The collected data are analysed by using the ratios, percentages and averages.

**Tools and Techniques**

To analyse liquidity position, current ratio, quick ratio and cash flow coverage ratio are computed.

$$\text{ratio} = \frac{\text{Current assets}}{\text{Current liabilities}}$$

$$\text{Quick ratio} = \frac{\text{Quick assets}}{\text{Current liabilities}}$$

$$\text{Cash flow coverage ratio} = \frac{\text{Net profit + Non – cash expenses}}{\text{Current liabilities}} \times 100$$

To assess the profitability position, gross profit ratio, gross operating ratio, return on shareholders' net worth, return on capital employed and return on total assets are computed

$$\text{Gross profit ratio} = \frac{\text{Gross profit}}{\text{Net sales}} \times 100$$

$$\text{Gross operating profit ratio} = \frac{\text{Gross operating profit}}{\text{Net sales}} \times 100$$

$$\text{Return on shareholders' net worth} = \frac{\text{Net profit}}{\text{Shareholders' fund}} \times 100$$

$$\text{Return on capital employed} = \frac{\text{Net operating profit}}{\text{Capital employed}} \times 100$$

$$\text{Return on total assets} = \frac{\text{EBIT}}{\text{Total assets}} \times 100$$

To know the effectiveness of asset utilization, fixed assets turnover ratio, inventory turnover ratio and debtors turnover ratio are used.

$$\text{Fixed assets turnover ratio} = \frac{\text{Net sales}}{\text{Fixed assets}}$$

$$\text{Inventory turnover ratio} = \frac{\text{Cost of goods sold}}{\text{Average stock}}$$

$$\text{Debtors turnover ratio} = \frac{\text{Net sales}}{\text{Average debtors}}$$

## ANALYSIS AND INTERPRETATION

### Analysis of liquidity position

Many firms are facing the problem of balancing between profitability and liquidity. Some firms are good in managing profitability and are poor in managing liquidity and solvency and other firms are vice versa. But the success of the firm depends on their effectiveness in balancing between the liquidity and profitability. Therefore, to be successful, the firm should meet these conflicting issues of profitability and liquidity.

**Table 1: Liquidity Ratios of the firm (In times)**

| Year | Liquidity Ratios | | |
|---|---|---|---|
| | Current ratio | Quick ratio | Cash flow coverage ratio |
| 2000-01 | 1.85 | 1.04 | 14.8 |
| 2001-02 | 2.92 | 1.67 | 27 |
| 2002-03 | 2.92 | 1.41 | 38.82 |
| 2003-04 | 2.25 | 1.16 | 25.34 |
| 2004-05 | 2.59 | 1.02 | 16.53 |
| 2005-06 | 2.96 | 1.47 | 9.96 |
| 2006-07 | 4.74 | 1.91 | 70.31 |
| 2007-08 | 3.05 | 1.46 | 68.16 |
| 2008-09 | 2.55 | 1.49 | 61.05 |
| 2009-10 | 2.57 | 1.12 | 43.86 |
| Average | 2.84 | 1.38 | 37.58 |

**Source: Annual reports PS&WM Ltd.**

Table: 1 shows the liquidity position of the firm. The current ratio is more than the standard ratio i.e. 2:1 except in 2000-01. The current ratio is highest in 2006-07 i.e. 4.74:1 and lowest in 2000-01 i.e. 1.85:1. The average current ratio of the firm in the study period is 2.84:1. It shows that the company highly concentrated on liquidity position. The quick ratio is also more than the standard ratio i.e. 1:1. In 2006-07 it was 1.91:1 and highest in the study period. In 2004-05 it was lowest but very nearer to the standard ratio i.e. 1.02:1. The average of quick ratio is also 2.62. Cash flow coverage ratio of the firm shows very good track record except in the year 2005-06. In 2006-07 it was highest i.e. 70.31 percent and in 2005-06 it was lowest i.e. 9.96 percent. The average of cash flow coverage ratio is 37.58 percent.

### Analysis of profitability position

Profitability is the overall measure of efficient and effective utilization of resources by the companies. The profitability ratios indicate how efficiently the resources of the companies are used and how effectively the costs have been controlled. The higher is the profitability ratio, the higher is the performance and lower is the profitability ratio the lower is the performance.

**Table 2: Profitability Ratios of the firm (In percentages)**

| Year | Profitability Ratios | | | | |
|---|---|---|---|---|---|
| | Gross profit Ratio | Gross operating Ratio | Return on shareholders' net worth | Return on capital employed | Return on total assets |
| 2000-01 | 1.87 | 1.56 | 35.34 | 7.28 | 4.45 |
| 2001-02 | 1.72 | 0.48 | 6.98 | 1.43 | 1.11 |
| 2002-03 | 2.38 | 0.88 | 11.92 | 2.37 | 1.88 |
| 2003-04 | 2.69 | 1.97 | 34.02 | 8.6 | 6.52 |
| 2004-05 | 4.05 | 4.26 | 56.67 | 15.01 | 11.89 |
| 2005-06 | 4.36 | 5.69 | 49.14 | 16.16 | 13.51 |
| 2006-07 | 5.23 | 3.04 | 36.79 | 10.75 | 11.06 |
| 2007-08 | 3.56 | -0.34 | -11.69 | -3.3 | -2.9 |
| 2008-09 | 3.08 | -3.63 | 15.26 | 4.23 | 3.46 |
| 2009-10 | 6.54 | 6.95 | 44.28 | 16.23 | 13.15 |
| Average | 3.55 | 2.09 | 27.87 | 7.88 | 6.41 |

**Source: Annual reports PS&WM Ltd.**

Table 2 shows the profitability ratios of the firm. The average of gross profit ratio is 3.55 percent. The gross profit ratio of the firm is in increasing trend from 2000-01 to 2009-10 except in 2007-08 and 2008-09. It was highest in 2009-10 i.e. 6.54 percent and lowest in 2001-02 i.e. 1.72 percent. In case of gross operating profit ratio, the firm having positive ratio in all years except in 2007-08 and 2008-09. In 2008-09 it was lowest i.e. -3.63 percent and in 2009-10 it was highest i.e. 6.95 percent.

Return on shareholders' net worth also showed the firm earned and en-

joyed lot of return in the study period except in 2007-08. It was highest in 2004-05 i.e. 56.67 percent and lowest in 2007-08 i.e. -11.69 percent. The average of return on shareholders' net worth is 27.87 percent. There was lot of ups and down in return on capital employed during the study period. It was highest in 2009-10 i.e. 16.23 percent and lowest in 2007-08 i.e. -3.3 percent. The average of return on capital employed is 7.88 percent.

Return on total assets ratio also shows that there was no regular and steady return. It was 13.51 percent in 2005-06 and the firm tasted a negative result in 2007-08 i.e. -2.9 percent. The average of return on total assets is 6.41 percent.

### Analysis of asset utilisation

The effectiveness in financial performance of the firm also depends on its effectiveness in utilizing the assets optimally. To examine the effectiveness of the firm in utilizing the assets optimally, it is necessary to compute asset turnover ratios, which involves comparison between the level of sales and investment in current assets and fixed assets. These ratios are used to measure the speed with which various accounts are converted into cash.

**Table 3: Turnover ratios of the firm (In times)**

| Year | Turnover ratios | | |
|---|---|---|---|
| | FATR | ITR | DTR |
| 2000-01 | 9.41 | 7.76 | 10.52 |
| 2001-02 | 5.93 | 7.14 | 12.33 |
| 2002-03 | 4.53 | 5.01 | 11.32 |
| 2003-04 | 6.1 | 6.14 | 10.61 |
| 2004-05 | 6.96 | 3.19 | 14.69 |
| 2005-06 | 6.93 | 3.69 | 11.93 |
| 2006-07 | 5.12 | 4.84 | 20.89 |
| 2007-08 | 3.68 | 5.06 | 13.66 |
| 2008-09 | 4.7 | 8.62 | 15.51 |
| 2009-10 | 4.77 | 4.95 | 20.88 |
| Average | 5.81 | 5.64 | 14.23 |

**Source: Annual reports PS&WM Ltd.**

It is evident from Table: 3 that the fixed assets turnover ratio has lot of ups and downs during the study period. It was highest in 2000-01 i.e. 9.41 times and lowest in 2007-08 i.e. 3.38 times. The average of fixed assets turnover ratio is 5.81 times. In case of inventory turnover ratio, the average is 5.64 times. It was highest in 2008-09 i.e. 8.62 times and lowest in 2004-05 i.e. 3.19 times. Similarly the debtors' turnover ratio also has lot of ups and downs. In the beginning it was 10.52 times in 2000-01 and at the ending it was 20.88 times. The average of debtors' turnover ratio is 14.23 times.

## FINDINGS AND SUGGESTIONS

1. The firm has maintained high current ratio and quick ratio. It reveals that the firm invested lot of funds in current assets. Instead of invest in current assets ideally it is better to invest in short-term securities. Cash flow coverage ratio also showed that the firm has feasibility to pay interest.
2. The overall performance of the profitability ratios is satisfactory except in 2007-08. The negative result happened due to lack of proper control on cost of production and sudden increase in prices of raw materials. The firm has to control cost of production through proper inventory management system.
3. The firm has given more importance to sales as compared to profitability of the firm. The average of fixed assets turnover ratio, inventory turnover ratio and debtors' turnover ratio showed the performance of the firm for using fixed assets and current assets effectively.

## CONCLUSION

The overall performance of the Pioneer spinning and weaving mills Ltd has been satisfactory except 2007-08. The gross operating profit, return on shareholders' wealth, return on capital employed and return on total assets are negative in the year 2007-08. Further, growth rate in sales, capital employed and net worth have been very low. The efficiency ratios like stock turnover ratio, debtors turnover ratio and fixed assets turnover ratio are also static during the study period. Therefore, the firm must try to improve the performance by making various forms of internal reconstruction like alteration of share capital, reduction of share capital, writing off lost assets. In addition, the firm should improve the management of working capital areas like cash management, inventory management and credit management to regulate the liquidity position and improve administrative and operation management to reduce the production and operating cost. The firm should also follow strategies like right person in right job to improve the productivity and overall financial performance.

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