

CHAPTER - VEVALUATION OF FINANCIAL MANAGEMENT PRACTICES AT MAYUR

- Attitude of Management
- Financial Management Praactices
- Raising of Funds
- Deployment of Funds
- Profitability, Profit Distribution and Creation of Reserves

V : EVALUATION OF FINANCIAL MANAGEMENT

PRACTICES AT MAYUR

'MAYUR' was established on 5th September 1966 with a main purpose to help unorganised and scattered small workshopowners by way of purchase of spare parts manufactured by them and to provide them an assured business through out the year. But by considering the overall business and activities run by MAYUR for the last 18 years, espacially for 5 years under study, starting from 1981-82 and ending with 1985-86, it seems that MAYUR's management could not do this effectively. This can be seen from the operational & financial performance shown in the previous chapters.

Attitude of Management :

After analysing the data that are presented in chapter II, one comes to the conclusion that the management's attitude towards MAYUR's business lacked direction and was totally lethargic. Export of diesel engines or domestic sale of power tillers, electric motors or bullock carts point out the directionless & lethragic attitude of MAYUR's management towards its business. Shifts in regionwise sales also support

this contention. Management of MAYUR has thus proved to be a total failure in respect of its marketing function.

Because of the managements' failure in marketing, other related aspects like production, finance etc. were badly affected. As sales declined, production also declined with increasing raw material inventory. Overheads started mounting as production came down. That had its adverse effects on cost factors. Cost of production & other related costs started shooting up. It ultimately resulted into cost of sales being higher than sales. Declining sales ultimately resulted in financial shortages. Management of MAYUR found out a short cut and started borrowings. Borrowings further increased the burden of interest. Simultaneously, MAYUR incurred losses on account of declining sales and rising costs. Accumulation of losses ultimately reduced the shareholders' own funds. Capital structure was heavily burdened with borrowed funds. That resulted into a very high financial risk for MAYUR. In 1985-86, MAYUR's management was unable to face all this adverse and risky situation which had arisen mainly on account of its own directionless and lethargic attitude.

Financial Management Practices :

Evaluation of financial management practices may be divided into the following three aspects :

- I) Raising of funds;
- II) Deployment of funds raised; and
- III) Profitability, profit distribution & creation of reserves.

I) RAISING OF FUNDS :

As shown in Table No. 3.4 (i.e. the funds flow statement), management of MAYUR had relied heavily on borrowings to finance its activities (e.g., borrowings amounted to Rs. 25.05 lakhs in 1983-84 & Rs. 21.22 lakhs in 1984-85). Purchases of fixed assets amounted to Rs. 3.22 lakhs, Rs. 2.29 lakhs, Rs. 0.44 lakhs & 0.01 lakhs in 1982-83, 1983-84, 1984-85 & 1985-86 respectively. In 1982-83 & 1983-84 there was an increase in net working capital to the tune of Rs. 1.87 lakhs & Rs. 20.75 lakhs respectively. The remaining two years, i.e., 1984-85 & 1985-86 witnessed a decrease of net working capital to the extent of Rs. 10.76 lakhs & Rs. 46.06 lakhs respectively. Raising of funds by issuing shares was nominal throughout the five year period, the highest amount

being Rs. 0.61 lakhs in 1982-83. MAYUR had collected an amount of Rs. 1.29 lakhs on Share Anamat Account in 1983-84 which remained unadjusted till the end of 1985-86.

Comparative Balance Sheets (Table NO. 4.2) & Common-Size Balance Sheets (Table No.4.4) also show MAYUR's heavy reliance on borrowed funds and eroding shareholders' equity. This is reflected in Debt- Equity Ratio & Debt-Asset Ratio for the last two years of study (Table No. 4.8). Debt-Equity Ratio which was 1.78 in 1983-84, rose to 3.9 in 1984-85 and further to 32.42 in 1985-86. Debt-Asset Ratios for 1983-84, 1984-85 & 1985-86 were 0.58, 0.72 and 0.85 respectively.

II) DEPLOYMENT OF FUNDS :

Funds raised are normally used for the investment in various assets fixed as well as current assets. Management must deploy these funds in these fixed & current assets in the most judicious manner so as to derive maximum returns from them to the organization. The assets, fixed as well as current, must, therefore, be acquired, utilised & managed in the most efficient manner possible.

Table No. 3.3 shows the Balance Sheet of MAYUR for the five years under study. From this & from other information provided in the previous chapters, it is noticed that investment in fixed assets was mainly done in the initial years. Sales were at their highest at Rs. 1.49 crores in the year 1981-82, followed by Rs. 1.34 crores in 1983-84. Sales declined to Rs. 0.79 crores in 1984-85 with a marginal improvement at Rs. 0.77 crores in 1985-86. As mentioned earlier in this chapter, management was directionless & lethargic in respect of marketing at MAYUR. This aspect of declining sales & neglect of marketing function is brought out at this stage for the purpose of understanding the inefficient use of assets. It resulted into unutilised capacity for majority of the 18 years for which data are presented for the purpose of this study. Asset Turnover Ratio (Table No. 4.7) for the five years of this study supports the above contention. Asset Turnover was 1.23, 1.22, 0.90, 0.50 and 0.84 in the years 1981-82, 1982-83, 1983-84, 1984-85 & 1985-86 respectively.

Management of current assets was not satisfactory. High current ratio and quick ratio (Table No. 4.5) indicate that unnecessary funds were locked up in current assets. Cash balance was as high as Rs. 8.00 lakhs in 1981-82, Rs. 3.86 lakhs in 1982-83 and it showed a 'normal' balance during the next three years of study. Management of inventory and receivables was also inefficient as could be observed from the following ratios for the five years:

| | Inventory Turnover (Times) | Receivable Turnover (Collection Period in Days) |
|---------|----------------------------------|---|
| 1981-82 | 2.83 | 102 |
| 1982-83 | 1.50 | 156 |
| 1983-84 | 1.46 | 163 |
| 1984-85 | 1.08 | 345 |
| 1985-86 | 1.73 | 215 |

III) Profitability, Profit Distribution and Creation of Reserves

During the five years of this study, profitability of MAYUR has continuously declined. This may be seen from Table Nos. 3.1 & 3.2 (Profit & Loss Account), 4.1 (Comparative Income Statements), 4.3 (Common-Size Income Statements), and 4.6 (Profitability Ratios).

Gross Profit earned during the first three years of the study was Rs. 14.11 lakhs, Rs. 16.83 lakhs and Rs. 14.23 lakhs in 1981-82, 1982-83 & 1983-84 reaspectively. Gross Profit Margin was 9.4%, 15% and 10% during 1981-82, 1982-83 & 1983-84 respectively. Gross loss incurred was Rs. 10.13 lakhs & Rs. 8.89 lakhs in the year 1984-85 and 1985-86 respectively. MAYUR could earn a net profit of Rs. 10,000 during 1981-82 i.e., the first year of this study. 'Lateron, in all the four years, MAYUR incured net loss. Net loss was Rs. 0.60 lakhs in 1982-83, Rs. 2.54 lakhs in 1983-84, Rs. 33.23 lakhs in 1984-85, and Rs. 30.67 lakhs in 1985-86.

The following additional points in this respect may also be noted :

- i) Sales revenue has declined throughout the five years of this study with a marginal increase over the previous year in 1983-84 and 1985-86.
- ii) Earnings Before Interest & Taxes (EBIT) were positive only during 1981-82. The figures for all the remaining four years were negative.
- iii) Cost of sales was more than sales revenue during 1984-85 & 1985-86.

- iv) Operating expenses showed a continuous increasing trend during the five years of study.
- v) Interest expense showed an increasing trend in the first four years of the study with a marginal decrease in the last year.

Profit Distribution & Creation of Reserves :

During the five years of the study, MAYUR has not distributed any profit in the form of dividend to the shareholder-members.

Reserves created during the five year period amounted to Rs. 1.81 lakhs. These reserves are all types of reserves.

Conclusion :

Management of MAYUR in general & its financial management in particular was lethargic and directionless. Declining sales, rising costs, declining profits & in later years, incurring heavy losses and inefficient use of fixed & current assets were the visible danger signals that could be easily noted by an alert & sincere management. Management of MAYUR did not pay any attention to these danger signals.

Sick Industrial Companies (Special Provisions) Act, 1985, provides that an industrial unit may be treated as sick if 50% of its net worth is eroded, among other things. As seen from Table 4.2, given in Chapter IV of this dissertation, MAYUR should be treated as a "sick" unit and further necessary action be taken at the Government level.