CHAPTER - I

INTRODUCTION, SCOPE, OBJECTIVES AND METHODOLOGY OF THE STUDY :

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I : INTRODUCTION

Introduction :

This Chapter will introduce the theoretical background of the subject matter and the Organisation which has been studied for this purpose. The Chapter is, therefore, divided into two parts (A) Background Analysis and (B) Methodology.

(A) BACKGROUND ANALYSIS :

Importance of financial manager has increased tremendously in today's complex business. Financial manager is required to work in close coordination with all other managers (like production manager, marketing manager, etc.) and he is having direct responsibility for control proces in a business organisation. The main functions of financial management are "to plan for, acquire, and utilise funds in order to maximise the efficiency and value of the enterprise."[1]

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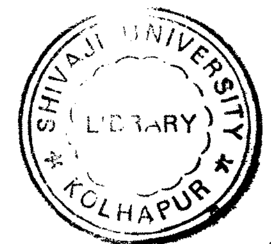
1. American Institute of Certified Public Accountants, "Statement of Accountancy Principles Board No.4 (New York, October 1970), P.17.

Corporate Financial Management is designed, therefore, to help general management take actions that will maximise the value of the firm & the wealth of the shareholders. Translated into operating terms, it means that share price maximisation is probably the most important goal of most firms (except public utilities), with twin sub-goals of (i) minimising the cost of capital and (ii) maximising the return on investiment (ROI). Financing decisions (i.e. decisions pertaining to obtaining funds, when required, from the owners & the lenders in a proper (sometimes called "optimal mix"), investiment decisions (i.e. decisions regarding deployment of funds in acquiring assets and efficient utilisation of such assets) and dividend decisions (i.e. decisions regarding deciding upon dividend pay-out & retaining profits) are normally taken by the finance manager with the above stated goals. The finance manager has, while taking & implementing these decisions, to have a trade-off between risk and return which are inversely related.



Management of Co-operatives :

"A co-operative society is both a human association and an economic enterprise,"[2] says Shri.Dubhashi. Management of Co-operative Society must, therefore, consider its twin characteristics and follow the following principles of Co-operation :

1. Voluntary & open membership;
2. Democratic organisation, management & control.
3. Limited rate of interest on capital,
4. Disposal of surplus in proportion to participation in business;
5. Service, self-helf and mutual help;
6. Political & religious neutrality;
7. Cash trading;
8. Co-operative education, and
9. CO-operation among co-operatives.

The first four of the above principles are treated as fundamental principles, the remaining ones being treated as of lesser significance.

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2. Shri. Dubhashi P.R. "Principles & Philosophy of Co-operation" (1970), Vaikunth Mehta National Institute of Co-operative Management, Pune, P.59.

Co-operative differ from any other form of private organisation (like a sole trader, partnership firm or a limited company) in that the co-operatives must run their businesses on the principles of co-operation given above. As an economic enterprise, a co-operative organisation must do its business efficiently and effectively. As a human organisation, on the other hand, a co-operative organisation cannot overlook the basic purpose of its existence which can be stated as economic upliftment of the members who have joined together in its formation. "Service, Self-help and mutual help" is the principle that guides any co-operative organisation in carying out its business. Unlike any other private business organisation, a co-operative organisation, by its very nature cannot keep before it profit motive. This is so because co-operatives are not a business organisation normally obtained in a capitalist economy. It is a business organisation as it is an economic enterprise; but as a human organisation, co-operatives are more oriented toward service giving aspect with the ultimate objective of economic upliftment of the members thereof.

Financial Management in Co-operatives :

Financial Management in a co-operative organisation differes from that in a limited company (or for that matter, any form of private sector organisation) on various counts. They are explained below :

1. Objectives : The main objective before financial management of a private sector organisation is to maximise wealth of the firm to the shareholder through the share price maximisation. Minimisation of cost of capital & maximising ROI are the two sub-objectives for a private sector organisation.

   In case of a co-operative organisation, maximisation of shareholder's wealth is never aimed at. Moreover, shares of co-operatives are never purchased & sold in stock market.

   Minimisation of cost of Capital cannot become a sub-objective to be pursued seriously. This is so on account of limitations put on capital structure of a co-operative organisation. Only a very few co-operatives (mainly federal apex societies) can issue debentures. Borrowing is limited by

the provisions contained in the bye-laws. Co-operatives have to borrow from co-operative banks. They can borrow from the development banks like Industrial Development Bank of India (IDBI), Industrial Finance Corporation of India (IFCI) etc. Co-operatives cannot, however, borrow from commercial banks (including the nationalised ones) unless specifically permitted by the Registrar, Co-operative Societies, Maharashtra State, Pune. Co-operatives can, however, accept deposits from their members. This has become one of the major source of raising capital (e.g. Sugar CO-operatives) which simultaneously is cheaper than any other source with regard to its cost.

The second sub-objective of maximising ROI may not have the same type of limitations in co-operatives. ROI is normally computed thus;

Profit Margin × Asset Turnover

$$\left[\frac{\text{Operating Income}}{\text{Sales}} \times 100 \right] \times \left[\frac{\text{Sales}}{\text{Assets}} \right]$$

$$= \frac{\text{Operating Income}}{\text{Assets}} \times 100$$

Co-operatives, like any other private sector organisation, can improve ROI by raising sales, controlling costs and using assets efficiently and effectively with the help of tighter management. But as the co-operatives are not profit oriented organisations, they generally have a tendency to fix the sale price with low profit margin. That affects the operating income adversely.

2. Financing Decision :

Financing decision is concerned with deciding the sources of finance to be tapped and also deciding the debt equity mix. Finance managers in private sector enterprises may try to achieve a balance with optimal capital structure. Optimal capital structure is one at which cost of capital is at the minimum & the value of the firm to the shareholder at the maximum. This optimal capital structure theory is criticised by many authorites. But as the practical applications of this theory are simple we may proceed with this traditional theory.

In co-operatives debt-equity mix is normally decided by the provisions contained in law. Co-operative Societies Act, the rules framed thereunder and the bye-laws of the society

taken together put restrictions on borrowings by a society. For example, in case of the Maharashtra Co-operative Engineering Society Ltd., Kolhapur, (i.e. The Society selected for this study) the bye-laws of the society provide that the Society can borrow to the maximum extent of 12 times its owned capital. Moreover, a co-operative is not concerned with maximisation of value of the firm to the shareholders (or members). Limitations of minimising cost of capital have already mentioned in (i) above under the sub head "objectives".

Thus there is a limited scope for co-operatives in having the optimal capital structure. Basically, co-operatives cannot pursue it as a matter of policy.

3. Investment Decision :

Investment decision is concerned with (i) investing funds in fixed as well as current assets, (ii) efficient & effective use of the assets so acquired and (iii) safeguarding them from wear & tear, theft, misappropriation etc.,

This decision is important not only from the viewpoint of an organisation in the private sector but also from the viewpoint of a cooperative organisation. In case of the Maharashtra Co-operative Engineering Society Ltd., Kolhapur (henceforth called "MAYUR") this aspect has been totally neglected by the management. This will be explained in detail at the appropriate stage lateron.

4. Dividend Decision :

Dividend decision is concerned with deciding dividend payout (i.e. the percentage of earnings to be paid in the form of dividend) and about earnings to be retained. This decision is important from the viewpoint of management of a private sector organisation as it affects the market value of share. Also important in the fact that companies in private sector give bonus shares out of the accumulated retained earnings.

In case of a cooperative organisation, however, both the payment of dividend and the earnings to be retained are governed by legal provisions contained in Co-operative Societies Act of the Concerned State, for example, in Maharashtra, a Co-operative Organisation cannot distribute

more than 12% dividend to its shareholders (Section 67 of Maharashtra Co-operative Societies Act, 1960) except with the prior sanction of the State Government. Section 66 of Maharashtra Co-operative Societies Act, 1960 provides that a Co-operative society shall carry at least 25% of the net profits each year to the reserve fund. Thus the dividend decision for a cooperative organisation is not a critical part from the viewpoint of its management. Moreover, there is neither an allotment of bonus shares out of retained earnings nor shares of a cooperative organisation are traded at any stock exchange in India.

(B) METHODOLOGY :

SCOPE AND OBJECTIVES OF STUDY :

This study is concerned with financial management of MAYUR. The researcher has considered how MAYUR has managed its finance function keeping in view the overall objectives of MAYUR. For this purpose data for the five years starting from 1981-82 and ending with 1985-86 are considered.

Objectives of the study :

The objectives of the study are :

i) To study financial management as practised at MAYUR,

ii) To suggest measures for improvement, if any, in respect, of financial management practices at MAYUR.

METHODS OF DATA COLLECTION :

The concerned primary data have been collected by researcher by taking personal interviews of accountants, engineers and store-keeper etc. of MAYUR.

Secondary data used for this study has been obtained from the office Records, Annual Reports Bye-laws and other concerned records of MAYUR.

Here the researcher has collected and considered data for five years starting from 1981-82 and ending with 1985-86,

because data relating to, say, a period of more than five years prove sometimes to be irrelvant for the purpose of financial evaluation and drawing conclusions. Five years' data normally give sufficient understanding of the trends obtained in an organisation.

CHAPTER SCHEME :

Report of this study has been divided into six chapters.

First Chapter includes introduction of the problem under study which is further sub-divided into two parts viz.

i) Background Analysis : Considers financial management from the viewpoint of a co-operative organisation.

ii) Methodology : Contains scope and objectives of study, methods of data collection and chapter scheme.

Second Chapter contains profile of MAYUR. It includes

i) Historical background,

ii) Organisation structure and

iii) Operational and financial details.

Third Chapter is on the presentation of data for the period under study starting from 1981-82 and ending with 1985-86.

Fourth Chapter gives the analysis and interpretation of data presented in the previous chapter.

Fifth Chapter evaluates the financial management practices at MAYUR.

Sixth Chapter deals with Summary and Conclusions.

Limitations of the Study :

As mentioned above this study covers financial management as practised at MAYUR. It must be remembered that MAYUR as a co-operative organisation has its limitations in respect of raising funds, or distributing dividends to its shareholders. These aspects have been considered during the course of this study. This could be done only with the help of data available from annual reports and office records of MAYUR. Certain technical aspects particularly regarding capacity utilisation could not, however, be scrutinised for want of such data and technical personnel who could give necessary explanation.