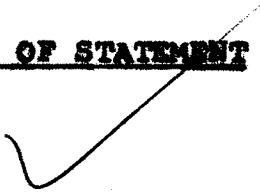


CHAPTER-V

INTERPRETATION OF STATEMENT



5.1 INTRODUCTION :

In this chapter we propose to present the interpretations of various ratios relating to 'Deccan Co-operative Spinning Mills Ltd., Ichalkaranji.'

5.2 STEPS TAKEN IN INTERPRETATION OF RATIOS :

The ratios may be interpreted classifying the ratios in various groups. Considering the purpose nature and objective of the analysis.

Classification of ratios according to nature is presented as follows : Solvency, Liquidity, Leverage, Profitability and activity. Classification of ratios according to importance : Primary Ratios and Secondary Ratios. Secondary Ratios are also classified as supporting ratios, general explanatory ratios, specific explanatory ratios.

Traditional classification : Balance sheet ratios, Revenue statement ratios and inter-statement ratios.

Functional classification : Liquidity, Profitability and Market Test.

For interpretation of ratios any one of the type may be taken into consideration to achieve the purpose of financial analysis.

The purpose of studying financial analysis of Deccan Co-operative Spinning Mills Ltd. is to judge the liquidity, solvency, safety, profitability of the mill. So classification of ratios according to nature is selected for interpretation of ratios.

While interpreting ratios following steps are followed :

- 1) Interpretation of Individual Ratio.
- 2) Ratios may be interpreted by expanding the analysis and considering a group of several related ratios.
- 3) Making comparisons over time i.e. Intra-firm comparisons.

Interpretation of Liquidity Ratios

A) Liquidity Ratios

- i) Current Ratio
- ii) Liquid Ratio
- iii) Absolute Liquid Ratio
 - a) Debtors Turnover Ratio
 - b) Inventory Turnover Ratio

B) Leverage Ratios or Capital Structure Ratio

- i) Capital gearing ratio
- ii) Total Investment to long-term Liabilities Ratios
- iii) Debt Equity Ratio
- iv) Ratio of current liabilities to proprietors fund

C) Solvency Ratios

- i) Debt Equity Ratio**
- ii) Ratio of Long-term debt to shareholders fund ratio**
- iii) Proprietary or equity ratio**
- iv) Solvency Ratio**
- v) Fixed assets to net worth**
- vi) Ratio of current assets to proprietors fund**
- vii) Ratio of fixed assets to proprietors fund**
- viii) Fixed assets Turnover Ratio**
- ix) Interest Coverage Ratios**

D) Profitability

a) General Profitability :

- i) G.P. Ratio**
- ii) Operating Ratio**
- iii) Expenses Ratio**
- iv) N.P. Ratio**
- v) Operating Profit Ratio**

b) Overall Profitability :

- i) Return on capital employed ratio**
- ii) Return on shareholders investment**
- iii) Return on equity capital**
- iv) Earning per share.**

E) Efficiency/Activity

- i) Inventory or Stock Turnover Ratio**
- ii) Debtors Turnover Ratio**
- iii) Creditors Turnover Ratio**
- iv) Average Collection Period**
- v) Average Payment Period**
- vi) Working Capital Turnover Ratio.**

1) Current Ratio

$$= \frac{\text{Current Assets}}{\text{Current Liabilities}}$$

$$1980-81 = \frac{6,69,96,908.34}{4,32,50,221.68}$$

$$= 1.55:1$$

$$1981-82 = \frac{8,38,74,225.68}{5,54,57,868.98}$$

$$= 1.52:1$$

$$1982-83 = \frac{8,65,61,144.13}{6,12,29,650.36}$$

$$= 1.42:1$$

$$1983-84 = \frac{8,41,80,732.16}{6,25,43,390.59}$$

$$= 1.31:1$$

$$1984-85 = \frac{8,21,81,630.91}{6,47,48,330.05}$$

$$= 1.26:1$$

Interpretation :

A relatively high value of the current ratio is an indication of the same liquidity and of the firm that the firm has the ability to pay its bills. On the other hand, a relatively low value of the current ratio is considered as an indication that the firm will find difficulty in paying its bills. As a conventional rule, a current ratio of 2:1 or more is considered to be satisfactory. This rule is based on the logic that in a worst situation even if the value of current assets becomes half, the firm will be able to meet its obligation. The current ratio represents the margin of safety, the larger the amount of current assets in relation to current liabilities, the more the firm's ability to meet its current obligations. However, an arbitrary standard of 2:1 current ratio should not be blindly followed. Firms with less than 2:1 current ratio may be doing well, while the firms with 2:1 or even higher current ratios may be finding great difficulties in paying their bills. This is so because the current ratio is a test of quantity and not quality. The current ratio measures only total rupees worth of current assets and total worth of current liabilities. It does not measure the quality of assets. Liabilities are not subject to any fall in value they have to be paid. But current assets can decline in value. If the firm's current assets consists of doubtful and slow paying debtors or slow moving and unsaleable stock of goods, then the firm's ability to pay bills is impaired, its short term solvency is threatened. Thus too much reliance should not be placed on

the quality of current assets should be carried. However, the current ratio is a crude and quick measure of the firms liquidity.

First three years current assets are increasing and in 1983-84 and 1984-85 current assets are decreasing. Index shows in 1981-82 current assets 125.47%, in 1982-83 - 128.90%, in 1983-84 - 125.50% and in 1984-85 122.46%.

Current liabilities are increasing continuously. In 1981-82 - 128.23%, 1982-83 - 141.57%, 1983-84 - 144.61%, 1984-85 - 149.71%.

In 1981-82 following current assets are increased. Cash, bank, stores and spare parts, coal, cotton at godown, yarn at packing section and bonded godown, deposits, purchases of cotton, building, construction, purchases of machinery, employees, prepaid insurance and advance payment of income tax.

Excise, account current, cotton work in progress, yarn in work in process, yarn at selling centre, saleable cotton waste at godown, debtors, stores purchases and expenses, purchases of shares, octroi earnest money, refundable excise duty and sales tax prepaid expenses etc. are decreased. But there is total net increase in current assets.

In 1982-83 : Cash, bank, excise account current, cotton work in process yarn at packing section and bonded godown yarn at selling centre, hardwaste, debtors, stores purchases and expenses, purchases of machinery, employees, octroi earnest money, excise

duty refundable, prepaid insurance, prepaid expenses, advance payment of income tax items shows increase.

Coal, cotton at godown, cotton work in process, saleable cotton waste at godown, deposits, stores purchases and expenses, building construction etc. are decreased. But there is total net increase in current assets.

In 1983-84 : Cash, stores and spares parts, cotton at godown, cotton work in process, yarn work in process, yarn at packing, section and bonded godown, yarn at selling centre, saleable cotton waste at godown, debtors, purchases of machinery, employees, excise duty refundable and sales tax refundable, prepaid insurance and expenses and advance payment of income tax items shows increase.

Bank, excise account current coal, hardwaste, deposits, purchases of cotton, stores purchases and expenses, building construction and control earnest money etc. items shows decrease but there is total decrease in current assets.

1984-85 : Bank, excise account current stores and spares parts, coal, cotton at godown, saleable cotton waste at godown, hardwaste, debtors, deposits, purchase of cotton, building construction, stores purchases and expenses, employees, prepaid insurance and expenses, advance payment of income tax shows increase.

Cash, cotton in work in process, yarn in work in process, yarn at packing section and bonded godown, yarn at selling centre, purchases of machinery, refundable excise duty and sales tax shows decrease. Thus there is total decrease in current assets.

Current Liabilities and Provisions :

Refundable Deposits are increased in 1981-82 and 1982-83. Loan taken from the Maharashtra State Co-operative Bank Limited, Bombay - On hypothecations is increased every year except 1984-85. On mortgage in 1981-82 and 1984-85, clean cash credit increased in 1981-82 and 1983-84 and decreased in 1982-83. Freeshipment cash credit is increased in only 1984-85. Deposits from contractors increased except in 1981-82. Deposits from yarn decreased only in 1983-84. Deposits from others decreased every year except 1981-82. Sundry creditors increased every year except 1981-82. Expenses are also increased every year except 1981-82, other expenses increased only in 1983-84. Sales tax is increased in 1982-83 and 1984-85 and decreased in 1981-82 and 1983-84. Income tax is decreased in 1983-84 only. No other changes are taken place in any other succeeding or preceding year. Dividend is decreased every year. Gratuity is decreased in 1981-82. But total current liabilities every year are increasing.

2) Acid Test Ratio

= $\frac{\text{Quick Assets}}{\text{Quick Liabilities}}$

1980-81	=	<u>2,78,32,898.06</u> 4,32,50,221.68
	=	0.64:1
1981-82	=	<u>3,43,01,225.82</u> 5,54,57,868.98
	=	0.62:1
1982-83	=	<u>3,47,31,200.40</u> 6,12,29,650.36
	=	0.57:1
1983-84	=	<u>1,56,41,198.05</u> 6,25,43,390.59
	=	0.25:1
1984-85	=	<u>2,69,37,214.10</u> 6,47,48,330.05
	=	0.42:1

Interpretation :

Generally a quick ratio of 1:1 is considered to represent a satisfactory current financial condition. Although the quick ratio is more penetrating test of liquidity than the current ratio. Yet it should be used cautiously. A quick ratio of 1:1 or more does not necessarily imply sound liquidity position. Similarly a low quick ratio does not necessarily imply bad liquidity position. It should be remembered that all the book debts may not be liquid and cash may be immediately needed to pay operating expenses. It should also be noted that inventories are not absolutely non-liquid. To a measurable extent inventories are available to meet current obligations. Thus a company with a high value of quick ratio can flounder if it

has slow paying, doubtful and stretched out in age receivable (book debts). On the other hand a company with a low value of quick ratio may really be prospering and paying its current obligation in time, if it has been managing its inventories very efficiently with a continuous salability. Nevertheless, the quick ratio remains an important index of the firms liquidity. To get an idea regarding the firms relative current financial condition, its current ratio and quick ratio should be compared with the industry average.

Total current liabilities are increasing every year. Index shows increase of 128.23%, 141.57%, 144.61%, 149.71% respectively to the base year. Liquid Assets are increased in 1981-82, 1982-83. In the year 1983-84 liquid assets are decreased. Again 1984-85 liquid assets are increased. Every year liquid assets are less than one. In 1983-84 liquid assets are too low, because of excess investment in stock. As the Deccan Mill is manufacturing concern and requires stock for processing and not for conversion into money. This ratio indicates the mill is not in a position to pay its current liabilities in time.

In 1981-82 following liquid assets are increased cash, bank, stores and spares parts, coal, deposits, purchases of cotton, building construction, purchases of machinery, employees, prepaid insurance and advance payment of income tax.

Excise account current, debtors, stores purchases and expenses, purchases of shares, octroi earnest money, refundable excise duty and sales tax, prepaid expenses etc. are decreased and thus total liquid assets are increased.

In 1982-83 cash, bank, excise account current, deposits, stores purchases and expenses, purchases of machinery, employees, octroi earnest money, excise duty refundable, prepaid insurance, prepaid expenses, advance payment of income tax items shows increase.

Coal, stores purchases and expenses, building construction etc. are decreased. But there is a total increase in liquid assets.

In 1983-84 : cash stores and spares parts, debtors, purchases of machinery, employees, excise duty refundable and sales tax refundable, prepaid insurance and expenses and advance payment of income tax items shows increase.

Bank, excise account current, coal, deposits, purchases of cotton, stores purchases and expenses, building construction and octroi earnest money items shows decrease. Thus there is total decrease in liquid assets.

In 1984-85 : Bank excise account current, stores and spares parts, coal, debtors, deposits, purchases of cotton, building construction, stores purchases and expenses, advance payment of income tax shows increase.

Cash, purchases of machinery, refundable sales tax and excise duty shows decrease. Thus there is total decrease in liquid assets.

Current Liabilities and Provision :

Refundable Deposits are increased in 1981-82 and 1982-83. Loan taken from the Maharashtra State Co-operative Bank Limited, Bombay - On hypothecations is increased every year except 1984-85. On mortgage in 1981-82 and 1984-85, clean cash credit increased in 1981-82 and 1983-84 and decreased in 1982-83. Freshment cash credit is increased in only 1984-85. Deposits from contractors increased except in 1981-82. Deposits from yarn decreased only in 1983-84. Deposits from others decreased every year except 1981-82. Sundry creditors increased every year except 1981-82. Expenses are also increased every year except 1981-82. Other expenses increased only in 1983-84. Sales tax is increased in 1982-83 and 1984-85 and frvtrd in 1981-82 and 1983-84. Interest liability is increased except in 1983-84. Income tax is decreased in 1983-84 only. No other changes are taken place in any other succeeding or preceding year. Dividend is decreased every year. Gratuity is decreased in 1981-82. But total current liabilities every year are increasing.

Overall liquidity :

As only one figure of set of figures cannot reveal any meaningful information or idea of the firm. In the same way a

ratio or set of ratios cannot reveal the strength or weakness of the firm. It is necessary to classify the ratios according to their nature and come to a conclusion using tests such as liquidity, profitability, solvency and safety etc. Only one type is also misleading to the firm. So analyst has to study all types and interpret them.

Overall Liquidity : A current ratio acid test ratio, a debtors turnover or a inventory turnover are included in liquidity test. Only one ratio is not guide to management. Considering all these ratios, its ingredients, and presentation analyst has to determine overall liquidity of the firm.

Liquidity ratios are relevant to the short term solvency of the firm. It is extremely essential for a firm to be able to meet its obligations as they become due. Liquidity ratio measure the ability of the firm to meet its current obligations. In fact, analysis of liquidity needs the preparation of cash budgets and cash flows statements but liquidity ratios, by establishing a relationship between cash and other current assets to current obligations, provides a quick measure of liquidity. A firm should ensure that it does not suffer from lack of liquidity and also that it is not too much highly liquid. The failure of a company to meet its obligations, due to lack of sufficient liquidity, will result in bad credit ratings, loss of creditors confidence, or even in law suits resulting in the closure of the company. A very high degree of liquidating is also bad idle assets earn nothing. The firm's funds will be unnecessarily tied up in

current assets. Therefore, it is necessary to strike a proper balance between liquidity and lack of liquidity.

Liquidity Ratios fluctuates not only because of movement of receivables and inventories but are also affected by changes in fixed assets investments, sales and profit or loss.

The manufacturing concerns requires stock for processing and not for conversion into money. Deccan Mill as a going concern requires stock for processing.

Working capital is determined by deducting current liabilities from current assets. The amount of working capital is sometimes used as a measure of the firms liquidity. It is considered that between the two firms are having the large amount of working capital has the greater ability to meet its current obligations. This is not necessarily so the measure of liquidity is the relationship rather than the difference between current assets and current liabilities. Thus it is the current ratio or the quick ratio which is better indicator of the firm's liquidating than the amount of working capital.

The highest value of the current ratios and quick ratio is able to survive the write off better. It has the highest amount of working capital after the loss of the value of receivables and inventory.



Decrease in current ratio and liquidity ratio indicates overtrading. A very big increase in current liabilities without a corresponding increase in current assets and liquid resources is like leagulation of blood.

Low current ratio indicates overtrading. A very high ratio will result from idleness of funds only therefore is not a good sign.

Liquid ratio is of great importance for banks and financial institutions but not for ordinary trading and manufacturing concern.

A good current ratio accompanied by a low quick ratio will indicate a disproportionately high investment in stocks.

Overtrading means excessive sales, resulting in shortage of working capital to meet the current liabilities of the business. It is an attempt of rapid expansion without sufficient working capital. This is a course to business.

Undertrading is reverse to overtrading. It signifies inadequate volume of business. Sales are less in relation to resources available, which in turn means that the assets are not fully utilised.

5.2 SOLVENCY RATIOS :

If the firm is actually liquidated for non-payment of debt holders dues, the worst sufferers will be shareholders - the residual owners. Though the use of debt magnifies the shareholders earning as well as increases their risk the debt holders earn interest a regular income. It does not depend upon the profitability of the firm.

Debt to Equity Ratio

$$= \frac{\text{Outsiders Fund}}{\text{Shareholders Fund}}$$

1980-81	=	$\frac{6,92,05,802.17}{8,59,63,652.68}$
	=	0.81:1
1981-82	=	$\frac{9,57,48,456.41}{9,38,43,921.36}$
	=	1.02:1
1982-83	=	$\frac{10,67,88,237.85}{10,49,26,211.49}$
	=	1.02:1
1983-84	=	$\frac{11,72,01,670.08}{11,84,62,498.89}$
	=	0.98:1
1984-85	=	$\frac{10,62,73,103.53}{12,54,19,558.16}$
	=	0.84:1

Interpretation :

Debt Equity Ratio is calculated dividing shareholder's fund to outsiders fund 1:1 ratio is considered as standard. In the year 1981-82 and 1982-83 has achieved standard. In the year 1983-84 it is near to standard. But in the year 1980-81 and 1984-85 it is below standard. Debt Equity Ratio is the device of measuring long term solvency. As ratio is below the standard it states that there is excess shareholders fund than outsiders fund, i.e. creditors have cushion for safety regarding their claims. Because at the time of liquidation shareholders are the last claimant.

Ratio above standard indicates there is excess outsiders liability than shareholders fund and fixed interest charge is the burden which has to bear to business and less amount of profit is available to the owners as a dividend.

In the year 1981-82 this ratio is increased because of increase in outsiders fund. There is increase in shareholders fund but proportionately less. In the year 1982-83 the ratio is constant. Though the figures shows increase, that increase in even proportion.

In the year 1983-84 the ratio is decreased, due to higher increase in shareholders fund than outsiders fund. In the year 1984-85 the ratio is also again decreased due to increase in shareholders fund and decrease in outsiders fund.

Though the share capital is refunded the amount Reserves and Surplus is increasing hence shareholders fund is increasing year to year.

Outsiders fund's composition is non-refundable and refundable deposits from members, secured and unsecured loan, loan for working capital, deposits, current liabilities and provisions etc. Non refundable deposits are constant for five years. Refundable deposits are constant for last three years and amount is increased to the second year secured loan decreased only in last years. In all preceding year the amount of secured loan is increasing. Unsecured loan is increased every year. The amount of loan for working capital is decreased in the year 1984-85 only. Deposits are increasing year to year. Current liabilities and provisions etc. are increasing. Due to decrease in working capital loan and secured loan total outsiders fund is decreased.

Due to heavy increase in the amount working capital loan and secured loan the outsiders fund shows increase and the ratio is unfavourable to creditors as well as shareholders.

Ratio of Long term debt
to Shareholder's Fund :

Long-term debt
= Shareholder's Fund

1980-81 = $\frac{2,52,56,567.42}{8,39,63,652.68}$
= 0.30:1

1981-82	=	$\frac{3,95,45,587.48}{9,38,43,921.36}$
	=	0.42:1
1982-83	=	$\frac{4,45,17,587.48}{10,49,26,211.49}$
	=	0.42:1
1983-84	=	$\frac{5,22,65,960.48}{11,84,62,498.39}$
	=	0.44:1
1984-85	=	$\frac{3,88,99,779.48}{12,54,19,858.16}$
	=	0.31:1

Interpretation :

Shareholders fund is increasing every year. Long term debt is increasing upto 1983-84 and 1984-85 it is decreased. This ratio indicates the proportion of borrowed capital to the shareholders fund. Low ratio indicates security to creditors in extending credit. A high ratio represents greater risk to creditors and also to shareholders under adverse business conditions. A very low ratio worry the shareholders as the company is not using debt to the best advantage of shareholders.

This ratio's constant for the year 1980-82 and 1982-83. There is proportionate increase in long term debt and shareholders fund in 1982-83.

In the year 1980-81 the ratio is 0.30:1. This implies that for every one rupee equity the mill has raised Rs. 0.30 long term debt or the long term debt is 30% of equity which means owners have (10/3) stake of creditors in the business the same situation exists in 1984-85.

In 1981-82, 1982-83, the situation is same i.e. the mill has raised Rs. 0.42 long term debt. In 1983-84 there is increase of Rs. 0.02 in long term debt.

The standard ratio is 1:1.

Proprietary or Equity Ratio :

$$= \frac{\text{Shareholders Fund}}{\text{Total Assets}}$$

$$1980-81 = \frac{8,59,63,652.68}{15,51,69,461.88}$$

$$= 0.55:1$$

$$1981-82 = \frac{9,38,43,921.36}{18,95,92,377.77}$$

$$= 0.49:1$$

$$1982-83 = \frac{10,49,25,211.48}{21,17,14,449.29}$$

$$= 0.49:1$$

$$1983-84 = \frac{11,84,62,498.29}{22,56,24,168.27}$$

$$= 0.52:1$$

$$1984-85 = \frac{12,59,19,558.16}{23,16,82,667.69}$$

$$= 0.54:1.$$



Interpretation :

This ratio establishes the relationship between proprietors funds and total assets 100% less percentage of this ratio = ratio of total liabilities to total assets.

Greater is the percentage of proprietors fund stronger is the financial position of the concern. This ratio is normally a test of strength of credit worthiness of the concern . To the extent the percentage of liabilities increase or the percentage of capital the credit strength of the concern deteriorates. This ratio should be considered along with the current ratio while considering the solvency of the concern.

A high proprietary ratio is however, frequently indicative of over capitalisation and excessive investment in fixed assets in relation to actual needs. A ratio bearing 100% often gives low earning per share and a low rate of dividend shareholders.

A low proprietary ratio on the other hand is a symptom of under capitalisation and an excessive use of creditors funds to finance the business.

Total assets consists of fixed assets, investments, current assets etc. fixed assets are taken at cost, hence the amount total assets shows overvaluation of assets and ratio is low.

Shareholders fund and total assets are increasing every year. In the year 1981-82 and 1982-83 the ratio is constant and shows decrease. This decrease indicates excessive investment in assets than shareholders fund,

The ratio is increased in the year 1983-84, 1984-85. Because there is sale of fixed assets.

Higher the ratio indicates better solvency position atleast 0.50 should be maintained for the sound financial position of the company.

Fixed Assets to Net Worth :

Fixed assets (after depreciation)
= Shareholders fund

1980-81	=	<u>1,60,80,144.31</u> 8,59,63,652.68
	=	0.419:1.
1981-82	=	<u>4,65,84,772.43</u> 9,38,43,921.36
	=	0.49:1.
1982-83	=	<u>5,49,25,749.75</u> 10,49,26,211.49
	=	0.52:1.
1983-84	=	<u>5,66,45,091.62</u> 11,84,62,498.29
	=	0.48:1.
1984-85	=	<u>5,10,76,754.97</u> 12,54,19,558.16
	=	0.41:1.


Interpretation :

This ratio shows relationship between fixed assets and shareholders fund. This indicates how much amount is invested by shareholders in fixed assets. If the ratio exceeds 100% it indicates that the company has used short term funds for acquiring fixed assets which policy is not desirable. To the extent the fixed assets exceed the amount of capital and reserves, the working capital is depleted. When the amount of proprietors fund exceed the value of fixed assets i.e. the percentage is less than 100, a part of the net working capital is supplied by the shareholders, provided that there is no other non-current assets. Though it is not possible to lay down a rigid standard as regards the percentage of capital which should be invested in each industry. The ratio should be generally 65%.

Shareholders fund is increasing every year. In 1984-85 the fixed assets shows decrease. Hence the ratio is deteriorating fixed assets are increasing year to year except 1984-85. Every where the ratio is below standard. It requires investment in fixed assets is necessary.

Solvency Ratio :

$$= \frac{\text{Total Liabilities to Outsiders}}{\text{Total Assets}}$$

$$1980-81 = \frac{5,05,35,350.68}{10,43,82,502.65}$$
$$= 0.48:1$$


$$1981-82 = \frac{7,49,69,69,386.92}{13,17,75,448.11}$$

$$= 0.57:1$$

$$1982-83 = \frac{8,69,07,478.36}{14,29,94,343.88}$$

$$= 0.60:1$$

$$1983-84 = \frac{9,64,20,581.59}{14,23,88,523.79}$$

$$= 0.60:1$$

$$1984-85 = \frac{8,54,91,350.04}{13,45,21,583.88}$$

$$= 0.64:1$$

Interpretation :

This ratio indicates amount available to creditors from investment in asset. Total liabilities shows increase every year except in 1984-85. Total assets shows increase in 1980-81, 1981-82, 1982-83. But in 1983-84 and 1984-85 total assets are decreasing. Total assets means fixed assets after depreciation, investments, and current assets. Lower the ratio favourable to creditors and vice versa. Lower ratio implies proportion to owner is also available. Higher the ratio is dangerous to creditors and owners. Because a company has to bear interest charges in case of loss.

The ratio shows increase for first four year and last year there is decrease due to decrease in total liabilities than decrease in total assets.

**Ratio of Current Assets
to Proprietors Fund**

Current Assets
= Shareholders Fund

1980-81 = $\frac{6,69,96,908.34}{8,59,63,652.68}$

= 0.78:1

1981-82 = $\frac{8,38,74,225.68}{9,38,43,921.36}$

= 0.89:1

1982-83 = $\frac{8,65,61,144.13}{10,49,26,211.49}$

= 0.82:1

1983-84 = $\frac{8,41,80,732.16}{11,84,62,498.29}$

= 0.71:1

1984-85 = $\frac{8,21,81,630.91}{12,54,19,558.16}$

= 0.66:1.

Interpretation :

This ratio is the proportion of proprietors funds invested in current assets. In case of too small investment of proprietors fund in current assets represents shortage of working capital current assets are increased in 1980-81, 1981-82 and 1982-83. In subsequent current assets are decreased. But shareholders fund shows continuous increase. Hence decrease in shareholders fund is responsible for decrease in ratio.

In the 1980-81 the ratio is 0.78. This implies for a rupee investment in shareholders fund represents a investment in current assets of Rs. 0.78.

Interest Coverage Ratio :

$$= \frac{\text{Net Profit (Before Interest and Taxes)}}{\text{Fixed Interest Charges}}$$

$$1980-81 = \frac{60,62,041.56}{55,54,851.19}$$

$$= 1.09:1$$

$$1981-82 = \frac{70,97,659.40}{84,63,734.82}$$

$$= 0.84:1$$

$$1982-83 = \frac{84,92,853.57}{96,21,094.19}$$

$$= 0.88:1$$

$$1983-84 = \frac{56,97,869.52}{1,19,69,216.79}$$

$$= 0.48:1$$

$$1984-85 = \frac{42,39,738.87}{1,33,43,540.33}$$

$$= 0.32:1.$$

Interpretation :


Fixed interest charges are increasing every year. Net profit before interest and taxes is increased only in first three years after that it is decreasing. A lower ratio indicates excessive use of debt. Proportion of using debt is increasing

every year. Net profit before interest and taxes shows increase upto 1982-83. After that net profit before interest and taxes is deteriorating.

Coverage Ratios:

The times interest earned ratio or the interest coverage ratio shows how many times the interest charges are covered by funds that are ordinarily available to pay the interest charges. The income tax should be included in the numerator because it is calculated after paying the interest. This ratio indicates the extent to which the earning may fall without causing any embarrassment to the _____ to the firm regarding the payment of the interest charges to higher ratio is desirable but too high ratio indicates that the firm is very conservative in using debt and that it is not using credit to the best advantage of shareholders. A lower ratio indicates excessive use of debt, or inefficient operations. The should make efforts to improve the operating efficiency or to retire debt to have a comfortable coverage ratio.

One of the limitations of the interest coverage ratio is that it does not consider fixed obligation like reference dividend and repayment of principal.



Fixed Assets Turnover Ratio :

$$= \frac{\text{Sales}}{\text{Fixed Assets (after depreciation)}}$$

$$1980-81 = \frac{11,53,76,919.61}{3,60,80,144.31}$$

$$= 3.19:1$$

$$1981-82 = \frac{13,60,34,235.67}{4,65,84,772.43}$$

$$= 2.92:1$$

$$1982-83 = \frac{14,05,74,717.59}{5,49,25,749.75}$$

$$= 2.56:1$$

$$1983-84 = \frac{14,19,36,395.04}{5,66,45,091.63}$$

$$= 2.51:1$$

$$1984-85 = \frac{19,04,39,964.88}{5,10,76,754.97}$$

$$= 3.73:1.$$

Interpretation :

The fixed assets turnover ratio measures the efficiency with which the firm is utilizing its investment in fixed assets. It also indicates the adequacy of sales in relation to investment in fixed assets. The fixed assets turnover ratio is sales divided by net fixed assets.

The firms fixed assets turnover ratio should be compared with past and future ratios and also with the ratios of similar firms and the industry average. Generally a high fixed assets

turnover ratio indicates efficient utilisation of fixed assets in generating sales, while a low ratio indicates inefficient management and utilisation of fixed assets. However, the analyst must be cautious in deriving conclusions from the fixed assets turnover ratio. To obtain fixed assets turnover ratio, sales are divided by depreciated value of fixed assets and not the market value. Thus a firm whose plant and machinery has considerably depreciated, may show a higher fixed assets turnover ratio than the firm which has purchased plant and machinery recently. Comparing the fixed assets turnover ratio of the two firms, it cannot be concluded that the former is efficient in managing fixed assets. Both the firms may be, in fact, equally efficient, or the second may be more efficient.

In the year 1980-81 the ratio is 3.19 times, this implies that a rupee investment in fixed assets generates a sales of Rs. 3.19. In subsequent years 1981-82, 1982-83, 1983-84 the ratio is decreasing. In 1984-85 the ratio is increased. In this year a rupee investment of fixed assets generates sales of Rs. 3.73. This increase may be due to decrease in fixed assets and increases in sales.

Total Long term Solvency :

Long term solvency of the indicates whether mill is able to survive in future or not. To achieve this purpose following ratios are calculated and interpreted :

- 1) Debt Equity Ratio
- 2) Ratio of Long-term debt to shareholders fund
- 3) Proprietary or equity ratio
- 4) Fixed Assets to Net worth
- 5) Solvency Ratio
- 6) Ratio of current assets to proprietors fund
- 7) Interest coverage ratio
- 8) Fixed Assets turnover Ratio

For long term solvency efficient use of assets is desirable. Under utilisation and over utilisation must be avoided in case of fixed assets optimum utilisation is required.

INTERPRETATION OF LEVERAGE RATIOS :

Leverage ratios represents the use of debt and equity in financing the assets, of the firm. The extent to which the practice of trading on equity can be carried on safely can be known through these ratios. These ratios are :

- 1) Capital gearing ratio.
- 2) Total investment to long term liabilities.
- 3) Ratio of current liabilities to proprietors fund.

Both the situations over capitalisation and under capitalisation is dangerous. Over capitalisation means business earnings are not sufficient to pay a fair or reasonable rate of return on capital employed.

Capital Gearing Ratio :

$$= \frac{\text{Equity Capital + Reserves and Surplus}}{\text{Preference Share Capital + Loan Capital}}$$

$$1980-81 = \frac{8,59,63,652.68}{3,23,98,887.55}$$

$$= 2.65:1$$

$$1981-82 = \frac{9,38,43,921.36}{5,85,93,845.22}$$

$$= 1.60:1$$

$$1982-83 = \frac{10,49,26,211.49}{6,51,34,988.73}$$

$$= 1.61:1$$

$$1983-84 = \frac{11,84,62,498.29}{7,88,69,716.69}$$

$$= 1.5:1$$

$$1984-85 = \frac{12,54,19,558.16}{3,30,67,309.74}$$

Interpretation :

This ratio is the analysis of capital structure. If the proportion of preference shares and loan capital is high or where the proportion of an ordinary share capital to the total capital is low capital is said to be highly geared.

In the year 1980-81 equity share capital and reserves and surplus totally is of Rs. 8,59,63,652.68 and loan capital is of Rs. 3,23,98,887.55. Here proportion of loan capital is low. For Rs. 2.65 owned capital there is only one rupee borrowed capital.

It means company is low geared low gearing indicates that equity shares are not paid adequate rate of return.

Preference share capital is not issued by the mill. Shareholders fund is increasing year to year. Loan capital is increased upto the year 1983-84 and in 1984-85 the loan capital shows decrease. Hence the ratio is increased and maximum. In the year 1981-82 the ratio is 1.60:1. This implies for Rs.1 loan capital the shareholders fund is available of Rs. 1.60. This ratio is decreased 1982-83 by 0.01 only. In the year 1983-84 the ratio is again decreased by 0.11. This trend is dangerous to creditors. Because they have losing cushion of safety.

Total Investments to long-term liabilities :

= Shareholders Fund + Long-term Liability
Long term-term liabilities

1980-81	=	$\frac{8,59,63,652.68 + 2,18,01,587.49}{2,18,01,587.49}$
	=	$\frac{10,77,65,240.17}{2,18,01,587.49}$
	=	4.94:1
1981-82	=	$\frac{12,41,34,508.49}{3,02,90,587.49}$
	=	4.10:1
1982-83	=	$\frac{15,04,84,798.88}{4,55,58,587.49}$
	=	3.30:1

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1983-84	=	$\frac{17,31,30,458.78}{5,46,67,960.49}$
	=	3.17:1
1984-85	=	$\frac{16,86,96,458.16}{4,32,76,900.00}$
	=	3.89:1

Interpretation :

This ratio indicates the proportion of long-term creditors to total investment. Total investment is increasing every year except 1984-85. Long-term liabilities shows increase except in 1984-85.

In 1980-81 for a rupee long term liability there is total investment of Rs. 4.94. Ratio is decreasing every year. But in 1984-85 it shows increase.

This ratio also indicates the proportion of total capital invested to borrowed funds.

There is no hard and fast rule of proportion loan capital to total investment. It depends upon the circumstances occurred in business. At the time of liquidation third party liabilities are met first and shareholders are the worst sufferers.

Higher the ratio is favourable to the mill. It indicates higher margin of safety to shareholders also.

Ratio of Current Liabilities
to Proprietors Fund :

= Current Liabilities
Shareholders Fund

1980-81	=	$\frac{4,32,50,221.68}{8,89,63,652.68}$
	=	0.51:1
1981-82	=	$\frac{5,54,57,858.98}{9,38,43,121.36}$
	=	0.59:1
1982-83	=	$\frac{6,12,29,650.36}{10,49,26,211.49}$
	=	0.58:1
1983-84	=	$\frac{6,25,43,390.50}{11,84,62,498.29}$
	=	0.53:1
1984-85	=	$\frac{6,47,48,330.05}{12,54,19,558.16}$
	=	0.52:1.

Interpretation :

The object of calculating this ratio is to analyse capital structure. This ratio is the relationship between current liabilities and shareholders fund. But in practice this ratio is meaningless. Because any solvent company cannot pay current liabilities out of shareholders fund. Shareholders fund is also liability of the business, though they are last claimants.

This ratio indicates for a rupee investment in shareholders fund how much current liability is existing in a business.

Current liabilities and shareholders fund is increasing year to year. But ratio is decreasing from the year 1982-83. Due to proportionate increase in current liabilities and shareholders fund the ratio is decreasing.

Interpretation of Overall Leverage Ratios :

To judge the long term financial position of the firm leverage or capital structure ratios are calculated. These ratios indicate the funds provided by owners and creditors. As a general rule there should be an appropriate mix of debt and owners equity in financing the firms assets. The manner in which assets have been financed has a number of implications first between debt and equity, debt is more risky from the firms point of view. The firm has a legal obligation to pay interest to debt holders irrespective of the profits made or losses incurred by the firm. If the firm fails to pay debt holders in time, they can take legal action against the firm to get payment and in extreme cases, can force, the firm into liquidation, second, employment of debt is advantageous to shareholders in two ways (a) They can retain control of the firm with a limited stake and (b) their earnings will be magnified when the firm earns a rate higher than the interest rate on the invested funds. The process

of magnifying the shareholders return through the employment of debt is called trading on equity or leverage. However, leverage can work in opposite direction as well. If the cost of the debt is higher than the firm's overall rate of return, the earnings of the shareholders will be reduced. Third, highly debt burdened firm will find difficulty in raising funds from creditors and owners in future. The owners equity is treated as a margin of safety by creditors, if the equity base is thin the creditors risk will be high. Thus the leverage ratios are calculated to measure the financial risk and the firms ability of using debt for the benefit of shareholders.

PROFITABILITY RATIOS :

General Profitability

1) Operating Ratios

$$= \frac{\text{Cost of goods sold} + \text{Operating expenses}}{\text{Net Sales}} \times 100$$

$$1980-81 = \frac{13,41,19,701.81}{11,53,76,919.61} \times 100$$

$$= 116.30\%$$

$$1981-82 = \frac{15,76,66,386.25}{13,60,34,235.67} \times 100$$

$$= 115.88\%$$

$$1982-83 = \frac{16,41,70,826.21}{14,05,74,717.59} \times 100$$

$$= 116.79\%$$

$$\begin{aligned}
 1983-84 &= \frac{16,23,10,979.57}{14,19,36,395.04} \\
 &= 114.37\% \\
 1984-85 &= \frac{22,33,08,512.01}{19,04,39,964.88} \times 100 \\
 &= 117.27\%
 \end{aligned}$$

Interpretation :

A higher operating is unfavourable since it will leave a small amount of operating income to meet interest, dividend etc. To get a comprehensive idea of the behaviour of operating expenses, variations in the ratio over a number of years should be studied. Certain expenses are within the managerial discretion, therefore, it should be seen whether change in expenses management policy. Detailed analysis may reveal that year to year variations in the operating ratio are temporary in nature arising due to some temporary conditions. The variations in the operating ratio, temporary or long lived, can occur due to several factors such as changes in sales price, changes in cost of goods sold and operating expenses or changes in the proportionate shares of sales of different products with varying gross margins. These and other causes of variations in operating ratio thoroughly examined.

The operating ratio is the yard stick of operating efficiency, but it should be used cautiously. It is affected by number of factors, such as external uncontrollable factors, internal factors, employee and managerial efficiency or

inefficiency all of which are difficult to analyse further operating ratio cannot be used as a test of financial condition in case of those firms where a non operating revenue and expenses form a substantial part of total income.

The operating ratio indicates the average aggregative variations in expenses, where some of the expenses may be increasing while some may be falling. Thus to know the behaviour of specific expenses items, the ratio of each individual operating expenses to sales should be calculated. These ratios when compared from year to year for the firm will throw light on managerial policies and programmes e.g. The increasing selling expenses, without a sufficient increase in sales can imply uncontrolled sales promotional expenditure, inefficiency of the marketing department, general rise in selling expenses, introduction of better substitutes by competitors and so on. Expenses ratio of the firm should be compared with the ratio of the similar firms and industry average. This will reveal whether the firm is paying higher or lower salaries to employees or officers as compared to other firms whether its capacity utilisation is high or low whether the salesmen are given enough commission, whether it is unnecessarily spending on advertisement and other sales promotional activities, whether its cost of production is high or low and so on.

2) Expenses Ratio :

a) Manufacturing expenses ratio

$$= \frac{\text{Manufacturing expenses}}{\text{Net Sales}} \times 100$$

$$1980-81 = \frac{3,12,55,596.20}{11,53,76,919.61} \times 100$$
$$= 27.12\%$$

$$1981-82 = \frac{3,57,30,375.47}{13,60,34,235.47} \times 100$$
$$= 26.27\%$$

$$1982-83 = \frac{4,18,03,489.64}{14,05,74,717.59} \times 100$$
$$= 29.72\%$$

$$1983-84 = \frac{4,30,50,631.35}{14,19,35,395.04} \times 100$$
$$= 30.37\%$$

$$1984-85 = \frac{4,94,78,408.25}{19,04,39,964.88} \times 100$$
$$= 25.99\%$$

Interpretation :

Higher the percentage is unfavourable to the firm. In 1980-81 manufacturing expenses are 27%. In 1981-82 are 26%. In 1982-83 are 29%, in 1982-83 are 30% and in 1984-85 are 26%.

Sales are increasing every year and proportionately manufacturing expenses are increasing. In 1984-85 manufacturing expenses are decreased by 20.01% to the base year. In 1983-84

these expenses are highest to the base year and this ratio is also highest.

Index also shows irrelevant trend in increase and decrease in manufacturing expenses workers wages, gratuity, provident fund, contribution supervisory staff and workers, electricity, fuel and wood expenses, packing material, cotton cess items are increased every year.

Supervisory staff payment is deer cased to 1981-82 and in subsequent year it has also increasing trend stores expenses are decreased for 1981-82 and 1983-84 and increased in 1982-83 and 1984-85.

Yarn bleaching and mercerizing and machinery repairs and maintenance are decreased in only 1983-84, in 1981-82 , 1982-83 and 1984-85 these expenses are also increased.

But totally all manufacturing expenses have increasing trend. A separate statement is attached for yearwise and itemwise increase and decrease in figures.

b) Selling and distribution expenses :

$$= \frac{\text{Selling and distribution expenses}}{\text{Sales}} \times 100$$

$$1980-81 = \frac{4,97,467.91}{11,53,76,919.61} \times 100$$

$$= 0.43\%$$

$$1981-82 = \frac{8,66,643.64}{13,60,34,235.47} \times 100$$

$$= 0.64\%$$

$$1982-83 = \frac{5,62,881.82}{14,05,74,717.89} \times 100$$

$$= 0.40\%$$

$$1983-84 = \frac{6,25,001.60}{14,19,36,395.04} \times 100$$

$$= 0.44\%$$

$$1984-85 = \frac{6,38,164.86}{19,04,39,964.88} \times 100$$

$$= 0.34\%$$

Interpretation :

Selling and distribution expenses ratio maximum in 1981-82 and minimum in 1984-85. Index also shows in 1980-81 selling and distribution expenses are 174.21% in 1982-83 114.15%, in 1983-84 -125.64% and in 1983-84 128.28%. In 1982-83 the expenses are least increased and ratio is 0.40%. Due to increase in sales this ratio is low sales are increasing every year. In 1984-85 sales are 165.06% and hence expenses ratio is low. With comparison to other years in 1982-83 expenses and sales percentage increase is minimum i.e. expenses 113.15% of sales 121.84% in 1982-83 sales are lowest 117.90% but selling and distribution expenses are highest. Hence expenses ratio indicates 64% maximum increase in expenses ratio.

c) Factory Overhead expenses Ratio

$$= \frac{\text{Factory overheads}}{\text{Sales}} \times 100$$

$$1980-81 = \frac{23,15,198.25}{11,53,76,919.61} \times 100$$
$$= 2.01\%$$

$$1981-82 = \frac{22,45,522.04}{13,60,34,235.47} \times 100$$
$$= 1.65\%$$

$$1982-83 = \frac{25,27,622.68}{14,05,74,717.59} \times 100$$
$$= 1.80\%$$

$$1983-84 = \frac{29,44,268.55}{14,19,36,395.04} \times 100$$
$$= 2.07\%$$

$$1984-85 = \frac{31,30,690.50}{19,04,39,964.88} \times 100$$
$$= 1.64\%$$

Interpretation :

This ratio is irrelevant in changes. In 1984-85 it is too low 1.64%. In 1981-82 it is 1.65% in 1982-83 it is 1.80%, in 1980-81 it is 2.01% and in 1983-84 it is 2.07%. This is increasing trend of ratio sales are increasing respectively every year.

Itemwise increase or decrease can be interpreted as follow. Insurance item is increasing every year. Water supply

item is increased in 1981-82, decreased in 1982-83, increased in 1983-84 and 1984-85.

Building repair and maintenance expenses decreased in 1981-82, increased in 1982-83 and 1983-84 and again decreased in 1984-85. Vehicle petrol and diesel expenses increased in 1984-85 and 1983-84 vehicle maintenance expenses increased in 1981-82 and 1982-83 and decreased in 1983-84 and 1984-85. Sanitation expenses are decreased in 1981-82 and 1982-83 and increased in 1983-84 and 1984-85. Lighting expenses are increased every year except 1983-84. Employees State Insurance is increased every year, legal fee is decreased every year except 1984-85. Workers Welfare expenses are increased in 1982-83 and 1983-84 and decreased in 1981-82 and 1984-85.

Thus total factory overhead expenses are decreased in 1981-82 and in subsequent year they are increased.

d) Administrative expenses Ratio

$$\begin{aligned} &= \frac{\text{Administrative expenses}}{\text{Sales}} \times 100 \\ 1980-81 &= \frac{27,43,358.84}{11,53,76,919.61} \times 100 \\ &= 2.38\% \\ 1981-82 &= \frac{27,91,730.42}{13,60,34,235.47} \times 100 \\ &= 2.05\% \end{aligned}$$

$$1982-83 = \frac{31,28,072.38}{14,05,74,717.59} \times 100$$

$$= 2.42\%$$

$$1983-84 = \frac{36,95,610.92}{14,19,36,395.04} \times 100$$

$$= 2.60\%$$

$$1984-85 = \frac{42,08,739.10}{19,04,39,954.88} \times 100$$

$$= 2.21\%$$

Interpretation :

Managerial expenses are increasing every 101.76%, 123.87%, 134.71%, 153.42% to the base year.

Sales are also increasing every 117.90%, 121.84%, 123.12%, 165.06% to the base year. Due to increase in sales this ratio is decreased. This ratio is irrelevant in changes. In 1981-82 this ratio is maximum and is unfavourable. In 1981-82 this ratio is minimum and is favourable variations in ratio is only in point and hence there is no greater variation.

Provident Fund contribution and printing stationary items are increasing every year. Office staff payment item is increased every year except 1981-82. Travelling expenses increased in 1981-82 and 1984-85 and decreased in 1982-83 and 1983-84.

Travelling expenses of Board of Directors in 1981-82 and in subsequent years decreased. Postage, telephone, telecon,

teleprinter increased every year except 1984-85. Bank Commission decreased in 1981-82 and 1984-85 and increased in 1982-83 and 1983-84. Donation decreased in 1981-82 sales tax decreased in 1981-82 guest house expenses increased every year except 1984-85. General charges increased every year except 1984-85. Gardening expenses increased 1981-82 and 1983-84 and decreased in 1982-83 and 1984-85. Allowance to board of directors decreased in 1981-82 and in 1982-83. Rent, rates and taxes decreased in 1981-82 and 1983-84 and increased in 1982-83 and 1984-85. Meeting fee of Board of Directors increased every year. Audit fee increased in 1984-85. In previous it is constant and hence no changes are required. Chief Minister Aid Fund is increased in 1982-83 and 1984-85. In 1983-84 it is decreased. Additional tax on sales tax is increased in 1984-85 only.

Thus total administrative expenses are increased every year.

3) Operating Profit Ratio

$$= \frac{\text{Operating Profit}}{\text{Net Sales}} \times 100$$

$$1980-81 = \frac{46,67,621.17}{11,53,76,919.61} \times 100$$

$$= 4.04\%$$

$$1981-82 = \frac{51,82,233.23}{13,60,34,235.47} \times 100$$

$$= 3.81\%$$

$$1982-83 = \frac{57,23,392.84}{14,05,74,717.59} \times 100$$

$$= 4.07\%$$

$$1983-84 = \frac{14,23,644.42}{14,19,36,395.04} \times 100$$

$$= 1\%$$

$$1984-85 = \frac{-(6,82,611.34)}{19,04,39,964.88} \times 100$$

$$= -0.36\%$$

Interpretation :

Operating profit is increasing for 1980-81, 1981-82 and 1982-83. After that it has decreasing trend. Sales are increasing every year operating profit is determined after adding non-operating expenses to net profit and deducting non-operating income from net profit. The purpose of calculating this ratio is to determine only profit obtained through business operations. Sales are increasing every year. Operating profit is increasing upto 1982-83 and after that it is decreasing. In 1984-85 there is operating loss. Higher operating profit shows management's efficiency in controlling expenses and increasing sales and vice versa. Higher the ratio is favourable and lower unfavourable to the firm.

From 1983-84 management is helpless in increasing operating profit. Reasons may be controllable or uncontrollable. May be the effect of price level changes.

Gross Profit Ratio

$$= \frac{\text{Gross Profit}}{\text{Sales}} \times 100$$

$$1980-81 = \frac{1,80,58,839.58}{11,53,76,919.61} \times 100$$
$$= 15.66\%$$

$$1981-82 = \frac{2,00,02,120.69}{13,60,36,235.67} \times 100$$
$$= 14.70\%$$

$$1982-83 = \frac{2,47,95,957.90}{14,05,74,717.59} \times 100$$
$$= 17.64\%$$

$$1983-84 = \frac{2,99,40,947.89}{14,19,36,395.04} \times 100$$
$$= 21.09\%$$

$$1984-85 = \frac{2,45,67,455.22}{19,04,39,964.88} \times 100$$
$$= 12.91\%$$

Interpretation :

Gross Profit Ratio is increasing every year except 1984-85. Sales are increasing every year. Gross profit margin reflects the efficiency with which management produces each unit of product. This ratio indicates the average between cost of goods sold and sales revenue. When we subtract gross profit margin from 100% we obtain the ratio of cost of goods sold to sales. Both these ratios shows profits relative to sales after the deduction of production costs and indicate the relation

between production costs and selling price. A high gross profit margin relative to industry average implies that the firm is able to produce at relatively lower cost.

A high gross profit margin ratio is a sign of good management. A gross profit margin may increase due to any of the following factors.

1) Higher sales prices, cost of goods sold remaining constant.

2) Lower cost of goods sold, sales prices remaining constant.

3) A combination of variations in sales prices and costs, the margin widening.

4) An increase in the proportionate value of higher margin items.

Reasons for decrease -

1) Undervaluation of stock.

2) Higher cost price, sales price remaining same.

3) Lower sales price, cost price remaining unchanged.

4) Pilferage of stock.

5) Some purchases might have been entered more than once.

6) Goods entered as bought might not have been received and thus not included in closing stock.


7) Some sales might have been recorded to misappropriate cash or inadvertently.

A low gross profit indicates high cost of production and inability of management to increase sales volume. On the other hand increase in the ratio may be due to increase in sales volume without proportionate increase in total cost, increase in sales price or decrease in costs.

The cost of production is increased by 14.84%, 20.93%, 25.89%, 52.92% respectively to the base year. The yarn selling and distribution expenses are increased by 74.21%, 13.15%, 25.64%, 28.28% to the base year 1980-81.

In the year 1984-85 the profit is too less comparing to the previous year and in this year the cost of production is increased by 52.92% yarn selling and distribution expenses are high in the year 1981-82 and profit is less.

Gross profit is fluctuating. It is not continuously increasing or decreasing. It may be due to inability of management in controlling expenses or sales volume G.P. should be adequate to recover all operating expenses incurred by the business. Managerial expenses are increasing every year. In the year 1981-82 Rs. 44,74,779.27, in 1982-83 by Rs. 60,73,113.17, in 1983-84 by Rs. 12,47,141.71 in 1984-85 By Rs. 64,27,776.90. Opening stock is increased every year except 1983-84. In 1983-84 it is decreased by Rs. 55,54,409.07. In 1982-83 it is increased by Rs. 76,07,595.51 and in 1984-85 by Rs. 25,30,459.98.




Purchases are also increased every year except 1982-83. In 1982-83 they are decreased by Rs. 1,11,56,520.70. In 1981-82 purchases are increased by Rs. 1,24,30,274.02, in 1982-83 by Rs. 98,22,572.48 in 1984-85 by Rs. 1,76,25,901.23.

Closing stock is decreased in 1981-82 in 1982-83 by Rs. 35,79,119.46 and in 1984-85 by Rs. 4,67,593.92 and in 1983-84 it is increased by Rs. 4,67,593.92.

As a result due to increase in manufacturing expenses cost of production is increased every year.

Net Profit Ratio

$$\begin{aligned} 1980-81 &= \frac{5,07,190.37}{11,53,76,919.61} \times 100 \\ &= 0.44\% \\ 1981-82 &= \frac{-(13,66,075.42)}{13,60,34,235.67} \times 100 \\ &= -1\% \\ 1982-83 &= \frac{-(11,28,240.62)}{14,05,74,717.59} \times 100 \\ &= -0.80\% \\ 1983-84 &= \frac{-(62,62,347.27)}{14,19,35,395.04} \times 100 \\ &= -4.41\% \\ 1984-85 &= \frac{-(91,03,801.46)}{19,04,39,964.88} \times 100 \\ &= -4.78\% \end{aligned}$$


Interpretation :

Generally non-operating incomes and expenses are excluded, when this ratio is calculated. This ratio establishes a relationship between net profit and sales and indicates managements efficiency in manufacturing administering and selling products, this ratio is overall measure of the firms ability to turn each rupee of sales into net profit. If the net profit margin is inadequate, the firm will fail to achieve satisfactory return on owners equity. This ratio also indicates the firms capacity to withstand adverse economic conditions. A firm with high net margin ratio would be in an advantageous position to survive in the face of falling sales prices rising costs of production or declining demand for the product. It would really be difficult for a low net margin firm to withstand these adversities. Similarly a firm with high net profit margin can make better use of favourable conditions. Such as rising sales prices, falling costs of production or increasing demand for the product. Such a firm will be able to accelerate its profits at a faster rate than a firm with low net profit margin.

Sales are increasing every year and only first year shows profit in succeeding year there is loss. Sales are increasing by 117.90%, 121.84%, 123.02%, 165.06% respectively. All revenue expenses charged to profit and loss account shows increasing trend except depreciation and investment allowance reserve.

Depreciation is decreased only in 1984-85. Investment allowance reserve is low in 1982-83 and shows increase in 1980-81, 1981-82, 1984-85 and 1983-84 respectively.

Index shows interest, commitment charges, managerial expenses, these items have increasing trend during 1980-81, 1981-82, 1982-83, 1983-84, 1984-85 respectively, factory overheads are decreased only in 1981-82. Education fund subscription is constant every year. In 1984-85 gross profit is low and revenue expenses are increasing so net loss is increasing.

Overall Profitability

1) Return on shareholders Investment
or Net worth

$$= \frac{\text{Net Profit (after interest and taxes)}}{\text{Shareholders Fund}}$$

$$1980-81 = \frac{5,07,190.37}{8,59,63,652.68}$$

$$= 0.06:1$$

$$1981-82 = \frac{-(13,66,075.42)}{9,38,43,921.36}$$

$$= -0.014:1$$

$$1982-83 = \frac{-(11,28,240.62)}{10,49,26,211.49}$$

$$= -0.011:1$$

$$1983-84 = \frac{-(62,62,347.27)}{11,84,62,498.29}$$

$$= -0.053:1$$



$$\begin{aligned}
 1984-85 &= \frac{-(91,03,801.46)}{12,54,19,558.16} \\
 &= -0.073:1
 \end{aligned}$$

Interpretation :

This ratio indicates how well the firm has used the resources of the owners. In fact, this ratio is one of the most important relationship in ratio analysis. The earning of satisfactory return is the most desirable objective of a business. This ratio reflects the extent to which this objective has been accomplished. This ratio is of great interest to present as well as prospective shareholders and also of great concern to management, which has the responsibility of maximising the owners welfare.

As mill has obtained. Net profit in 1980-81 and in subsequent years it has incurred losses, its rate of earning is decreasing. The earning of a satisfactory return is most desirable but the adverse situation is existing. The proportion of losses is increasing every year.

In 198081 for a rupee shareholders fund the profit is available only 0.06 paisa. In subsequent years these returns are negative. In 1981-82, 0.014, in 1982-83, 0.022, in 1983-84, 0.074, in 1984-85, 0.04. This indicates that mill has losing its control in utilising resources.

The return on owners equity of the company should be compared with the ratios for other similar companies and the

industry average. This will reveal the relative performance and relative strength of the company in attracting future investments.

Only in the year 1980-81 return is positive small fraction. In subsequent year these returns are negative. This ratio is unfavourable as returns are decreasing.

Shareholders fund is the composition of shares capital and reserves and surplus. This fund is increasing. Individual item shows following trend. Development Rebate Reserve, Dividend equalisation fund, Reserve for bad and doubtful debt fund, Building fund are constant.

Reserve fund, Depreciation fund, Investment Allowance Reserve Fund, is increasing every year.

Capital Redemption Reserve Fund is constant for first two years then in subsequent years it is decreasing.

Common good fund is constant every year except 1980-81.

In 1980-81 profit and loss account has credit balance in subsequent year it has debit balance and this balance is increasing. Increase in net profit shows management's efficiency in administering the manufacturing expenses, selling and distribution expenses, managerial expenses and factory overheads. Net Profit is decreasing every year.

2) Return on equity capital

$$= \frac{\text{N.P. (after taxes and preference dividend)}}{\text{Paid up equity capital}}$$

$$1980-81 = \frac{5,07,190.37}{75,68,000.00}$$

$$= 0.066$$

$$1981-82 = \frac{-(13,66,075.42)}{75,68,000.00} \times$$

$$= -0.180$$

$$1982-83 = \frac{-(11,28,240.62)}{72,68,000.00}$$

$$= -0.155$$

$$1983-84 = \frac{-(62,62,347.21)}{69,68,000.00}$$

$$= -0.898$$

$$1984-85 = \frac{-(91,03,801.46)}{64,08,000.00}$$

$$= -1.421$$

This ratio indicates the how much amount will be returned for a rupee investment in equity capital. Higher the ratio is favourable and vice versa.

Equity capital is constant for first two years. In subsequent years it is decreasing. Because of redemption of capital.

Only in 1980-81 there is positive net profit in subsequent years it is negative and negative profit i.e. loss is increasing it means profit is decreasing.

3) Earning Per Share

	<u>Net Profit (after tax and dividend)</u>	<u>No. of equity shares</u>
1980-81	<u>5,07,190.37</u>	7,568
	=	67.01
1981-82	<u>-(13,66,075.42)</u>	7,568
	=	-180.50
1982-83	<u>-11,28,240.62</u>	7,268
	=	-155.23
1983-84	<u>-62,62,347.27</u>	6,968
	=	-898.73
1984-85	<u>-91,03,801.46</u>	6,408
	=	-1,420.69

Interpretation :

The profitableness of the common shareholders investment can be measured in many other ways. One such measure is to calculate the earning per share. The earning per share calculations made over years indicate whether or not the firms earning power on per share basis has changed over that period. The earning per share should be compared with the industry average and the earning per share of other firms. The earning per share measure simply shows the profitability of the firm on a per share basis.

It does not reflect how much is paid as dividend and how much is retained in the business. But a profitability index, it is a valuable and widely used index. The number of equity shares is constant for first two years. As no. of equity shares is decreasing the net loss is increasing.

In 1980-81 the ensuing per share is positive and in subsequent year loss is increasing decrease in net profit may be due to increase in costs of managerial expenses and factory overheads and fixed interest charges or decrease in non-operating income.

4) Return on Capital Employed

$$= \frac{\text{Profit (before interest and taxes)}}{\text{Capital employed}} \times 100$$

$$1980-81 = \frac{60,62,041.56}{11,11,86,058.68} \times 100$$

$$= 5.45\%$$

$$1981-82 = \frac{70,97,659.40}{13,13,98,564.80} \times 100$$

$$= 5.32\%$$

$$1982-83 = \frac{84,92,853.57}{14,93,34,866.31} \times 100$$

$$= 5.68\%$$

$$1983-84 = \frac{56,97,869.52}{16,20,99,408.99} \times 100$$

$$= 3.51\%$$

$$1984-85 = \frac{45,68,054.87}{16,59,00,358.37} \times 100$$

$$= 2.75\%$$

Return on capital employed indicates how well management has used the funds supplied by creditors and owners. The higher the ratio, the more efficient the firm in using funds entrusted to it. The ratio should be compared with the ratios of similar business and the industry average. The comparison will reveal the relative operating efficiency of the firm.

Capital employed amount is increasing every year. Profit before interest and taxes amount is increasing for first three years and in last two years it is decreasing.

In the year 1982-83 the return on capital employed is highest and in the year 1984-85 it is lowest. Capital employed = Working capital + Non-current Assets.

Presentation of fixed assets, current assets and current liabilities is made as follows.

All fixed assets are increased every year except water installation in 1983-84. In 1983-84 it is decreased by Rs. 42,432.63.

All types of investments are increased in 1981-82 except investment made in Industrial Finance Corporation of India. Investment in IFCI decreased in 1984-85 by Rs. 2,00,000. Investments in National Savings Bonds decreased in 1982-83 and 1983-84. In remaining year it shows increase.

In 1981-82 following current assets are increased. Cash, Bank, Stores and spare parts, coal, cotton at godown, yarn at

packing section and bonded godown, deposits, purchases of cotton building construction, purchases of machinery, employees, prepaid insurance and advance payment of income tax.

Excise account current, cotton work in process, yarn at selling centre, saleable cotton waste at godown, debtors stores purchases and expenses, purchases of shares, octroi earnest money refundable sales tax and excise duty, prepaid expenses etc. are decreased. But there is total increase in current assets.

In 1982-83 cash, bank, excise account current, cotton work in process, yarn at packing and bonded godown, yarn at selling centre, hardwaste, debtors, stores purchases and expenses, purchases of machinery, employers, octroi earnest money, excise duty refundable, prepaid insurance, prepaid expenses, advance payment of income tax items shows increase.

Coal, cotton at godown, cotton work in process, saleable cotton waste of godown, deposits, stores purchases and expenses, building construction etc. items shows decrease. But there is total net increase in current assets. In 1983-84 cash stores and spares parts, cotton at godown, cotton work in process, yarn work in process, yarn at packing section and bonded godown, yarn at selling centre, saleable cotton waste at godown, debtors, purchases of machinery, employees, excise duty refundable, sales tax refundable, prepaid insurance and expenses, advance payment of income tax shows increase.

Bank, excise current account, coal, hardwaste, deposits, purchases of cotton, stores purchases and expenses, building construction and octroi earnest money items shows decrease and there is total decrease in current assets.

In 1984-85 bank, excise account current, stores and spares parts, coal, cotton at godown, saleable cotton waste at godown, hard waste, debtors, deposits, purchases of cotton, building construction, stores purchases and expenses, employees, prepaid insurance and expenses, advance payment of income tax shows increase.

Cash, cotton in work in process, yarn in work in process, yarn at packing section and bonded godown, yarn at selling centre, purchases of machinery, refundable excise duty and sales tax, shows decrease and there is decrease in total current assets.

Current liabilities and provisions - Refundable deposits are increased in 1981-82 and 1982-83. Loan taken from the Maharashtra State Co-operative Bank Ltd., Bombay on hypothecation is increased every year except 1984-85. On mortgage in 1981-82 and 1984-85 clean cash credit increased in 1981-82 and 1983-84 and decreased in 1982-83. Freeshipment cash credit is increased in only 1984-85. Deposits from others decreased every year except 1981-82. Sundry creditors increased every year except 1981-82 and expenses are also increased every year except 1981-82. Other expenses increased only in 1983-84. Sales tax is increased in 1982-83 and 1984-85 and decreased in 1981-82 and 1983-84. Interest

liability is increased except in 1983-84. Income tax is decreased in 1983-84 only. No other changes are taken place in any other succeeding or preceding year. Dividend is decreased every year. Gratuity is decreased in 1981-82. But total current liabilities are increasing every year.

TOTAL PROFITABILITY :

The Deccan Co-operative Spinning Mills Limited is a co-operative enterprises. Its main objective is not to earn profit but to serve the society by creating employment.

Every year workers wages are increasing it shows additional employment to employees every year.

Profitability is assessed in relation to sales and in relation to investment. To assess profitability in relation to investment. To assess profitability in relation to sales following ratios are calculated. To judge general profitability :

- a) operating ratios.
- b) expenses ratios.
 - i) Manufacturing expenses ratio
 - ii) Selling and distribution expenses ratio
 - iii) Managerial expenses ratios
 - iv) factory overheads ratio.
- c) Operating profit ratios.
- d) Gross profit Ratio
- e) Net Profit Ratio.

To judge overall profitability following ratios are calculated,

- i) Return on shareholders investment.
- ii) Return on equity capital.
- iii) Earning per share.
- iv) Return on capital employed.

A company should earn profit to survive and grow over a long period of time. Profits are essential, but it would be wrong to assume that every action initiated by management of a company should be aimed at maximising profits, irrespective of social consequences. It is unfortunate that the word profit is looked upon as a term of abuse since some firms always act to maximise profits at the cost of employees, customers and society. Except in such a infrequent cases, it is the fact that sufficient profits must be earned to sustain the operations of the business to be able to obtain funds from investors for expansion and to contribute towards the social overheads for the welfare of the society.

Profit is the difference between total revenue and total expenses over a period of time. Profit is ultimate output of the company and it will have no future if it fails to make sufficient profits. Therefore, the financial manager should continuously evaluate the efficiency of its company in terms of profits. The profitability ratios are calculated to measure the operating efficiency of the company. Besides management of the company,

creditors and owners are also interested in the profitability of the firm. Creditors want to get interest regularly and return of principal at maturity. Owners want to get reasonable return on their investment. This is possible only when company earns enough profits.

A company should be able to produce adequate profit on each rupee of sales. If sales do not generate sufficient profit it would be very difficult for the firm to cover operating expenses and interest charges, as a result will fail to the company should also be evaluated in terms of the firm's investment in assets and in terms of capital contributed by creditors and owners. If the company is unable to earn a satisfactory return on investment, its survival is threatened.

An analyst will be able to interpret the firms profitability more meaningfully, if he evaluates both the ratios gross profit and net profit jointly. If gross profit margin has increased over years, but net profit margin has either remained constant or declined, or has not increased as fast as gross margin this implies that the operating expenses relative to sales have been increasing. The analyst should conduct a further analysis to find out expenses which are increasing. Similarly if gross profit margin falls, it may be interpreted that either sales price has declined or cost of production is has increased. This will have consequences of reducing net profit margin. If operating expenses remained unchanged or increase. Net profit margin can

remain constant on increase, with a falling gross profit margin only if the operating expenses decline sufficiently. The crux of the argument is that both the ratios should be jointly analysed and each item of expenses should be thoroughly investigated to find out causes of decline in any or both the ratios.



ACTIVITY RATIOS :

The funds of creditors and owners are invested in various kinds of assets to generate sales and profits. The better the management of assets, the larger the amount of sales. Activity ratios are employed to evaluate the efficiency with which the firm manages and utilises its assets. These ratios are also called turnover ratios because they indicate the speed with which assets are being converted or turned over into sales. Activity ratios, thus, involves a relationship between sales and various assets and presume that there exists an appropriate balance between sales and the various assets. A proper balance between sales and assets generally reflects that assets are managed well. Several activity ratios can be calculated to judge the effectiveness of asset utilisation.

Inventory Turnover Ratio

$$= \frac{\text{Cost of goods sold}}{\text{Average inventory}}$$

$$1980-81 = \frac{9,73,08,080.03}{3,62,23,728.80}$$

$$= 2.68:1$$

$$1981-82 = \frac{11,60,32,114.98}{4,43,68,505.07}$$

$$= 2.60:1$$

$$1982-83 = \frac{11,57,78,759.69}{5,07,01,471.79}$$

$$= 2.28:1$$

1983-84 = $\frac{11,19,95,447.15}{6,01,84,739.42}$

= 1.86:1

1984-85 = $\frac{16,59,52,509.66}{6,22,02,000.74}$

= 2.66:1

Interpretation :

The inventory turnover shows how rapidly the inventory is turning into receivable through sales. Generally a high inventory turnover is indicative of good inventory management and a lower inventory turnover suggests an inefficient inventory management. A low inventory turnover implies excessive inventory levels than warranted by production and sales activities, or a slow moving or obsolete inventory. A high level of sluggish inventory amounts to unnecessary tie up of funds, impairment of profit and increased costs. If the obsolete inventories have to be written off this will adversely affect the working capital and the liquidity position of the company. Again a relatively high inventory turnover should be carefully analysed. A too high inventory turnover may be the result of very low level of inventory such results in frequent stock outs. The turnover will also be high if the firm replenishes its inventory in too many small lot sizes. The situation of frequent stock-outs and too many small inventory replacements are costly for the firm.

In the year 1980-81 ratio is 2.68:1 times. It means when the average inventory is 1 the cost of goods sold will be nearly 3 times. In the year 1981-82 this ratio is nearly three times. In 1984-85 this ratio is also nearly 3 times. It shows that in first three years inventory turnover is more or less constant. In the year 1982-83 this ratio is decreased it is two times. This decrease may be due to decrease in cost of goods sold and increase in average inventory. In 1983-84 the same situation exists, Cost of goods sold decreases and average inventory increases. In this year the ratio is less than two. In 1984-85 the cost of goods sold is increased due to increase in sales volume. But there is proportionate increase in average inventory and hence this ratio does not fluctuate widely.

Debtors Turnover Ratio

$$= \frac{\text{Total Annual Sales}}{\text{Debtors}}$$

$$1980-81 = \frac{11,53,76,919.61}{30,74,131.86}$$

$$= 37.53:1$$

$$1981-82 = \frac{13,60,34,235.47}{20,95,044.52}$$

$$= 64.94:1$$

$$1982-83 = \frac{14,05,74,717.59}{10,37,682.13}$$

$$= 135.66:1$$

$$1983-84 = \frac{14,19,36,395.04}{20,89,321.41}$$

$$= 67.94:1$$

$$1984-85 = \frac{19,04,39,964.88}{31,12,935.12}$$

$$= 61.19:1$$

Interpretation :

A firm sells goods on credit and cash basis. When the firm extends credits to its customers book debts (debtors or accounts receivables) are created in the firms accounts. Debtors are expected to be converted into cash over a short period and therefore, are included in current assets. The liquidity position of the firm depends on the quality of debtors to a great extent. To judge the quality or liquidity of debtors financial analyst employs debtors turnover ratio. This ratio indicates the number of times debtors turned over on an average each year. Generally the higher the value of debtors turnover, the more efficient is management of assets. This ratio may increase either increase in sales or decrease in debtors.

In 1982-83 debtors are least and in 1984-85 debtors are highest sales are increasing every year respectively. In 1982-83 though this ratio is highest it is not necessarily favourable. Because sales volume is not widely fluctuated but debtors figure is small. It indicates sales are made to only selected customers whose financial position is undoubtedly sound. Sales are restricted.

Debtors turnover ratio is increasing 1980-81, 1984-85, 1981-82, 1983-84, 1982-83 respectively.

Average Collection Period

$$= \frac{\text{Trade Debtors}}{\text{Net Sales}} \times \text{No. of working days.}$$

$$1980-81 = \frac{30,74,131.86}{11,53,76,919.61} \times 365$$

= 10 days.

$$1981-82 = \frac{20,95,044.52}{13,60,34,235.47} \times 365$$

= 6 days.

$$1982-83 = \frac{10,37,682.13}{14,05,74,717.59} \times 365$$

= 3 days.

$$1983-84 = \frac{20,89,321.41}{14,19,36,395.04} \times 365$$

= 6 days.

$$1984-85 = \frac{31,92,935.12}{19,04,39,964.88} \times 365$$

= 7 days.

Interpretation :

The average collection period ratio measures the quality of debtors since it indicates the rapidity or slowness of their collectibility. The shorter the average collection period the better the quality of debtors as a short collection period implies prompt payments by debtors.

An excessively long collection period implies a too liberal inefficient credit and collection performance. This certainly delays the collection of cash and impairs the firms debt paying ability. The chances of bad debt losses increased. On the other hand too low a collection period is not necessarily favourable. Rather it indicates very restrictive credit and collection policy. Because of fear of bad debt losses, the firm sells only to those customers whose financial conditions are undoubtedly sound and who are very prompt in making payment. Such a policy succeeds in avoiding the bad debt losses but so severely curtails the sales that overall profits are very low. In such a situation the firm should relax its credit and collection policy to enhance the sales level and improve the profitability.

In addition to measuring the firm's credit and collection efficiency with its own credit terms, the analyst must compare the firms average collection period with the industry average if there is great divergence between the industry average and the firm's collection period, the analyst must investigate the causes. The investigation may reveal that the firm manages its debtors more efficiently or inefficiently than the industry or its credit policy is too liberal or too restrictive. It may be further analysed that what shall be the effect on sales profit and liquidity if the firms present credit and collection policy is changed.

The collection period ratio provides the analyst with the significant measurements of debtors. He can initially test the company's collection period against its own credit terms and conditions to determine the collectibility of debtors and measure credit and collection efficiency. Then he can gauge the company's ratio against the industry average to ascertain its competitive strengths and weaknesses relative to credit terms and overall financial accomplishments.

Creditors Velocity

$$= \frac{\text{Total Annual Purchases}}{\text{Trade creditors}}$$

$$1980-81 = \frac{7,43,95,578.78}{26,76,084.51}$$

$$= 27.80:1$$

$$1981-82 = \frac{8,68,25,852.80}{8,82,178.69}$$

$$= 98.42:1$$

$$1982-83 = \frac{7,56,69,332.10}{23,11,637.97}$$

$$= 32.86$$

$$1983-84 = \frac{8,54,91,904.58}{33,35,687.15}$$

$$= 25.63:1$$

$$1984-85 = \frac{10,31,17,805.81}{63,61,212.24}$$

$$= 16.21:1$$

Interpretation :

A firm purchases goods on credit and cash basis when the firm is allowed to extend its credit period creditors are created in the firms accounts. A firm purchases goods from various customer spread in various parts. The liquidity position of firm depends on the quality of creditors to a great extent. This ratio indicates the number of times creditors turned over on an average each year. Generally the lower the value of creditors turnover the more, efficient is management of liabilities. This ratio may increase either increase in purchases or decrease in creditors.

In the year 1984-85 the ratio is lower. Ratio is increased in 1983-84, then 1980-81, 1982,83, 1981-82 respectively. Creditors and purchases are fluctuating. There is no relevant increase or decrease. Index shows purchases increased in 1981-82 - 113.65%, decreased in 1982-83 - 99.05%, increased in 1983-84 - 111.91% and increased in 1984-85 - 134.98% to the base year.

Average Payment Period

$$= \frac{\text{Total Trade Creditors}}{\text{Average Daily Purchases}}$$

$$= \frac{\text{Total Trade Creditors}}{\text{Total Purchases}} \times \text{No. of working days}$$

$$1980-81 = \frac{26,76,084.51}{7,43,95,578.78} \times 365$$

$$= 14 \text{ days.}$$

$$1981-82 = \frac{8,82,178.69}{8,68,25,852.80} \times 365$$

$$= 4 \text{ days.}$$

$$1982-83 = \frac{23,11,637.97}{7,56,69,332.10} \times 365$$

= 12 days.

$$1983-84 = \frac{33,35,687.15}{8,54,91,904.58} \times 365$$

= 15 days.

$$1984-85 = \frac{63,61,212.24}{10,31,17,805.81} \times 365$$

= 23 days.


Interpretation :

Sometimes business purchases raw material on credit.

The average payment period ratio measure the quality of creditors. Since it indicates the rapidity or slowness of their payment. The larger the average payment period is better the quality of creditors.

An excessively short payment period implies inefficient credit and payment performance. This implies prompt payment to creditors. Longer payment period is necessarily favourable.

In addition to measuring the firms payment efficiency with its customers credit terms, the analyst must compare the firms average payment period with the industry's customers average payment period. The analyst must investigate the causes of divergence. Investigation may reveal that the firm manages its creditors more efficiently or inefficiently.



Working Capital Turnover Ratio

$$= \frac{\text{Net Sales}}{\text{Net Working Capital}}$$

$$1980-81 = \frac{11,53,76,919.61}{2,35,46,686.66}$$

$$= 4.90:1$$

$$1981-82 = \frac{13,60,34,235.47}{2,82,16,356.70}$$

$$= 4.82:1$$

$$1982-83 = \frac{14,05,74,717.52}{2,53,38,183.77}$$

$$= 5.55:1$$

$$1983-84 = \frac{14,19,36,395.04}{2,16,37,341.57}$$

$$= 6.56:1$$

$$1984-85 = \frac{19,04,39,964.88}{1,74,33,300.86}$$

$$= 10.92:1$$

Interpretation :

Net sales i.e. total sales are increasing every year respectively. Total sales increase indicates either higher unit sales at optimum price or sales of lesser units at higher rate. Working capital is increasing upto the year 1982-83 and after that it is decreasing working capital turnover ratio indicates how many times working capital is turning into a sales throughout the year. Higher the ratio favourable and vice versa. Lower

ratio indicates higher working capital. The idle fund locked in business. Higher ratio indicates low working capital and efficient use of working capital.

It is necessary to increase sales volume and decrease in working capital. If there is adverse situation it is curse to business. Adequate working capital is required by business. Negative working capital and excess working capital must be avoided.

OVERALL EFFICIENCY :

Presentation consists management of Inventory, Management of debtors, management of creditors and management of working capital.

Shorter collection period and longer payment period is desirable. With comparison to average collection period and average payment period only in the year 1981-82 collection period is 6 days and payment period is 4 days i.e. it is unfavourable. But in other years the ratio is favourable.

Higher working capital turnover ratio represent higher sales and low working capital. It is the situation of over trading. which is curse to business. This indicates that overall efficiency of mill is decreasing. The reasons may be controllable or uncontrollable.