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Profitability Analysis and Tax Incidence in Cement Companies

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Abstract

In this article, the published accounts of the sample companies for a period of five years have been analyzed through ratio technique. "Ratio discriminating calculated and, wisely interpreted can be useful tool of financial analysis. These are used for high lighting in arithmetical terms, the relationship between figures drawn from financial statements over the period, a few ratios have been standardized for analyzing profitability, turnover, allocation of profits, balance sheet structure and cost structure. The study has adhered to these ratios worked out by R.B.I. for the Industry as a whole in their studies for joint stock companies. Ratio analysis adds depth to the present study. The comparison of ratios for a period of five years, shall be helpful to find trends of profitability. An important variation in the ratios may be due to changes in environment for the industry or due to changes in management policies due to passage of time. A word of caution as regards interpretation of various ratios, will not be out of place here. Some times, there are deviations in ratios from the past or from the norms, generally acceptable. It need not be construed as meaning that the firm or industry is behaving efficiently. The change in the ratios may be the result of some modification or innovation in the accounting policies, which limits the comparison of such ratios. In the present study, various ratios have been calculated, considering different variables. The study has commenced with the profitability analysis of cement Industry. The various terms used in the discussion are defined at appropriate places and bear the same meaning, throughout the study.

1. CONCEPT OF PROFITABILITY

The primary goal of business firms, is always to earn profit. This is also one of the important criteria for evaluation of managerial skills. In case, an enterprise fails to make profit, it reduce its capital and finally it may goes in liquidation. Profit may be compared with the soul without which the body is useless.

"But it is also to be considered that the maximization of profits cannot be resorted to at the cost of the society or even for the long-term interest of business. Any enterprise can not afford profit maximization at the cost of customer dissatisfaction or at the loyalty of its labour force."

It is the profit, which is observed by different parties in their own way. The management tests the efficiency of the concern, or that of any proposal, with the help of their investment, the creditors accept it as a guarantee of their loans, employees' take it as a source of wage increase and other fringe benefits.

Government measures it for taxable capacity, customers look at it from the angle of a possible cut in price of products. The legislature uses it for passing different legislations. The economist measures it to know the growth of the country; the planning commission regards as a measure of National Income and its allocation. This is how, so many parties take interest in a business enterprise and this is how a single concern satisfies so many people at once by running the business at profit. The study shall use the following important ratios to analyse the profitability of the sample companies.

i) Gross Profit to Net Sales: This ratio is an indicator of the profit margin in relation to turnover. Gross Profit is the difference between the sales revenue and operating expenses, interest, remuneration to managerial personnel, and other indirect expenses are excluded, in computation of gross profits. It is one of the important data in trading account, which tests the profitability of turnover, which is the profit earning capacity of the concern in regular buying, manufacturing and selling operations of the firms.

ii) Gross Profit to Total Capital Employe: "This ratio is widely acknowledged as an indicator of overall profitability and is assumed the fore most yard stick of financial viability. It is not absolute amount of profit that is of any importance to the analyst, which is supported to be interested in the yield or rate of return. The value of profit may depend largely on the amount of capital sunk in the business. Total capital employed is taken as sum of the net assets of the balance sheets of the sample companies under study.

iii) Profit After Tax to Net Sales: This is the part of the net profit, which remains with the company after meeting all direct and indirect expenses including interest and income tax. In order to maintain this ratio, the firm, will have to shift the burden of income tax to the shareholders by paying of reduced dividends.

iv) Profit After Tax to Net Worth: 'Net worth' is shareholders' equity, which includes share-capital, reserves and surplus including development rebate. This ratio helps to serve the interest of the shareholders,. because they are interested to know that funds of the company must be invested in appropriate securities, because, the profits distributed as dividend may create high burden of taxes to the individual shareholders.

v) Dividend to Net Worth: It is not the rate of dividend interms of paid-up share capital, but the return on the total interest of the shareholders in any concern, which is generally shown as networth. Shareholders are more interested to enhance their networth.

vi) Cash Earnings to Net Worth: It is interesting to note that, there are several parties, other than shareholders, who are interested in the profitability and generating of funds. Creditors of long-term finances are highly interested, not only in profitability, but in the generation of funds in the form of cash earnings. This will ensure regular debt serving cash earnings are equivalent to profits after tax plus depreciation; as it is not paid out of the business not with standing it being an allowable deduction.

2. SCOPE OF STUDY AND PROFITABILITY ANALYSIS

In all, ten public limited companies (old and new) listed on various stock exchanges have been the subject matter of study for a period of five year from 2005 to 2009 (31 March). The financial data of all these companies have been collected from their published accounts (Balance Sheet and Profit & Loss Accounts). The performance of these companies has been examined on three counts, viz, sales, profit before tax (PBT) and earnings per share (EPS). As qualitative data on various aspects of debt-equity management were collected through questionnaire administered through post of personal meetings about 80% companies suggested to a specific question, that they had no formal financial planning system. Still they had no formal financial planning system. Still they respond to various questions in the questionnaire. This seems to imply that though these companies do not have formal arrangement in the form of administrative paraphernalia, the use of intuition, holding wider consultations with the executives, with knowledgeable sources in government, trade and industry, observing the environmental situation, etc. cannot be wholly ruled out in their case, especially, when some people have put their entire life savings at stake.

Extending this logic further, the study cannot presume that, those who have not responded to our repeated requests for information are prepared to sink their money without being watchful or mindless of what happens in and around them. Not surprisingly, some of them may even have extensive formal financial planning system. Therefore, perhaps, the distinction between a company operating on informal or non-formal basis and a company having a formal system of planning must be in terms of effort put in recapitulations, haphazardness of approach or ill-organization of data, absence of systematic procedures, acting at a spur of moment without well-thought out responses and things of this kind, which may subject a company to delayed or at times even wrong decisions. Only because companies donot have formal planning systems, or they have not responded, it is not fair to assume total absence of financial planning in non- responding companies. The non-responding companies would, in fact, include both types of companies, which use high debt-equity ratio and those which donot. It would not be far

Table - 1.1
Companywise Distribution of Surveyed Cement Companies in 2005

S. No.	Name of the Company	Respondent Company (RC)	Non-Respondent Company (NRC)
1.	ACC	-	NRC
2.	Ambuja Cements	RC	-
3.	Birla Corporation	-	NRC
4.	Chettinad Cement	RC	-
5.	Everest Industries	-	NRC
6.	India Cements	RC	-
7.	Jai Prakash Industries	RC	-
8.	Madras Cements	RC	-
9.	Shree Cements	RC	-
10.	Ultra Cement	RC	-

Source: Questionnaire & Interviews.
Note: RC; Responding Companies adopted financial planning
NRC: Non-Responding Companies

Table 1.2
Sales of Cement Companies during 2005 to 2009 (Amount in Crores)

S. No.	Name of the Company		Financial Year				
			2005	2006	2007	2008	2009
1.	ACC	NRC	4550	3724	6468	7865	8300
		FBI	100	85	142	173	182
2.	Ambuja Cements	RC	2305	3026	7023	6470	7090
		FBI	100	131	305	281	308
3.	India Cements	RC	1385	1829	2611	3554	3839
		FBI	100	132	189	257	277
4.	Jai Prakash Industries	RC	557	903	1231	1615	1531
		FBI	100	162	221	290	275
5.	Shree Cements	RC	723	824	1613	2440	3097
		FBI	100	114	223	337	428
6.	Ultratech Cements	RC	3132	3785	5484	6286	7160
		FBI	100	121	175	201	229
7.	Birla Corporation	NRC	1343	1434	1795	1997	2049
		FBI	100	107	134	149	153
8.	Chettinand Cement	RC	521	586	842	1110	1322
		FBI	100	113	162	213	254
9.	Everest Industries	NRC	136	210	199	228	255
		FBI	100	154	146	168	188
10.	Madras Cement	RC	733	1004	1567	2005	2929
		FBI	100	137	273	274	345

Sources: Financial Statements of the sample companies.

from reality that a larger proportion of these companies would have only very weak systems of gathering and processing information. There; the researcher avoids the use of expressions like 'planning' and 'non-planning' companies and label them 'respondent and non-respondent' companies. However, the presumption is that 'RPF' should do better than 'NRF'. Table 1 presents distribution of cement companies in 2005 a-s base year for the purpose of the study.

3. CONCLUSION

In this part, the researcher examined the profitability of cement companies, using sales, PBT, EPS, Return on Networth, Return on Capital Employed, Dividend Payout Ratio, and Fixed Assets Turnover Ratio, and test H03, H04 & H05 and it is found that, in most of the cases, companies using strategic management techniques are performing better than those, who do not used, except in few cases, on the basis of Return on Capital-Employed and Fixed Assets Turnover Ratio.

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