

CONCLUSIONS AND SUGGESTIONS

Movements in financial variables are always subject to activities in operating and trading phases of the business and the industry, and are much sensitive and volatile. As funds for the business is very much difficult to control, similarly a gainful use of fund also becomes much difficult. Unless funds are aligned precisely to each and every activity of business, a disruption in its flow is inevitable. Hence a rational planning and much careful allocation of fund is very much necessary for smooth and proper functioning of business activities.

The Terai tea industry is operating over a century. For many years its operating and trading phases have hardly been stable. The present study through observation of the movements of financial variables both short-run and long-run, brings out a number of uneasy features to light.

GROSS PROFIT MARGIN.

During the octennium the initially buoyant gross profit margin (GPNS) has declined. The average GPNS is also a sluggish one. During the first-half of the octennium (1974-77), buoyant market and favourable climatic conditions made a favourable GPNS and, thereby, the gross profit margin in absolute terms; but the adverse climatic conditions enjoined later by severe draughts (1977-81) decreased the volume of output. The market prices

including international prices reflected a recessional trend.

The declining GPNS ratio value is the effect of a cost-push feature. The cost increase in per kilogram of tea produced can be observed in all items of expenditure. The increase in expenditure is the highest in cultivation followed by labour welfare, manufacturing and plucking.

Being labour intensive tea industry has shown a higher rate of cost increment and is less susceptible to the methods of cost reduction. Every rupee of cost includes 86.4 paise by the way of direct cost and factory overheads; direct labour charges amounting to 57.5 paise. The differential wage structure has enhanced the financial burden of the tea companies. The three revisional schemes of wages implemented during 1978-81 have resulted in an overall increase of 58.34 per cent in the wage rate. Besides, the amount of subsidy by way of concessional provisions to labour has also increased by 14.58 per cent. All these increased costs have reduced profitability and thereby, availability of working capital.

GPNS - NPNS AND NPTA.

The net effect of GPNS was reflected on the NPNS, the overall fall of which has considerably reduced the return on total investment in assets. The NPNS ratio bears no direct relationship with NPTA. Expansion in Cultivation also provides no immediate increase in output upto first five years. Thus, tea companies in Terai lack resource profitability.

OVER INVESTMENT IN FA.

The expansion activities have mainly been financed from reserves. The base of internal funds has not been widened. Despite scope to enlarge capital structure, the industry could not trade on equity because of the declining rate of return on equity. Though there is no idle capacity, yet the tea companies in Terai suffered from the over investment in FA. 'Land, Cultivation and Buildings' account for over investment.

SHORT-TERM FUNDS : LIQUIDITY AND PROFITABILITY.

A higher yield provides a better credit worthiness. The yield on total investment debarred the industry from securing external funds for fixed zone use. The short-term external sources have, therefore, been managed in such a fashion that part of these funds stand transferred to fixed zone and thus a number of companies have been pushed to the brink of bankruptcy. The study of solvency ratios disclosed a sorry state of affairs at the current zone of operations. The industry bears greater insolvency risk of financing current operations from fixed zone resources. Again, holding of non-positive non-zero WC by most of the companies clearly reveals the heavy liabilities of the Terai tea industry.

The huge burden of loans and advances (CL) cannot be mitigated on account of poor and negative return on selling activities. In addition, the increase in inventory has frozen the flow of current funds. Thus debt paying capacity of the companies has

been reduced to a large extent. In Terai tea industry, the liquidity, which is always diametrically opposite to profitability, has always been low like the profitability.

WORKING CAPITAL.

The current liabilities of the industry were always more than current assets. Whenever WC assumes a non-positive value it indicates a red signal of insolvency. The sample units disclose a very dismal picture of WC; not less than 63.16 per cent of the units disclose non-positive WC. The companies with positive WC disclose piling up of inventories and thus a locked up WC. These companies could have improved the inventory turnover from the existing 2.8047 times but decline in productivity and partial decline in prices did not permit them to do so. Such poor turnover reduced the liquidity of funds and the risk of insolvency was further aggravated.

Though the WC should be reasonably responsive towards NS it has not been so in Terai. The mean value of sales elasticity (SeWC) was less than unity (0.9670) and the mean values of profit elasticity of WC (PeWC) (-0.1041) and the net operating fund flow elasticity of WC (NOFeWC) (-2.0448) were negative. All these compelled Terai tea companies to secure funds from external sources to meet current operations. The only way out was to borrow from short-term sources i.e. by resorting to loans and advances. This, in turn, increased not only the risk of insolvency but also the cost of interest.

The need for WC has been frequently met by transferring funds from fixed zone to current zone either by liquidating FA or by diverting long-term loans. The policy of financing current operations by diverting funds from fixed zone is not in consonance with the basic principles of financial management. As a result, financial imbalances have been found to prevail. It has its ill-effects also upon the capital employed in fixed zone.

DEPRECIATION.

The annual depreciation which signifies the conversion of FA into WC has been charged on diminishing balance method and the average rate comes to 0.0736. Though it has been accumulated to the extent of 13.65 times of the average annual depreciation it is not readily available for replacements as it remains invested to cater the needs of WC. The average DPNS is only to the extent of 0.0251 indicating the amount reserved for the use of depreciable capital assets. The productivity of existing plant and machinery and other equipments is rapidly diminishing and renovation and replacements are overdue. The paucity of funds is the bottleneck in the way.

NET WORTH.

In Terai tea industry a number of sample unit have NW more than the net block. The erosion of NW became evident during 1978-81. This internal source has been utilized even to the extent of 93.43 per cent in FA and which is 2.1642 times of

equity (1975). The erosion of NW manifests a sign of over capitalization and such apparent over capitalization in units having NW more than net block is, on an average, to the extent of 70.81 per cent of equity capital. Though on the basis of the principles of financial management it seems reasonable that such huge fund should not have been put into the uses in current zone but erosion of NW compelled the firms to divert such funds (excess NW) to current zone.

FIXED ASSETS.

Because of declining density of FA in the total asset structure FA turnover ought to have increased. In reality it has declined. The sub-optimum feed of the investible funds in the fixed zone obviously resulted in reversing the trend of assets turn over. Though adjustments in the size of FA corresponding to the current activity levels is not usually possible, these should remain within certain reasonable limit. In a number of Terai companies, such imbalances are beyond reasonable limits and, hence, not conducive to the efficient functioning. The FA have also not generated sufficient flows to current zone through its liquidation.

CURRENT LIABILITIES.

In most of the companies' the CL have exceeded the CA. With setting in of monsoon the demand for WC shoots up heavily, but the estimation of cash flow becomes very difficult as the expenses to be incurred are very much linked with monsoon boons which is

quite uncertain and vacillating. Again, the prices fetched are in most cases linked with global demand and supply. Thus fairly reliable budgets cannot be drawn.

Again, the short-term creditors, either for cash or other inventories, both private sources and the commercial banks, hesitate to accommodate tea companies in general because of companies' routine nature of obtaining short-term loans to meet WC needs; as well as because of delinquency in repayment. The cost of short-term loans is also disturbing. Due to discretionary powers of sanctioning authority the interest rate may vary between 16 to 20.5 per cent but lately a uniform pattern of 19.5 per cent has been observed. The short-term loans are gradually swelling because of their irregular and partial discharge.

LONG-TERM LIABILITY.

The instances of securing long-term loans from financial institutions are an exception. The FL had not been properly streamlined in fixed zone, rather these had been, by and large, transferred to current zone. Though the cost of such loan is not unreasonable, the transfer of such funds to current zone to meet the acute paucity of current fund cannot be justified.

CAPITAL STRUCTURE.

The capital structure consists mainly of equity capital and retained earnings. Only two sample units constituting

an exception, contain a three member set of preference share capital, the equity capital and the retained earnings. The capital structure of Terai companies is, thus, conservative and less dynamic. It has deprived the companies of the gains of trading on equity.

DIVIDEND.

The Terai tea industry is not a good pay master. Six companies out of nineteen had never paid any dividend during the octennium under review; four companies had paid dividend only once during this period. Only two companies have followed a stable dividend policy. Even in these two cases the paying capacity has little relevance with size of dividend.

COST OF CAPITAL.

The overall cost of capital in Terai comes to 4.41 per cent and is too low. This is because of non-payment of dividend by a large number of companies for most of the years. The rate of return provided to investors in equity is too poor. They could have obtained about three times of this return from risk-free investments in National savings certificates. Thus the return on equity is quite unsatisfactory as well as irrational.

To sum up; Terai tea industry suffers from low profitability, high illequidity as well as higher risks of insolvency. The fixed and current zone funds have not been

properly managed despite the long experience of the management in this business. Due to improper and deliberate policy of managing the funds a number of imbalances and contradictions have crept in.

S U G G E S T I O N S

In Terai tea industry lack of finance - both long-term and short-term is considered to be the major problem. The plant and machinery are old and worn out and call for modernisation and replacement. Extension and replacement of tea bushes is also an urgent need. The Tea Board has already observed that "a considerable portion of area not utilized for tea can be brought under plantation and the scope of it lies with the bigger size-groups"⁽¹⁾.

Though Tea Board is providing loans under hire-purchase scheme for replacement and renewals, soft loan for replantation (Rs. 20,000 per hectare @ 9 per cent per annum) and replanting subsidy (Rs. 10,400 per hectare) the quantum granted "was reported to be inadequate when actual cost is taken into consideration"⁽²⁾. Hence necessary loans on a long-term basis at a reasonable rate of interest repayable over longer periods would help to modernise the plant and machinery and would also enlarge the area under actual cultivation. The former would improve the quality of tea and, thereby, fetch a higher price and latter would enable increased volume of green tea leaves leading to larger volume of output. Such availability of funds would also reduce the tendency towards obtaining bank finance as 'filler finance' and would augment the capacity to generate

'self-finance'.

The acute shortage of working capital is the common feature. On one hand, it has aggravated the liquidity problem increasing the risk of insolvency, on the other, it has its reflections on the profitability of companies. In order to remove the crises of WC, a balance has to be struck between the requirement for and availability of such funds i.e., between demand for and supply of WC.

The ever rising CL may also be, at least, partially controlled, if a part of it is allowed to be converted into a long-term liability and, thereby, its transfer to fixed zone. Such action would help to avail of a cheaper source and would reduce the pressure on much needed WC; the creditors may also readily accept such conversion as it secures them a floating senior charge against assets.

To improve liquidation of fixed zone assets and, thereby, to improve flow of funds for current operations as well as for replacements, the present method of depreciating FA by reducing balance method needs a change as this method never recovers the full value of assets and it also does not consider the actual productive capacity of FA that decreases with the passage of time. The DPNS diminishes irrespective of the variation in NS. The present overall depreciation rate of 7.36 per cent is definitely not justified under present inflationary conditions. Hence the 'sum-of-years-digit' method, though another sort of diminishing balance

method, would be more suitable as it takes into account the differential productive capacity of the FA along with its effective economic life. However, despite controversies between different accounting schools of thought, considering the inflationary realities, the depreciation should be allowed to be charged on the current market prices.

The tea bushes are productive assets having a most effective economic life from 5 to 50 years of their age and thereafter the productivity depreciates over time. Not a single tea company in India makes any provision for this depreciable asset even when 50th year of age is crossed. The Tea Board of India asserts that "Terai, in general account for about 38% of the total planted area which crossed economic age-group of over 50 years" ⁽³⁾ (Table-IX.1).

TABLE - IX.1

Area under different Age-group of bushes in Terai
(as on 31.12.80)

Age of bushes (years)	below 5	5 - 10	11 - 20	21 - 30	31 - 40	41 - 50	above 50
Distribution of area (%)	7.59	7.74	16.69	11.48	6.30	11.76	38.44

Source - TEA STATISTICS, 1981 - 82, Tea Board of India, Calcutta, 1983, p. 23.

The composition of tea bushes of sample units (Table-IX.2) reveals that 41.67 per cent of the area under tea belongs to the uneconomic age-group and requires replacement. Had these assets been depreciated at a reasonable rate, fund, could have been

generated internally for replacement. On one hand, this could have liquidated the investment in fixed zone to current zone and, on the other, it could have improved flow of funds from FA to CA and thereby augmented the WC condition which was always making a clarion call for help. An indepth study in this area can help to open a new channel of liquidity from FA to CA.

TABLE - IX.2

Age composition of tea bushes in planted area of sample units.

Age of bushes (years)	Upto 5 years	5 - 10	11 - 30	31 - 50	above 50 years
Distribution of area (%)	8.73	6.11	25.27	18.22	41.67

The efficiency of finance function at micro level and, thereby, at macro level is always subject to the efficiency of operational activities. Despite prescriptions of given sets of financial management principles and practices for the betterment of overall efficiency as well to tackle financial problems, the intuitive judgement, which is a subjective one, is most essential. The above suggestions may act as corrective actions to remove the maladies of Terai tea industry. However, as the economic viability of the Terai tea industry is deteriorating over years, there is an urgent need for making all round efforts to keep the industry a viable one. For this, various agencies like State