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The financial performance of the textile industry: an empirical study

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Abstract:

By reviewing literature, the present study aims to investigate the empirical perspectives of using financial ratios in various research areas of the textile industry. The purpose of this study is to investigate the application of the financial ratios, such as profitability ratio, solvency ratio, break-even point analysis, in various research works of monetary performance of textile industries. Study findings indicate that financial ratios have not only helped the firms, but also the business units and their managers to make a range of decisions, including setting prices and preparing competitive bids.

Key words: Empirical, break-even point, profitability ratio, solvency ratio, textile industry.

Introduction:

Financial performance is a subjective measure to know how skillfully a firm can use its assets from its primary mode of business and generate revenues and is also used as a general measure of a firm's overall financial health over a given period (*Kenton , 2019*). Financial performance is the blueprint of the financial affairs of concerned business units. It judges the personnel performance of any organization to earn profit and to enlarge profit by making the most efficient use of resources available to them. There are various ways to measure financial performances (Kenton, 2019). To measure the financial performances of a firm the financial statements like balance sheet, income statement, and statement of cash flow of a company are used (Kenton, 2019). There are various methods for the analysis of the financial performances of textile industries adopted by different researchers in their research works. Among them, the use of financial or ratio analysis is one of the best ways of evaluating the financial performances of a sector (Naz, Ijaz, Naqvi, 2016). The ratio analysis indicates the relation between one quantity or performance indicators over another hence regarding the financial performance of a firm, the ratio analysis provides mathematical expression and attempts to summarize a huge database for one eye view (Naz, Ijaz, Naqvi, 2016). Based on various literature reviews; *Hossain 2015*, *Kulkarni (2012*), *Desai (1997*), *Mulla (2002*), *Shiralashetti (2011)*, etc. the present study has made an attempt to study the financial performances of the textile industries in with the help of various methods and their outcomes of these industries.

Description:

According to MetCalf and Titard (1976), financial analysis is the process of evaluating the relationship between various financial components that obtain a better understanding of a firm's position and performance. The study of Pandey,(1986) reveals that the financial strength and weaknesses of the firm can be identified by financial analyses that help to establish a relationship between the items in a balance sheet and profit and loss account.

Profitability Ratio :

Profitability is a ratio that expresses between profit and different types of utilized resources, since the higher the profit rate, the higher the profitability rate. *Chowdhury (1981a), Rahman (1980*) found that by using profitability measurement on the handlooms, power looms, and mills operating in Bangladesh, resulted that comparison of handlooms with power looms operating under cottage industries and large mill for the weaving of every single type of fabrics, handlooms were economically more efficient production technique. *Hossain,(2015*), has found that the technical inefficiency of the handloom weaving industry was, directly related to the profitability of the units. Again, *Kulkarni,(2012*) in his study, it was found that all the selected five company's of the Gujarat textile industry, financial performances were sound effect and they were analyzed by using ratio analysis, descriptive statistics, etc. By using liquidity performance, profitability, and turn over of working capital in a few cotton mills of Ahmadabad, *Desai (1997*) found that liquidity and profitability of the firms were not influenced by its size as he had classified the selected firms into three groups based on the size for his study. *Mulla (2002*), analyzed that the current assets had been declined due to the negative profitability performance, whereas the current liabilities had been increased due to the poor liquidity performance of Shri Venkatesh Co-operative textile mills ltd. Due to high expenses in the period of 2002-2003 and 2008-2009, the overall performance of the Gadag Co-operative Cotton Textiles Mill Ltd was found poor by the study of *Shiralashetti (2011)* and during the study period he had used to analyze the trends in capital employed, the firm's net worth, the trends in sales, selling costs of goods, gross profit /loss, and net profit/loss. Profitability is more or less depends upon the better utilization of resources and manpower and it is worthwhile to increase production capacity and use advanced technology to cut down the cost of production and wage cost to increase profitability, not only against the investment but also for investor's return points of view, which is found by the study of (Varghese; 2011). The study of Sharma and Sharma (2011), attempts to

find out the relationship between the financial parameters and the profitability of the textile industry. This study also attempts to find out whether the key identified parameters move in a synchronous way going up and coming down with basic profitability parameters. **Liquidity Ratio :**

Dhandapani, and *Ganesh (2013*), by studying liquidity position, profitability position, and the effectiveness of asset utilization in pioneer spinning and weaving mills ltd of Andhra Pradesh, found that the firm had maintained very good liquidity position and current ratio, as well as the quick ratio, was more than the standard. During the study period, the efficiency ratios like stock turnover ratio, debtors turnover ratio, and fixed assets turnover ratio were also static. In his study, Ayyappan, S et. al. (2014), has suggested that the return on capital employed of three textile company can be improved by increasing their production. Based on the result of correlation coefficient matrices of the selected variables with the dependent variable, i.e., return on total assets of selected textile companies of India, it was found that almost all the companies creditors turnover ratio, inventory turnover ratio, and fixed asset turnover ratio were positively correlated with the profitability of the company and it was also found a close relationship between the financial performances of these companies and the proportion of changes in return on total assets(Indhumathi, C and Palanivelu, P.;2013).

Solvency Ratio:

In the long run, a company's ability to pay is evaluated by the solvency ratio, since the lenders, investors, and credit-rating agencies are very concerned about a company's ability to meet its operational commitments (Mills & Yamamura,1998). Total assets to total liabilities are calculated at a single point in time in the balance sheet statement, which is one of the most commonly used solvency ratios, while the cash flow from operations to average total liabilities ratio covers a period and is more useful than the former (Kajananthan, 2014). As the total assets to total liabilities ratio ignore the varying liquidity of assets for covering various levels of debt and this deficiency is overcome by focusing directly on cash flow (Coltman & Jagels, 2001; Schmidgall, Geller, & Ilvento, 1993; Mills & Yamamura, 1998). Since higher this ratio, the better is the operation's ability to pay off its debts with cash, hence, it is suggested that a minimum ratio of 20 percent is acceptable in the lodging industry (Davidson, Stickney & Weil, 1988; Schmidgall, Geller, & Ilvento, 1993). With the purpose of look at the margin of safety in meeting debt interest payments, the cash flow-interest coverage ratio is similar to the times' interest earned ratio, since interest expense is paid with cash, the cash flow interest coverage ratio may be more realistic than the time's interest earned ratio and it can provide a more obvious warning that an inability to pay interest may be on the horizon than does the traditional interest coverage ratio (Coltman & Jagels 2001; Schmidgall, Geller, & Ilvento, 1993).

The study of Gupta et al (2017), has revealed that the analysis of the liquidity, solvency, profitability, and managerial efficiency in textile companies, give the result of a significant difference in Return on Capital Employed, Net Profit Margin, Current Ratio, Debt equity, and fixed turnover ratio. The possible causes for weak performance and the reasons behind the slow pace of growth of four selected public sector textile units (Barshi Textile Mills, India United Mill No. 5, Poddar Mills, and Tata Mills) are found after evaluating the financial performances of these industries based on their turnover, solvency, and liquidity for the period of 10 years starting from 2006-2016 (Mohammed et al. ; 2017). Solvency ratio and liquidity have a significant impact on profitability but the turnover ratio has an insignificant impact on the profitability of selected textile units in Maharashtra (Pal; 2012). For any organization to become solvent and at the same time to maximize the shareholders' wealth, the optimum working capital management is essential, by following the dilemma that financial manager face is that excess current asset may decrease the default-risk but it may increase the unutilized asset in the firm and on contrary, a less current asset may increase the default-risk but on the other hand, it can increase the scope of investment and So, the finance manager must have to manage the working capital in such a way that the firm reduces its default-risk and in the same time, it can utilize its current assets (Huda; 2014). The study based to investigate the effect of solvency on profitability among Jordanian industrial sectors found that, at a 5% level of significance, the solvency has a significant relationship with earnings before interest and tax (EBIT), Net Profit Margin (NPM), Return on Asset (ROA)(Omari, Warrad, Nimer; 2015).

Break –even point :

The Break-even point is the point at which total cost and total turnover are equal: there is no net loss or gain, and one has "broken even'' from the viewpoint of the economics, business, and specifically cost accounting and although opportunity costs have been paid, profit or a loss has not been made, and when the firms at zero profit, capital has received the risk-adjusted, and all the expected return or in short all the payable costs of the firms are paid in that situation (Hung Tang Tri – Vu Phan Hoai – Thien Nguyen Huu – Hieu Nguyen Thi Thu;2016), hence to calculate the break-even point, we have to know the total fixed cost of a period, the selling price of that time as well as cost per unit of product sold (Anderson et al., 1993; Zimmerer et al., 2005). Contribution margin is the difference between the cost and selling price of the product, which is used to compensate for the fixed costs in the operation period and the contribution margin of several consumed products compensate for total fixed costs called break-even point, hence once achieved break-even point, the marginal turnover per unit of product sold is the profit (Potkany, et al., 2015). Break-even point (BEP) analysis is al a planning tool for the investors and business owners, that always calculate BEP when investing in the establishment of new businesses or business expansion and is also useful for determining the prices of products (Greenfield, 1989; Horngren et al., 1993). The application of break-even analysis is not free from the limitations besides, it has usability, such as the lack of experience of the managers in the classification of fixed costs and variable costs, the lack of determined for the retail business with multiple products and have many different prices as well as limited by the assumptions to be analyzed break-even point (Greenfiel, 1989; Hatten, 1997; Zimmerer et al., 2005). In Cost Volume Profit (CVP) analysis Break –Even-Point is one of the main tools since it is one of the important tools used to measure the profitability of a firm and hence, it is defined as the point where total revenue equals total variable and fixed expenses (Garrison, 2011). To equal its expenses, a company's break-even point is the number of sales or revenues that it is generated (Wikipedia, 2014). Hence, at this

point, the company neither generates profits nor suffers a loss. It is a powerful quantitative tool for the managers of calculating the break-even point through break-even analysis, or break-even analysis provides insight into whether or not revenue from a product or service can cover the relevant costs of production of that product or service and hence the managers can use this information in making a wide range of business decisions, including setting prices, preparing competitive bids, and applying for loans (Manishranalkar, 2014).

Conclusion:

From the above literature reviews it has cleared that financial analysis is the process of evaluating the relationship between various financial components that obtain a better understanding of a firm's position and performance in the textile industries. The use of various financial ratio analysis provides one of the best ways of evaluating the financial performances of textile industries. The use of financial ratios have not only helped the firms but also the business units and their managers to take a wide range of business decisions,including setting prices, preparing competitive bids etc.

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