Performance of Paper Mills in India

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From the early days when the art of paper making was kept a fairly guarded secret by a few families, it has developed into a large industry with a total of about 75 units having a total installed capacity of over a million tons per year and providing employment to lakhs of people both directly and indirectly. The value of paper produced by this Industry exceeds Rs. 500 crores annually. The Industry has registered a rapid growth of production in the past, however the growth rate has slowed down considerably recently. Therefore it is highly essential that management of paper mills, which contribute an important input to the economy, should improve performance of paper mills.

One method to cause improvement in performance is by inter-firm comparisons based on financial ratio analysis. For this the emphasis is on the turnover and profitability ratios. The idea of comparing the results of similar firms is not new but has not yet been adopted extensively in India. The increasing degree of competition in Industry coupled with decreasing profit margins call for such analysis.

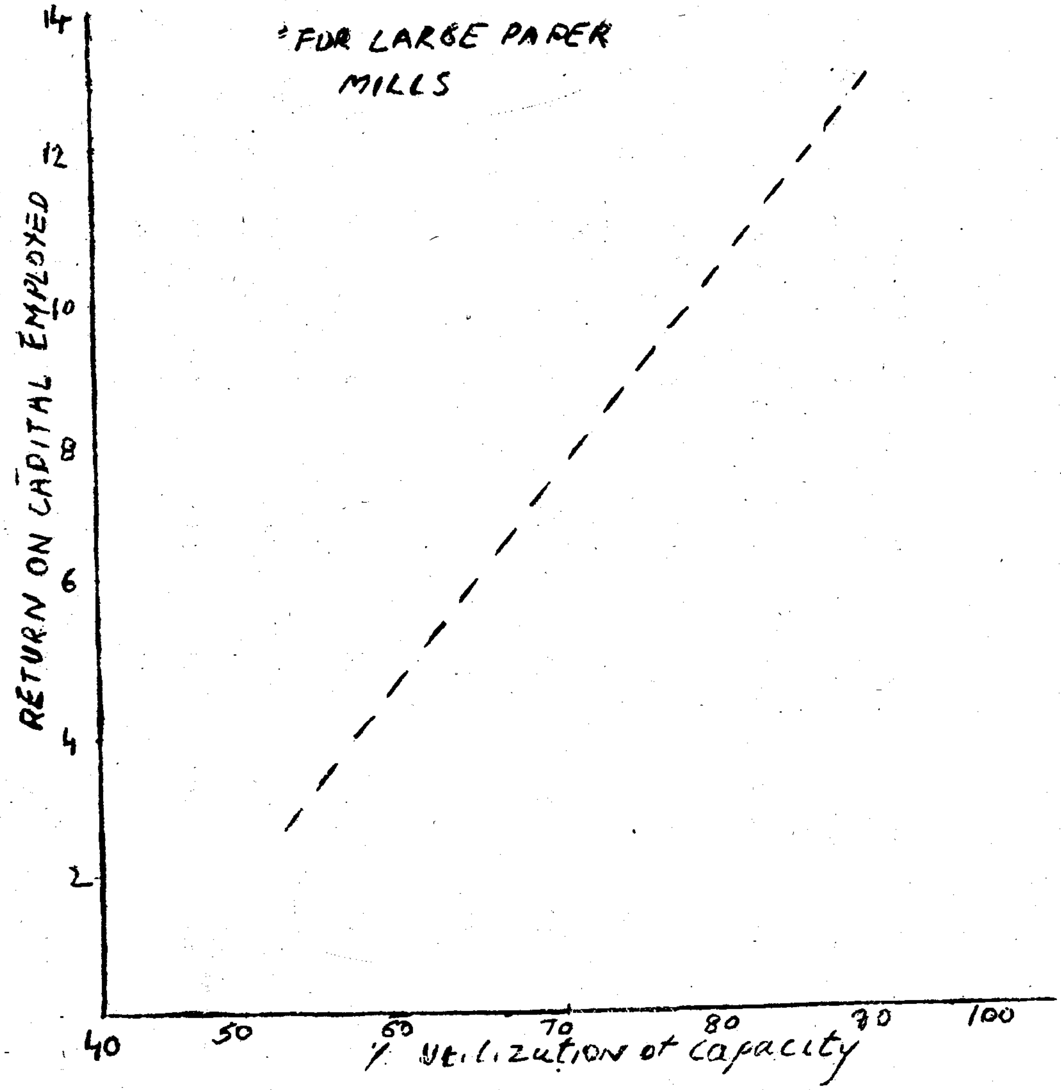
The technique of inter-firm comparisons are based on use of common items from financial accounts and other records available from annual reports from which various ratios can be calculated to aid in management decision making. These ratios of comparable companies are important as they can be used as yardsticks to evaluate the results of a company. An analysis of ratios will highlight the probable inefficiencies at various stages which can be eliminated or reduced. The idea is to profit from the experience of most efficient company in reducing costs.

The paper mills are divided into three categories—Mills with an installed capacity of 200 tons/day or more are classified as large, 50 to 200 tons/day as medium and upto 50 tons/day as small. Some of the important ratios are tabulated giving average value, and the high and low for industry. It can be seen that such important things as return on capital employed and pretax profit to net sales is because of combined effect of a number of factors. However one factor which has a direct relationship with return on capital is capacity utilization.

The table shows a wide range for most of the ratios calculated. These differences not only show the great scope for improvement but also can help in analysing why the profitability of two firms differ or which are weak departments in a firm and require to be improved. Thus companies should get a challenge and incentive to improve their performance.

From the table it is also clear that profitability difference between firms is less due to size (installed capacity). It is more due to other factors about which management can do something. The major factors seems primarily managerial efficiency. Even the best firms profitability-wise are not so good in some areas. Improvement in those can help them in achieving still higher profits.

The analysis of sales to assets ratio, for example, will reveal whether the company is selling enough to justify the proper and full use of assets employed. The inventory of finished goods should be low to decrease working capital, improve profitability. The cost of goods sold to average stock ratio should be high. Companies can also use some other ratios like selling expenses to total sales etc. for identifying areas requiring change.



THE OVERALL PROFITABILITY OF THE OPERATIONS OF THE BUSINESS, AND THE OVERALL SUCCESS OF THE MANAGEMENT ARE REFLECTED BY THE RATIO :

$$\frac{\textbf{PROFIT BEFORE TAX}}{\text{TOTAL ASSETS EMPLOYED}}$$

- $\frac{\text{Profit before tax}}{\text{Sales}}$
  - $\frac{\text{Gross Profit}}{\text{Sales}}$
  - $\frac{\text{R.M. Cost}}{\text{Sales}}$
  - $\frac{\text{Selling Expenses}}{\text{Sales}}$
- $\frac{\text{Sales}}{\text{Total Assets Employed}}$
  - $\frac{\text{Sales}}{\text{Fixed Assets}}$
    - $\frac{\text{Sales}}{\text{Land \& Building}}$
    - $\frac{\text{Sales}}{\text{Plant \& Machinery}}$
  - $\frac{\text{Sales}}{\text{Current Assets}}$
    - Stock turn-over
    - Turnover of Debtors

TABLE

Sl. No.	Ratios	LARGE (Above 200 T/D)			MEDIUM (50 to 200 T/D)			SMALL (Upto 50 T/D)		
		High	*Low*	*Average*	*High*	*Low*	*Average*	*High*	*Low*	*Average*
	Turnover Ratios :									
1.	Net Sales to Total Assets	1.57	0.24	0.95	1.57	.24	0.95	1.73	0.42	0.89
2.	Net Sales to Net Worth	7.87	0.97	2.55	2.95	.49	2.0	5.22	0.72	2.42
3.	Net Sales to Plant & Machinery	2.97	0.94	1.44	1.75	.21	1.17	4.00	0.76	2.0
4.	Cost of Goods Sold/Net Stock	3.57	0.89	2.02	2.88	.19	1.73	6.30	0.41	
5.	Cost of Goods Sold/ Average Stock	24	3	10.6	6.14	2.99	4.7	14.23	1.97	
6.	Debtors to Avg. Daily Sales	86	29	52	83	33	54	154	33	
7.	Percentage Capacity Utilization	95	53	80	100	53	82	97	40	78
	Profitability Ratios :									
1.	Gross Profit to Net Sales%	27	—3	17	30	24	27	37	1	20.2
2.	Operating Profit to Net Sales %	11	—11	3.42	19	—12	4.0	17	—19	3.8
3.	Pretax Profit to Net Sales %	20	—11	6.1	20	—11	5.0	19	—16	6.2
4.	Net Profit to Net Sales%	9	—10	2.6	7	—11	—	8	—16	1
5.	Return on Capital Employed %	16.97	—8.12	10.3	16.97	2·70	10.3	11.75	—8.72	9
6.	Net Profit to Total Assets %	10	—3	4.1	10	—3	3.7	5	—9	2