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TREND OF INTERNAL FINANCING IN INDIAN CORPORATE SECTOR: A STUDY OF CEMENT AND CEMENT PRODUCT INDUSTRY

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ABSTRACT

The paper shows the trend of Internal Financing of Cement and Cement Product Industry over the period 2003-04 to 2012-13. Here we have seen that External Financing is the major fund of Cement Industry. Moreover, we have also seen that there is a positive relationship between Internal Financing and Total Financing of Cement Industry over the period of the study. Moreover, we have also observed that Retention of earnings is the major component of Internal Financing over Depreciation over the period of the study. This paper also tries to address us that Retained earnings and Depreciation both are positively correlated with Internal Funds of Cement Industry. Due to the nature of Cement Companies i.e. heavy industry, External Financing is the major source of fund by having strong equity base or having good accession to Money and Capital Market.

KEYWORDS

internal financing, retained earnings, depreciation, total financing, cement industry.

INTRODUCTION

Internal source of finance refers to retained portion of profit which is kept invested in the business. It is also called as ploughing back of profits or self-financing. It is called internal financing because the firm relies on its internal funds for financing business. Although internal funds involve opportunity cost to the shareholders but, 'since the funds are easily accessible without making an issue, or without any special effort of justification, it is a short step to assume that internal financing is costless.' Our focus is to highlight the trend of Internal Financing of Cement and Cement Industry in India.

LITERATURE REVIEW

- **Braj Kishor (1980)** in his study on '**Corporate internal finance: A study of overall trends and retentions**', Studied on aggregate trends and retentions and determinants of corporate savings behaviour for the period 1951-52 to 1973-74. He found that average annual retentions recorded a consistently rising trend during the period 1951-52 to 1973-74. In this study retentions played an important role on expenditure incurred on assets expansion.
- **Daniel Creamer, Sergi P. Dobrovolsky, Israel Bornstein, Mertain Bernstein (1960)** in their study on '**Internal and External financing**', measured the trend of long term Internal and External financing and different components of debt & equity components of external financing of manufacturing & mining industry. In their study ratio of retained earnings to assets change showed an increasing trend in 1900-1919 to 1919 to 1929 the ratio was relatively low.
- **B.C. Purohit (1986)** in his research study on '**corporate savings behaviour- An econometric analysis**', measured that during the period 1950-51 to 1979-80 the rate of corporate savings was highest in 1978-79 i.e. 23.9% and was lowest in the year in 1952-53. This study also revealed that savings of private corporate sectors was very low compared to public and household sectors.

RESEARCH GAP

The review of literature suggests that in Indian context, so far no systematic analysis has been made on the components of internal financing, i.e. the proportion of internal funds provided mandatorily by way of statutory requirement like depreciation, reserve creation, etc. and voluntarily by retaining distributable profits.

RESEARCH QUESTION

- Does Internal Financing consume major portion of Total Financing of Cement and Cement Product Industry?
- Does Retained earnings consumes major portion of Internal Financing of Cement and Cement Product Industry?

OBJECTIVES OF THE STUDY

In this paper, we are highlighting the trend of Internal Financing along with its components over the period of the study i.e. 2003-04 to 2012-13 of Cement and Cement Product Companies listed in National Stock Exchange (NSE) of India. The objectives of the study are as below;

- To highlight the trend of Internal and External Financing to Total Financing of Cement and Cement Product Industry.
- To show the trend of the components of internal Financing to Internal Financing of Cement and Cement Product Industry.
- To highlight the relationship between Internal Financing and Total Financing of Cement and Cement Product Companies.
- To establish the association between the components of Internal Financing and Internal Financing of Cement and Cement Product Companies.

HYPOTHESES OF THE STUDY

The paper is based on some Hypotheses. These are as follows;

- H₁: There is a positive relationship between Internal Financing and Total Financing of Cement and Cement Product Industry in India.
H₂: Internal Financing and Retained earnings are positively correlated of Cement and Cement Product Industry in India.

RESEARCH METHODOLOGY

The research paper is mainly empirical in nature. We are highlighting the trend of Internal Financing of Cement and Cement Product Industry. Here we are selecting non-banking and non-financial public Ltd Companies excluding PSUs listed in National Stock Exchange (NSE) in India. The sample Companies in Cement and Cement Product Industry are ACC Cement, Ambuja Cement, Ultratech Cement and Grasim Industries Ltd. The period of the study is 2003-04 to 2012-13. The nature of the data is panel data and we have 40 observations of 4 Companies in 10 years. For the purpose of analysis, SPSS software is used. Here we have also used a Statistical technique i.e. Correlation analysis.

RESULTS AND DISCUSSION

In this paper, we have to address the following issues,

- To show the trend of Internal and External Financing to Total Financing of Cement and Cement Product Industry.
- To highlight the trend of components of Internal Financing to Internal Financing of Cement and Cement Product Industry.
- To establish the relationship between Internal Financing and Total Financing of Cement and Cement Product Industry.
- To show the relationship between the components of Internal Financing and Internal Financing of Cement and Cement Product Industry.

TO SHOW THE TREND OF INTERNAL AND EXTERNAL FINANCING TO TOTAL FINANCING OF CEMENT AND CEMENT PRODUCT INDUSTRY

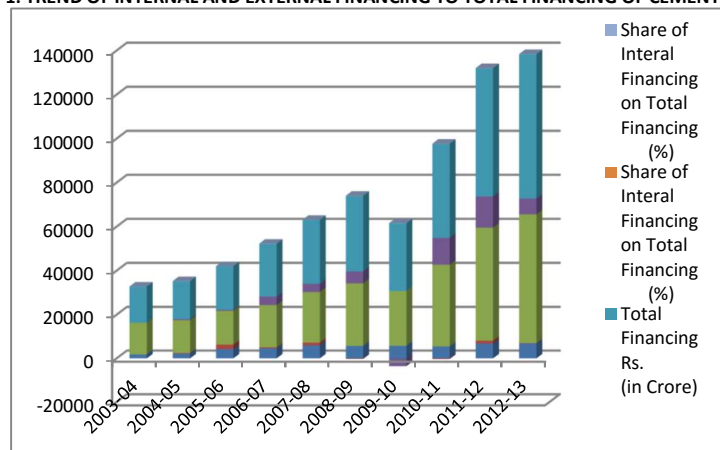
In this segment we are highlighting the trend of Self financing and External Financing to Total Funds of Cement and Cement Product Companies in Indian Corporate Sector during the period 2003-04 to 2012-13.

TABLE 1: TREND OF INTERNAL AND EXTERNAL FINANCING TO TOTAL FINANCING OF CEMENT INDUSTRY

Year	Internal Financing Rs. (in Crore)	Annual Variation Rs. (in Crore)	External Financing Rs. (in Crore)	Annual Variation Rs. (in Crore)	Total Financing Rs. (in Crore)	Share of Internal Financing on Total Financing (%)	Share of External Financing on Total Financing (%)
2003-04	1840.65	0	14537.05	0	16377.7	11.238758	88.761242
2004-05	2160.2	319.55	15045.4	508.35	17205.6	12.55215	87.444785
2005-06	4250.08	2089.88	15483.72	438.32	19733.8	21.537058	78.462942
2006-07	4667.17	417.09	19322.93	3839.21	23990.1	19.454567	80.545433
2007-08	5952.15	1284.98	23064.95	3742.02	29017.1	20.51256	79.48744
2008-09	5734.52	-217.63	28523.88	5458.93	34258.4	16.739019	83.260981
2009-10	5768.46	33.94	24991.44	-3532.44	30759.9	18.753182	81.246818
2010-11	5479.33	-289.13	37222.47	12231.03	42701.8	12.831614	87.168386
2011-12	6792.57	1313.24	51428.03	14205.56	58220.6	11.666953	88.333047
2012-13	6901.11	108.54	58617.49	7189.46	65518.6	10.533055	89.466945

Source: Annual Report of Cement and Cement Product Companies.

FIGURE 1: TREND OF INTERNAL AND EXTERNAL FINANCING TO TOTAL FINANCING OF CEMENT INDUSTRY



Trend of External and Internal Financing have been depicted in Table 1 where External Financing shows a positive trend over the period of the study except in the year of 2009-10. It signifies that Cement Industry do rely on External Financing for growth and expansion. Owing to the nature of the Industry Companies in Cement Industry are able to maintain adequate amount of External Funds for various purposes. Moreover, we have seen that External Financing is the single largest source of Total Financing over Internal Funds. The main reason behind it that Companies in Cement Industry do not earn adequate amount of profit over the period of the study and they simultaneously do not retain earnings.

TO ESTABLISH THE RELATIONSHIP BETWEEN INTERNAL FINANCING AND TOTAL FINANCING OF CEMENT INDUSTRY

Here we are showing the relationship between Internal Financing and Total Financing of Cement Companies listed in National Stock Exchange (NSE) over the period of the study.

TABLE 2: CORRELATION ANALYSIS OF INTERNAL FINANCING AND TOTAL FINANCING OF CEMENT INDUSTRY

Correlations		INTERNAL	TOTAL
INTERNAL FINANCING	Pearson Correlation	1	.813**
	Sig. (2-tailed)		.000
	N	40	40
TOTAL FINANCING	Pearson Correlation	.813**	1
	Sig. (2-tailed)	.000	
	N	40	40

** Correlation is significant at 1% level (2 tailed)

This Table shows the association between Internal Financing and Total Financing of Indian Cement Product Industry over the period 2003-04 to 2012-13. Here we have seen that Internal Financing is positively correlated with Total Funds of Cement Companies. The correlation coefficient between them is 0.813 which means they are highly positive correlated. It indicates us that for every one unit change in Total Financing, Internal Financing will move by 0.813 units.

TREND OF COMPONENTS OF INTERNAL FINANCING TO INTERNAL FINANCING OF CEMENT AND CEMENT PRODUCT INDUSTRY

There are two major components of Internal Financing i.e. i) Retained earnings and ii) Depreciation.

RETAINED EARNINGS

Retained earnings mean undistributed part of profits after payment of dividend to the Shredders. It is considered as major component of Internal Fund because over the period of the study, the Company should retain maximum amount of profits for making more profitable investment opportunities and it is involved with no cost of financing except opportunity cost to the Shareholders. It is required for corporate growth and expansion.

DEPRECIATION

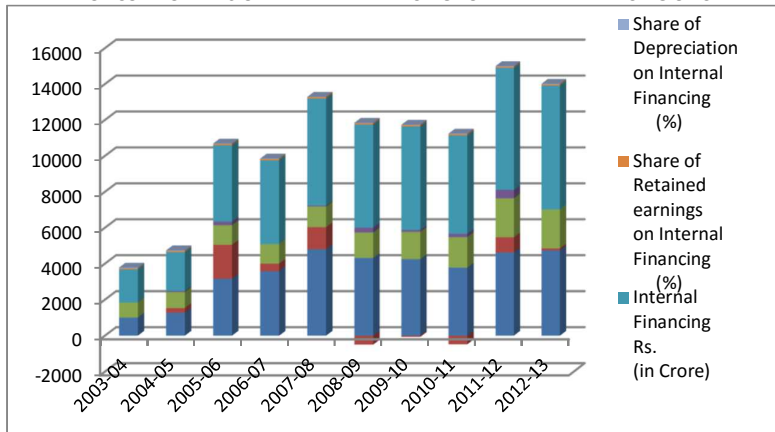
Depreciation is an allowance which is kept by the Company for supplying funds for Assets replacement. More Depreciation funds inserts more amount of investment has been made in Fixed assets over the period of the study. Some of the Experts think that Depreciation is the easy accessible component of Internal Financing over retained earnings.

TABLE 3: TREND OF COMPONENTS OF INTERNAL FINANCING OF CEMENT INDUSTRY

year	Retained earnings Rs. (in Crore)	Annual Variation Rs. (in Crore)	Depreciation Rs. (in Crore)	Annual Variation Rs. (in Crore)	Internal Financing Rs. (in Crore)	Share of Retained earnings on Internal Financing (%)	Share of Depreciation on Internal Financing (%)
2003-04	1007.61	0	833.04	0	1840.65	54.74207	45.25792519
2004-05	1271.58	263.97	888.62	55.58	2160.2	58.86399	41.13600593
2005-06	3161.68	1890.1	1088.4	199.78	4250.08	74.39107	25.60892971
2006-07	3581.24	419.56	1085.93	-2.47	4667.17	76.73258	23.26741901
2007-08	4807.71	1226.47	1144.44	58.51	5952.15	80.77266	19.22733802
2008-09	4315.47	-492.24	1419.05	274.61	5734.52	75.25425	24.7457503
2009-10	4249.37	-66.1	1519.09	100.04	5768.46	73.66559	26.33441161
2010-11	3775.86	-473.51	1703.47	184.38	5479.33	68.91098	31.08902001
2011-12	4621.71	845.85	2170.86	467.39	6792.57	68.04067	31.95933203
2012-13	4732.51	110.8	2168.6	-2.26	6901.11	68.57607	31.42393035

Source: Annual Report of Cement and Cement Product Companies.

FIGURE 2: TREND OF COMPONENTS OF INTERNAL FINANCING TO INTERNAL FINANCING OF CEMENT INDUSTRY



Trend of Components of Internal Financing have been presented in Table 25. Here we have seen that Retained earnings show an insignificant trend over the period of study. Initially it shows a positive trend and then it is negative in three years. After that it shows negative trend. The main reason as we have already discussed previous that Internal Funds of Cement Industry is not significant over the period of the study.

These Companies are not able to retain sufficient amount of profits over the period of the study because of low amount of profits over the period of the study. On the other hand, we have also seen that Depreciation shows an insignificant trend over the period of the study. It signifies that Companies belonging to Cement Industry do not investment sufficient amount in Fixed Assets over the period of the study.

In addition to the above, we have also seen that Retained earnings are the single largest components of Internal Funds over the period of the study. Retained earnings constitute approximately 54% to 68% to Internal Financing over the period of the study and it shows positive trend over the period of the study. It indicates that inspite of having low retentions over the period of the study; Companies of Cement Industry do give priority to Retained earnings over Depreciation. Moreover, we have also noticed that Depreciation only shares 45% to 31% to internal Financing of Cement Companies over the period of the study. It indicates low amount of investment in Fixed Assets over the period of the study.

TO SHOW THE RELATIONSHIP BETWEEN COMPONENTS OF INTERNAL FINANCING AND INTERNAL FINANCING OF CEMENT INDUSTRY

In this segment we are highlighting the relationship between components of Internal Financing and internal financing of Cement Industry.

TABLE 4: CORRELATION ANALYSIS BETWEEN COMPONENTS OF INTERNAL FINANCING AND INTERNAL FINANCING OF CEMENT INDUSTRY

Correlations				
		RETAINED EARNINGS	DEPRECIATION	INTERNAL FINANCING
RETAINED EARNINGS	Pearson Correlation	1	.564**	.973**
	Sig. (2-tailed)		.000	.000
	N	40	40	40
DEPRECIATION	Pearson Correlation	.564**	1	.740**
	Sig. (2-tailed)	.000		.000
	N	40	40	40
INTERNAL FINANCING	Pearson Correlation	.973**	.740**	1
	Sig. (2-tailed)	.000	.000	
	N	40	40	40

**Correlation is significant at 1% level of significance (2 tailed)

From the above table, it has been seen that both the components of Internal Financing i.e. Retained earnings and Depreciation are positively correlated with Internal Funds of Cement Industry. The correlation coefficient between Internal Financing and Retain earnings is 0.973 which signifies that there is highly positive correlation between Internal Financing and Retained earnings of Cement Industry.

On the other hand, we have seen that the correlation coefficient between Internal Financing and Depreciation is 0.740 which means that there is also highly positive relationship between Internal Financing and Depreciation of Cement Industry over the period of the study.

FINDINGS

We have seen from the study that due to the nature of Cement Industry, External Financing is the major finance over Internal Financing. Most of the Companies either are large or old Company. So they have very good access to money and capital market. So the Cement Companies are able to procure finance with huge cost of financing.

Next we have found that out of the two major components, retained earnings share more to Internal Financing over Depreciation. This is due to the fact that Cement Companies are capable enough to retain sufficient amount of profits over the period of the study for making more profitable investment opportunities.

RESULT OF HYPOTHESES

H₁ states that there is a positive relationship between Internal Financing and Total Financing of Cement and Cement Product Industry in India. Table 2 states that correlation coefficient between Internal Financing and Total Financing is 0.813 which is significant at 1% level of significance. So we can reject null hypothesis and accepts alternative hypothesis which denotes that there is a positive relationship between Internal Financing and Total Financing of Cement and Cement Product Companies.

H₂ states that Internal Financing and Retained earnings are positively correlated of Cement and Cement Product Industry. Table 4 depicts that correlation coefficient between Retained earnings and Internal Financing is 0.973 which is significant at 1% level of significance. So we can reject null hypothesis and accepts alternative hypothesis which denotes that Internal Financing and Retained earnings are positively correlated of Cement and Cement Product Companies.

RESULT OF RESEARCH QUESTION

Does Internal Financing consume major portion of Total Financing of Cement and Cement Product Industry? The Answer is that Internal Financing of Cement Industry does not consume major portion of Total Financing. Table 1 depicts that External Financing consumes major funds of Total Financing.

Does Retained earnings consumes major portion of Internal Financing of Cement and Cement Product Industry? The answer is that Retained earnings consume major fund of Internal Financing of Cement Industry. Table 3 and 4 depicts that Retained earnings is the major component of Internal Financing of Cement Industry.

CONCLUSIONS & SUGGESTIONS

So we can conclude from the study that External Financing is the major source of fund in Cement Industry. This is quite obvious because the Industry has strong capital base. So the Companies in Cement Industry should issue more share capital and retain adequate amount of profits over the period of the study. The Cement industry should maintain the volume of Internal Financing over the period of the study for making corporate growth and expansion and modernization needs.

The Cement Companies in India must procure adequate amount of Depreciation fund over the period of the study for Assets replacement and making more investment in Fixed Assets.

LIMITATION OF THE STUDY

Our study is completely based on secondary data collected from the Annual report of the respective Companies. So data of some year may be unavailable.

SCOPE FOR FURTHER RESEARCH

Internal Financing is a burning issue in Today's world for corporate sector. This study can be extended to the following areas:

- Determinants of Internal Financing in Indian Corporate Sector.
- Trend of Internal Financing of non-banking and non-finance public limited Companies listed in Bombay Stock Exchange (BSE)
- Role of Internal Financing in expansion of the Company.

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