Financial outlook of spinning industry of pakistan

Business, Industries

Spinning industry of Pakistan is one of the oldest and well organized manufacturing industries of Pakistan. At the time of Partition, there were two big mills in Pakistan. However, in 2009, there are more than 450 spinning mills and nearly 12 million spindles are installed in Pakistan. These mills are providing yarn to local industry and have a significant share in international yarn trade. Furthermore, this sector has contributed a lot for the promotion of textileeducationand training in Pakistan.

Government of Pakistan imposed education tax on the mills for National Textile University, formally National College of Textile Engineering Faisal Abad. In addition, All Pakistan Textile Mills Association (APTMA) made a generous contribution to establish Textile Institute Pakistan in Karachi (APTMA 2008). Spinning industry is capital intensive in nature and needs a huge investment to put a mill into function. Furthermore, there is a need of continuous support of banks for the regular supply of fibers. APTMA annul report of 2008 depicts that spinning industry is in crises.

Nearly 20% mills have been closed down their functions and are facing crises. It is a serious matter since this sector is one of the sectors who have a significant share in employment, GDP and capitalization. If something happens wrong with this sector, it would be absurd for the economy of Pakistan. Financial Ratios and Spinning Mills of Pakistan One can have a deep idea about the future of firms from its financial ratios. These ratios are derived from the financial statements provided by the firms. This report is an effort to have an idea about the current problems and financialhealthof the mills.

Considering these ratios, one can develop an idea about the future of this sector. We did not find any combined report on the financial position of mills. This is an effort to give a comprehensive view of this sector. Significance and Implication of Financial Ratios: A Literature Review Financial Ratios are derived from financial reports of the firms. There is certain objectivity behind calculating the ratios. These ratios indicate financial health and strength of the firms. There is a long list of financial ratios. Sometimes, such long list can create some sort of confusion.

The user needs to array all available ratios and then has to group them under various heads. Such exercise can help user to earmark the useful ratios (Gombola and Edward, 1983). There is a logical connectivity among these groups since they are derived from the same source. Classification and selection of useful ratios depends upon the objectives as well as the business dynamics. This classification is based on the natural and instinct nature of the ratios. Chen and Shimerda (1981) have discussed the significance of financial ratios in evaluating the performance and financial position of the firms.

They concluded that such ratios also helped people to predict the bankruptcy of firms up to 90%. It shows that ratios demonstrate picture of the firm and one can anticipate the future of the firms. Rapid changes in business has forced business world to develop functional and practical financial ratios of the organization. There are many usages of these ratio but primarily these ratios are used for prediction purpose (Gupta and Huffier 1972). Beaver

(1966) points out that ratio analysis is in use since the beginning of the nineteenth century and initially current ratio was common.

This ratio was used primarily for the evaluation of creditworthiness. However by the end of the century there are numerous ratios commonly under use. Beaver further states that useful of ratios is mainly linked with the objectivity if the study. Ratios are widely used in real business world and people rely on these ratios. These ratios are quite important for investor, lenders etc. On the other hand, academicworld is moving away from this traditional concept and demands to develop a multivariate discriminatory model. Particularly, to predict the bankruptcy.

Altman (1968) writing about this idea developed a model which has given 95 % accurate results. Above debate is quite valid and needs a serious discussion. This debate reveals that there is a serious difference of opinion between academic world and real business world. Nevertheless, one thing is common that both agree that the ratios are quite useful for the prediction of future. The main difference is how one uses these ratios. This paper is an effort to assess the current financial health of a sector, which is very much important for the economy of Pakistan.

We prefer to apply traditional method to measure financial ratios. However we believe that for prediction of solvency, such limited knowledge is quite meager and needs in depth information to have a reliable result. There are certain issues while selecting and comparing the ratios. Literature is full of such discussions that selection of ratios needs a careful consideration keeping in mind the objectivity of the study. Chen and Shimerda (1981)

discussed the issue regarding selection of useful ratios. They have tried to help people in selecting the useful by analyzing the empirical studies.

Their conclusion tells that there is no constant and set rule which may be useful in selecting the ratios. In our view such selection is of subjective nature and biased towards the nature and objectivity of the researchers. Financial ratios are derived for certain application. There is an emerging trend in transforming these ratios into a meaningful predicting model by using advance statistical techniques. Application of statistical techniques are providing useful results but accuracy and usefulness of these results are under question (Deakin 1976).

Application of statistical techniques depends upon some assumptions. As described by Deakin, it is not possible in all cases that such techniques can be used to predict the future of the firms. Statistics in its nature relies on the assumptions and it provides the probability of the outcome. Keeping this limitation Deakin does not support to use advance statistical tools rather prefers traditional use of ratios to assess financial health of the firms. Gupta and Huffier elaborate two main problems related to study of the ratios when these are used at macro level or for a cluster.

One is related to data validity and second selection of standards which can be used as benchmark. Without having any standard it would be highly difficult to comment on the number derived through financial analysis. Furthermore, current nature of business world requires to develop standards on a continuous basis to accommodate the rapid changes. We believe that there is also a third problem associated with these ratios and that is the

acceptability of these standards. It is not like the measuring unit of a length or volume which is acceptable throughout the world.