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A cost structure analysis of Lakshmi machine works (LTD)

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Abstract

This study investigates the importance of cost structure for the manufacturing company. The study has been conducted on the basis of secondary data of Lakshmi Machine works Ltd for a period between 2012 to 2016. The cost structure analysis helps to take an in-depth look at how a firm's cost structure affect its optimal quantity of goods. To assess the firm's cost structure, tools like overall cost structure analysis are used. The improvised tools enables the firm to be analysed in the view of cost and performance. The fund flow is used to analyse the reasons for the changes in the financial position of a company. It shows the inflow (source) and outflow (application) of the firm. The application of financial tools like fund flow, cost structure helps to measure the company's performance and to take decisions based on the company's cost of capital.

Keywords: Financial performance, cost structure, inflow, outflow

Introduction

Costing is a process of determining the cost of production of any product or service. The technique of costing consists of principles and rules for ascertaining the costs of products and services. Financial performance is a subjective measure of how well a firm can use assets from its primary mode of business and generate revenues. This term is also used as general measure of firms overall financial health over a given period of time and can be used to compare similar firms across the same industry or to compare industries or sectors in aggregation. Value creation is the primary aim of any business entity creating value for customers helps sell products and services, while creating value for shareholders in the form of increases in stock price, it shows the future availability of investment capital to fund operations. From a financial perspective, value is said to be created when business earns revenue that exceeds expenses. It is increasingly being recognized as a better management goal than strict financial measures of performance, many of which tend to place cost-cutting that produces short term results ahead of investments that enhance longterm competitiveness and growth.

Statement of the problem

The financial success of every firm mainly depends on its performance and the cost structure. This leads the company to earn stable profit and high earnings to the shareholders. The shareholders are the building blocks of a company. For the purpose of creating value to the shareholders, the company has to undertake some measures. This leads to wealth maximization of the shareholders. On the other hand, its value depends on strategic decisions made by senior management, including the ability to make wise investment and generate a healthy return on invested capital. The potential drawback of the movement of corporations is that it can lead to poor or unsustainable business practices. Therefore there must be a proper mix of utilization of funds in building value for the ultimate shareholders.

Review of Literature

To analyze the financial feasibility of Lakshmi Mills Ltd., Nirmala and Remya Cheriyan (2015) ^[1] have conducted a study based on secondary data collected for the period of five years from 2009-10 to 2013-14 of Lakshmi Mills Ltd., with the objectives to determine the financial feasibility. Ratios and leverage have been used to analyze the data.

The results of the study highlighted the profitability and financial position, efficiency in asset and fund utilization of the selected company. It has been found that the company's profitability and activity satisfies, whereas, the liquidity position has not satisfied due to improper management. It has been concluded that the poor management causes for poor liquidity position of the company. It has been suggested that the company has to focus on developing the strategies relating to liquidity.

Babatolu Ayorinde Tobi, Aigienohuwa Osarenren Osasreve and Adewumi Ademola Adeniran (2015) [2] has undertaken a study "An Analysis on Cost Techniques and Pricing Decisions of Manufacturing companies in Ogun State" for the period 2007-2010. The population of analysis comprised of 98 manufacturing companies with the sample size of 22 selected manufacturing companies using convenient sampling technique. The data analysis techniques used for the study were Kolmogorov Simonov Test and Kruskal Wallis Test through the aid of statistical package for social science. The findings of the study revealed that there were no significant difference in the use of activity based costing technique for pricing decision and there was a significant difference in the use of target costing technique for pricing decision. The study has been concluded that there was a strong consensus on the wide use of activity based costing and target costing for pricing decision.

Objectives

- To analyze the cost structure of Lakshmi Machine Works Ltd.,
- To assess the effective utilization of funds in Lakshmi Machine Works Ltd.,

Research Tools

The study consists the period of 5 years from 2012-2016. The study is based on secondary data, it have been collected from various websites, articles, publications, journals, books and annual reports of the company.

Data Analysis and Interpretation

Raw Material Cost Analysis

Raw materials are those materials which can be identified in the product and can be conveniently measured and directly charged to the product.

Table 1: Percentage of raw material consumed to cost of sales (Rs. in crores)

| Year | Raw Material Consumed | Cost of Sales | Percentage (%) |
|---------|-----------------------|---------------|----------------|
| 2011-12 | 1305.11 | 1686.69 | 77.38 |
| 2012-13 | 1201.50 | 1556.58 | 77.19 |
| 2013-14 | 1421.63 | 1825.00 | 77.90 |
| 2014-15 | 1476.11 | 1895.50 | 77.87 |
| 2015-16 | 1529.82 | 1971.11 | 77.61 |
| Average | 1386.83 | 1786.996 | 77.61 |

Source: www.ndtvprofit.com

The raw material consumed is high in the year 2013-14 and low in the year 2012-13. This depicts the usage of raw material in the production process of final product. The analysis has made out the percentage of raw material consumed which was 77.61% to the total cost of sales which shows the increased production and profitability position.

Direct Labour Cost Analysis

Direct labour can be identified or attributed wholly to a particular job, product or process or expended in converting raw materials into finished goods. The cost of direct labour is a part of wage bill or payroll that can be specifically and consistently assigned to or associated with the manufacture of a product, a particular work order, or a provision of a service.

Table 2: Percentage of Direct labour to Cost of sales (Rs.in crores)

| Year | Direct Labour Cost | Cost of Sales | Percentage (%) |
|---------|--------------------|---------------|----------------|
| 2011-12 | 173.50 | 1686.69 | 10.29 |
| 2012-13 | 179.57 | 1556.58 | 11.54 |
| 2013-14 | 226.92 | 1825.00 | 12.43 |
| 2014-15 | 227.73 | 1895.6 | 12.01 |
| 2015-16 | 240.09 | 1971.11 | 12.18 |
| Average | 209.56 | 1786.996 | 11.73 |

Source: www.ndtvprofit.com

The direct labour cost analysis experience an increasing trend over the years from 2012 to 2016. This increase depicts the involvement of direct labour more in numbers as compared to previous years towards production.

Factory Overheads Cost Analysis

Factory overheads indicate the indirect material cost, indirect wages, indirect labour and indirect expenses.

Table 3: Percentage of factory overheads to cost of sales (Rs.in crores)

| Year | Factory Overhead Cost | Cost of Sales | Percentage (%) |
|---------|-----------------------|---------------|----------------|
| 2011-12 | 215.96 | 1686.69 | 12.80 |
| 2012-13 | 239.8 | 1556.58 | 15.40 |
| 2013-14 | 225.61 | 1825.00 | 12.36 |
| 2014-15 | 226.62 | 1895.60 | 11.96 |
| 2015-16 | 269.75 | 1971.11 | 13.68 |
| Average | 235.55 | 1786.99 | 13.18 |

Source: www.ndtvprofit.com

The factory overhead analysis shows a fluctuating trend from 12.80 in 2012 to 13.68 in 2016. The factory overhead also pertains to the quality assurance costs insurance premium regarding property. Therefore, the company has expended for the quality of the product and its reasonable assurance.

Administration Overheads Cost Analysis

Administration overhead is the indirect expenditure incurred in formulating the policy, directing the organization, controlling and managing the operations of an undertaking which is not related directly to a research, development, production or selling activity or function.

Table 4: Percentage of administration overheads to cost of sales (Rs.in crores)

| Year | Administration Overheads Cost | Cost of Sales | Percentage (%) |
|---------|-------------------------------|---------------|----------------|
| 2011-12 | 35.31 | 1286.69 | 2.09 |
| 2012-13 | 40.86 | 1556.58 | 2.62 |
| 2013-14 | 42.55 | 1825.00 | 2.33 |
| 2014-15 | 46.11 | 1895.0 | 2.43 |
| 2015-16 | 5.57 | 1971.11 | 0.28 |
| Average | 34.08 | 1786.99 | 1.90 |

Source: www.ndtvprofit.com

The administration overhead analysis has experienced decreasing trend over years from 2012 to 2016. The company reduced its administrative expenses regarding cost of sales and its contribution towards office expenses.

Selling Overheads Cost Analysis

Selling overheads is the cost of seeking to create and stimulate demand and recurring orders for the articles or commodities dealt in with marketing and selling activities.

Table 5: Percentage of selling overheads to cost of sales (Rs.in crores)

| Year | Selling Overheads Cost | Cost of Sales | Percentage (%) |
|---------|------------------------|---------------|----------------|
| 2011-12 | 82.77 | 1686.69 | 4.91 |
| 2012-13 | 79.11 | 1556.58 | 5.08 |
| 2013-14 | 92.95 | 1825.00 | 5.09 |
| 2014-15 | 111.20 | 1895.50 | 5.87 |
| 2015-16 | 102.15 | 1971.11 | 5.18 |
| Average | 93.64 | 1786.99 | 5.24 |

Source: www.ndtvprofit.com

The selling overhead analysis shows a fluctuating trend from 2012 to 2016. The selling overhead amounts to salaries of sales personnel, advertising costs etc, which is pertaining to sales. In the given case, the company in average expended about 5.24% in the total cost of sales for the marketing of the product.

Table 7: Fund flow statement of LMW LTD for the years 2012-2016

| Particulars | 2012 | 2013 | 2014 | 2015 | 2016 |
|--|---------|---------|---------|---------|---------|
| Net profit | 769.48 | 806.98 | 884.65 | 1025.87 | 1156.07 |
| Add:Non-fund and non-operating items debited to P&L Depreciation | 113.95 | 117.72 | 102.51 | 96.50 | 82.89 |
| Discount on issue of shares | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Appropriation To general reserve | 886.45 | 923.01 | 1083.91 | 1233.32 | 1375.98 |
| To contingency | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Sinking fund | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Provision for taxation | 86.38 | 53.21 | 76.93 | 80.55 | 108.30 |
| Provision for proposed dividend | 500 | 200 | 300 | 375 | 400 |
| Loss on sale of fixed assets | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Less:Non-fund and non-operating items | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Appreciation on value of revaluation of fixed assets | 84.51 | 78.72 | 115.48 | 106.33 | 98.37 |
| Dividend / interest received | 6.44 | 1.18 | 1.62 | 1.61 | 0.87 |
| Profit on redemption of shares & debentures | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Excess provisions written back | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Other non-trading items | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Net profit (or) retained earnings (opening bal) | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| FUNDS FROM OPERATIONS | 2265.31 | 2021.02 | 2330.70 | 2703.30 | 3024.00 |

Source: www.ndtvprofit.com

The flow of funds has shown an increasing trend over the years. It is lower in the year 2012 and it gets further decreased to 2013 and it gradually increases towards 2016. This trend shows a favorable position towards the investment of funds in the working capital. This flow or change pertains to the company’s profitability and enable creditors to have a confident on the firm.

Findings and Suggestions

- Cost structure analysis of LMW Ltd.,shows the contribution of various costs incurred in respect of cost of sales.
- Raw material cost analysis shows a fluctuating trend. It is high in the year 2013-14 and low in the year 2012-13.

Overall Cost Structure Analysis

Table 6: Average percentage of the elements of cost to cost of sales

| Particulars | Average Percentage (%) |
|--------------------------|------------------------|
| Raw material | 77.61 |
| Direct labour | 11.73 |
| Factory overheads | 13.18 |
| Administration overheads | 1.90 |
| Selling overheads | 5.24 |

Source: www.ndtvprofit.com

The above table shows the average percentage of the elements of cost. It is clear that the major cost incurred has been for raw materials. Direct expenses are incurred majorly showing a favourable condition of the company as its nature of business is manufacturing basically. It is also noted that selling and distribution expenses are comparatively higher showing that LMW has incurred expenses for moving its products for the market. Administration overhead are reasonable compared to their volume of business.

Fundflow Statement Analysis

Fund flow statement is a statement prepared to analyze the reasons for changes in the financial position of a company between two balance sheets. It shows the inflow and outflow of funds i.e. sources and applications of funds for a particular period.

This shows the usage of raw materials in the production process of final product.

- The raw material should be consistently supplied for the increased production
- Direct Labor cost analysis and factory overhead cost analysis shows a fluctuating trend over the years. Direct labor cost is high in the year 2013-14 and low in the year 2011-12. Factory overhead cost is high in the year 2014-15 and low in the year 2012-2013.
- The Direct labor cost increase depicts that the company has incurred cost towards employee benefits like training costs, staff welfare expenses etc. Factory overhead costs pertains to the quality assurance costs, insurance premium.

- The Company is in encouraging position regarding direct labor and factory overheads which increases the quality of the product.
- Administration overhead costs show a decreasing trend. It is high in the year 2012-13 and low in the year 2015-16. This shows that the company has reduced its office expenses.
- This is a good move for the company which decreases its office expenses and concentrates more towards raw materials and direct labor.
- Selling overhead shows a fluctuating trend over the years. It is high in the year 2014-15 and low in the year 2011-12. This depicts that the company incurs cost towards selling and distribution expenses for the promotion of the product.
- The company shall focus more towards selling and distribution expenses and overall the administration costs should be reduced and raw material, direct labour and selling overheads shall be increased.
- Fund flow statement shows an increasing trend from 2011-12 to 2015-16. This depicts a favorable position towards investment of funds in the working capital.

Conclusion

The study is aimed to analyse the cost structure of “Lakshmi Machine Works Ltd.”, for the period of 2012-2016. It has concluded that cost structure analysis reveals that the financial performance of the company is good. The overall cost incurred by the company shows a favorable condition. The flow of funds pertains to the company’s profitability and enables creditors to have a confident on the firm. Thus, the suggestions made in this study are taken into consideration for developing an array of survival and growth strategies in the context of highly competitive domestic and international business environment, we hope the company will be able to improve its financial performance and achieve the turnover earlier than expected.

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