Determinants of Retained Earnings in Profitable Textile Companies in India: A Study of Textile Sector

Dr. Sohaib Masood

Assistant Professor

Secretarial Practice Section, University Women's Polytechnic

Aligarh Muslim University.

Abstract

In this paper an attempt has been made to identify the important determinants of retained earnings in profitable textile companies in textile sector of India and which have impact on the retention of earnings of textile companies under study. Multiple linear regression is used to identify the determinants of retained earnings for a period of sixteen years. Also the importance of retained earnings as a source of finance for textile sector companies is also studied in the paper.

Key words: Retained Earnings, PAT, DP, RES, CR, DER, INVS, INV.

Introduction

Retained earnings refer to that part of corporate's net profit after tax which is not distributed to the shareholders as dividend but is reinvested in the business. Retained earnings therefore, are the sum of a company's profits after dividend payments, since the company's inception. They are also called earned surplus, retained capital or accumulated earnings. Retained earnings are an important source of internal or self-financing by a company. The savings generated internally by a company in the form of retained earnings are ploughed back into the company for diversification of its business. Retention of earnings by companies reduces their dependence on funds from external sources in order to finance their regular business needs.

The need for retained earnings arises for the purpose of replacement of old assets which have become obsolete, for expansion of growth and business, for contributing towards the fixed as well as working capital needs of companies, for improving working efficiency of plants and equipment's, to make companies self-dependent of finance from external sources, for redemption of loans and debentures.

Retained earnings is favorable for companies as issuing of new capital is inconvenient as well as involve floatation costs also if company raises debt, the financial obligation and risk will increase. Retained earnings not only give rise to growth in the value of the firm but also appreciate the value of its shares.

Literature Review

The review of studies which studied the subject matter of retained earnings is presented under this heading.

Rao (1977) analysed the financing practices of corporate sector from 1972 – 1975 using RBI statistics. His analysis showed that corporate gross saving was diverted to investment in fixed assets and a part of internal savings was used to finance inventory holdings.

Divatia and Shanker (1979) examined the capital formation and it's financing by the public and private limited companies. The result of their study revealed that internal sources played a dominant role in financing of capital formation for the period in between 1962 to 1976.

Rao and Vivekananda (1980) covered the period from 1950-51 to 1962-63, 1960-61 to 1970-71 and 1970-71 to 1974-75 to study the determinant of corporate savings. Their study was based on the aggregate manufacturing sector data of Reserve Bank of India. They concluded that the most important determinant of corporate savings was corporate income. In addition, they found that savings were positively related to investment demand and liquidity position.

Myers and Majluf (1984) concluded that investment decisions made by managers were subject to the pecking order of financing choices available. Managers preferred retained earnings to debt and debt to equity floatation to finance the available projects.

Mayer (1990) in his study found that two third on the average of investment financing in developed countries like USA, UK, Japan, Germany, France, Italy, Canada and Finland are mobilized through internal financing.

Donaldson (1961) in his study viewed and established the importance of retained earnings as the funds over which management has complete and independent control.

Mittal (1992) examined the determinants of retained earnings covering a period of ten years (1980 -1990) and the sample size consisted of 23 large textile public companies of the public sector. The study concluded that retained earnings decision was a residual one this was because of the variation in dividends payments which was very low in comparison to the variations in retained earnings in large sized textile companies. Current ratio had the most significant effect on retention ratio whereas debt equity ratio and corporate tax rate had a depressing effect on retention ratio. The desire to hold more inventories and to avoid interest burden not significantly induced the managements to retain more profits.

Karak (1993) concluded that management in India, as a rule has recently followed conservative policies with regard to dividends. There was an increasing tendency on their part to finance the expansion out of internal resources as far as possible.

Athey and Laumas (1994) examined the importance of accelerator, internal funds and depreciation for investment by manufacturing firms in India covering a period from 1978 to 1986. Results of the study indicated that internal funds and depreciation had a significant explanatory power in a sales accelerator model of investment and that there existed heterogeneity among firms in the link between internal funds and investment. In particular internal funds were relatively more important for large firms and firms that produced luxury goods.

Bartram (2000) found that the availability of internal funds or retained earnings guarantee the realization of profitable investment projects and at the same time avoid higher capital cost.

Kumar (2001) examined the financing pattern in India for the period from 1956 to 1999 using RBI statistics, results of his study showed that internal funds were the major source of funds in the 1950s.

Salvary (2004) attempted to determine whether allocation of regional financial capital flow was efficient as suggested by the neo classical model, specifically the study attempted to ascertain whether the corporate retained earnings model was a good predictor of the regional flow of financial capital. The results of the study suggested that the corporate retained earnings model had an impact on the predictive ability of the neo classical model, that is regional flows of financial capital were influenced in part by corporate retained earnings.

Saggar S (2005) analyzed the financing and investment pattern of non-financial, non-government, public limited firms over the period 1971-72 to 1999-2000 of majority industry groups. On the source side, the financing pattern of Indian firms was found to be debt based but their share of internal sources increased markedly in the latter half of the 1990s which had an impact on share prices.

RBI (Reserve Bank of India, 2005) study observed that the corporate sector in India has mobilised a large share of resources from internal sources which accounted for 60.7% during 2000-01 to 2004-05.

Mahakud (2005) analyzed the trends and the determinants of retained earnings. For trends in the retained earnings, the study was conducted on public limited companies, private limited companies and foreign companies in India during the period 1966-67 to 2001-02. The determinants of corporate retained earnings were studied using panel data pertaining to 500 companies listed in S&P CNX 500 index for the period1996-97 to 2003-04. Results of the study found that the corporate retained earnings in India were not increased much and remained at a low level throughout the period of study. As regards the determinants of retained earnings it was concluded that profit after tax, investment opportunities, availability of external funds, cost of borrowings, dividend policy and the shareholding patterns had been the major determinants of retained earnings.

Kaushik (2007) examined the factors that acted as determinants of retained earnings with a comparative study of domestic and multinational companies. Sample size consisted of 100 companies (50 domestic and 50 MNCs); the study covered a period of 15 years i.e. from 1990 to 2004. The study concluded that there existed a

significant difference between domestic and multinational companies with regard to the manner in which retained earnings were managed and also the factors that determined retained earnings.

Salvary (2007) studied the problem of under investment, risk management and corporate earnings retention for a period from 1983 to 1990 consisting of 45 firms for purpose of study. Study concluded that risk management was viewed as the management of firm's operations activities and financing practices to produce a portfolio of risks which resulted in average pay off. The two most common forms of risk mitigation i.e. insurance and hedging does not addressed the under investment problem, corporate earnings retention by means of dividend policy provided a firm with an important means of risk mitigation.

Kamat (2008) investigated the trends in dividends across 20 industries to know how the private corporate sector of India appropriated its profits over period from 1961 to 2007. He also examined whether internal funds were a significant source of finance and the dynamics of relation between dividends relative to earnings across type of companies and industries. Results of the study showed that Indian corporate sector paid relatively more dividends, the paying of cash dividends decreased with shareholder concentration and regulated companies paid relatively larger dividends, dividend payouts for all type of companies declined after liberalization period thus, indicating a greater choice of internal financing by means of retained earnings.

Seppa (2008) showed that Estonian non-financial companies followed pecking order theory of financial hierarchy while making capital structure choices as they preferred internal funds to external funds. The results provided no or very weak supports that the tradeoff theory was followed in the long run.

Beena P L (2011) analysed the sources of financing pattern Indian private corporate sector for the period from 1999 to 2009. Result of the study found an increasing trend in internal finance since year 2000 and retained earnings contributed a major share of finance during the period of study.

As far as review of earlier studies on determinants of retained earnings, it is seen that a very few studies attempted to identify the determinants of retained earnings in India.

Research Methodology

This part explains the scope, objectives, period of study, sample size, database, statistical tool, and development and testing of hypotheses for the study.

Scope: The paper aims to identify the determinants of retained earnings in profitable textile companies of textile sector in India for a time period of sixteen years i.e. 1995-96 – 2010-11.

Objectives

The paper aims is to meet the following objectives:

1. To identify the determinants of retained earnings in profitable textile companies of textile sector in India.

2. To study the importance of retained earnings as a source of finance for textile companies.

Source of Data

The paper is based on the secondary data collected from the CMIE (Center for Monitoring of Indian Economy) Prowess Database.

Sample Selection and Period of Study

The sample size consists of 24 profitable textile companies. The period of study ranges from 1995-96 to 2010-11, i.e. a period of 16 years. The technique of selecting the sample of number of companies for selected textile sector companies is judgmental sampling. The number of sample companies in is given below as obtained from the CMIE Prowess database.

List of Sample Companies in Selected Sector

Sr. No.	Sector	No. of Companies
1-	Textile	24
Total		**24**

The number of sample companies selected for textile sector is based on the following criteria.

a) The necessary financial data required for study is available throughout the period of study i.e. from 1995-96 to 2010-11.

b) The number of sample companies selected for textile sectors are profitable during the period of study.

c) The companies are listed on BSE (Bombay Stock Exchange).

d) The data required for study is available with the CMIE Prowess database (Centre for Monitoring of Indian Economy).

Technique of Data Analysis

The data collected relating to the sample textile companies for cement sector is analyzed using the statistical technique of multiple linear regression using SPSS version 19 (Statistical Package of Social Sciences). The technique of multiple linear regression has been applied primarily to minimize the problem of multi collinearity. This technique of multivariate analysis is used because it is the most appropriate tool for evaluating the individual and combined effect of a set of independent variables on dependent variable.

The significance of the coefficient of various explanatory variables is tested at 99% and 95% level of significance by computing beta (β) and t values.

Variables of the Study

A large number of variables, such as profit after tax, reserves, investments, depreciation etc affects or impacts the retained earnings of companies or retention of their earnings. All the possible variables that are believed to impact retained earnings have been incorporated in the model. Retained Earnings (RE) has been considered as the dependent variable and assuming a linear relationship, the following variables have been identified as independent variables. To be specific, the following have been considered as independent variable for the present paper.

- **Profit after Tax (PAT):** Profit after Tax is the net profit earned by the companies after deducting all expenses like interest, depreciation, taxes. It is the PAT that is divided between dividend and retained earnings.

- **Dividend Paid (DP):** Dividend is the portion of the profit after tax which is distributed to the shareholders .Dividend payment though increases the market price of share of companies but payment of dividends reduces the amount of after tax profits from which the companies can retain earnings.

- **Reserves (RES):** Creation of reserves enables companies to overcome difficult financial periods in future as such, they retain from profits to have adequate level of reserves to meet different financial obligations. Reserves of the organization also have an effect on the retention policy.

- **Current Ratio (CR):** Current ratio is the ratio of current assets to current liabilities, this ratio denotes how much liquid or liquidity companies have to meet their financial obligations within short period of time usually one year.

- **Debt Equity Ratio (DER):** Debt Equity Ratio is worked out to ascertain the soundness of the long term financial policies of the companies. Debt is considered to be a cheap source of finance as tax liability goes down with the payment of interest. In order to take full advantage of tax shield, the equity base needs to be strengthened by retaining the profits.

- **Investment (INVS):** Investments by companies also affect the retained earnings decision of companies and companies with high increase in investment in fixed assets in the current year are likely to retain more.

- **Inventory (INV):** Inventory consists of raw materials, finished goods, etc. To maintain sufficient level of inventories company's needs funds as such retained earnings of companies is internal and cheap source of funds which can be used in maintaining an adequate level of inventories for companies.

Thus, the general model that has been considered for determination of relative role of each independent variable is:

$$RE = PAT + DP + RF + CR + DER + INVS + INV$$

This model has been run using multiple linear regression in SPSS Version 19 (Statistical Package for Social Sciences).

Formation and Testing of Hypotheses

As the objective is to identify the determinants of retained earnings for selected textile sector companies as such, a total of seven(7) hypotheses have been framed and tested. In order to identify the determinants of retained earnings, the hypotheses have been framed on the basis of impact of independent variables on dependent variable i.e. retained earnings. The second objective of the paper which aims at studying the importance of retained earnings as source of finance for textile sector companies has been answered on the basis of review of literature of earlier previous studies carried out.

The hypotheses developed for textile sector companies are as follows.

H0 1(T): There is no significant impact of profit after tax (PAT) on retained earnings (RE) of textile sector companies.

HA 1(T): There is a significant impact of profit after tax (PAT) on retained earnings (RE) of textile sector companies.

H0 2(T): There is no significant impact of dividend paid (DP) on retained earnings (RE) of textile sector companies.

HA 2(T): There is a significant impact of dividend paid (DP) on retained earnings (RE) of textile sector companies.

H0 3(T): There is no significant impact of reserves (RES) on retained earnings (RE) of textile sector companies.

HA 3(T): There is a significant impact of reserves (RES) on retained earnings (RE) of textile sector companies.

H0 4(T): There is no significant impact of current ratio (CR) on retained earnings (RE) of textile sector companies.

HA 4(T): There is a significant impact of current ratio (CR) on retained earnings (RE) of textile sector companies.

H0 5(T): There is no significant impact of debt equity ratio (DER) on retained earnings (RE) of textile sector companies.

HA 5(T): There is a significant impact of debt equity ratio (DER) on retained earnings (RE) of textile sector companies.

H0 6(T): There is no significant impact of investment (INVS) on retained earnings (RE) of textile sector companies.

HA6 (T): There is a significant impact of investment (INVS) on retained earnings (RE) of textile sector companies.

H0 7(T): There is no significant impact of inventory (INV) on retained earnings (RE) of textile sector companies.

HA 7(T): There is a significant impact of inventory (INV) on retained earnings (RE) of textile sector companies.

Profile of Textile Industry

The textile industry plays very important role in Indian economy. It is one the leading textile industries in the world. Though it was predominantly unorganized industry a few years back but the scenario started changing after the economic liberalization of Indian economy. The opening up of the economy gave the much needed thrust to the Indian textile sector.

The textile sector in India contributes about 14 percent to industrial production, it contributes 4 percent to the country's gross domestic product (GDP) and 17 percent to the country's export earnings. Indian textile industry largely depends upon the textile manufacturing and export. India earns about 35 percent of its total foreign exchange through textile exports.

The textile sector in India continues to be the second largest employment generating sector. Textile sector provides direct employment to 35 million people including substantial segments of weaker sections of the society with a very low important intensity of about 1.5 percent only. The Indian textile industry comprises of different segments which are cotton textiles, silk textiles, woolen textiles, handlooms, jute textiles and man made fibres.

Cotton is predominant fabric used in the Indian textile industry. Nearly 60 percent of the overall consumption in textile and more then 75 percent production in spinning mills are of cotton. India is one of the world's largest producer of cotton with nearly nine hectares million under cultivation and an annual crop of around 3 million tones.

Wool industry in India is primarily located in northern states of Punjab, Haryana, and Rajasthan, these states account for more than 75 percent of production capacity with both licensed and decentralized players. There are more then 700 registered units in this sector provide employment to approximately 1.2 million people. The large players in this sector have made significant in roads into the world markets.

Indian silk industry is the second largest producer of silk in the world contributing about 18 percent to global production. The value of silk produced in India is about over US$ 1.78 billion. India also exported over US$ 190 million of silk goods and over US$357 million of silk yarns, fabrics and made up growing demand for traditional silk fabrics and export of handloom products have spurred growth in the silk demand.

Jute industry occupies an important place in Indian economy, being one of the major industries in eastern region particularly in west Bengal. It supports nearly four billion families besides providing employment directly to 260,000 industrial workers and livelihood to another 140,000 people in the tertiary sector and allied activities.

The handloom industry is based on Indian traditional crafts, it employs nearly 7 .5 million people and contributes 13 percent to cloth production. Handlooms receives preferential policy treatment as they are highly labor intensive and viewed as a source of employment and supplementary income for 6 to 7 million people in over 3 million weavers households.

Man made fibres include manufacturing of clothes using fiber or filament synthetic yarns. It is produced in large power looms factories. They account for the largest sector of the textile production in India. This sector has a share of 62 percent of India's total production and provides employment to about 4.8 million people.

Indian textile sector is one of the leading industries in the world. Currently it is estimated to be around US$ 52

The Indian textile industry is in a stronger position than it was in the last six decades. The industry which was growing at 3 to 4 percent during the last six decades has now accelerated to annual growth rate of 9 to 10 percent. The Indian textile sector is also globally well placed as the share of Indian global textile trading increased to 7 percent in five years.

The major companies in the Indian textile sector include Bombay Dyeing, Grasim industries, JCT limited, Welspun India, Alok Industries, Arvind Mills, Raymond Limited, and Century Textiles etc.

The future of Indian textile sector is bright. There is a large scope of improvement in the textile industry of India as there is a huge increase in personal and disposable income among the Indians after the 1991 liberalisation. There is also a large growth of the organized sector in the Indian textile industry. The foreign brands along with collaboration of Indian companies are establishing business in India.

The government has taken several steps to strengthen the textile sector of the country like it has introduced the integrated textile parks scheme which envisages the creation of textile parks in the public and private partnership. To facilitate the technological up gradation in this sector the government launched the technological upgrading fund scheme (TUFS). This scheme provides for reimbursement of 5 percent interest paid on term loans for technological upgrading of textile machinery.

The textile sector has established its supremacy in cotton based products especially in readymade garments and home furnishing segments, these two segments will be key drivers of growth for Indian textile industry.

Foreign direct investment is 100 percent freely allowed in spinning, weaving, garments and knitting sectors under the automatic route for both new ventures and existing companies except in cases where industrial licensing is required from the government.

Analysis and Interpretation for Textile Sector

On the basis of hypotheses developed for textile sector companies, following analysis is done with the help of multiple regression by testing each framed hypothesis for each independent variable with dependent variable i.e. retained earnings. The variables depreciation, cash flows, corporate tax and interest were dropped from the analysis due to the problem of multi collinearity in case of textile sector companies. The results of multiple regression for textile sector are given in Table below.

Profit after Tax (PAT) with Retained Earnings (RE)

Null Hypothesis: H0 1(T): There is no significant impact of profit after tax (PAT) on retained earnings (RE) of textile sector companies.

Alternate Hypothesis: HA 1(T): There is a significant impact of profit after tax (PAT) on retained earnings (RE) of textile sector companies.

Multiple regression test results gives a positive regression coefficient (beta value) of 0.923 that indicates there is a positive impact of profit after tax on retained earnings for textile sector companies. For assessing the statistical significance of this impact the t and significant values are obtained which are 162.114 and 0.000, as the significant value is less than 0.01 (99%) and less than 0.05 (95%) level of significance hence, the impact is statistically highly significant therefore, the null hypothesis H0 1(T) is rejected and the alternate hypothesis HA 1(T) is accepted.

Dividend Paid (DP) with Retained Earnings (RE)

Null Hypothesis: H0 2(T): There is no significant impact of dividend paid (DP) on retained earnings (RE) of textile sector companies.

Alternate Hypothesis: HA 2(T): There is a significant impact of dividend paid (DP) on retained earnings (RE) of textile sector companies.

Multiple regression test results give a negative regression coefficient (beta) value of -0.012, which indicates there is a negative impact of dividend paid on retained earnings for textile sector companies. For assessing the statistical significance of this impact the t and significant values are obtained which are -4.618 and 0.000, as the significant value is less than 0.01 (99%) and less than 0.05 (95%) level of significance hence, the impact is statistically highly significant therefore, the null hypothesis H0 2(T) is rejected and the alternate hypothesis HA 2(T) is accepted.

Reserves (RES) with Retained Earnings (RE)

Null Hypothesis: H0 3(T): There is no significant impact of reserves (RES) on retained earnings (RE) of textile sector companies.

Alternate Hypothesis: HA 3(T): There is a significant impact of reserves (RES) on retained earnings (RE) of textile sector companies.

Multiple regression test results gives a positive regression coefficient (beta value) of 0.891 which means there is a positive impact of reserves on retained earnings for textile sector companies. To check whether this impact is statistically significant or not the t and significant values are obtained which are 2.892 and 0.004, as the significant value is greater than 0.01 (99%) but less than 0.05 (95%) level of significance as such it is significant at 95% level of significance hence, the impact is statistically significant therefore, the null hypothesis H0 3(T) is rejected and the alternate hypothesis HA 3(T) is accepted.

Current Ratio (CR) with Retained Earnings (RE)

Null Hypothesis: H0 4(T): There is no significant impact of current ratio (CR) on retained earnings (RE) of textile sector companies.

Alternate Hypothesis: HA 4(T): There is a significant impact of current ratio (CR) on retained earnings (RE) of textile sector companies.

It is inferred from the multiple regression test that there is a neutral impact of current ratio on retained earnings of textile sector companies as regression coefficient (beta value) is low with value of 0.002 that indicates there is a neutral impact of current ratio on retained earnings for textile sector companies. For assessing the statistical

significance of this impact the t and significant values are obtained which are 0.260 and 0.795, as the significant value is greater than 0.01 (99%) and also greater than 0.05 (95%) level of significance hence, the impact is statistically not significant therefore, the null hypothesis H0 4(T) has failed to be rejected.

Debt Equity Ratio (DER) with Retained Earnings (RE)

Null Hypothesis: H0 5(T): There is no significant impact of debt equity ratio (DER) on retained earnings (RE) of textile sector companies.

Alternate Hypothesis: HA 5(T): There is a significant impact of debt equity ratio (DER) on retained earnings (RE) of textile sector companies.

Validating the impact of debt equity ratio on retained earnings for textile sector companies, multiple regression results gives a negative regression coefficient (beta value) of -0.043 which shows a negative impact of debt equity ratio on retained earnings for textile sector companies. To assess whether this impact is statistically significant or not the t and significant values are obtained which are -6.732 and 0.000, as the significant value is less than 0.01 (99%) and less than 0.05 (95%) level of significance hence, the impact is statistically highly significant therefore, the null hypothesis H0 5(T) is rejected and the alternate hypothesis HA 5(T) is accepted.

Investment (INVS) with Retained Earnings (RE)

Null Hypothesis: H0 6(T): There is no significant impact of investment (INVS) on retained earnings (RE) of textile sector companies.

Alternate Hypothesis: HA 6(T): There is a significant impact of investment (INVS) on retained earnings (RE) of textile sector companies.

It is inferred from multiple regression test results which gives a positive regression coefficient (beta value) of 0.015 that indicates there is a positive impact of investment on retained earnings for textile sector companies. For assessing the statistical significance of this impact the t and significant values are obtained which are 1.498 and 0.135, as the significant value is greater than 0.01 (99%) and greater than 0.05 (95%) level of significance hence, the impact is statistically not significant therefore, the null hypothesis H0 6(T) has failed to be rejected.

Inventory (INV) with Retained Earnings (RE)

Null Hypothesis: H0 7(T): There is no significant impact of inventory (INV) on retained earnings (RE) of textile sector companies.

Alternate Hypothesis: HA 7(T): There is a significant impact of inventory (INV) on retained earnings (RE) of textile sector companies.

Multiple regression test results gives a positive regression coefficient (beta value) of 0.110 that indicates there is a positive impact of inventory on retained earnings for textile sector companies. For assessing the statistical significance of this impact the t and significant values are obtained which are 7.657 and 0.000, as the significant value is less than 0.01 (99%) and less than 0.05 (95%) level of significance hence, the impact is statistically highly significant therefore, the null hypothesis H0 7(T) is rejected and the alternate hypothesis HA 7(T) is accepted.

The value of R Square (coefficient of determination) in Table for textile sector is equal to 0.88 which indicates that 88% variance in the dependent variable i.e. retained earnings is explained by the independent variables.

Table for Analysis of Textile Sector

Variable	Beta (β)	t	Sig	R Square
(Constant)		- 6.439	0.000	0.88
PAT	0.923	162.114	0.000**	
DP	- 0.012	- 4.618	0.000**	
RES	0.891	2.892	0.004*	
CR	0. 002	0.260	0.795	
DER	- 0.043	- 6.732	0.000**	
INVS	0.015	1.498	0.135	
INVN	0.110	7.657	0.000**	

** Represents Significant at 99% level of significance

*   Represents Significant at 95% level of significance

Conclusion

On the basis of analysis of secondary data with the help of multiple regression tests for framed hypotheses, the following conclusions are presented for variables understudy for textile sector companies. Followings variables have been identified as important determinants of retained earnings in case of textile sector companies.

The variable **PAT** showed positive impact on the retained earnings in case of textile sector companies. A positive impact of PAT indicates more profit after tax at the disposal of companies to retain from. The impact of **PAT** is statistically significant.

The variable DP showed negative impact on the retained earnings in case of textile sectors and for each sector separately. Statistically the variable impact is found to be significant. The variable **DP** can be concluded as an important determinant of retained earnings that has a negative impact on the retained earnings of selected textile sector companies under study.

The impact of **RES** is positive for textile sector companies which indicate that textile sector companies do more retention of earnings to suffice its reserves position, the variable impact statistically is found to be significant for this sector but on statistical examination the impact is statistically significant for textile sector only. In case of textile sector the impact of **CR** is substantially low as such the impact of CR on retained earnings is treated as neutral that is **CR** does not much affect the retained earnings of textile sector companies. For textile sector Companies the impact is neutral but statistically not significant.

 DER showed a negative impact on retained earnings for textile sector and statistically the impact is not significant. A negative DER indicates that when companies have a higher proportion of debt in its capital structure in comparison to its equity proportion, as a result of higher debt proportion they have to pay a higher amount of interest on the borrowed capital in the form of debt from which reduce their profit margin resulting in less profit after tax from which retention of earnings is done as such it leads to lesser retained earnings For textile sector cpmpanies statistically the impact is not significant.

The variable **INVS** showed a positive impact for textile sector companies which implies that when profitable investment opportunities which earns them more than the required rate of return than the amount invested these sectors tend to do more retention of earnings with a view to earn more from their prospective profitable investment opportunities but on statistical ground the impact is not significant. The impact of variable **INV** on retained earnings of textile sector companies is positive and statistically the impact is significant, the positive impact of inventory on retained earnings for this sector indicates that when inventories are efficiently used which in turn results in increased production and sales, the companies in these sectors do more retention of earnings and divert them for funding of inventories.

Conclusion for Studying the Importance of Retained Earnings as a Source of Finance for Companies:

For the objective of studying the importance of retained earnings as a source of finance for textile sector companies, the review of literature gives an account of earlier studies that highlights the importance of retained earnings as a source of finance for companies. The present paper concludes that importance of retained earnings as a source of finance for companies is immense and of significant importance. The importance of retained earnings is established by the fact that retained earnings is an internally generated source of finance by companies from their after tax profits. The management of companies has complete and independent control regarding the decision to retain earnings after paying reasonable dividends to their shareholders.

The study found that retained earnings provides companies the benefit of being a cheap and easily available source of finance as it does not involve any external cost and formalities involved like other external sources of finance. The value maximising investments of companies are preferred to be firstly financed by retained earnings. Companies use retained earnings as a means of risk mitigation, to with stand depressions, to equalize dividend payments. The availability of internal funds or retained earnings guarantee the realization of profitable investment projects and at the same time avoids higher cost of capital.

The research and development and expansions programs of companies are financed by the retained earnings. Companies use retained earnings to finance their investments when supply of funds is limited on account of poor profits in a particular financial year. Companies divert their earnings retained to profitable investment opportunities which earn them higher rate of return which in turn maximises the market value of companies. The importance of retained earnings as source of finance for companies is also adjudged by the fact that retention of earnings by companies provides them with long term capital gains. Retained earnings contribute a significant share in capital base of companies. In developed countries like USA, UK, Germany, Finland, Italy, two third of average investment financing is mobilised through internal finance or retained earnings.In India the corporate sector mobilises a large share of finance by way of internal sources like retained earnings. The share of retained earnings or internal sources has increased remarkably by the latter half of 1990 which in turn influenced and impacted the share prices of companies in positive direction.

The above mentioned importance of retained earnings as a source of finance for textile sector companies has been supported by a number of earlier existing studies on retained earnings focusing on the importance / benefits / advantages retained earnings provides to companies. Most of the earlier studies found retained earnings to be of significant importance for companies. The conclusion for this objective are supported by the studies of Beena (2011), Bhayani (2009), Salvary (2007), Sagar S (2005), RBI (2005), Bartram (2000).

BIBLIOGRAPHY & REFERENCES

Books:

1. Chandra P. (2003) *Financial Management Theory and Practice*. 5th edition, Tata

McGraw Hill Publishing, New Delhi.

2. Pandey, I. M. (2005) *Financial Management*. 8th edition, Vikas Publishing House

Pvt Ltd, New Delhi.

References:

Athey, J. M. and Laumas, S. P. (1994), Internal Funds and Corporate Investment in

India, *Journal of Development Economics*, 45, 287-303, http://www.jstor.org.com,

accessed on 4th February 2009.

Bhayani, S. J. (2009), Dividend Payout Policy: An Empirical Analysis of Indian

Bartram, S. M. (2000), Corporate Risk Management as a Lever for Shareholder

Value Creation, *Financial Markets, Institutions and Instruments*, 9(5), 279- 324.

Beena, P. L. (2011), Financing Pattern of Indian Corporate Sector under

Liberalisation: With Focus on Acquiring Firms Abroad, Working Paper 440, Centre

for Development Studies, Trivananthpuram, Kerala (India), 1- 47.

Divatia, V.V. and K. S. (1979), Capital Formation and Its Financing in the Private

Corporate Sector, *Journal of Income and Wealth*, 3(2), 118-152,http://www.elsevier.com, accessed on 16th July

2009.

Donaldson, G. (1961), Corporate Debt Policy, Harvard University Press, Boston, U.

S. A.

Kaushik, K.P. (2007), Determinants of Retained Earnings in Highly Profitable

Companies of India: A Comparative Study of Domestic & Multinational Companies,

The ICFAI Journal of Applied Finance, 13(6), 19-42.

Kamat, S. M. (2008), The Ownership and Industry Effects of Corporate Dividend

Policy In India, 1961-2007, MPRA Paper No 12545, 1-20.

Karak, H. (1993), Dividend Profit and Dividend Decision, *The Management*

Accountant, 235- 237.

Mahakud, J. (2005), Corporate Retained Earnings in India: Trends and Determinants,

The ICFAI Journal of Applied Finance, 11, 59-72.

Mittal, R.K. (1992), Determinants of Corporate Retained Earnings, *Indian Management, 31, 35-38.*

Mayer, A. and Colin R. (1990), Financial Systems, Corporate Finance and Economic Development, NBER, Chicago University Press, U.S.A.

Myer, S. C. and Majluf, N. S. (1984), Corporate Financing and Investment Decisions

When Firms Have Information that Investors do not Have, *Journal of Financial*

Economics, 13, 187- 221, http://www.elsevier.com, accessed on 17th January 2009.

Rao, Subba K.G.K. (1977), Shift In The Pattern of Financing of Capital Formation In

The Private Corporate Sector, RBI Staff Occasional Papers, 2(1), 136-148.

Rao, V.G. and Vivekananda, M.A. (1980), The Determinants of Corporate Saving

Behaviour, *Margin*, 12, 38-50.

Reserve Bank of India (RBI). (2005), RBI Report on Currency and Finance,

Mumbai, India.

Salvary, C.W.S. (2007), The Underinvestment Problem & Corporate Earnings

Retention, *The ICFAI Journal of Financial Risk Management*, 1 4(2), 7-24.

Seppa, R. (2008), Capital Structure Decisions: Research in Estonian Financial

Companies, *Baltic Journal of Management*, 3(1) 55-70, http://www.emerald.com,

accessed on 24th December 2010.

Saggar, S. (2005), Financing and Investment Pattern of Indian Firms, *Economic and Political Weekly*, January 15, 2005.

Salvary, C. W. S. (2004), The Neo Classical Model, Corporate Retained Earnings and The Regional Flows of Financial Capital, Canisus College, U.S.A, 1-46.

REPORTS:

Department of Industrial Policy and Promotion.

Government of India, http://www.dipp.nic.in.

Annexure: Name of Textile Companies Selected of Textile Sector:

1) Alok Industries Ltd. 2) Adhunik Synthetics Ltd. 3) Century Enka Ltd. 4) Deepak Spinners Ltd. 5) Donear Industries Ltd. 6) Grasim Industries Ltd. 7) J B F Industries Ltd. 8) Jaipur Syntex Ltd. 9) Konark Synthetic Ltd. 10) ModernSyntex India Ltd. 11) Raymond Apparel Ltd.12) SantogenTextile Mills Ltd. 13) Sarla Performance Fibres Ltd. 14) Zenith Fibres Ltd. 15) Season Texties Ltd. 16) Shri Lakshmi Cotsyn Ltd. 17) Valson Industries Ltd. 18) Zodiac Clothing Ltd. 19) Futura Industries Ltd. 20) Siyaram Silk Mills Ltd. 21) APM Industries Ltd. 22) BSL Ltd. 23) Banswara Syntex Ltd. 24) Bombay Dyeing & Manufacturing Co Ltd.