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EMPIRICAL ANALYSIS OF CAPITAL STRUCTURES: A STUDY OF PHARMACEUTICAL COMPANIES OF INDIA

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ABSTRACT

Since the liberalization of Indian economy, there has been a continue research on company financing activities, particularly aimed at understanding how companies finance their activities and why they finance their activities. In practice, it is observed that finance managers use different combinations of debt and equity to meet the various financial requirements of the company at least cost and risk. Therefore, this study is aimed to make the comparative analysis of capital structures of various companies for the period of 2011-2012, determine the company having effective capital mix and analyse the effect of changes in capital structure over the period of time on the company's performance. To study the set objectives, this paper include the comparative analysis of detail financial information of three most reputed pharmaceutical companies, that are Dabur Ltd, Sun Pharma Ltd, Cadila Health Care Ltd related to the financial pattern over the period of time.

Key Words – Finance, Business risk, Capital Structure, Market Value, Debt ratio, Dividend Decision

INTRODUCTION

The finance manager is always looking to maximize the economic welfare of the owners as represented by the market value of the firm. For this purpose, he has to take number of decisions like investment, financing and dividend decisions. Since last, 50 years or so, there is a tremendous change in the role of financial management. The size of business firms, ownership structure, financial system, instrument and stock markets have greatly changed. As a result, the status of the finance manager has improved than merely a fund raiser. Financing decisions (1) are one of the most critical areas and the challenging job for the finance managers, because, It has direct impact on the financial performance and capital structure of the companies. Generally, the firms have the internal and external sources of fund to finance their investments. Internal sources include retained earnings and depreciation; whereas the external sources consist of new borrowings or the issue of shares. The financing decision is mainly involves two choices. The first is the dividend choice – the distribution of retained earnings to be ploughed back and to be paid out as dividends. The second is a choice of capital structure – the proportion of external finance to be borrowed and the proportion to be raised in the form of new equity. In real sense, the decisions about both the choice should not impact on the value of the firm. Because these decisions are related to either the form of distribution, type of security, or make up of the ownership structure, but not to the investment decision.

Capital structure decisions(2). have great impact on the firm's financial performance. Exactly how firms choose the amount of debt and equity in their capital structures remains an enigma. Generally, it consists of debt and equity used to finance the firm. The effective financing decision is determine the optimal mix of debt and equity, with respect to the

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relative numbers of shareholders and debt holders, and the distribution of investment proceeds between dividends, interest and capital gains.(3). To be specific, "capital structure decision is not only based on the internal environment of the company but also on external environment of the firm including corporate governance, legal framework and institutional environment of the countries in which the firm operates". Capital structure is the combination of debt and equity that finance the organization's strategic plan. The effective strategic management of capital structure ensures the availability of required fund to finance the future growth and enhance the financial performance.

The debt equity relationship is depends upon the nature of industries involved like company's line of business and its development. 4. A company is said to be highly leveraged, if it includes the maximum debt source of finance in its capital structure, which results, the company find its freedom of action restricted by its creditors and may have its profitability affected with the payment of high interest costs. Similarly this paper is focus on the comparative analysis of various pharmaceutical company's capital structure and determine the various influences.

PHARMACEUTICAL SECTOR OF INDIA

The Indian Pharmaceutical sector is highly fragmented with more than 20,000 registered units. It has grown drastically during the last two decades. The 250 pharmaceutical leading companies control 70% of the market with market leader holding nearly 7% of the market share. It is an extremely fragmented market with severe price competition and government price control. 5. The Indian pharmaceutical industry meets around 70% of the domestic demand for bulk drugs, drug intermediates, and pharmaceutical formulations. There are about 250 large units and about 8000 Small Scale Units, which form the major empire of pharmaceutical industry in India (including 5 Central Public Sector Units). These units produce the large range of pharmaceutical formulations, like medicines ready for consumption by patients and about 350 bulk drugs, including chemicals having therapeutic value and used for production of pharmaceutical formulations. Due to the de-licensing policy, most of the drugs and pharmaceutical products got exemption. Manufacturers are free to produce any drug duly approved by the Drug Control Authority. Totally self-reliant and technologically strong, the pharmaceutical industry in India has low costs of production, innovative scientific manpower, low R&D costs, strength of national laboratories and an increasing balance of trade.

6. India's pharmaceutical industry is now ranked as the third largest industry in the world in terms of volume. Its rank is 14th in terms of value. Between September 2008 and September 2009, the total turnover of India's pharmaceuticals industry was US$ 21.04 billion. The domestic market was worth US$ 12.26 billion. This was reported by the Department of Pharmaceuticals, Ministry of Chemicals and Fertilizers. As per a report by IMS Health India, the Indian pharmaceutical market reached US$ 10.04 billion in size in July 2011.

REVIEW OF LITERATURE

Toy 5 reported that companies having higher operating risk showed higher the debt ratio. They found that there was positive relationship between debt ratios and growth related to growth typically measured as sales growth and return on investment was negatively related to debt ratio. **Bhat and Pandey** 6 found that dividend payments were depend on current and expected earnings as well as the pattern of past dividends. Dividends were paid even if there was profitable investment opportunity. **Carelton and Siberman** 7 concluded that, if lower the degree of financial leverage adopted then higher will be the variability in rate of return on invested capital. Hence, the ultimate determinant of leverage would be the variance, not the rate of return. **Bhaduri** 8 study the capital structure choice in a sample of 363 Indian firms

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between 1989 and 1995 by employing the factor analytic approach. His results suggested that the financial mix of the firm is influenced by firm size, growth, and uniqueness. **Jackling and Johl 9** the ownership of family firms were frequently associated with pyramiding, family trusts and cross holding. These structures increased the divergence of control and cash flow rights presenting special agency problems associated with corporate governance. **Eldomiaty 10** stated that researchers decided to take India as sample of emerging market and evaluate performance of firms against capital structure After the comparison to the developed markets like America, Europe etc. He found that capital markets were less efficient and suffered from higher level of asymmetry in terms of information in emerging and developing markets than capital markets in developed countries.

RESEARCH METHODOLOGY

Research is a process of systematically obtaining accurate answers to significant and pertinent questions by the use of scientific method of gathering and interpreting information. This study is based on the secondary data i;e financial information from the company's annual reports. The main focus of the study is to determine the impact of change in the capital structure of the company on its performance over the period of time. To achieve the set objectives of the study the financial analysis technique is applied i;e comparative financial statement analysis on the company's financial statements for the period of 2011-2012.

OBJECTIVES OF THE STUDY

1. To make the comparative analysis of capital structures of various pharmaceutical companies for the period of 2011-2012.
2. To make the company analysis and determine the company having effective capital mix.
3. To determine the effect of changes in capital structure over the period of time on the company's performance.

ANALYSIS OF THE STUDY

Dabur India Ltd

Dabur India Limited 13 is one of India's leading FMCG Companies with revenues of US$ 599 Mn. building on a legacy of quality and experience for over 120 years, Dabur is today India's most trusted name and the world's largest Ayurvedic and Natural Health Care Company. The company has its manufacturing facilities spread across the Asia & Africa with 8 units being in India and 5 outside India. Dabur has entreched brand equity not only in India but in International markets, which contributes 18% of the overall turnover. The company remains committed to drive growth aggressively and enhance the shareholder value. Dabur India Limited has marked its presence with significant achievements and today commands a market leadership status.Due to the effective leadership the company has achieved the status of Leading consumer goods company in India with 3 major strategic business units (SBU) - Consumer Care Division (CCD), Consumer Health Division (CHD) and International Business Division (IBD), 17 ultra-modern manufacturing units spread around the globe and wide deep market penetration with 50 C&F agents, more than 5000 distributors and over 2.8 million retail outlets all over India. Similarly the company is earning maximum growth in the profitability over the period of time. Therefore to study the objective of the study, the comparative analysis is made on the basis financial statements for 2011-2012. The comparative statement is as under 16.

Comparative Financial Statement Analysis (2011-2012)

Particulars	Absolute Increase/	% Increase/

	Decrease	Decrease
Shareholders' Funds		
Share Capital	8717	100.31
Reserves and Surplus	26461	39.94
Loan Funds		
Secured Loans	-670	-27.71
Unsecured Loans	15417	179.89
Deferred Tax Liability (Net)	545	45.61
Current Liabilities and Provisions		
Liabilities	6422	14.82
Provisions	9526	21.64

Particular	Absolute Increase/ Decrease	% Increase/ Decrease
Profit	3808	8.7

As per the company analysis it is clear that the company has increase it share capital doubled than the previous year and the amount of reserve and surplus, which ultimately effect the profitability due to the increase in the cost of capital and cash balance in the company.
In case of loan capital, company has redeemed the secured loan i;e 27% as compared to the previous year, on the other hand the company has increase loan amount from unsecured sources , which has increased the financial risk for the business.
According to this analysis, it seems that the company is very risk averse, it is mostly focusing on creating the reserves and provisions for meeting the future unexpected liabilities & secure it position.
Company's operational position is not looking to be satisfactory because the analysis states the increasing balance of tax liability over the period of time.
As far as the company's current liabilities are increasing at 14 %, where as the profitability is increasing at 8%, it means the company is not also properly utilising of their resources.

Sunpharma Ltd

Sun Pharma 14 began in 1983 with just 5 products to treat psychiatry ailments. Sales were initially limited to two states in Eastern India. Sun Pharma was listed on the main stock exchanges in India in 1994; and the Rs. 55 crore issue of a Rs. 10 face value equity share offered at a premium of Rs. 140/-, was oversubscribed 55 times. This money was used to build a greenfield site for API manufacture, as well as for acquisitions of new assets. The first API manufacturing plant was built in Panoli in 1995, another API plant, in Ahmednagar plant, was acquired from the multinational Knoll Pharmaceuticals in 1996, and expanded and substantially upgraded for regulated markets, with capacity addition over the years across differentiated API lines such as anticancer and peptides.

In 1997, the headquarter was shifted to Mumbai, India's commercial capital and made the first international acquisitions with an initial $7.5 million investment in Caraco, Detroit. By 2000, company had completed 8 acquisitions, each such move adding new therapy areas or offering an entry to important international markets. In 2004 the company established the research centre and the post 2005 years have witnessed important acquisitions to strengthen it US business- the purchase of manufacturing assets for controlled substances in Cranbury,NJ; that of a site to make creams and lotions in Bryan, that of Alkaloida, a Hungary based API and dosage form manufacturer , and, Chattem Ltd., a Tennessee-based controlled substance API manufacturer. In September 2011 acquisition of Taro Pharmaceuticals doubled the size of US business and brought us a range of generics including a strong line of dermatological.

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Similarly the high business growth witnesses the strong profitable position of the company. Therefore, the comparative analysis is made for the period 2011-2012. 17.

Comparative Financial Statement Analysis (2011-2012)

Particulars	Absolute Increase/ Decrease	% Increase/ Decrease
Shareholders' Funds		
Share Capital	0	0
Reserves and Surplus	9625.5	17.14
Loan Funds		
Secured Loans	210.4	71.35
Deferred Tax Liability (Net)	131.8	11.43
Current Liabilities and Provisions		
Liabilities	506.3	19.23
Provisions	906.2	20.46

Particular	Absolute Increase/ Decrease	% Increase/ Decrease
Profit	4851.5	53.9

The analysis of the company financial statements states that the company has not raised any funds through share capital, but on the other hand company is emphasising on maintaining the maximum amount of reserves and surplus over the period of time. It shows the strong position of the company.

On the other hand the company has raised more debt as compared to the previous year, which ultimately has increased the financial risk for the company, whereas it has decrease the overall cost of capital for the company, which can be a reason for increase in profit over the period of time by 53.9%.

Increase in deferred tax liabilities balance does not show the positive impression of the company policies towards the government regulation.

In case of current liabilities, it has been proved that company is following the conservative approach to meet the future uncertain liabilities by creating more provisions in the current period, where due to increase in the balance of current liabilities, it seems that the company is not properly utilising its all operational resources, which will ultimately effect the profitability of the company.

Cadila Health Care Ltd

Zydus Cadila 15 is an innovative global pharmaceutical company that discovers, develops, manufactures and markets a broad range of healthcare products. The cadila produce a wide range of product including API to formulations, animal health products and cosmeceuticals. The company's headquartered is situated in the city of Ahmedabad in India, the company has global operations in four continents spread across USA, Europe, Japan, Brazil, South Africa and 25 other emerging markets.

In its mission to create healthier communities globally, Zydus Cadila delivers wide ranging healthcare solutions and value to its customers. With over 12,000 employees worldwide, a world-class research and development centre dedicated to discovery research and eight state-of-the-art manufacturing plants, the company is totally dedicated to improving people's lives. Similarly the company is also performing well on its operational part and having the strong profitable and financial position. The comparative financial analysis of the company for the year 2011-2012 is as follow 18.

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Comparative Financial Statement Analysis (2011-2012)

Particulars	Absolute Increase/ Decrease	% Increase/ Decrease
Shareholders' Funds		
Share Capital	342	50.15
Reserves and Surplus	4336	27.90
Loan Funds		
Secured Loans	-225	-4.06
Unsecured Loans	-76	-19.05
Deferred Tax Liability (Net)	44	3.83
Current Liabilities and Provisions		
Liabilities	1155	29.76
Provisions	287	18.92

Particular	Absolute Increase/ Decrease	% Increase/ Decrease
Profit	1071	21.2

On the basis of above comparative analysis, it is observe that the company has raised more share capital, whether it makes the company financially strong, but on the other hand it has increased overall cost of capital of the company. Along with it, the company is also focusing on maintaining the more balance of reserves and surplus over the period of time.

The overall cost of capital is also affected with the redemption of loan capital and the increase in the share of share capital. Similarly, It seems that some of portion of financial risk has been decrease in 2012.

According to the above analysis, it looks that the company's tax liability is increasing year by year, which is not a good sign of company's operational position, and its approach toward the payments of current and government liabilities.

Another observation states that the company is very risk averse, because it is maximum focus on creating additional provisions of 18.92 in current year. Similarly as creating the more reserve to secure it from future uncertain or unexpected losses in future.

Last but not the least the company's current liabilities has increased by 28%, which means the company is using it maximum cash balance for its business operation in spite of paying its current liability, which will ultimately have the effect on profitability over the period.

TO SUM UP

As per the overall analysis of the study, it is clear that the Dabur ltd has the amount of capital mix as compare to the Sunpharma and Cadial Health Care, because as per the above Analysis the Dabur company has raised 100% additional share capital in 2012 and 178% unsecured loan capital, where as the Sunpharma company has not raised any capital but it has increased the burden of loan capital by 71.35% in 2012 as compare to the previous year. In case of Cadila Health Care the company has raised the additional 50% share capital but also redeem some of the external liabilities in 2012.

Similarly the Dabur company has made the maximum balance of reserves and surplus by creating 39.9% additional reserve in 2012 as compare to 17.14 of Sunpharma and 27.9% of Cadila Health Care. It means the Dabur company is more risk averse as compared to the other companies to secure it future, to meet uncertain financial crunch.

With regard to the loan capital, Dabur company has the more loan capital and has raised the 178% additional loan as compare to the 71% of Sunpharma, but the Cadila Health Care has redeemed some of the portion of its loan capital in 2012. Similarly it is clear that the Dabur

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company has increase its financial risk maximally as compare to Sunpharma, where as the cedilla has reduce the risk of financial burden from the company.
As far as the profitability of the companies is concern the Sunpharma Company has the maximum growth of profitability in 2012 by 53% as compare to 21% of cardial health care and 8% of Dabur India Ltd. The reason for such differences in the growth of profitability is the effect of capital mix, because the Dabur ltd and Cadila Health Care has raised the maximum share capital, which results in increase in overall cost of capital. On the other hand Sunpharma has not made any addition in its existing share capital in 2012 as compare to the previous year, therefore the profitability of the company is higher than others.
With regard to the tax liability the Dabur ltd is seems to be maximum liberal as compare to the other companies, because it has increased 45% additional balance of tax liability in 2012 as compare to the previous year, whereas the Sunpharma has11% and Cadila Health Carehas 3% increased tax liability as compare to previous year.
The Cadila Health Care Company is not seems to be so effective to maintain its current solvency, because it has increased the maximum balance of current liabilities by 29.76 as compare to the previous year and compare to other companies, which ultimately have an effect on the profitability. Whereas the Dabur Ltd and Sunpharma Ltd has increased the balance of current liability by 14% and 19% in 2012, which is less than the Cardila Health Care. On the other hand, due to the increase in current liability of the company the Dabur ltd is also seems to be more risk conscious because it has also increase the balance of provision by 21% in 2012 as compare to the other company like Sunpharma and Cadila Health Carehas increase it by 20% and 18.9% as compare to the previous year.
At last but not the least, It can be said on the basis of Financial Comparative Analysis that the Sunpharma Ltd is financially efficient and having the effective capital mix as compare to the Sunpharma Ltd and Cardila Health Care, which evident the maximum profitability and effective utilisation of company's resources.

CONCLUSION

In the recent time, financial manager always plans an optimum capital structure for his company to obtain the higher market value per share. An optimal capital structure is usually defined as one that will maximizing shareholder's wealth by minimize the firm's cost of capital. Capital structure decisions have great impact on the firm's financial performance. Exactly how firms choose the amount of debt and equity in their capital structures remains an enigma. Generally, it consists of debt and equity used to finance the firm. Similarly, as per the analysis of this study the Sunpharma Ltd Company has the efficient capital mix, which states the strong financial as well as operational position. Such performance of the company can be traced from the growth of profitability in the current year as compare to the previous year and effective utilisation of all the current assets and having least balance of current liabilities as compare to the other companies i;e Dabur Ltd and Cardila Health Care. Similarly, there is a significant difference between the industry and the individual companies within an industry in terms of capital structure. There are number of factors influencing the capital structure decision of the company, but the judgment of the person making the capital structure decision plays a crucial part. Two similar companies can have different capital structures as per the different judgement of decision makers with the significance of various factors. Thus, the financing decisions have no affect on firm value, as it is the residue of the more important investment decisions. Therefore, firms, managers, and investors, devote more time and resources to making and analysing financing decisions about dividends and capital structure.

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