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# CONTENTS

Sr. No.	TITLE & NAME OF THE AUTHOR (S)	Page No.
1.	<b>mHEALTH EFFECTIVENESS AND POTENTIAL IN INDIA</b> <i>SURENDRA NATH SHUKLA, J K SHARMA &amp; DR. BALVINDER SHUKLA</i>	1
2.	<b>AN EFFICACY OF IMPACT OF TURNOVER RATIOS ON PROFITABILITY WITH SPECIAL REFERENCE TO INDIAN PHARMACEUTICAL INDUSTRY</b> <i>DR. N. PASUPATHI</i>	7
3.	<b>5S TECHNIQUE: THE EMERGING CONCEPT OF SERVICE QUALITY</b> <i>SIMERJEET SINGH BAWA, DR. HARPREET SINGH &amp; DR. NITYA</i>	11
4.	<b>PERCEIVED ORGANIZATIONAL SUPPORT AND AFFECTIVE OCCUPATIONAL COMMITMENT AS MEDIATING VARIABLES ON THE RELATIONSHIP BETWEEN ORGANIZATIONAL CAREER GROWTH AND EMPLOYEES PERFORMANCE</b> <i>SAUD NAPITUPULU, TULUS HARYONO, HUNIK SRI RUNNING SARWITRI &amp; MUGI HARSONO</i>	16
5.	<b>PUBLIC SERVICE INNOVATION: STUDY OF MASS TRANSPORT SERVICE THROUGH THE MASS RAPID TRANSIT (MRT) IN JAKARTA</b> <i>ERIE SYAHRIAL, DR. SRI SUWITRI, DR. BAMBANG RIYANTO &amp; DR. SUNDARSO</i>	28
6.	<b>ROLE OF ISO IN IMPROVING QUALITY OF MANAGEMENT EDUCATION IN INDIA</b> <i>DR. KOMAL CHOPRA &amp; DR. PRADNYA CHITRAO</i>	34
7.	<b>REPORTING QUALITY OF SOCIAL SUSTAINABILITY INDICATORS OF INDIAN MANUFACTURING FIRMS: AN ANALYSIS</b> <i>DIGANTA MUNSHI &amp; DR. SRABONI DUTTA</i>	38
8.	<b>SERVICE QUALITY IN HIGHER EDUCATIONAL INSTITUTIONS: AN EMPIRICAL ASSESSMENT</b> <i>DR. MUSHTAQ AHMAD BHAT &amp; MUDASIR QUADIR SOFI</i>	42
9.	<b>AN EMPIRICAL STUDY ON PMJDY SCHEME IMPLEMENTATION AT KANEKAL MANDAL OF ANANTAPUR DISTRICT</b> <i>G DIVAKARA REDDY</i>	49
10.	<b>HRM PRACTICES AND ITS CONTRIBUTION TO LEARNING ORGANIZATION: A LITERATURE REVIEW</b> <i>ESHA SINGH</i>	53
11.	<b>KISSAN CREDIT CARD SCHEMES AND FARMERS AWARENESS - INITIATIVES OF KERALA GRAMIN BANK</b> <i>DR. PRAKASH. C, NEBU CHERIAN. P &amp; JOBY JOSEPH THOOMKUZHY</i>	56
12.	<b>A CASE STUDY ON CASH MANAGEMENT PRACTICES IN COOPERATIVE BANKS</b> <i>DR. MOHD. IQBAL DARZI</i>	75
13.	<b>FINANCIAL INCLUSION IN VILLAGES OF INDIA: A CASE STUDY OF VILLAGES OF SHYAMSUNDAR GRAM PANCHAYAT</b> <i>DR. BANESWAR KAPASI</i>	77
14.	<b>MARKETING STRATEGIES OF RETAIL SECTOR IN INDIA</b> <i>PRIYA MALIK</i>	80
15.	<b>YOUTH ENTREPRENEURSHIP DEVELOPMENT</b> <i>DR. B. KANNAN. &amp; R. DHANABAL</i>	85
16.	<b>A STUDY ON AGRICULTURAL COMMODITY IN TRICHY</b> <i>K. DHINESHNI &amp; DR. S. P. DHANDAYUTHAPANI</i>	88
17.	<b>PORTRAYAL OF NATURE IN ENGLISH LITERATURE AND CONSERVATION OF NATURE</b> <i>SANGEETHA .J</i>	91
18.	<b>A STUDY ON SUPPLY CHAIN MANAGEMENT IN FMCG IN MYSURU CITY</b> <i>JAGATH PONNANNA &amp; SANDHYA P</i>	93
19.	<b>ASSESSMENT OF FACTORS AFFECTING PERFORMANCE OF WOMEN ENTREPRENEURS IN MSEs: THE CASE OF EAST SHOA ZONE OF OROMIA REGIONAL STATE-ETHIOPIA</b> <i>SILESHI LETA NEMERA</i>	96
20.	<b>FACTORS AFFECTING ECONOMIC DEVELOPMENT AND GROWTH OF INDUSTRY IN INDIA</b> <i>SHRUTI SHARMA</i>	99
	<b>REQUEST FOR FEEDBACK &amp; DISCLAIMER</b>	100

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## AN EFFICACY OF IMPACT OF TURNOVER RATIOS ON PROFITABILITY WITH SPECIAL REFERENCE TO INDIAN PHARMACEUTICAL INDUSTRY

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### ABSTRACT

*The impact of the turnover ratios on profitability has been examined by computing co-efficient of correlation and regression between profitability ratio (PBT to total assets ratio) and turnover ratios (CR, LR, ITR, RTR, TATR and FATR). The study of the impact of turnover ratios on profitability of Indian pharmaceutical industry should both negative and positive impacts. All the turnover ratios have shown positive association with profitability.*

### KEYWORDS

profitability analysis, Indian pharmaceutical industry.

### INTRODUCTION

In the conventional production function approach for determination of relationship between output and profit, fixed capital is taken into account as explanatory variable amongst others; the role of profitability is ignored<sup>1</sup>. If a company desires to take a greater risk for bigger profits and losses, it reduces the size of its working capital in relation to its sales. If it is interested in improving its liquidity, it increases the level of its working capital. However, this policy is likely to result in a reduction of the sale volume, therefore of profitability. Hence, a company should choose between liquidity and profitability and decide about its working capital requirements<sup>2</sup>. It is therefore felt that there is the need to study the important role of working capital in profit generating process.

The two important aims of finance are short-term solvency and profitability. To ensure solvency, the enterprises should be very liquid. If the enterprises maintain a relative large invest of long-term funds in current assets, they will not face the risk of cash shortage or stocks-outs. However, there is a cost associated with maintaining a sound liquidity position. A considerable amount of the firm's funds will be tied up in current assets and to the extent the investment is idle, the firm's profitability will suffer<sup>3</sup>. To have higher profitability, the firms may sacrifice solvency and maintain a relatively low level of current assets. When the firms do so, their profitability will improve as fewer funds are tied up in idle current assets, but their solvency will be threatened<sup>4</sup>. Sakar and Saha have aptly observed that management of working capital has an important bearing on the profitability of an enterprise<sup>5</sup>. Generally, the higher the working capital, the less the rate of return on capital employed while a lower value of working capital yields a higher rate of return<sup>6</sup>.

Hence, in this part, analysis is concerned with the study of association of profitability with working capital. The impact of Turnover ratios on profitability has been examined by computing co-efficient of correlation and regression between profitability ratio and working capital ratios, viz., current ratio, liquid ratio, inventory turnover ratio, receivable turnover ratio, total assets turnover ratio and fixed assets turnover ratio.

### OBJECTIVES OF THE STUDY

The person study in general aims as making a comparative a study on growth and profitability performance of selected pharmaceutical industry in India the specific objectives of the study are as per following:

1. To assess the impact of turnover ratios on profitability of Indian pharmaceutical industry.
2. To examine the camping effect of the ratio relating to turnover ratios and profitability with the assistance of correlation and co-efficient.

### RESEARCH METHODOLOGY

#### SELECTION OF SAMPLE

Keeping in view the co scope of the study it is decided to include all the company under pharmaceutical industry working before or from the year 2003-04 to 2012-13. But owing to several constraints such as non availability of financial statements or non working of company in a particular year etc. The researcher is compelled to restrict the no of sample companies to five, therefore this study is export factor based on survey method making the survey of five companies in Indian pharmaceutical industries. They are more than ten companies operating in the Indian pharmaceutical industry.

#### PERIOD OF THE STUDY

The period 2003-04 to 2012-13 is selected for this study of Indian pharmaceutical industry. This ten years period is chosen in order to have a fairly long. Cyclically well balanced period, for which reasonably homogenous, reliable and up to-date financial data would be available. Further, this span chosen for they study is there period of the beginning of liberalization measures introduced by the government of India. Hence the period 2003-04 to 2012-13 is an era of growth and profitability performance in the manufacturing sector particularly pharmaceutical industry and has got genuine economic significant of its own.

#### SOURCES OF DATA

A study is mainly based on secondary data the major source of data analyzed interpreted in this study related to all those companies selected is collected from "PROWESS" data base, which is the most reliable on the empowered corporate database of center for monitoring Indian economy (CMIE). The database provides financial statements, ratio analysis, funds flow, cash flow, product profiles, return and risk on the stock market etc.

Besides prowess database relevant secondary data have also been collected from BSE & NSE official directory, CMIE Publications, Annual Survey of Industry Business Newspapers, Reports on currency and finance, Libraries of various institutions, through internet etc.

#### FINANCIAL AND STATISTICAL TOOLS

The ratios relating to turnover ratios which have been selected and computed for the study are Current Ratio (CR), Liquid Ratio (LR), Inventory Turnover Ratio (ITR), Receivable Turnover Ratio (RTR), Total Assets Turnover Ratio (TATR), Fixed Assets Turnover Ratio (FATR) and determined Profit Before Tax to Total Assets Ratio (PBT to Total Assets Ratio) is used for analyzing data simple statically tools like 't' test and Karl Pearson's Correlation Co-efficient have been used to examine the interrelationship the variables and level of significance.

#### LIMITATIONS OF THE STUDY

The data used in this study have been taken only secondary source and as such it findings depends entirely on the accuracy of such data.

### ANALYSIS & INTERPRETATION

#### AUROBINDO PHARMA LIMITED

The co-efficient of correlation between turnover ratios and profitability ratio for the Aurobindo Pharma Limited are presented in Table 1.

Firstly, it is evident from the table that the co-efficient of correlation between profitability ratio and current ratio is 0.08. It reveals a low positive correlation which is significant at 1 per cent level. Secondly, the co-efficient of correlation between profitability and liquid ratio stands at -0.20. It is a negative correlation which is



significant at 1 per cent level. Thirdly, the co-efficient of correlation between profitability ratio and inventory turnover ratio is 0.20. It shows a positive correlation between the two variables, which is insignificant. Fourthly, the co-efficient of correlation between profitability ratio and receivables turnover ratio is found to be 0.37, which is found to be significant at 1 per cent level. It shows that there is a positive correlation between the two variables. Fifthly, the co-efficient of correlation between profitability ratio and total assets turnover ratio indicates higher positive association of 0.51, which is significant at 1 per cent level. Lastly, the co-efficient of correlation between profitability ratio and fixed assets turnover ratio shows that high degree of positive correlation of 0.66, which is significant at 1 per cent level. Total assets turnover ratio and fixed assets turnover ratio confirm with the assumption that higher the turnover increases the profitability of the Aurobindo Pharma Limited industry.

Thus, the analysis of the impact of turnover ratios on profitability in the Aurobindo Pharma Limited industry showed that LR have shown a negative correlation with profitability ratio and CR, ITR, RTR, TATR and FATR have shown positive correlation with profitability ratio. All the independent ratios except ITR are found to have significant association with profitability ratio.

#### **DIVI'S LABORATORIES LIMITED**

The co-efficient of correlation between turnover ratios and profitability ratios for the Divi's Laboratories Limited are presented in table 2.

It is evident from the table 5.24 that the co-efficient of correlation between profitability ratio and current ratio is 0.13. It shows a low degree of positive correlation between the variables. This is significant at 1 per cent level. Secondly, the co-efficient of correlation between profitability ratio and liquid ratio stands at 0.62. It is also indicating that there is moderate degree of positive correlation between these two variables. The value of co-efficient of correlation is found to be significant at 1 per cent level.

The co-efficient of correlation between profitability ratio and inventory turnover ratio is 0.93 and receivables turnover ratio 0.93. It reveals that very high degree of positive correlation between the variables, which is significant at 1 per cent level. The co-efficient of correlation between profitability ratio and total assets turnover ratio 0.69 and fixed assets turnover ratio 0.67 are found to have a positive association with profitability ratio. It reveals that moderate degree of correlation between the variables, which is significant at 1 per cent level.

Thus, the analysis of the impact of working capital ratios on profitability in the Divi's Laboratories Limited showed that CR, LR, ITR, RTR, TATR and FATR have shown a positive correlation with profitability ratio. It is also inferred from the table that all the independent ratios are significantly associated with profitability ratio.

#### **DR. REDDY'S LABORATORIES LIMITED**

The co-efficient of correlation between inventory ratios and profitability ratios for the Dr. Reddy's Laboratories Limited are presented in table 3.

It is evident from the table 3 that the co-efficient of correlation between profitability ratio and current ratio is -0.65. It shows a low degree of negative correlation between the variables. This is significant at 1 per cent level. Similarly, the co-efficient of correlation between profitability ratio and liquid ratio stands at -0.20. It is also indicating that there is low degree of negative correlation between these two variables which is significant at 5 per cent level.

The co-efficient of correlation between profitability ratio and inventory turnover ratio 0.72 and fixed assets turnover ratio 0.79 are found to have a positive association with profitability ratio. It reveals that high degree of correlation between the variables. ITR is statistically significant at 1 per cent level whereas FATR is significant at 10 per cent level. The co-efficient of correlation between profitability and receivable turnover ratio is 0.17. This is positive correlation found to be significant at 1 per cent level. Moreover, the co-efficient of correlation between profitability ratio and total assets turnover ratio is 0.82. This is also positive correlation found to be significant at 5 per cent level.

Thus, the analysis of the impact of turnover ratios on profitability in the Dr. Reddy's Laboratories Limited showed that ITR, RTR, TATR and FATR have shown positive correlation with profitability ratio and CR and LR have shown a negative correlation with profitability ratio. It is also inferred from the table that all the independent ratios are significantly associated with profitability ratio.

#### **IPCA LABORATORIES LIMITED**

The co-efficient of correlation between turnover ratios and profitability ratios for the IPCA Laboratories Limited are presented in table 4.

It is evident from the table that the co-efficient of correlation between profitability ratio and current ratio is 0.34. It shows moderate degree of positive correlation between the variables. This is significant at 1 per cent level. Similarly, the co-efficient of correlation between profitability ratio and liquid ratio stands at -0.11. It is also indicating that there is low degree of negative correlation between these two variables. The value of co-efficient of correlation is found to be significant. Both the ratios current and liquid ratios confirm with the assumption that larger amount of current and liquid assets decreases risk as well as profitability.

The co-efficient of correlation between profitability ratio and inventory turnover ratio 0.07 and receivable turnover ratio 0.26 are found to have a positive association with profitability ratio. It reveals that high degree of correlation between the variables, which is significant at 1 per cent and 5 per cent level. Lastly, the co-efficient of correlation between profitability and total assets turnover ratio is 0.43 and fixed assets turnover ratio is 0.52. This is also high positive correlation found to be significant at 1 per cent level and 5 per cent level.

Thus, the analysis of the impact of turnover ratios on profitability in the IPCA Laboratories Limited showed that LR have shown only a negative correlation with profitability ratio and CR, ITR, RTR, TATR and FATR have shown positive correlation with profitability ratio. It is also inferred from the table that all the independent ratios are significantly associated with profitability ratio.

#### **TORRENT PHARMACEUTICALS LIMITED**

The co-efficient of correlation between turnover ratios and profitability ratios for the Torrent Pharmaceuticals Limited are presented in table 5.

It is evident from the table 5.29 that the co-efficient of correlation between profitability ratio and current ratio is 0.14. It shows a low degree of positive correlation between the variables. This is significant at 1 per cent level. Secondly, the co-efficient of correlation between profitability ratio and liquid ratio stands at -0.18. It is also indicating that there is moderate degree of negative correlation between these two variables. The value of co-efficient of correlation is found to be significant at 1 per cent level.

The co-efficient of correlation between profitability ratio and inventory turnover ratio is 0.38 and receivables turnover ratio -0.01. It reveals that positive and negative correlation between the variables respectively, which is significant at 1 per cent level. The co-efficient of correlation between profitability ratio and total assets turnover ratio 0.41 and fixed assets turnover ratio 0.55 are found to have a positive association with profitability ratio. It reveals that moderate degree of correlation between the variables, which is significant at 1 per cent level.

Thus, the analysis of the impact of turnover ratios on profitability in the Torrent Pharmaceuticals Limited showed that LR and RTR have shown a negative correlation with profitability ratio. CR, ITR, TATR and FATR have shown a positive correlation with profitability ratio. It is also inferred from the table that all the independent ratios are significantly associated with profitability ratio.

## **RESULTS AND DISCUSSIONS**

### **FINDINGS**

- ✓ The analysis of the impact of turnover ratios on profitability in the Aurobindo Pharma Limited industry showed that LR have shown a negative correlation with profitability ratio and CR, ITR, RTR, TATR and FATR have shown positive correlation with profitability ratio. All the independent ratios except ITR are found to have significant association with profitability ratio.
- ✓ The impact of working capital ratios on profitability in the Divi's Laboratories Limited showed that CR, LR, ITR, RTR, TATR and FATR have shown a positive correlation with profitability ratio. It is also inferred from the table that all the independent ratios are significantly associated with profitability ratio.
- ✓ The analysis of the impact of turnover ratios on profitability in the Dr. Reddy's Laboratories Limited showed that ITR, RTR, TATR and FATR have shown positive correlation with profitability ratio and CR and LR have shown a negative correlation with profitability ratio. It is also inferred from the table that all the independent ratios are significantly associated with profitability ratio.
- ✓ The co-efficient of correlation between turnover ratios and profitability of IPCA Laboratories Limited showed that LR have shown only a negative correlation with profitability ratio and CR, ITR, RTR, TATR and FATR have shown positive correlation with profitability ratio. It is also inferred from the table that all the independent ratios are significantly associated with profitability ratio.

- ✓ Thus, the analysis of the impact of turnover ratios on profitability in the Torrent Pharmaceuticals Limited showed that LR and RTR have shown a negative correlation with profitability ratio. CR, ITR, TATR and FATR have shown a positive correlation with profitability ratio. It is also inferred from the table that all the independent ratios are significantly associated with profitability ratio.

## CONCLUSION

The impact of the turnover ratios on profitability has been examined by computing co-efficient of correlation and regression between profitability ratio (PBT to total assets ratio) and turnover ratios (CR, LR, ITR, RTR, TATR and FATR). The study of the impact of turnover ratios on profitability of Indian pharmaceutical industry should both negative and positive impacts. All the turnover ratios have shown positive association with profitability. In the Aurobindo Pharma Limited LR, Dr. Reddy's Laboratories Limited CR & LR, IPCA Laboratories Limited LR, Torrent Pharmaceuticals Limited CR and RTR have shown negative correlation and in Divi's Laboratories Limited all the turnover ratios have shown positive correlation with profitability ratios. The overall results of the model showing impact of turnover ratios on profitability of Divi's Laboratories Limited is encouraging.

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## TABLES

**TABLE 1: IMPACT OF TURNOVER RATIOS ON PROFITABILITY –SIMPLE CORRELATION ANALYSIS (Aurobindo Pharma Limited)**

Year	CR	LR	ITR	RTR	TATR	FATR	PBT To Total Assets Ratio
2003-04	1.20	1.14	4.20	3.53	1.01	2.11	0.08
2004-05	1.14	1.56	3.53	3.01	0.86	2.03	0.02
2005-06	1.28	1.42	3.84	3.21	0.97	2.43	0.14
2006-07	1.54	1.71	3.89	2.90	0.90	2.34	0.15
2007-08	1.78	2.59	4.10	2.99	0.89	2.38	0.04
2008-09	2.04	2.60	3.99	3.36	0.81	2.30	0.10
2009-10	1.85	3.83	4.24	3.30	0.79	2.12	0.07
2010-11	1.50	2.55	4.10	2.87	0.78	1.74	0.04
2011-12	1.54	1.77	3.96	2.57	0.77	1.73	0.02
2012-13	1.69	2.06	5.76	3.09	1.10	2.77	0.10
<b>R</b>	<b>0.08</b>	<b>-0.20</b>	<b>0.20</b>	<b>0.37</b>	<b>0.51</b>	<b>0.66</b>	
<b>T</b>	<b>16.00*</b>	<b>8.07*</b>	<b>21.88</b>	<b>35.98*</b>	<b>29.95*</b>	<b>23.12*</b>	

Source: Computed from the annual reports of the respective units.

\*Significant at 0.01 level

**TABLE 2: IMPACT OF TURNOVER RATIOS ON PROFITABILITY – SIMPLE CORRELATION ANALYSIS (Divi's Laboratories Limited)**

Year	CR	LR	ITR	RTR	TATR	FATR	PBT To Total Assets Ratio
2003-04	2.18	0.36	2.94	2.94	0.89	1.77	0.25
2004-05	2.11	0.23	3.12	3.12	0.91	1.88	0.25
2005-06	2.35	0.09	2.60	2.60	0.77	1.55	0.21
2006-07	2.80	0.16	2.14	2.14	0.65	1.16	0.21
2007-08	2.65	0.52	3.57	3.57	1.05	1.68	0.29
2008-09	2.14	0.38	4.29	4.29	1.26	1.84	0.32
2009-10	1.68	0.35	3.71	3.71	1.23	1.84	0.27
2010-11	1.50	0.22	2.39	2.39	0.92	1.39	0.16
2011-12	1.53	0.22	2.85	2.85	1.09	1.47	0.22
2012-13	1.34	0.11	3.52	3.52	1.21	1.49	0.27
<b>r</b>	<b>0.13</b>	<b>0.62</b>	<b>0.93</b>	<b>0.93</b>	<b>0.69</b>	<b>0.67</b>	
<b>t</b>	<b>11.34*</b>	<b>0.54*</b>	<b>14.63*</b>	<b>15.87*</b>	<b>13.51*</b>	<b>20.79*</b>	

Source: Computed from the annual reports of the respective units.

\*Significant at 0.01 level

TABLE 3: IMPACT OF INVENTORY RATIOS ON PROFITABILITY – SIMPLE CORRELATION ANALYSIS (Dr. Reddy's Laboratories Limited)

Year	CR	LR	ITR	RTR	TATR	FATR	PBT To Total Assets Ratio
2003-04	1.53	0.40	6.29	2.61	0.89	2.16	0.17
2004-05	1.44	0.74	5.96	3.47	0.93	2.20	0.15
2005-06	1.44	0.36	5.67	3.65	0.85	2.08	0.12
2006-07	2.07	0.19	5.45	3.77	0.76	1.96	0.11
2007-08	3.15	0.52	5.57	3.66	0.73	1.98	0.13
2008-09	3.05	1.05	6.16	3.66	0.76	2.17	0.10
2009-10	2.21	1.68	6.11	3.53	0.69	2.27	0.09
2010-11	1.85	1.88	8.69	4.94	1.03	3.45	0.24
2011-12	2.49	1.82	5.64	4.21	0.76	2.05	0.07
2012-13	3.73	1.73	5.79	3.78	0.73	1.79	0.01
<b>R</b>	<b>-0.65</b>	<b>-0.20</b>	<b>0.72</b>	<b>0.17</b>	<b>0.82</b>	<b>0.79</b>	
<b>T</b>	<b>8.24*</b>	<b>4.18**</b>	<b>21.16*</b>	<b>19.76*</b>	<b>31.73**</b>	<b>16.05***</b>	

Source: Computed from the annual reports of the respective units.

\*Significant at 0.01 level;

\*\*significant at 0.05 level;

\*\*\* Significant at 0.10 level

TABLE 4: IMPACT OF TURNOVER RATIOS ON PROFITABILITY – SIMPLE CORRELATION ANALYSIS (IPCA Laboratories Limited)

Year	CR	LR	ITR	RTR	TATR	FATR	PBT To Total Assets Ratio
2003-04	1.96	0.13	4.01	7.37	1.41	2.00	0.17
2004-05	1.72	0.14	4.17	6.57	1.36	2.07	0.16
2005-06	1.62	0.32	4.55	4.97	1.30	2.03	0.17
2006-07	1.59	0.35	4.76	4.34	1.32	1.94	0.17
2007-08	1.51	0.30	4.70	4.33	1.28	1.96	0.08
2008-09	1.48	0.31	4.46	4.93	1.30	2.02	0.15
2009-10	1.40	0.73	4.71	6.04	1.50	2.03	0.15
2010-11	1.48	0.98	4.53	5.40	1.42	1.94	0.10
2011-12	1.51	0.88	4.45	4.87	1.46	2.25	0.15
2012-13	1.52	0.83	5.13	5.01	1.68	2.80	0.19
<b>r</b>	<b>0.34</b>	<b>-0.11</b>	<b>0.07</b>	<b>0.26</b>	<b>0.43</b>	<b>0.52</b>	
<b>t</b>	<b>29.63*</b>	<b>3.33*</b>	<b>44.45**</b>	<b>16.91*</b>	<b>35.25*</b>	<b>25.21**</b>	

Source: Computed from the annual reports of the respective units.

\*Significant at 0.01 level; \*\*significant at 0.05 level

TABLE 5: IMPACT OF TURNOVER RATIOS ON PROFITABILITY – SIMPLE CORRELATION ANALYSIS (Torrent Pharmaceuticals Limited)

Year	CR	LR	ITR	RTR	TATR	FATR	PBT To Total Assets Ratio
2003-04	1.62	0.51	5.09	4.47	1.27	2.53	0.20
2004-05	1.41	0.65	5.65	5.55	1.15	2.22	0.14
2005-06	1.56	0.55	6.15	5.85	1.14	2.12	0.16
2006-07	1.91	0.98	6.79	5.69	1.09	1.96	0.17
2007-08	1.81	0.94	6.54	5.33	1.09	1.81	0.12
2008-09	1.78	0.61	5.62	5.44	1.19	1.71	0.13
2009-10	1.78	2.47	5.10	6.44	1.30	1.77	0.13
2010-11	1.48	2.21	4.77	8.62	1.25	1.88	0.10
2011-12	1.24	2.31	4.47	10.42	1.25	1.76	0.08
2012-13	1.35	3.10	5.62	13.78	1.70	1.82	0.20
<b>r</b>	<b>0.14</b>	<b>-0.18</b>	<b>0.38</b>	<b>-0.01</b>	<b>0.41</b>	<b>0.55</b>	
<b>t</b>	<b>20.73*</b>	<b>4.14*</b>	<b>23.33*</b>	<b>7.57*</b>	<b>21.08*</b>	<b>23.91*</b>	

Source: Computed from the annual reports of the respective units.

\*Significant at 0.01 level

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