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   REVIEW OF LITERATURE

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   STATEMENT OF THE PROBLEM

   OBJECTIVES

   HYPOTHESES

   RESEARCH METHODOLOGY

   RESULTS & DISCUSSION

   FINDINGS

   RECOMMENDATIONS/SUGGESTIONS

   CONCLUSIONS

   SCOPE FOR FURTHER RESEARCH

   ACKNOWLEDGMENTS

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   APPENDIX/ANNEXURE

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ASSESSMENT OF LIQUIDITY IN INDIAN PHARMACEUTICAL INDUSTRY – A STUDY

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ABSTRACT

This paper aims at assessment of the liquidity enjoyed by the Indian Pharma Industry through the application of ratio analysis, trend analysis and statistical tests. To this end, 12 pharmaceutical companies have been chosen and categorized into three distinct groups (A) Better Performing Companies (BPCs), (B) Moderately Performing Companies (MPCs) and (C) Low Performing Companies (LPCs). The adequacy of liquidity and solvency is judged both from the point of view of technical and actual sense. Technical liquidity (Current ratio and Liquid Ratio) of BPCs was strong enough, whereas, MPCs was nearer to the industry average. But, LPCs was below the industry average, as well as the other two groups of the IPI, indicating poor technical liquidity. The actual liquidity (net cash flow coverage to current liabilities) in BPCs and MPCs was encouraging, whereas, low in LPCs which leads to lesser degree of liquidity and solvency.

KEYWORDS
liguidity management, finance, Indian pharmaceutical industry.

1.0 INTRODUCTION

Liquidity plays a significant role in the successful functioning of a business firm. A firm should ensure that it does not suffer from lack of or excess liquidity to meet its short term compulsions. A study of liquidity is of major importance to both the internal and the external analysts because of its close relationship with day to day operations of business. Measuring the liquidity and solvency through the actual approach basically differs from the technical approach. The technical approach assumes that the firm might become insolvent at any point of time. But, the actual approach considers liquidity of a business undertaking from the going concern hypothesis. The computation of actual liquidity attempts to measure the potentiality of the firm in meeting out the current obligations on the basis of cash flows originating from the operations (net profit plus non cash expenses). The actual approach is based on the idea that an enterprise cannot or is least expected to pay off its current liabilities from its current assets, when, it is on the run, irrespective of whatever source cash is generated from. It definitely provides coverage to the current obligations.

2.0 METHODOLOGY

Multi-stage Sampling Technique is adopted in selecting the sample for the study. Companies which undertake (i) Manufacturing; (ii) Research and Development; and (iii) Plant approvals by various International agencies alone are considered for making out the sample. Based on Return on Capital Employed (ROCE), companies have been categorized as: (i) Better Performing Companies (BPCs) under group – A where ROCE is 20 per cent and above; (ii) Moderately Performing Companies (MPCs) under group – B where ROCE is in between 10 and 19 per cent; and (iii) Low Performing Companies (LPCs) under group – C where ROCE is below 10 per cent. Twelve companies were chosen for the study consisting 4 each from A, B and C groups at random. The sample, therefore, constitutes 12 pharmaceutical companies formed into 3 distinct groups – A, B and C for the study. The data drawn from the annual reports of select companies for the period from April, 2002-03 to March, 2009-10 have been tabulated and analysed and interpreted through ratio analysis, trend analysis, co-efficient and student'‘t' test.

3.0 OBJECTIVES

The adequacy of liquidity and solvency can be judged both in technical and actual sense. For the purpose of the present study, liquidity includes: (1) Technical liquidity and solvency and (2) Actual liquidity and solvency.[1] To judge the technical liquidity and solvency, current ratio and quick ratio or acid test ratio have been compiled and to ascertain actual liquidity and solvency, the ratio of coverage of cash flow to current liabilities has been considered. Technical liquidity considers various current assets or quick assets where, the concerns may find it difficult to convert them into cash due to lack of demand or lack of quality of conversion. The actual liquidity approach considers liquidity from the going concern hypothesis, hence, it considers net cash flows generated from its own operations but not by current assets alone.

TECHNICAL LIQUIDITY AND SOLVENCY

CURRENT RATIO

The current ratio measures the ability of a firm to maintain solvency over the short run. The significance of this ratio is that, it is not only a measure of solvency but is an index of the working capital available to the enterprise.[2] Hence, this ratio, sometimes, is called as working capital ratio.

The current ratio is computed as shown below:

$$\text{Current Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}}$$

Higher current ratio is a clue to the company's ability to pay its maturing debts within a year. A low ratio shows inadequacy of working capital which may deter the smooth functioning of the enterprise. A "two to one" Current Ratio and "one to one" Quick or Acid test ratio are considered to be indications of a satisfactory liquidity position of a business concern.[3]

The current ratio of BPCs on an average worked out to 2.08 times. The ratio had exceeded the ideal norm of 2:1.[4] The liquidity position of BPCs was very strong. The current ratio, though decreased initially, had shown an uptrend in the subsequent periods, i.e., from 2006-07 (See Table – 1). Technically speaking, it may be inferred that the liquidity and solvency condition of BPCs was excellent. The average current ratio of MPCs worked out to 1.88 times. The ratio had exceeded the ideal norm in 2004-05 and 2005-06. Though, the current ratio had shown fluctuations during the study period, its average was nearer to the industry average of 1.84 times. Hence, it may deduce that the liquidity and solvency position of MPCs was good. The average current ratio of LPCs of 1.74 times is below the industry average, and moreover, the current ratio started declining year after year as shown in Table – 1 indicating that the LPCs had to face short term liquidity crunch.

The current ratio, on an average worked out to 1.84 times in IPI. Except in 2004-05, the ratio had shown a fluctuating trend. In other words, the liquidity position of IPI was moderate in technical sense.

In comparing with ideal ratio of 2:1, BPCs is 2.08 which is above the ideal norm, MPCs is below ideal norm but above the industry average. Whereas, LPCs are below the ideal ratio and also the other two groups in IPI. Therefore, it is concluded that the short term solvency position of BPCs is good and MPCs moderate, whereas, LPCs weak.

STATISTICAL ANALYSIS OF CURRENT RATIO OF ALL GROUPS VIS-À-VIS IPI

The higher the current ratio, the more liquid the company is. Current Ratio is equal to current assets divided by current liabilities. If the current assets of a company are more than industry average, then that company is generally considered to have good short-term financial strength. If the current liabilities exceed current assets, then the company may have problems in meeting its short term obligations. The Current Ratio is more satisfactory in the case of BPCs and MPCs, because the ratio is more than the industry (IPI) average. They were able to meet their maturing current obligations, during the study period, and the averages of these groups are higher than the industry average. Coefficient of Variation (CV) of CR of the BPCs, MPCs and LPCs is 28.37 per cent, 15.43 per cent and 29.31 per cent respectively. The CV in MPCs is less, indicating more consistency in MPCs than the other two groups during the study period.

TABLE – 1: CURRENT RATIO OF ALL GROUPS VIS-À-VIS IPI

Year	Current Ratio (CR)			
	BPCs	MPCs	LPCs	IPI
2002-03	2.03	1.65	2.07	1.85
2003-04	1.70	1.34	2.66	1.70
2004-05	1.62	2.23	2.23	2.05
2005-06	1.60	2.20	1.51	1.84
2006-07	1.78	1.97	1.36	1.70
2007-08	1.94	1.96	1.36	1.75
2008-09	2.73	1.88	1.35	1.86
2009-10	3.23	1.78	1.37	1.93
Mean	**2.08**	**1.88**	**1.74**	**1.84**
Standard Deviation	**0.59**	**0.29**	**0.51**	**0.12**
C.V	**28.37**	**15.43**	**29.31**	**6.52**

TESTING OF HYPOTHESIS OF CURRENT RATIO

Null Hypothesis : There is no significant difference between the CR of individual groups and that of IPI.

Alt. Hypothesis : There is significant difference between the CR of individual groups and that of IPI.

TEST STATISTICS

Name	Mean	Industry Mean	t - Value	Sig (2 tailed)
BPCs	**2.08**	**1.84**	**1.14**	**0.27**
MPCs	**1.88**	**1.84**	**0.37**	**0.72**
LPCs	**1.74**	**1.84**	**0.51**	**0.61**

Accept H0, the difference is insignificant.

After testing the statistical hypothesis, it is confirmed that when compared with IPI, the null hypothesis is accepted for all groups in IPI and alternate hypothesis is rejected. Therefore, there is no significant difference between CR in all the groups of IPI.

QUICK RATIO

This Ratio is a measure of judging the immediate ability of a firm to pay off its currently maturing obligations. It is obtained by dividing quick assets by current liabilities. Quick assets would comprise those assets which can be liquidated immediately and at a minimum loss in order to meet the firm's pressing financial obligations. Inventory as a current asset takes time for conversion into cash. So, this current asset is deducted from the value of total current assets to arrive at the value of quick assets. The ratio is computed as shown below.[5]

$$\text{Quick Ratio} = \frac{\text{Quick Assets (i.e, Current Assets – Inventory)}}{\text{Current Liabilities}}$$

The quick ratio was more than unity for the all the years of study in BPCs. The ratio had varied from 1.03 to 2.59 and average being 1.47 times. It had shown a declining trend in the first three years of the study period, later showing an uptrend indicating thereby, that the liquidity position in BPCs was strong. In MPCs, the quick ratio is more than unity for all the years of study except in 2003-04. The ratio varied between 0.89 and 1.79, the average being 1.43 times. It fluctuated, during the study period indicating thereby that the liquidity position was satisfactory in MPCs. The quick ratio in LPCs was more than unity only in the first four years of the study period, but later on it was below unity, the average being 1.21 times as can be observed from Table – 2. LPCs were unable to meet the currently maturing obligations fully and therefore, the liquidity condition of this group has not been satisfactory. In IPI the quick ratio was more than unity for all the years. The ratio had varied between 1.12 and 1.50 averaging at 1.34 times. It had shown fluctuations in between indicating liquidity position of IPI is satisfactory.

The ideal quick ratio is 1:1.[6] The short term liquidity position of BPCs is 1.47 and MPCs were 1.43. Both groups were able to record current ratio above the ideal ratio as well as industry average, which reflects their strong liquidity. LPCs otherwise have been facing severe liquidity crunch.

STATISTICAL ANALYSIS OF QUICK RATIO

Table 2 shows that liquid ratio is more satisfactory in the case of BPCs and MPCs because the ratio is more than the industry average. They have been able to meet their matured current obligations under the study period and the averages of BPCs and MPCs are significantly higher than the industry average. But the average of LPCs is less than the Industry average. Coefficient of Variation (CV) of the BPCs, MPCs and the LPCs is 39.46 per cent, 22.38 per cent and 28.10 per cent. The CV of MPCs is less than the other two groups which shows more consistency in this group.

TABLE – 2: QUICK RATIO OF ALL GROUPS VIS-À-VIS IPI

Year	Quick Ratio (QR)			
	BPCs	MPCs	LPCs	IPI
2002-03	1.31	1.10	1.48	1.25
2003-04	1.05	0.89	1.83	1.12
2004-05	1.03	1.79	1.46	1.50
2005-06	1.06	1.79	1.11	1.40
2006-07	1.19	1.54	0.99	1.27
2007-08	1.40	1.54	0.94	1.31
2008-09	2.13	1.53	0.95	1.45
2009-10	2.59	1.29	0.90	1.42
Mean	**1.47**	**1.43**	**1.21**	**1.34**
Standard Deviation	**0.58**	**0.32**	**0.34**	**0.13**
C.V	**39.46**	**22.38**	**28.10**	**9.70**

Testing of Hypothesis of Liquid Ratio

Null Hypothesis : There is no significant difference between the LR of individual groups and that of IPI.

Alt. Hypothesis : There is significant difference between the LR of individual groups and that of IPI.

Test Statistics

Name	Mean	Industry Mean	t - Value	Sig (2 tailed)
BPCs	**1.47**	**1.34**	**0.62**	**0.54**
MPCs	**1.43**	**1.34**	**0.77**	**0.45**
LPCs	**1.21**	**1.34**	**1.03**	**0.32**

Accept H0, the difference is insignificant.

After testing the statistical hypothesis, it is confirmed that when compared with IPI, the null hypothesis is accepted for all groups in the IPI and alternate hypothesis is rejected. Therefore, there is no significant difference between LR in all the groups of the IPI.

ACTUAL LIQUIDITY AND SOLVENCY POSITION

Actual liquidity position of an enterprise mostly depends on its ability to pay off its current financial obligations from the net cash flows generated from its own operations but not by current assets alone, when it is on run. It is understandable that a manufacturing concern is unable to dispose of its current assets due to either lack of demand in the market or current assets lack the quality of conversion into cash at a given point of time. The higher the cash flow ratio, the greater the degree of liquidity and solvency of a firm and vice-versa. Hence, the relationship of current liabilities with the net cash flows may be measured by computing Net cash flows to current liabilities ratio.

NET CASH FLOWS TO CURRENT LIABILITIES RATIO

The actual approach considers liquidity of an enterprise from the going concern hypothesis. The following formula is used to calculate the ratio of net cash flows to current liabilities.

$$\text{Ratio of Net Cash Flows} = \frac{\text{Net Profit + Non-Cash Expenses}}{\text{Current Liabilities}} \times 100$$

NET CASH FLOWS TO CURRENT LIABILITIES OF ALL THE GROUPS VIS-A-VIS IPI

The percentage of cash flow to current liabilities, on an average, worked out to 50.13 per cent in the IPI as manifested in Table 3. The coverage ratio ranged from the lowest of 41.52 per cent to the highest of 59.47 per cent which means that the industry is maintaining moderate cash flows to meet its short term liquidity.

In BPCs, the percentage of cash flow to current liabilities, on an average, worked out to 80.63 per cent and coverage ratio ranged from a minimum of 65.44 to the highest of 89.89 per cent. In MPCs the percentage of cash flow to current liabilities, on an average worked out to 57.54 per cent, the coverage ratio ranged from a minimum of 49.21 per cent to the highest of 68.43 per cent. The average coverage in MPCs provided was higher than the industry mean, but less than the BPCs. This indicates that the creditors can get their dues paid, whenever they demand, because of the strength in the cash flow coverage to current liabilities in both the groups.

In LPCs, the percentage of cash flow to current liabilities on an average worked out to 19.07 per cent. The coverage ratio ranged from a minimum of 8.47 per cent to the highest of 47.21 per cent, which is far below the industry average as well as the other two groups. Therefore, LPCs are covering very low cash flow ratio, which ultimately leads to lesser degree of liquidity and solvency.

The analysis confirms the findings shown by current and quick ratios. The cash flow coverage ratio was strong in BPCs, and moderate in MPCs of IPI. But, LPCs were maintaining very less cash flow coverage ratio reflecting poor liquidity.

TABLE -3: NET CASH FLOW COVERAGE TO CURRENT LIABILITIES OF ALL GROUPS VIS-À-VIS IPI (Rupees in Millions)

Particulars	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10	Average
	BPCs								
Net Profit + Non-Cash Expenses	3,495.90	4,866.57	5,212.22	6,285.30	8,096.67	9,770.63	11,226.36	11,266.29	7,527.49
Current Liabilities	4,931.10	6,291.71	7,965.25	9,432.05	9,228.97	11,151.79	12,489.27	13,199.62	9,336.22
Ratio in %	70.89	77.35	65.44	66.64	87.73	87.61	89.89	85.35	80.63
	MPCs								
Net Profit + Non-Cash Expenses	4,656.08	5,832.90	6,822.90	9,205.88	12,046.05	19,411.76	19,552.69	17,748.64	11,909.61
Current Liabilities	8,521.47	10,855.10	13,866.01	18,489.90	23,109.39	28,368.97	34,467.31	27,908.83	20,698.37
Ratio in %	54.64	53.73	49.21	49.79	52.13	68.43	56.73	63.60	57.54
	LPCs								
Net Profit + Non-Cash Expenses	1,464.91	1,935.73	1,216.76	1,508.64	3,216.05	3,936.82	1,893.44	6,348.36	2,690.09
Current Liabilities	4,327.54	4,100.21	5,762.69	13,025.89	20,380.93	20,175.14	22,357.03	22,714.02	14,105.43
Ratio in %	33.85	47.21	21.11	11.58	15.78	19.51	8.47	27.95	19.07
	IPI								
Net Profit + Non-Cash Expenses	9,616.89	12,635.20	13,251.88	16,999.55	23,358.77	33,119.21	32,672.49	35,363.29	22,127.16
Current Liabilities	17,780.11	21,247.02	27,593.95	40,947.84	52,719.29	59,695.90	69,313.61	63,822.47	44,140.02
Ratio in %	54.09	59.47	48.02	41.52	44.31	55.48	47.14	55.41	50.13

CONCLUSION

Through current ratio and liquid ratio, it is observed that the liquidity of BPCs was strong enough. The average current ratio and liquid ratio of MPCs was nearer the industry average but less than BPCs. Hence, it may be inferred that the liquidity of MPCs was good. The current and liquid ratio of LPCs was below the industry average as well as the other two groups of the IPI. Therefore, it is concluded that LPCs may have to face short-term liquidity crunch. The cash flow coverage to current liabilities in BPCs and MPCs was higher than the industry average indicating strength in the cash flow coverage to current liabilities. But in LPCs, the coverage is far below the industry average as well as the other two groups. Hence, LPCs are having very low cash flow coverage, which ultimately leads to lesser degree of liquidity and solvency.

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With sincere regards

Thanking you profoundly

Academically yours

Sd/-

Co-ordinator

ABOUT THE JOURNAL

In this age of Commerce, Economics, Computer, I.T. & Management and cut throat competition, a group of intellectuals felt the need to have some platform, where young and budding managers and academicians could express their views and discuss the problems among their peers. This journal was conceived with this noble intention in view. This journal has been introduced to give an opportunity for expressing refined and innovative ideas in this field. It is our humble endeavour to provide a springboard to the upcoming specialists and give a chance to know about the latest in the sphere of research and knowledge. We have taken a small step and we hope that with the active co-operation of like-minded scholars, we shall be able to serve the society with our humble efforts.

Our Other Journals