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REVIEW OF LITERATURE
NEED/IMPORTANCE OF THE STUDY
STATEMENT OF THE PROBLEM
OBJECTIVES
HYPOTHESIS (ES)
RESEARCH METHODOLOGY
RESULTS & DISCUSSION
FINDINGS
RECOMMENDATIONS/SUGGESTIONS
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IMPACT OF CAPITAL STRUCTURE ON PROFITABILITY OF PHARMACEUTICAL SECTOR IN INDIA - AN EMPIRICAL STUDY

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ABSTRACT

Pharmaceutical sector is considered as one of the largest and fastest growing sectors in India and it ranks fourth in the world. The changes happening in the pharmaceutical sector have had a significant impact on Indian Economy. Capital structure decision is considered as one of the most complicated areas of financial decision which directly affects the changes in profitability of Pharmaceutical sector in India. The main objective of the study is to investigate interrelationship between capital structure and profitability of Pharmaceutical Sector over a period of time. Apart from that, the study also identifies the major factors which affect the changes in profitability of Pharmaceutical sector and the changes in capital structure of Pharmaceutical sector through theoretical investigation. The paper has opted for both analytical and descriptive research designs as it examines the pattern of capital structure and profitability. For the study, secondary data has been used and it is taken from the various sources like Reports of Centre for Monitoring Indian Economy (CMIE) and Capital Line. At the time of data collection, there were total 233 Pharmaceutical companies listed on BSE out of which 45 companies are selected for the purpose of analysis. The data for the period of 10 years from 2007 to 2016 is considered. The paper provides that capital structure has a strong impact on profitability of pharmaceutical companies. The debt proportion has negative impact while the equity proportion has positive impact on profitability. Further, capital structure and profitability are influenced by common factors like: Inflation, liquidity, tax policies and dividend policy. The sample size of the research is 20 percent of the total population which leaves the further scope of research open for other researchers. Moreover, similar research can be conducted on other sectors.

KEYWORDS

India, capital structure, profitability, pharmaceutical sector.

INTRODUCTION

There is an increase in the research on corporate as well as company finance in recent years. Most of the researches focuses on the way companies finance their projects, and the reason due to which they choose a particular way of financing their projects. One of the reasons behind the increasing research interest in the field of company finance is liberalization. Since the period, we have access to internet facility, liberalization and globalization have been facilitated immensely and ultimately it has opened up many opportunity gates for foreign investments and financing. With this the dependence on capital market has increased in order to grab the business in overseas market and to expand the business. A new business requires capital and still more capital is needed if the firm is to expand. The requirement of capital can be satisfied from many different sources, in different forms. Two major components of capital are: Equity and Debt. Hence, most of the capital requirements can be met under these two components. The best choice is a mix of debt and equity. One of the most confounding issues facing financial managers is the relationship between capital structure, which is the mix of debt and equity financing. In simple words, proportion of debt, equity shares and preference shares determine the capital structure of a company.

The relationship between capital structure and profitability is one that received considerable attention in the finance literature. In this changing scenario of increased competition and globalization, it is extremely important for companies to perform their best. Profitability is the best measure of checking financial performance. The study on the effects of debt equity proportion on profitability will help in knowing the potential problems in financial performance of firms.

Pharmaceutical sector is one of the fastest growing sectors of Indian economy which is growing at the rate of 14 percent per annum. The Indian Pharmaceutical sector is also expected to be among the top ten Pharma based markets in the world in the next ten years. In India, there are many national and international players challenging each other and developing at rapid rates. Pharmaceutical companies in India offer a wide-ranging Pharmaceutical plans. The Indian Pharmaceutical Industry is one of fastest emerging international centre for contract research and manufacturing services. Due to the growing demand for Pharmaceutical, more and more companies are now emerging in the Indian Pharmaceutical sector. The Indian Pharmaceutical Industry is one of the biggest producers of the active pharmaceutical ingredients (API) in the international arena. Profitability of the Pharmaceutical sector directly affect the growth of our country. The findings will help in selecting the appropriate capital structure to reach at the optimum level of profitability for pharmaceutical companies.

REVIEW OF LITERATURE

Ransariya (2013) investigated the relationship between capital structure and profitability of Indian pharmaceutical industry during the study period of 2007-08 to 2011-12. He measured performance by operating profit margin, gross profit margin, net profit margin, return on capital employed and return on net worth with debt equity ratio. He concluded that there was a strongly negative relationship between capital structure and firms' profitability (except net profit margin and return on net worth) of pharmaceutical industry.

Reddy (2012) studied Impact of Capital Structure on Profitability 20 software companies that were listed in Bombay Stock exchange for a period of ten years from 2002 to 2011. Profitability was measured by taking debt as a percentage of equity, Profit before tax as a percentage of capital employed and profit after tax as a percentage of capital employed. It was found that the structural composition of the capital of a company organization would have an impact on its profit earning capacity.

Shubita and Alsawalhah (2012) examined the effect of capital structure on profitability of the industrial companies listed on Amman Stock Exchange during a six-year period (2004-2009). They concluded that there was significantly negative relation between debt and profitability. They concluded that increased debt leads to decrease in profitability. The results also showed that profitability increased with control variables; size and sales growth.

Purohit and Khanna (2012) found that growth of assets was negatively related to leverage; owing to information asymmetry, outside investors were weakly informed of the firms' growth options and were concerned about agency problems. Hence, they demanded for higher premium. The results were in agreement to researchers who suggested that firms with potentially valuable future growth projects would not borrow from public debt markets owing to high disclosure costs of revealing sensitive information.

Liu and Chen (2011) studied the correlation between the debt structure and the corporate performance of listed companies in the pharmaceutical industry from 2005 to 2009. Regression results showed that the corporate liabilities of these companies had a major impact on their performance.
Buttner, Overesch, Schreiber and Wamser (2009) found that the local tax burden exerted important effects on an affiliate's leverage. This referred not only to external debt; our findings indicated that a higher local tax rate was also associated with an increase in internal debt. This showed that multinationals had access to an additional instrument which could be used to exploit the tax savings opportunities of debt finance.
Sufian (2009) examined the determinants of the profitability of the Chinese banking sector. The empirical analysis was done to the 4 SOCB and the 12 JSCB during the post reform period of 2000–2007. The empirical findings of this study suggested that size, credit risk, and capitalization were positively related to the profitability of China banks, whereas liquidity, overhead costs, and network embeddedness had negative impacts.
Morri and Cristanziani (2009) concluded that the negative relationship between operating risk and leverage demonstrated that the managers of riskier firms tended to reduce the overall company's uncertainty by adopting a more careful capital structure. Moreover, more profitable firms had less recourse to leverage. Evidence also suggested that the company's asset size was able to directly influence the amount of debt issued.
Omet (2008) provided supporting evidences to the fact that ownership structure did have a significant impact on capital structure even though this impact had not been clearly defined, although the ownership structure of companies had a negative impact on one measure of leverage and a positive impact on another measure of leverage.
Antoniou, Guney and Paudyal (2008) conducted a study to investigate how firms operating in capital market-oriented economies (the United Kingdom and the United States) and bank-oriented economies (France, Germany, and Japan) determined their capital structure. They found that capital structure of a firm was heavily influenced by the corporate governance practices and exposure to capital markets.
Talberg, Winge, Frydenberg and Westgaard (2008) found that Asset structure was positively related to the debt ratio; growth, profitability, and age were negatively related to the debt ratio, and the size was both positively and negatively related to the debt ratio depending on the size intervals.
Azhagaiah and Premgeetha (2004) suggested that the rapid ability to acquire and dispose of debt provided the desired financial flexibility of firms with a goal for growth. The non-debt tax shield and growth rate were statistically significant, which meant that these variables were the major determinants of the capital structure of Pharmaceutical Companies in India.

OBJECTIVES

1. To identify the major factors which affect the changes in profitability of Pharmaceutical sector through theoretical investigation.
2. To identify the major factors which affect the changes in capital structure of Pharmaceutical sector through theoretical investigation.
3. To investigate interrelation between capital structure and profitability of Pharmaceutical sector through theoretical investigation.
4. To investigate interrelation between capital structure and profitability of Pharmaceutical Sector over time.

HYPOTHESES

Research hypothesis: Various measures of Capital Structure (through different ratios) have different impact on various measures of profitability (through different ratios).
Null hypotheses: Table no. 1 shows the detailed null hypotheses which are tested further.

TABLE NO. 1: NULL HYPOTHESES

Sr. No	Null Hypotheses
$H0_1$:	There is no correlation between D/E Ratio and ROCE.
$H0_2$:	There is no correlation between D/E Ratio and RONW.
$H0_3$:	There is no correlation between D/E Ratio and PBIT.
$H0_4$:	There is no correlation between D/E Ratio and PAT.
$H0_5$:	There is no correlation between D/E Ratio and EPS.
$H0_6$:	There is no correlation between LTDE Ratio and ROCE.
$H0_7$:	There is no correlation between LTDE Ratio and RONW.
$H0_8$:	There is no correlation between LTDE Ratio and PBIT.
$H0_9$:	There is no correlation between LTDE Ratio and PAT.
$H0_{10}$:	There is no correlation between LTDE Ratio and EPS.
$H0_{11}$:	There is no correlation between I/C Ratio and ROCE.
$H0_{12}$:	There is no correlation between I/C Ratio and RONW.
$H0_{13}$:	There is no correlation between I/C Ratio and PBIT.
$H0_{14}$:	There is no correlation between I/C Ratio and PAT.
$H0_{15}$:	There is no correlation between I/C Ratio and EPS.
$H0_{16}$:	D/E Ratio has no impact on ROCE.
$H0_{17}$:	D/E Ratio has no impact on RONW.
$H0_{18}$:	D/E Ratio has no impact on PBIT.
$H0_{19}$:	D/E Ratio has no impact on PAT.
$H0_{20}$:	D/E Ratio has no impact on EPS.
$H0_{21}$:	LTDE Ratio has no impact on ROCE.
$H0_{22}$:	LTDE Ratio has no impact on RONW.
$H0_{23}$:	LTDE Ratio has no impact on PBIT.
$H0_{24}$:	LTDE Ratio has no impact on PAT.
$H0_{25}$:	LTDE Ratio has no impact on EPS.
$H0_{26}$:	I/C Ratio has no impact on ROCE.
$H0_{27}$:	I/C Ratio has no impact on RONW.
$H0_{28}$:	I/C Ratio has no impact on PBIT.
$H0_{29}$:	I/C Ratio has no impact on PAT.
$H0_{30}$:	I/C Ratio has no impact on EPS.
$H0_{31}$:	All Capital Structure ratios have no impact on ROCE.
$H0_{32}$:	All Capital Structure ratios have no impact on RONW.
$H0_{33}$:	All Capital Structure ratios have no impact on PBIT.
$H0_{34}$:	All Capital Structure ratios have no impact on PAT.
$H0_{35}$:	All Capital Structure ratios have no impact on EPS.

RESEARCH METHODOLOGY

Research Design: A research design is a definite plan for obtaining a sample from a given population. This study examined the pattern of capital structure and profitability of Pharmaceutical Sector of India. Hence, this study has followed both the analytical and the descriptive research designs.

Sample Size and Sampling Technique: At the time of selection, there were total 233 Pharmaceutical companies listed on BSE. So from this population, 20% sample was considered on the basis of convenient sampling. Thus, 45 Pharmaceutical companies were considered.

Time period of the study: For this study, 10 years of period was selected from 2007-2016 of Selected Listed Indian Companies of Pharmaceutical Sector so as to analyze the change over the period of time.

Data collection methods: For the study, secondary data has been used. The data has been taken from the various sources like Reports of Centre for Monitoring Indian Economy (CMIE), Capital Line, annual reports of the companies etc.

FINDINGS AND ANALYSIS

TABLE NO. 2: CORRELATION ANALYSIS

Variables					
Capital Structure	Profitability	Correlation Value	Significance Level	Hypothesis No.	Null Hypothesis
D/E	ROCE	.964	.000	$H0_1$	Rejected
D/E	RONW	.964	.000	$H0_2$	Rejected
D/E	PBIT	.985	.000	$H0_3$	Rejected
D/E	PAT	.579	.000	$H0_4$	Rejected
D/E	EPS	-.992	.000	$H0_5$	Rejected
LTDE	ROCE	.959	.000	$H0_6$	Rejected
LTDE	RONW	.964	.000	$H0_7$	Rejected
LTDE	PBIT	.986	.000	$H0_8$	Rejected
LTDE	PAT	.586	.000	$H0_9$	Rejected
LTDE	EPS	-.990	.000	$H0_{10}$	Rejected
I/C	ROCE	.964	.000	$H0_{11}$	Rejected
I/C	RONW	.967	.000	$H0_{12}$	Rejected
I/C	PBIT	.996	.000	$H0_{13}$	Rejected
I/C	PAT	.642	.000	$H0_{14}$	Rejected
I/C	EPS	-.980	.000	$H0_{15}$	Rejected

Table No. 2 showed that in Pharmaceutical Sector, all null hypotheses from $H0_1$ to $H0_{15}$ were rejected as D/E is significantly and positively related to ROCE, RONW, PBIT and PAT but significantly and negatively related to EPS. The result showed that LTDE was significantly and positively related to ROCE, RONW, PBIT and PAT but significantly and negatively related to EPS. The result showed that I/C was significantly and positively related to ROCE, RONW, PBIT and PAT but significantly and negatively related to EPS.

TABLE NO. 3: BIVARIATE REGRESSION ANALYSIS

Dependent Variables	Adjusted R^2	F value	Significance Level	Independent Variables	Beta Unstandardized Coefficients	t
ROCE	.928	17.45	.000	(Constant)	-7.809	-8.060
				D/E	15.724	41.769
RONW	.928	17.73	.000	(Constant)	-39.975	-14.879
				D/E	43.632	41.797
PBIT	.970	43.39	.000	(Constant)	146.565	60.926
				D/E	61.567	65.868
PAT	.330	67.419	.000	(Constant)	113.081	42.873
				D/E	8.415	8.211
EPS	.984	84.053	.000	(Constant)	17.728	134.562
				D/E	-4.693	-91.681
ROCE	.918	15.15	.000	(Constant)	-9.686	-8.929
				LTDE	19.245	38.923
RONW	.929	17.58	.000	(Constant)	-45.808	-16.300
				LTDE	53.701	41.923
PBIT	.971	45.43	.000	(Constant)	138.262	56.027
				LTDE	75.811	67.399
PAT	.339	70.158	.000	(Constant)	111.675	40.637
				LTDE	10.492	8.376
EPS	.980	65.03	.000	(Constant)	18.325	116.928
				LTDE	-5.762	-80.660
ROCE	.929	17.61	.000	(Constant)	6.511	9.986
				I/C	2.057	41.961
RONW	.935	19.43	.000	(Constant)	-.455	-.263
				I/C	5.727	44.054
PBIT	.991	15.54	.000	(Constant)	201.638	232.413
				I/C	8.141	124.794
PAT	.407	93.746	.000	(Constant)	119.357	71.197
				I/C	1.220	9.682
EPS	.961	32.33	.000	(Constant)	13.366	94.999
				I/C	-.606	-57.325

Table No. 3 showed that in Pharmaceutical Sector, all ratios of capital structure had a strong negative impact on profitability which meant that if capital structure ratios increase, the profitability ratios increase. The explanatory power of all the equations was more than 90%. However, when capital structure ratios were compared to PAT then the explanatory power of equations was around 40%. Moreover, the exception was EPS where the relationship with all capital structure ratios was positive. Further, all the beta coefficient was also significant as p value was less than 5%. The results showed that all null hypotheses from $H0_{16}$ to $H0_{30}$ were rejected as significant values were less than 5%.

TABLE NO. 4: MULTIPLE REGRESSION ANALYSIS

Dependent Variables	Adjusted R^2	F value	Significance Level	Durbin Watson	Independent Variables	Beta Unstandardized Coefficients	t	Significance Level
ROCE	.929	176.1	.000	1.399	(Constant)	6.511	9.986	.000
					D/E			
					LTDE			
					I/C	2.057	41.961	.000
ROCE = 6.511 + 2.057 (I/C) + e (1)								
RONW	.935	194.1	.000	.550	(Constant)	-.455	-.263	.793
					D/E			
					LTDE			
					I/C	5.727	44.054	.000
RONW = -.455 + 5.727 (I/C) + e (2)								
PBIT	.998	259.3	.000	3.581	(Constant)	266.902	92.164	.000
					D/E	-34.981	-12.60	.000
					LTDE	-38.853	-11.09	.000
					I/C	16.809	44.540	.000
PBIT = 266.902-34.981 (D/E) -38.853 (LTDE) + 16.809 (I/C) + e (3)								
PAT	.946	790.9	.000	3.178	(Constant)	252.394	67.162	.000
					D/E	-77.640	-21.56	.000
					LTDE	-72.393	-15.93	.000
					I/C	18.995	38.787	.000
PAT = 252.394-77.640 (D/E) -72.393 (LTDE) + 18.995 (I/C) + e (4)								
EPS	.998	185.6	.000	2.548	(Constant)	24.632	95.145	.000
					D/E	-6.871	-27.70	.000
					LTDE	-5.812	-18.56	.000
					I/C	.904	26.787	.000
EPS = 24.632-6.871 (D/E) -5.812 (LTDE) +.904 (I/C) + e (5)								

Table No. 4 showed that in Pharmaceutical Sector, ROCE and RONW were regressed on D/E, LTDE & I/C as independent variables, Durbin Watson value was less than 2 which showed multicollinearity problem. When PBIT was regressed on D/E, LTDE & I/C as independent variables using stepwise Multiple Regression Method, the equation no. 3 came out which showed that D/E and LTDE had negative effect on PBIT but I/C had positive effect on PBIT. When PAT was regressed on D/E, LTDE & I/C as independent variables using stepwise Multiple Regression Method, the equation no. 4 came out which showed that D/E and LTDE had negative effect on PAT but I/C had positive effect on PAT. When EPS was regressed on D/E, LTDE & I/C as independent variables using stepwise Multiple Regression Method, the equation no. 5 came out which showed that D/E and LTDE had negative effect on EPS but I/C had positive effect on EPS. Adjusted R^2 was more than 92% which was very high. The results showed that all null hypotheses from $H0_{31}$ to $H0_{35}$ were rejected as significant values were less than 5%.

CONCLUSION

The first objective of the study was to identify the major factors which affect the changes in profitability of Pharmaceutical Sector through theoretical investigation. It was found that there were various factors like Industry Size, Inflation, Tax Rate, Interest Rate, Gross Domestic Product Growth, Size, Liquidity, Long term debt, Managerial Control, Business Risk, Political Party in Power, Liquidity, R&D Expenditure, Well-efficient management, Network embedded ness, Stock market capitalization, Location, Dividend Policy, Product uniqueness which determined the Profitability in both Foreign as well as Indian context.

The second objective of the study was to identify the major factors which affect the changes in capital structure of Pharmaceutical Sector through theoretical investigation. It was found that there were various factors like Size, Profitability, Liquidity, Inflation, Business Risk, Managerial Control, Product uniqueness, Tangibility of assets, Growth opportunities, Non-debt Tax Shields, Asset structure, Earning volatility, Industry classification, Leasing, Dividend Policy, Share Price Performance, Gross Domestic Product Growth which determined the capital structure in both Foreign as well as Indian context.

The third objective of the study was to investigate interrelation between capital structure and profitability of Pharmaceutical Sector through theoretical investigation. It was found that many researchers had done analysis through regression model and they had mixed responses with regard to relationship between Capital Structure and Profitability. According to the findings of the researchers, few debt ratios had the positive relation with the profitability ratios and few debt ratios had the negative relation with profitability ratios. Further, it was found that those firms who preferred to finance the investment activity using the equity were more profitable than firms who financed by using borrowed capital.

The fourth objective of the study was to investigate interrelation between capital structure and profitability of Pharmaceutical Sector over time. It was found that there was a negative relation between capital structure variables and profitability variables which meant that in Pharmaceutical sector, companies preferred more equity over debt. Apart from that, it was found that there was a strong impact of capital structure on profitability in Pharmaceutical sector in India.

SCOPE OF FURTHER RESEARCH

Here, in this paper, researchers have focused on pharmaceutical sector of India for the study of the impact of capital structure on profitability. Similar, research can be conducted on other sectors of India and other countries where the factors considered in this research are relevant.

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