

ANALYSIS OF THE CAPITAL STRUCTURE ON VALUE OF PHARMACEUTICALS COMPANIES

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ABSTRACT

The combination of financing is the biggest question for businesses knowing the amount of capital needed. The financial provisioning methods that are consistent with the investment policy of companies and profitability should be careful of the companies. Each form of company entity has to control the capital structure and capital structure. The capital structure judgment is the decisive decision that a financial manager has to make. India's pharmaceutical industry is at the frontier with a large range of pharmaceutical and technical capabilities. The Indian pharmaceutical industry has experienced steady growth among the Indian economy industries, with many Indian pharmaceutical companies being favourite partners in contract manufacture and in research and development. A number of factors and interplay between capital structure factors must be taken into account in the decision on the financing of capital. Capital structure represents a share of debt and equity, and so their combination is an essential problem for business when calculating the amount of capital needed. In assessing investment methods and formulating an investment plan and profitability, businesses should be more careful. This paper is try to find the impact on value of pharmaceutical company's according to capital structure in India and to address the impact the capital theories on value of pharmaceutical companies.

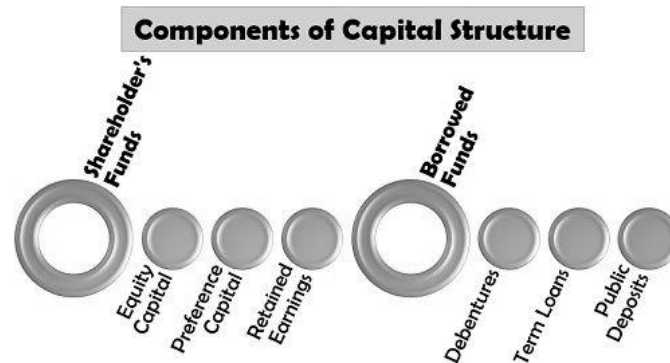
KEYWORDS: *Capital Structure, Pharmaceutical, Impact on Value.*

Introduction

One of the financial managers' many goals is to increase the shareholders' capital. This depends on issues such as controlling lower capital costs, creating debt-financing tax shield benefits and reducing debt and equity costs, etc. All these challenges are defined and handled in an efficient capital structure. Financial managers also seek to ensure the company's capital structure has an optimal balance of debt and equity. Due to differences in the sector the form for the capital structure varied. The researchers need to assess the applicability and potential factor of the defined capital structure. In addition, a research challenge is to identify the possible determinants of the structure of the capital within a given industrial setting. The capital structure, which blends debt with equity, would clearly increase the shareholders' wealth. Although the questions above are very relevant, theory and literature were not very helpful to address these practical questions satisfactorily. On the other hand, the universal theory of the capital system is not present, and the conclusions of some theories are contradictory.

Capital structure decisions are an important decision in the role of financial management in today's economic climate. The capital structure refers to the debt-to-equity balance of different long-term assets i.e. the debt and equity ratio of the company's overall capitalization. Decisions regarding the capital structure are known as one of a company's main decisions because it has a direct effect on the company's performance or failure. Too much debt threatens bankruptcy and too much equity limits the company's profitability. At this stage there arises a question of what is the optimal capital structure. There have been many hypotheses and several studies on capital structure decisions have been carried out over the past few decades.

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Without adequate knowledge on what factors influence the decisions on capital structures were given by research or theory. The scope and importance of the finance function has undergone a great change in the recent years with the globalization of the economies. Mobility of capital, introduction of variety of financial instruments and greater integration of capital markets have greatly increased both the challenges and opportunities for finance. Increased mobility of capital has meant greater challenges to the finance manager who has to provide better returns in order to retain capital within the enterprise and also ensure that investors are willing to invest in the firm whenever the firm requires additional funds for expansion or diversification.

Review of Literature

W. Richardson (1998) explain the option of capital structures and the various factors. First this research provides many traditional theories of capital structure, such as the principle of trade-offs, expense theory and boxing orders. It proposes seven factors that affect decisions on capital structures and the correlations between them and the choice of capital structure.

Ayyappannatrajan (2003) This paper analyses the trade-off, order of punching and the principle of timing of the market. The leverage decision was taken into account such factors as industry media, book-to-book asset ratio, tangibility, profitability, scale and inflation. Some variations of the commercial theory of capital structure tend to be fairly consistent with the empirical evidence. This paper focuses on agency-cost theories of the theories of capital structures, asymmetric knowledge, market interactions and considerations of corporate control. The paper is based on Modern Modigliani & Miller's (1958) theory of capital structure, which excludes corporate tax. Consequently, The author focussed on the theories of non-tax capital structure. The Author states that four determinants of capital structure are involved and that fluctuations in leverage are caused by stock price changes.

Prof. N.R Singh (2014) showed how Indian companies were improving their positions in terms of capital structures. The ENTER & Phase process regression was used. The study showed that the decisions of the capital structure of Indian companies in particular ROCE and RONW in the major part of the years, are based mainly on profitability.

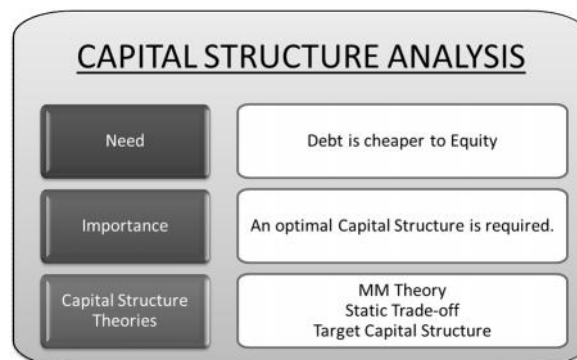
G.William (2003) explores the relative significance of the capital structure judgment of two independent ordinary least-square regressions by publicly traded Indian companies in six variables. This paper is based on past studies in Indian capital markets and models all key factors influencing the decisions of Indian capital structure after India has adopted a liberalization policy. Factors such as material asset, growth, company size, market risks, liquidity and profitability were a major influence on the leverage structure chosen by companies in the Indian context.

Stiglitz J.E. (2008) This paper explores the determinants of different theories of capital systems empirically. The aim is to develop and test for large manufacturers' companies in India a new theory of capital structure. Short and long-term debt instruments have been measured with various theoretical and management effects. The results are contradictory to traditional finance theory.

Millar's study (2009) attempted to evaluate the corporate capital structures that calculated the size, market risk, growth rates, profit rates, dividend payouts, debt service capability as leveraging of companies listed on Nepal Stock Exchange Ltd. The impact of identified explanatory variables on capital structure has been assessed by eight variable multiple regression models. This study demonstrates how the capital structure of listed firms is statistically important in scale, growth rate and earnings rate.

Capital Structure Theories

In the simplest possible words, the capital structure means the share of debt and equity that constitutes the business's overall capital needed to finance the investment and day-to-day operating activities. The fact that it usually is less costly to receive debt funding compared to equity results in the need for the decision on an acceptable capital structure. The companies must therefore be cautious to use such a share of debt, whose expense does not outweigh the profits on their investment, and thus leaves the shareholders with a larger share of returns. We call such an analysis 'Capital Structure Analysis.' For small companies, it is equally necessary to decide the best suited capital structure as it is for big companies. The optimal capital structure strikes a balance between risks and returns to optimise stock prices while at the same time reducing capital costs. It also affects the risks of the organizations, the ability to access and expense the financing, resistance to economic and industrial downturns, appeal and anticipated return on investment from different stakeholders.



Modigliani and Miller presented a road breaking paper in 1958, began the history of modern capital theories. Miller and Modigliani (M&M) proposals maintain that if the valuation of the company depends on the capital structure, arbitration options must be offered within the perfect capital market. The proposition sounds good theoretically, but it is not practical to use it in actual terms, but only under the optimal conditions of the market (no tax is one). The corrected version of this proposal contains the effects of the value tax on the capital cost of the business (Modigliani and Miller 1963). In 1976, Miller's next edition was released of his obsolete theory of capital structure. Irrelevant theory recalled that the decisions on corporate and personal tax capital structures of corporations are irrelevant (Miller 1977) and contribute to the creation of a static model of trade-offs. The trade-off model concludes that there is an optimum capital structure.

A business sets its debt target and then works towards it progressively. This principle notes that the business reaches the maximum debt-equity ratio when the marginal current value of the added debt tax is equal to the real value increase of financial distress costs. According to this theory, the power of a business aims at three rival forces: I taxation, (ii) the cost of bankruptcy (financial distress), and (iii) the cost of the agency. Static model exchange, funded by Jensen and Meckling (1977), Btradley, Grossman, Hart (1982), Jarrel, Jensen and Jensen, 1986, Harris and Raviv (1990), Stulz (1990), Chang and Kraus and Litzenberger (1973), Jensen, Jörg (1977), and Hart (1976), both in tax and agency costs models, includes Tax models (1999). Agency theory drafted by Jensen and Meckling in 1976 also implies that the capital structure's debt levels can be minimised by reducing agency costs resulting from divergent managers' divergent interest in shareholders and debt holders. Jensen and Meckling (1976) assume that either the company's ownership or debt usage should be driven to regulate managers' tendency to excessive payments in order to balance managers' interest with that of their holders. Jensen (1986) has a free cash flow problem in the agency.

In the 1984 theory of Myers and Majluf, which captured the impact of the knowledge on new securities, there are no well-defined target debt ratios. Investors are usually seen to be more knowledgeable about the pricing-sensitive details of businesses by managers. The assumption of investors is that when managers are overpriced, they issue risky securities. This view of investors leads to a new equity problem being lowered. Often the price is so severe that the current shareholders lose significantly. To avoid the issue of knowledge asymmetry, businesses meet their funding needs by choosing the key source of financing to profits, then to provide debt and eventually to finance external equity. Thus a hierarchy of priorities for the release of new capital will be formed in the capital structure. This has been termed as "Pecking Order Theory".

Current Status of Indian Pharmaceutical Sector

The Indian pharmaceutical sector, as described in the Equity Master report, is the third in volume and the 13th in value (KPMG report). In recent years, the Indian pharmaceutical sector has grown at record high levels. India is the global largest generic drug manufacturer with 20% of the world's Indian generic exports. Between 2015 and 2020 the Indian pharmaceutical industry is projected to expand by 15% per year. It is valued at \$33 billion in 2017 in the medicine market. In 2015-20, CAGR 22.4% would grow the pharmaceutical industry in the country to US\$55 billion. Indian pharmaceutical exports in FY18 amounted to US\$17.27 billion and in FY19 exceeded US\$19.14 billion. Pharmaceutical exports include mass vaccines, medicines, biologics and ayush drugs, pharmaceutical products and surgical products.

In 2017, Indian companies were authorized by the U.S. 304 New Food and Drug Administration Application Shortlists (ANDA) (USFDA). The country accounts for some 30% (by volume) and some ten percent of the generics industry in US\$70-80 billion (value). The biotech and bio-pharmaceutical industry in India is anticipated to increase at about 30 per cent per year average and hit a level of US\$ 100 billion by 2025. The average growth of India is projected to be around 30 per cent annually. The Cabinet has expressed its support for an amendment to the current Pharmaceutical Foreign Direct Investment (FDI) Policy to allow FDIs to produce medical devices subject to certain conditions up to 100 per cent automatically. Data registered in the Department of Industrial Policy and Promotion (DIPP) have attracted US \$15.98 billion of cumulative FDI inflows between April 2000 and March 2019 (DIPP).

Conclusion

The paper shows the theoretical history of the capital structure of pharmaceutical companies in India as well as its effect on pharmaceutical companies' valuation in India. The paper shows The pharmaceutical industry is one potential explanation of why the promising and contributing portion of the national economy is concerned with the theoretical conclusions and empirical results on determinants of the capital structure and taking an optimal decision on capital structures in this sector. According to the theories of capital structures, pharmaceutical firms adopt the best capital blend to prevent the effect of a poor capital structure. The pattern and decision-making of each company, the legal/regulatory system, corporate tax policies, taxation holidays, time of study, mistakes in sampling, etc which lead to a mixed output of some of the variables of this study and not to explain the capital structure better. An study of the determinants of capital structure will be carried out and this will definitely lead to useful new insights.

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