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A Study of Shareholder Value Creation of Selected Indian Pharmaceutical Companies

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Abstract: ***Maximizing shareholders wealth is becoming the new corporate standard in India. Shareholders' wealth is measured in terms of the returns they receive on their investment. Traditionally, the yardsticks used to measure the efficiency and profitability of a business organization were accounting based measures like ROI, ROE, ROCE, EPS, RONW and financial ratios. But, now a day's value added measures have emerged as a replacement of the traditional accounting based measures. The reason behind this is that the financial performance of a business organization is measured from the shareholders' value point of view. Value added represents the wealth created by an enterprise during a specified period. No companies can survive and grow, if it fails to generate value to its existing and potential shareholders. Hence, value added is a basic measure which is used for measuring the financial performance of an enterprise. By keeping this in mind, this study is an attempt to analyze the value creation in Indian Pharmaceutical Industry from 2005 to 2014 by using regression analysis.***

Keywords: ***Value Creation, Economic Value Added, Market Value Added, ROI***

I. INTRODUCTION

Maximizing shareholders value has become the new corporate paradigm in recent years. The Corporate, which gave the lowest preference to shareholders curiosity, are now bestowing the utmost preference to it. Shareholder's wealth is measured in terms of returns they receive on their investment. It can either be in forms of dividends or in the form of capital appreciation or both. Financial information is used by various stakeholders to assess firm's current performance and to forecast the future as well. Maximizing the shareholder value is considered as one of the fundamental goals of all businesses. There are a number of value based management (VBM) frameworks, shareholder value analysis (SVA) Rapport (1986) and Economic Value Analysis (EVA) developed by Stern Stewart (1990) is the two well-known ones. Maximizing shareholders value is becoming the new corporate standard in India.

II. INDIAN PHARMACEUTICAL INDUSTRY

The Indian Pharma Industry was dominated by multinationals in the 1960's and 1970's. 7 out of top 10 organizations were multinationals who controlled the market on the basis of their blockbuster brands.

The scenario was reversed in the 1990's, with 7 out of top 10 companies being Indian national companies. The change was aided by empowering policies and regulatory procedures which provided impetus to Indian Manufacturers. This was coupled with the technical brilliance of Indian scientists and technocrats, who used the opportunity provided by the process patents regime to bring imitations of patented products to the Indian market at affordable prices. Moreover the cost of entry and exit in the pharma industry was minimal compared to the global context.

The drug policy (revised every 8th year beginning 1971) was designed to increase the availability and affordability of medicines but created pressures on pricing and profitability, forcing the Industry to reinvent itself. In 2005 with the introduction of product patents, the entire domestic market became a generics (or branded generics) market overnight.

According to Union Minister of State for Chemicals and Fertilizers, Mr. Srikant Kumar Jena, India tops the world in exporting generic medicines worth of USD 11 billion and currently the Indian pharmaceutical industry is one of the world's largest and most developed.

On the other hand, India is expected to rank among the top 10 global pharmaceutical markets by 2015. The increasing higher income group segment of the Indian population will open a potential USD 8 billion market by 2015 for selling expensive drugs. Total domestic revenues are being pegged at USD 20 billion by 2015 making India a lucrative market indeed. Health Infrastructure issues need to be dealt with in order to enable India to grab this opportunity to make itself a big consuming market for the world.

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Pharmacy retail is growing at the rate of 20-25 per cent annually. The organized pharma retail market size has the potential to grow to USD 9 billion by the year 2011.

III. REVIEW OF LITERATURE

Lehn and Makhija (1996) stated that EVA and Market Value Added (MVA) are increasingly being eyed as alternative measures of business performance and strategic development.

Kramer and Pushner (1997) tested the hypothesis that EVA is highly correlated with MVA. The study concluded that no clear evidence to support the contention that EVA is the best internal measure of corporate success in adding value to shareholder investments.

Banerjee (1997) has conducted an empirical research to find the superiority of EVA over other traditional financial performance measures.

KPMG-BS Study (1998) assessed top companies on EVA, sales, PAT (Profit after Tax), and MVA criteria. The survey has used the BS 1000 list of companies using a composite index comprising sales, profitability and compounded annual growth rate of those companies covering the period 1996-97.

Pattanayak and Mukherjee (1998) discussed that there are traditional methods to measure corporate income or there is also a modern method to measure corporate income.

Anand, et.al. (1999) revealed that EVA, REVA (Refined Economic Value Added) and MVA are better measures of business performance than NOPAT and EPS in terms of shareholders' value creation and competitive advantage of a firm.

Madhu Malik (2004) examined the relationship between shareholder wealth and certain financial variables like EPS, RNOW and ROCE. By using correlation analysis, it was found that there was positive and high correlation between EVA and RONW, ROCE.

Karam Pal Singh and Mahesh Garg (2004) examined the disclosure of EVA in Indian corporate. The study revealed that out of 50 companies, only 32 companies have generated positive EVA and 18 companies have destroyed their shareholders' wealth in 1998.

Singh (2005) examined an appropriate way of evaluating bank's performance and also found out which Indian banks have been able to create (or destroy) shareholders' wealth since 1998- 1999 to 2002-2003.

Panigrahi (2005) examined how the Economic Value Added (EVA) is superior to Market Value Added (MVA). This has been examined by financial performance of ITC Ltd, which has adopted the EVA as its performance measurement.

Ghanbari and Sarlak (2006) studied economic value added in Indian automobile industry. The objectives of the study are: to compute and analyze Economic Value Added (EVA) of firms in the automobile industry and to identify the EVA trend of the industry the period of the study.

IV. RESEARCH OBJECTIVE

1. To analyse the trend and growth of shareholders' value in Indian Pharmaceutical Industry in terms of Economic Value Added, Market Value Added and return on investment
2. To examine the relationship between EVA, MVA and ROI in comparison to shareholder value.

V. RESEARCH METHODOLOGY

Sampling Design:

Convenient sampling technique is applied for study.

Period of the Study:

The present research paper will cover a period of ten years from 2004-05 to 2013-14. The financial data for these years will be compiled from the annual reports of respective pharmaceutical companies. Data required for analysis has been taken from Capital line and CMIE Prowess.

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Tools for Analysis:

There are many techniques which may be used for analysing the shareholder value measurement. Regression model has been used to analyse the shareholder value measurement

VI. DATA ANALYSIS

Looking to the empirical results from the regression model I can conclude that return on net worth influence return on investment of the firm and significant at 5% level. It means that the relationship between return on investment and retune on net worth was positive (2.270). It was further concluded that return on investment influence by 2.270% by the 1% change in return on net worth. . It means higher return on net worth lead to higher return on investment.

I also find that debt equity ratio of the firm is positively related to ROI and also significant at 5% level in firm's performance. The relationship between return on investment and debt equity ratio was positive (2.254). It means 1% change in debt equity ratio was affected 2.254% in Return on investment. It means high debt equity ratio leads to increase in Return on investment of the firm.

Creditor's velocity of the firm is significant at 5% and negatively correlated to return on investment in financial performance of firm, The relationship between return on investment and creditor's velocity was negative (-2.346). It means 1% change in creditor's velocity was affected by 2.346% in Return on investment. It means company should take care of the vendors and make timely payment to increase return on investment. Interest coverage ratio is positively (5.243) related with return on investment capacity of the firm. Interest coverage ratio is significant at 1% level. It means that return on investment is influence by 5.243% by the 1% change in interest converge ratio. It can be said that increase in interest coverage ratio will leads to increase in ROI.

In regression analysis results shows that the value of R2 is 0.775, which shows that the sample regression explain 77.5% of aggregate data. The overall model is also significant with adjusted R2 value of 0.746. So, it can be concluded that the model applicable to Indian Pharmaceutical industry. So model is fit for study.

The classical finance theory said that firm's shareholders value creation is based on firms earning ability and firms return on its net worth. On the basis of regression research I have proved that the firm's return on investment is highly dependent on economic return on net worth, debt equity ratio, and creator's velocity and price earnings ratio.

VII. CONCLUSION

Though computation of EVA is not compulsory for pharma companies they show keen interest in such computation as they believe that it ensures higher accountability for managerial actions, facilitates them in aligning their performance with that of the shareholders' expectations, helps them in preparation of concrete performance reports, designing of incentive compensation on fair and equitable basis and efficient capital planning.

Internationally-known companies like Dr. Reddy's, Nicholas Piramal and JB Chemicals have followed the EVA model and all of them have recorded positive EVAs. JB Chemicals reported an EVA of 1,143.41 lakh in its annual report for the financial year 2004-05. The Indian pharma industry has to capitalize on the giant leaps made in IT and biotechnology. The future of the industry will depend on its ability to diversify its risks, the extent to which it is able to build its marketing network, co-marketing and licensing agreements, its forward and backward integration capabilities and its mergers and acquisitions. Special attention is needed with regard to its investment in R&D. In this industry, the investment made in R&D may/may not yield returns; therefore, the risk is very high which makes the industry to be very conservative in this area. The industry should be willing to take up risk with optimistic approach and that will pay rich dividends in the future.

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