CHAPTER-7
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Financial Analysis: Study of Ratios

The two liquidity ratios studies to assess the health of the seven diversified companies were current ratio and acid test ratio. It was found that on the whole all the companies had a sound average current ratio for the six years period. While some like Pfizer and BILT maintained higher liquidity levels, others like L&T and Glaxo maintained lower liquidity position. Regarding acid test ratio it was observed that Glaxo (0.56), HLL (0.50) and L&T (0.63) maintained a lower ratio than the normal accepted standard of 1:1. BILT on the other hand maintained a higher ratio of 1.88. Here again, it must be mentioned that some firms seemed to be more cautious, while others relied on their past experience to be less conservative and yet remain unvulnerable.

The debt-equity ratio which is a leverage ratio employed, revealed that compared to the generally accepted standard of 2:1, the average D-E ratio of all the firms revealed a much lower debt component. Pfizer had the lowest at 0.28, while L&T had the highest at 0.82. Another noticeable trend was that by large the calculated ratios for most companies for all the years were more or less uniform.

Five profitability ratios were studied namely G.P. ratio, N.P. ratio, ROA, ROCE and ROE. The G.P.
and N.P. ratios revealed that the firms had performed well as the results were satisfactory. However, firms like ITC and Pfizer which had high G.P. ratios (81.77 percent and 45.0 percent respectively) revealed rather low N.P. ratio (1.96 percent and 1.79 percent). Further, L&T which had a G.P. ratio 15.94 revealed a high N.P. ratio of 4.97. On examination these were found to have occurred because of the accounting practices adopted by the firms and the nature of their businesses. As far as ROA is concerned it was observed that wide differences existed between the seven companies studied. Some had consistently high ratios and others consistently low ratios. Further, some revealed an increasing trend, while others a declining trend and still others a fluctuating one. The observations regarding ROCE were similar to that of ROA. Even with respect to ROE the same could be said. HLL had a very high ratio of (24.18 percent) while BJ&I a low ratio of (3.83 percent) while Glaxo revealed an increasing trend, BJ&I showed a fluctuating trend.

The activity ratio employed in the study was the asset turnover ratio. This ratio for all the companies except for L&T and to some extent BILT, showed efficient management of assets. In other words, it indicated that for every rupee of investment in fixed and current assets, the firms could generate an amount of sales which was more than the investment. Even for L&T for example, the low ratio was more because of the nature of the business it operates in rather than a sign of inefficient management per se.
Besides these, the dividend pay out ratio was also computed to check on the performance of the firms. The overall financial position as reflected by DPS ratio was more or less satisfactory as the return per share varied between 1.25 (Pfizer) and 3.30 (HLL).

The Kruskal–Wallis test was used to rank companies on all the ratios. In case of liquidity ratios, K–W test results revealed the need for ranking. Pfizer and Ballarpur Industries did well in both ratios. While others had a combination of good and relatively good results or relatively good on both fronts. Results regarding profitability ratios revealed that in all cases statistically significant variation existed which required ranking. However, visual inspection revealed desparity in performance of individual companies on the five profitability ratios. Therefore, all the five were studied together. This revealed that statistically speaking, all the seven companies had more or less performed uniformly well and hence, ranking on individual profitability ratios was rendered superfluous.

The K–W test revealed the necessity for ranking on D–W ratio. ITC received the first rank, closely followed by HLL. The last rank went to Pfizer. Regarding the asset turnover ratios too, the ranking was required. Here again ITC occupied the first place followed by HLL. On the whole all firms have done well barring the heavy capital intensive ones.
The foregoing analysis reveals that the overall financial health of the companies was satisfactory. This, in other words, accepts the first hypothesis that diversification has led to sound financial performance and health. It is clear that all the seven diversified companies had not performed equally well on all the ratios examined. However, some had performed consistently well on most fronts, while others had revealed uniformly mediocre results comparatively.

Though it is difficult to strictly state that diversification had led to good performance, yet it can be emphasised that the diversified companies studied had performed well. It is possible that factors other than diversification could have contributed to this success. But as no other factor was considered for the present study, nothing can be said in the affirmative or otherwise.

Product Portfolio Analysis and Diversification Index

It was observed that Glaxo had four product groups in its total portfolio out of which only two were contributing significantly to total sales. Though the contribution of bulk vaccines was negligible, chemicals accounted for approximately 7 percent of the firms sales. However, the three groups, chemicals, formulations and foods had a compound growth rate varying between 11.5 percent to 13.5 percent which was a healthy sign.

With HLL, the percentage contribution to total sales of a single product category – soaps and
detergents was found to be very high. But it was significant to note that when compared to the first year, the last year showed a healthier trend. The dependence on soaps and detergents had declined and there was a substantial increase in the sales of chemicals, revealed by a compound growth rate of 32.36 percent. The fact that footwear was introduced in its portfolio during the period of study, and its growth in sales was high, was inferred as a step which will further diversify HLL and reduce dependence on a single product group.

In case of ITC, the compound growth rates of all its product categories were high. The average compound growth rate (CGR) for its product groups was 14.52 percent, which was the highest compared to rest of the firms. Like HLL, ITC too depended heavily (85 percent) on one portfolio namely cigarettes. But the 1989-90 scenario showed that the company management was seized of this problem and had reduced the dependence on cigarettes. The CGR for this product was the lowest at 13.44 percent. Its contribution to total sales reduced by 5 percent and the proportion of other product groups had increased.

BJ&I which had four major product categories, obtained its largest sales turnover from cement. The proportion to total sales of cement had grown to 70.4 percent during the last year, with the highest CGR of 11.62 percent. Also in case of two other products namely synthetics and carbide & gas the CGRs were good (8.79 and 6.81 per cent respectively). In terms of physical volume too these two had grown
considerably. However, in percentage contribution to total sales they had marginally reduced. It was important to note that BJ&I had reduced its emphasis on Jute goods. This was a good sign as the future of Jute products is quite bleak.

That Pfizer is basically a pharmaceutical firm was reflected by its product portfolios. It relied almost totally on Medicines (98.6 percent) for its sales. However, the CGRs showed that Feed Supplements was growing faster (20.34 percent) than Medicines. But in absolute terms it was insignificant.

L&T which had as many as fifteen product groups, revealed that on account of its large size, diverse and global operations, its risk was low. On comparison, very little variation could be seen between the first and last years of its operation. Barring cement (25.6 percent) and to some extent medical test equipment (16.1 percent), other products contributed almost uniformly to the firms total sales. The average CGR for L&T was good at 12.67 percent and its sales volume too had grown substantially.

Relying on four major product groups with stress on paper, BILT had a good all round performance reflected in its average CGR of 13.86 percent. Besides, all the groups had a similar CGR except for vanaspati unit which lagged behind. BILT had reduced its dependence on paper by nearly 5 percent over the five years. Chemicals had increased its share to 18.1 percent and so had the 'others' category (16.8 percent).
The results of the diversification index (DI) worked out revealed that wide variations existed between companies in their indices. However, it was interesting to note that for each company, over the years, there was only marginal fluctuations. The average index for the six year period revealed that the seven companies fell into three broad classes namely high, medium and low. Those securing an index value of 0.60 and above were classified as high, those varying between 0.30 and 0.59 as medium and those below 0.30 as low. Thus, two companies namely L&T having an average index of 0.86 and BILT with an average index of 0.60 fell into the first category. Three companies came into the second group: These were BJ&I (0.48), Glaxo (0.47) and HLL (0.31). In the last class again, there were two companies namely, ITC with an average diversification index of 0.19 and Pfizer having an index value of 0.02.

The results of the correlation done between the diversification index and gross profit revealed that five companies namely, Glaxo, HLL, ITC, Pfizer and BILT had positive correlation coefficients, 'r' being 0.256, 0.693, 0.850, 0.319 and 0.815 respectively. While two companies had negative correlation coefficients, BJ&I (-0.793) and L&T (-0.047). The standard error calculated and its test for significance for the seven companies showed that only two companies i.e., HLL and ITC had their 'r_s' significant at 80 percent and 95 percent confidence levels. Since the others were significant at lower levels or not significant, it implied that the samples were biased. It could be due to inadequate number of observations or haphazard nature of data.
The conclusion on the Product Portfolio Analysis performed was that the average CGRs of the seven diversified companies were high though the product portfolios were not balanced. But this had in no way proved to be a threat to the existence and growth of any company. However, it is advisable that the firms move towards more balanced product portfolio for own welfare in the future.

Though the DI employed revealed that the seven companies fell into three main classes of high, medium and low, it was clear that a high index value was not necessarily an indication of superiority and vice versa. Even the correlation between profit and DI could not establish any fact deterministically. In the ultimate analysis it was found that no conclusive deduction could be arrived at. Meaning that the profits and indices of diversified companies may be significant or not, depending on individual firms and not as a general rule.

Performance Analysis - Exports and R&D

It was observed that the companies had earned foreign exchange through exports. The gross export earnings of some firms like HLL, ITC, L&T, BJ & I and BILT were high. While some firms like BILT and L&T had shown consistently increasing trend, others had shown inconsistency in lesser or larger degree.

Regarding net export earnings, it was noted that only three firms namely HLL, ITC, and BJ&I had shown positive net export earnings for all the six years. Companies like Pfizer and BILT had shown
negative net export earnings for the years. But even with those firms which had shown positive results in export earnings, none had been fully consistent.

Some companies like HLL, ITC, BJ&I and BILT had received awards from government or renown bodies for their excellence in the field of exports.

In the R&D field on the whole it was found that the level of expenditure made was low compared to international standards. However, companies like Glaxo, Pfizer and to some extent L&T had invested around 1 percent of their total turnover in R&D activity which by Indian standard is good. But companies like ITC, BILT, and BJ&I had spent very little on R&D.

It was observed that most companies had achieved some breakthrough in the R&D field, which had led to either efficiency, pollution control, import substitution or improved quality. In some cases it had also directly or indirectly led to employment generation.

In the final analysis and conclusion it can be said that though all the diversified companies studied had achieved sound levels of exports, in many cases the extent of imports nullified these export earnings leading to a negative position. Further, that diversification had let to exports cannot be firmly stated, but certainly the thrust on exports by diversified companies was high.
In the realm of R&D, though the average expenditure made by the companies was low, the achievements made by way of breakthroughs and winning of prestigious national and other awards were high. The low outlay in this field for some companies like Glaxo and Pfizer, was because of the assistance they got from their parent company worldwide. Others had like (BJ&I) associated with reputed R&D institutions of which they were members. Still others had not felt the need for R&D as competition was not very acute. But it was observed that the awareness and stress on R&D, in general, amongst the seven diversified companies was on the increase. Though very little evidence existed to proved that diversification had contributed to import substitution, the enhanced expenditure on R&D by most firms could well have happened because of the addition of new and diverse portfolios to its business.

**Trend Analysis**

For Glaxo, HLL and ITC, the trend analysis performed revealed largely similar scenarios. The $R^2$ was high for all the three firms with the only exception that in case of HLL it was 0.95 and more for all the four variables studied. In all cases the 'T' and 'F' tests conducted delivered results which were significant at 5 percent confidence level. The 'D-W' test was also satisfied.

In case of BJ&I the $R^2$ for net profit was very low (0.18) and the T & F statistics results were not significant even at 10 percent level. Hence, no trend could be forecast. In fact the computer forecast
turned out to be negative or declining. The trend for dividend was also rather poor. For Pfizer, the $R^2$s were low uniformly with only 0.03 for dividend. Further, the T & F tests were not satisfactory for all other variables except for sales.

L & T had mixed performance as far as $R^2$ was concerned. But the T&F statistics for NP & GP proved to be non significant. Yet the forecast made, gives a reasonable trend. Similar was the performance revealed in case of BILT. Its $R^2$ for NP & GP was low at 0.52 and 0.54. Further, like L&T, the T&F tests for these two variables were found to be non significant.

The results of ranking done based on the regression analysis showed that three companies had done well. ITC was in the lead with first rank in net profit and dividend and second rank in sales and dividend. HLL was first in dividend payment, second rank in gross profit and third in both sales and net profit. The last in this category was L&T, with first rank both in gross profit and dividend and fourth position in net profit.

The remaining four companies had not done well. BILT had two fourth ranks, one fifth positions and a lone second (net profit). BJ&I had one fourth position (gross profit), two fifth ranks and one last rank.

The remaining two were really poor. Glaxo India had three sixth ranks and one fifth, while Pfizer had come first and second from the bottom on all the four fronts.
The trend analysis revealed that the future of the seven diversified companies with regard to their sales, net profit, gross profit and dividend is a mixture of bright, dull and intermediate performances. Some are bright on all parameters while others have mixed future. Thus to a large extent it can be said that enhanced future potential and performance of the diversified companies can be a consequence of pursuing diversification strategy.

It must be borne in mind that invariably a sound and clear trend could not be forecasted because the data proved to be haphazard. This under no circumstances hinted at the fact that the profitability of the seven companies could be questioned. However, a steady growth in the past would certainly have revealed a similar future.