CHAPTER-VII

SUMMARY OF FINDINGS AND SUGGESTIONS
Introduction

In the present undertaking titled “Financial performance of Small and Medium Enterprises – A study with particular reference to the Pharmaceutical units in Andhra Pradesh”, the financial strength and weakness of the ten selected representative pharmaceutical units in the Pharmaceutical sector of Andhra Pradesh was examined in detail. The argument developed in the study is summarized and workable suggestions are offered here for improving the financial performance of the pharmaceutical units in Andhra Pradesh. A study of the financial performance of a business concern involves a scientific evaluation of its profitability and financial strength. In fact, financial analysis is the process of making an anatomical study of the financial and operational data contained in the profit and loss account and the balance sheet of a given concern and thereby satisfying the information needs of the internal and external users of such data. On the other hand, financial performance is the process of scientifically making a proper and comparative evaluation of the profitability and financial health of the given concern on the basis of the summarized and analysed data, i.e., the output of financial analysis. Therefore, financial performance of a concern simply is the process of its scientific evaluation. Such financial tools and techniques as Ratio analysis, Trend analysis, Common Size analysis, Comparative statement analysis, Funds flow analysis and Cash flow statement analysis have been used to evaluate and appraise the financial statements of a selected undertakings.

The present study is confined to the financial performance of a sample of pharmaceutical units in the SMEs of Andhra Pradesh. Out of the 198 SME units in Andhra Pradesh 10 pharmaceutical units were chosen as the sample. The data relating to them is collected primarily from their annual reports and supplemented with the information obtained from other relevant sources. The data so drawn was tabulated, analysed and appraised with the help of the various financial tools and techniques mentioned the earlier besides the application of certain familiar statistical tools.

Small and Medium enterprises have a very important role to play in the industrialization as well as economy of the country. Keeping in view the importance of the small-scale industry sector, and its entrepreneurs, the government of India has
made considerable efforts to promote their growth during the last five decades. The SMEs form the backbone of the Indian manufacturing sector and have become engines of economic growth in India. Micro, Small and Medium Enterprises (MSME) development Act, 2006 came into force from 2nd Oct, 2006. The Act aims at facilitating the promotion and development of Micro, Small and Medium Enterprises as well as ensuring their competitiveness and smooth flow of credit to them as well as minimizing instances of sickness among them. The strategy for the development of the small and medium scale sector comprises formulation and pursuance of deliberate policies for its protection and development, stepping up plan allocations for it, evolving and implementing various programmes for its development including extension of concessional finance both short-term and long-term through a number of supporting institutions.

The Indian pharmaceutical industry grew from a mere US$0.3 billion turnover in 1980 to about $19 billion in 2008 of which the local market was worth US$10.76 billion and the international market was worth US$8.24 billion. It accounts for nearly 2% of the global market in terms of value and 10% in terms of volume. The Indian pharmaceutical industry is now ranked 4th in terms of volume of production and 13th in terms of domestic consumption. One reason for the lower value share is the lower cost of drugs in India ranging from 5% to 50% less as compared to the cost of the drugs in the developed countries. The industry grew at a CAGR of 13 per cent between 2002 and 2008.

Andhra Pradesh has been pioneer in the field of medical/human and animal healthcare. Most of the companies in the state have their R&D facilities, thus, making the state a leader of the pharmaceutical industry of the country. The greater part of the credit for the progress Andhra Pradesh has been making in the pharmaceuticals business front goes to the state government, which has extended its helping hand to set up a pharma city in the state and provide other facilities and perks required to enable its pharma industry to grow.
Findings:

1. The growth of small and medium scale industries in Andhra Pradesh in the recent past has been significant. The available literature on the industrial front of Andhra Pradesh denotes that the State has sound infrastructural facilities. These facilities are not only adequate for the existing industrial units at present but also sufficient for setting up units further in the future.

2. From the analysis of the data obtained from the sample units, it is found that the growth of different types of industries in Andhra Pradesh has not been uniform. It is true of both small and medium sectors. Further, the number of units functioning has been uneven.

3. It is observed that both small and medium industries suffer from shortages of working capital.

4. In addition to the shortage, there are problem of idle of finances, lack of demand, seasonal nature of manufacturing or demand, poor quality of products labour problems, shortage of raw materials, fluctuations in power supply, etc., these are found to be the major reasons for the idle capacity of several small and medium units.

5. It is found that no single unit is free from problems of its size and structure, which have hampered its growth.

6. The units experience at different stages problems related to production, labour, marketing and finance.

7. It is also found that many units suffer production problems due to the shortages of inputs such as raw materials, skilled labour, breakdowns in equipment and machinery and shortages of power.

8. Non-availability of skilled labour has affected some units. Many units experience such problems of labour as absenteeism, turnover, etc.

9. Low investments in innovative R&D and lack of resources to compete with the MNCs for research and new drug discovery and global commercialisation of molecules.
10. High cost of discovering new products; and consequently fewer discoveries

11. High entry cost in the newer markets

12. High cost of sales and marketing

13. Absence of strategic future planning and poor technology forecasting

14. The image of pharmaceutical industry is tarnished at home and abroad because of production of spurious and low quality drugs by some them.

15. Large pharmaceutical units abroad seem to have for better chance of monopoly than small and medium units in the pharma industry, and consequently Indian pharma companies may have to struggle hard for their survival.

16. The increasing trend of short-term funds is a matter of concern for all the sample units. The short-term creditors gradually seem acquire to more or less a permanent stake in all the units.

17. An analysis of the trends in working capital of the pharma units reveal that the overall working capital position in the units gained some strength during the period of study. But the analysis of individual units has revealed that the net working capital is negative in the Phaamasia unit, the working capital is satisfactory in Krebs Bio Chemicals, the SMS pharmaceuticals, Avon Ogranics, Venkat pharma, Vivimed Labs, Hindustan Bio sciences, while Suven life sciences and Granules India units enjoy a sound working capital position.

18. The main sources of capital in the selected pharmaceutical units are equity share capital including retained earnings, preference share capital and funded debt composed of debenture capital and loans from financial institutions and government. Thus, long-term funds constitute the major source of financing the assets.

19. Equity capital including retained earnings is found to be a major source of finance for all the units under study. The second important source are long-term borrowings from financial institutions and the government.
20. Preference share capital is not popular as a source of finance in the sample units.

21. Debentures as a means of borrowed funds are unpopular among them. But debenture capital as a means of finance has not been given much priority in a few of the sample companies.

22. The overall position of the sample units indicates that long-term funds as a whole are inadequate to finance their fixed assets requirements. Loan capital constitutes the major source of finance in Andhra Pradesh.

23. On an average the proportion of long-term funds as a percentage of total assets registered a declining trend during the period of study. The net worth showed a declining trend while the long-term borrowed funds registered a marginal increasing trend.

24. The debt-equity ratio on an average was higher than the generally accepted standard norm of 1:1 in five out of the ten sample units. It may be inferred that the units have preferred to use more short-term loans and advances to meet their current obligations year after year. Since the trend of the debt-equity ratio registered a decline, it may be said that an increasing proportion of debt was employed every year. However increasing employment of loans did not maximise the earnings to equity shareholders which is evident from the interest-coverage ratio.

25. The net profit margin in the sample units was meagre in view of the presence of high interest charges on the one hand and heavy tax burden on the other.

26. The earning power of the shareholder’s funds in the units was found to be incompatible with Shareholders’ funds, which were used inefficiently and therefore, funds owned by the units were least productive.

27. Inventory was the dominant item of current assets in the sample units. The investment in inventories as per cent to total current assets was considerably high. The size of inventory maintained in the units varied based on their scale of operations.
28. It is observed that though the sales and debtors increased simultaneously, the rate of increase was more in the latter than the former during the first part of the period study. As a result the rate of turnover declined and the collection period increased.

29. Analysis of the overall position of the fixed assets investment in the sample units reveals that the size of investments improved considerably during the period of study.

30. Plant and machinery formed the dominant item of fixed assets in all the sample industries.

31. The declining turnover of fixed assets in the sample units indicates that the fixed assets were utilized inefficiently by them. Short supply of raw materials, labour unrest, and power shortage were mainly responsible for the ineffective use of fixed assets in these units. The capital structure of the units was low-g geared during the period of study, except in the Suven Life Sciences and Hindustan Bio Sciences.

Suggestions:

The following suggestions are made to resolve the various issues confronted by the small and medium sectors, mentioned above.

The SMEs significantly contribute to social and economic development of the nation by labour absorption, income distribution, rural development, poverty eradication, regional balance and promotion of entrepreneurship. Since India’s Independence this sector therefore has acquired a prominent place in the socio-economic development of the country. Its performance has been creditable, but yet. The sector needs many corrective steps to perform better. The key to success of the SMEs would lie in looking at the globe as a market and succeed there. As a result of globalization and liberalization, and the WTO regime, Indian SMEs have been passing through a transition. With the slowing down of economics of the US and European Union on the one hand, and the ever-increasing competition from Chinese economy on the other, Indian economy has to take better and measured steps.
REQUIREMENTS TO BOOST THE COMPETITIVENESS OF THE PHARMA INDUSTRY

➢ Extension of deduction of 150% of R&D expenses would encourage more and more companies to invest in R&D.

➢ The government has earmarked 150 crores for R&D. This is not at all enough. It should be augmented to at least 2000 crores.

➢ Drug Price Control Order (DPCO) has to be rationalized so as to ensure adequate availability of quality medicines at affordable prices. The product patent regime will make it obligatory for Indian companies to compete in the R&D if they want to survive. Similarly, the WTO led global trading system will result in import tariffs coming down. Indian companies, to compete with cheap imports, they will have to invest in cost effective technology and processes. Therefore, it is imperative that the pharma industry has surplus for investment. In this context, a liberalized price control regime becomes very important.

➢ An academic-industrial relationship has to be explored, on the lines of the US model, where universities are the sites of innovation and the industry commercializes the product. If universities are permitted to own the Intellectual Property Rights (IPR) and get a share of the profits, academic institutions will then become engines of entrepreneurship. This also requires the setting up of a larger number of centres of academic excellence throughout India, so that people from across the country can avail themselves of such education and make their contributions without feeling the need to look beyond India for achieving academic excellence.

➢ Income tax exemptions should be given on clinical trials and contract research done outside the company and abroad, because India is seen emerging as a major centre for outsourcing clinical trials for the Pharmaceutical MNCs.

Reviewing theoretical aspects of the sources of capital, the structure of long-term and short-term funds, working capital, the inadequacy of long-term funds to invest in fixed assets, the adequacy of cash in terms of liquidity and funds flow behaviour in the sample units are analysed.
As the selected industries did not use as efficiently as desired their finances, it is necessary that the finances of individual units' undertakings should be managed productively with a pragmatic outlook in order to facilitate steady progress of the industry. The concept of profit, profitability and rate of return, basis of profitability, measuring the profitability in relation to capital employed sales and shareholders' investment, inventory adequacy and efficiency, structure and growth of fixed assets, their financing pattern and utilization of these assets have been analysed.

1. To strengthen their long-term solvency position, the units should use more long-term funds to finance their fixed, and core current assets. The use of long-term funds, enables them to lessen the pressure of using short-term loans and advances, and eliminates the risk of arranging for finances regularly.

2. The practice of trading on equity did not increase earnings to the shareholder in many of the units. As the earnings were not adequate to cover reasonably the interest charges, there is the possibility of non-payment of interest charges to creditors which may cause financial complications. Therefore, under these circumstances it is better for the units not to opt for debt capital including short-term loans and advances. Instead, the present debt can be retrieved through the issue of equity shares and also to certain extent through redeemable preference share capital. Even in financing the expansion and modernization programmes, these industries should use only the equity capital besides retained earnings. It is better if liabilities and capital are readjusted and reorganized in the units as specified above so as to improve their financial strength.

3. In order to strengthen the long-term solvency, the existing short-term borrowed funds, especially working capital loans from commercial banks may be converted into long-term borrowed funds.

4. The decisions concerning long-term funds should not be impulsive and haphazard as practiced now by the units. These decisions have to be taken carefully in order to maximize the earnings to the equity shareholders.

5. The diversion of working funds to finance the expansion programmes should altogether be stopped immediately. Further-more expansion should be undertaken only when there is sufficient amount available to meet the working capital requirement not only for the present but also for the future.
6. The shooting prices of inputs have put a severe strain on the sample units resulting in inflated operating ratio. Therefore, the need of the hour is the effective control of operating costs. Adoption of profit planning and control techniques such as marginal costing, cost-volume-profit analysis, standard costing and flexible budgetary control systems may in fact enable the units to bring down the operating costs and boost up the profits.

7. The quantum of sales generated should be improved impressively in order to promote better capital turnover ratio and to enjoy higher returns on investment.

8. There are certain non-financial factors such as worsening industrial relations, increased wage bill, frequent power cuts etc., which have caused lower profits or at times losses. Some of these can be rectified by adopting a proper approach.

9. Inventory is the major item of current assets in such private sector industries. Hence, effective procedures and methods have to be developed in order to optimize investment in this component of current assets.

10. To control the overall level of inventories, norms should be developed for different inventory holdings. These norms should be compared with the actual consumption and the loopholes, if any, blocked cautiously.

11. To strengthen the liquidity position, long-term funds have to be used to finance core current assets and a part of temporary current assets. It is better if the units can reduce oversized short-term loans and advances.

12. To provide greater coverage to fixed assets, the extent of the use of owner’s funds has to be immediately increased. To avoid the financing of fixed assets by using short-term debt, it is better to strengthen the long-term funds position.

13. The expansion of gross block should enlarge the sales so that the units can make more operating profits. For this the fixed assets of the units have to be utilized more efficiently, so that the quantum of sales reaches the highest possible level. This enables the units to establish and maintain proper relationship between the size of investment in fixed assets and the quantum of sales. Pharmaceutical units have to replace their out-dated and obsolete
machinery so as to improve their capacity utilization. Modernisation of the units should fall in line with the present technology and it should be carried out irrespective of cost considerations. Funds needed for these purpose may be raised in the form of equity share capital besides using internal funds.

To conclude, the working capital position in the units studied is found to be very unsatisfactory as they have operated with meagre working funds. The SME pharmaceutical units in Andhra Pradesh should design and develop a balanced capital structure, use fixed assets efficiently, create adequate depreciation provision, optimize the inventory investment, strengthen the degree of liquidity, and control operating expenses effectively in order to improve their financial efficiency.