

Debt to equity ratio and its impact on pharma company profitability

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Abstract

In a capitalistic structure, there are numerous risks and factors that can play a role in the outcome of business. Government policies also play a major role in the outcome of business activities.

The policies that are laid down by the business-friendly governments are mostly in accordance with the aim of an increased level of economic activities in the countries. However, the business activities or the economic results shown by the organizations are determined by numerous layers of performance indications. One such indication is that of the Debt Equity Ratio or DER of the organizations. The debt equity ratio of a company is calculated by dividing the liabilities that the company poses in its account to the equity that is invested in the company through its shareholders. In pharmaceutical companies, the onus is on the ability of the CEO of the firm to continuously encourage and enable the investors to rely on their money invested in the organization in various times. There are many studies that provide indications and suggestions regarding the performance of the CEO of the organizations in the matter of DER. Many of these studies suggest that DER is a bigger factor in case of pharmaceutical companies than in case of an average multinational corporation.

1. Aim, Objectives and Research Questions

The aim of the research is to find out if there is a definite connection between the DER of a company and its ability to garner profit in the market.

The objectives of the research are to find out

- The links between the DER and other performance indicators of the company.
- The technical and researched aspects about the company that would increase the profitability of the company in a large scale.

The research questions are as follows

- Does an increase in the level of DER increases the risk of operations of a pharmaceutical company?
- Is the ability of the company to attract new and more enthusiastic investors in the market a strong factor that determines its profitability?

Is the company's overall performance dependent more on the public and market image than its efficiency in operations?

2. Literature Review

According to studies, the leverage that the company has in the market is one of its main valuable assets that determines its overall performance. The DER of a company signifies the leverage the company would possess in the market (Zuhroh, p. 2017, 2019). For a smooth flow of trade and

other operations, it is necessary for the company to maintain a high standard of leverage in the market. If that is sought and delivered by the company, the chances for the new and improved investors being attracted towards the financial aspects of the company would be high. There can be a lot of factors that would end up in demeaning the leverage for the company (Aminah, Laba and Pakki, p. 57, 2019). For example, it is believed that the higher the involvement of the founding family in a pharmaceutical firm, the more the chances of leverage being non-predictable from time to time. This would go on to hurt the causes and the purposes of the company. The factors that make the company operate in a smooth direction in the market can be influenced negatively by the

interference. It might result in the economic situation becoming unstable and not trustworthy for the functionalities of the company (Harahap, p. 729, 2018). This is one of the factors that the CEO and the board of directors of the corporation has to thoroughly introspect. The solution lies in the development of a situation where the interference is minimized through the mechanisms and performance of the board. Any economic downturn that the corporation has to go through should be thoroughly investigated and the situation deserves to be monitored by the high authorities within the corporation.

Capital structure is a term that signifies the various debts and equities that the company uses to finance its operations. It can be debts or it can be equities. However, in most of the occasions, the companies use both debts and equities as factors that would provide for the investment that the company needs are its specific range of activities (Munthashofi and Purnamasari, 2019). For example, the company can use the bank loans to make for the finances that would propel the activities that the company is about to undertake in the near future. The loans can either be of short term or long terms. In case it is short term, the company has to make sure that the amount of investment is returned to the investors within the given period of time of the agreement (Endri, Lisdawati, Hakim and Sugianto, p. 592, 2020). In case it is a long-term investment, the company has to make sure that a proper agreement exists between the representatives and the lender. The existence of a proper agreement is crucial because in business, there are many facets that makes the proceedings unreliable. Hence, a proper standard of understanding has to be set up between the borrower and the lender (Murniati, p. 27, 2016). It needs to have clauses and sub clauses that define the nature of the understanding based on which the proceedings would move forward.

The areas that the stakeholders of the company would always have on top of the priority list is the business risk that they have to deal with in the midst of their operations. For companies to survive, it is important that they have to manage the risks in an efficient and effective manner. Without risks, no company would be able to survive (Sukmawardini, D. and Ardiansari, p. 216, 2018). It is how the management can handle risks that determine how the company would fare in the proceedings in the near and long-term future. A company that is operationally effective would be prompted to use the debt to make sure that the risks that can potentially lead the company to uncertain situations would be averted and prevented. Sometimes, operating the risks can be an intimidating factor for the company. It can end up with a situation where the profitability and the overall performance of the company would be put in a position of compromise (Hirdinis, 2019). To prevent this situation, the presence of a reasonable DER for the company is essential. A low number on the DER would signify that the company is operating at a level where the lenders would be appropriated for a loan in a smoother and more effective manner. The lower the number of DER, the more the risk that would come into play for the company (Putri and Rahyuda, p. 149, 2020). This also signifies that there would be a more

standard level of profit making for the pharmaceutical companies when the DER levels are lower. The lower the DER levels for these companies, the more the investors would be interested to proceed with their operations and their plans for the company. It would lead to a situation where the company would be able to generate a much more stable level of profits (Priyanto, 2016). From this, it can be inferred that the level of profit making that the company operates on would be under general circumstances be dependent on the DER ratio or the leverage that the company would hold in the market.

3. Research Methodology

Research Philosophy

Through a research process, knowledge is gained by the researcher. The subject throws the opportunity to the researcher to gain new levels and new layers of information in the field. However, a research process is not just about gaining information. The information that is gained in the process of the research is only a tool that provides direction to the researcher. The knowledge is connected with the proceedings and the overall procedures that are undertaken by the researcher in the whole process (Lolowang and Hastuti, p. 537, 2019). There are four main philosophies in research that are utilized to gain a high level of knowledge about the subject matter and incorporate the same in the field of application. These four rough fields are as follows

- **Positivist Research Philosophy:** In the positivist research philosophy, the main argument is that the dynamics of the world can be systemized and represented properly and through empirical information sharing. In this particular research process, it is not the aspects of the social world that is being discussed (Bukit, Haryanto and Ginting, p. 012137, 2018). The discussion is mainly about the scientific

mechanisms that can prove whether or not the DER can affect the profit-making ability of the pharmaceutical companies. The dynamics of the world that is being discussed in the positivist research philosophy can also be about the systems of the share market and investment. However, on an empirical scale, this does not have relevance in connection to what is prescribed in positivist philosophy.

- **Pragmatist Research Philosophy:** Pragmatist research philosophy is the one that deals with the facts that are relevant in the research process. The proceedings of such a process of research would be largely dependent on the facts that are calculated and applied in the research process. The facts play a key role in the development of the phases of the research.
- **Interpretivist Research Philosophy:** According to the philosophy of the Interpretivist researcher, the observation that is carried out in the research process is highly critical for the researcher. The result of the research is dependent on the way the observation process is carried out in the research. Therefore, according to this philosophy, it is highly recommended that the research observation process covers all the areas of the research thoroughly.
- **Realistic Research Philosophy:** In the realistic research process, the role of the assumptions of the research process are critical. It is important in the research that the variables of the process are defined properly and extensively and the behavior of the variables are laid out in a systematic manner (Widhiastuti, Ekasaputra and Jayadi, p. 43, 2020). These variables form the base of the research process and it is highly important

that it is thoroughly studied and properly established before the research proceeds to the very next stage.

Out of these four philosophies laid down about the process, in this particular research it is the pragmatist approach that would yield the results for the research process in the most effective manner. The facts are most important in establishing the relation between DER and profit-making ability of the pharmaceutical companies. Hence this was chosen in this research as the philosophy that would form the base of the research process.

4. Research Strategies

There are numerous strategies that help the research process to achieve its aims. These strategies are mechanisms applied by the researcher to gather data in the processes. The mechanisms that are applied by the researcher would be dependent on the perception that is formed by the researcher in the process (Mulyani, Amboningtyas and Fathoni, 2017). The mechanism to carry out the research and apply the strategies that help move the research forward towards achieving an end in the process are as follows:

- **Case Studies:** This mainly focuses on a particular case that and the research process is based on throwing light on the occurrences and the aspects possessed by the case. The facts of the case study would be verified by the researcher in the process and the relationships of the aspects in the case study would be under the microscope of the research. In a case study, the ability of the research personnel to investigate the variables of the research process and the application of the variables in real life simulations is highly important.
- **Qualitative Interviews:** In interviews, the most useful information of the research would be gathered from the eminent personalities that are attached with the subject of the research process. In this particular method of research, it is highly important to make sure that the personalities that are chosen for the interaction would have a high standard and extensive level of knowledge about the topic of the research process. It is the interactive sessions that would reveal the facts about the topic.
- **Quantitative Surveys:** In the process of quantitative surveys, the notable fact is that there are numerous sources from where the data is gathered. It consists of optional requests wherein the participant of the research process would have multiple options that would illustrate how much the notions of the participant are in line with the propositions that are put forward by the researcher in the process.

Out of these three, it is the quantitative survey that is chosen as a strategy of research in this particular case. This is because a quantitative research would take a lot less time than the other prescribed methods of the research process. The research was carried out with proper scrutiny in this particular case in the sense that it was verified whether the participants of the process of research are executing the responses in a false manner. A proper level

of interaction between the personality behind the research process and the participants of the research was carried out in this case. The sampling of the population was carried out based on the knowledge and application that the participants would pose to the researcher. The samples of the research process consisted of personalities who are knowledgeable in the areas of investment and the functionalities of DER.

5. Evaluation and Analysis

These are the following questions that were posed to the participants of the research in the quantitative survey.

SL	QUESTIONS	Highly Agree	Agree	Disagree	Highly Disagree
1	Do you think the public face of a pharmaceutical company is important?	67	21	6	6
2	Do you think the investment in a pharmaceutical company needs a smooth flow?	51	33	9	7
3	Do you believe the investors from the stock market can fluctuate based on performances?	31	27	22	10
4	Do you believe the indicators are highly important for the ultimate investment that the company can garner?	42	23	17	18
5	Do you believe the DER indicator is a big factor for the investors?	44	31	17	9
6	Do you think companies that ensure a smooth flow of investment can also ensure a high level of profit?	33	26	24	17
7	Do you think the public face of the company in the market is associated with the performance in generating profit?	62	26	9	3
8	Do you believe pharmaceutical company investors can benefit from a stable and decisive standing in the ratio of its debt to its equity?	57	26	8	9

According to the results of the survey, one of the most notable aspects that is significant for the observers of this research process is that most of these personalities from the roster of the participants are undecided about the effect of a smooth level of flow in the investment process of a pharmaceutical company (Saputra and Asyik, p. 6, 2017). According to the participants of the research process, a smooth level of flow can be important and can also lead to a high level of success for the company in the immediate future. However, the success that the company would generate in the process in this case would also be dependent on other critical factors. For example, it is important that the flow of investment of the company is not from a single and particular source or a limited number of sources. If the investment or the flow of cash into the company is limited to a few sources, it means that the success of the company would be highly dependent on the ability of the company to retain the partnerships which are limited in the scenery. In this particular case, it might be something else that also plays a

factor in the success of the companies in generating profit (Cahyono, Andini and Raharjo, p. 2, 2016). The factor can also be the limited scope within which the company has to operate. In such a case, the further growth of the company would not be feasible because the operations of the company do not go beyond the comfort zones of the company. Yet it is noticeable that the company is able to garner a high level of success in terms of the profitability in the market. The external factors that can be associated with a multinational organization does not play any role in this case.

A factor that is also worth noticing from the generated interview results is that most of the participants of the research process believe that the public face of the company is highly important in its ability to perform in the market. The public face is dependent on the ability of the company to convince the investors to come forward and be part of the operations and ventures of the company (Sudjiman and Sudjiman, p. 1337, 2019). The survey also revealed that a high part of the population among the participants of the research process believed that a stable level of DER of the company would make sure that the investors are satisfied with the performance of the company. In such a case, it would be possible for the company to make sure that more people are involved in the investment opportunities and it would also lead to a high level of profitability of the company.

6. Conclusions

The Debt that a pharmaceutical company holds to its lenders and the equity that the investors have at stake in the stock market are both crucial factors that determine the performance that the company would be able to garner in the process. Most of all, the ratio of these two factors decide the leverage the company is going to possess in the market. The more balanced the level of the debt to equity ratio, or the DER of the company, the more there is a chance that the investment process for the operations and new ventures of the company would be able to garner. As a result of these factors, it would be ensured that the investment opportunities and the return on investment opportunities would be guaranteed a level of immediate success for the companies.

This would directly lead to a situation where the performance of the company in the DER ratio in the market would determine that the profitability of the company would remain at a high standard and the operations has a higher level of opportunity to be run smooth as far as the immediate future of the company is concerned. The survey that was conducted in the research revealed the fact that the company has a higher chance of success if the public face or the public image of the company to its investors remained at a high standard.

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