

CORPORATE SECTOR'S AND INDIAN ECONOMY

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Abstract: The entrepreneurs are driven by different motives. They are the contributors of Govt. exchequers, international trade, social services and employment centers. The country's growth rate depends on growth rate of industrial sector. The average job creation remains at 264 lakhs persons per year. The total collection of corporation taxes s increased. The industries are life blood of economy. Achievement of economic objectives and prosperity is not possible without industries. Since 1991 industrial sector is looking for the benefits of globalization. The industries are facing competition at international level. Change in industrial, commercial and labor laws is also one of the significant factors in the development. Recent announcement of establishment of Mudra bank (Micro Units Development and Refinance Agency) with initial funding of Rs 20 thousand corers is a positive step taken by government in this regard. The achievements of Disinvestment target is not as per expectations however recently the issue is properly taken up by the present government. With a strong industrial base, economic planning becomes less risky, being able to plan ahead also assists industrial growth with profits re-invested into infrastructure development which in turn helps to boost and attract industry.

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Introduction: India launched a series of economic reforms in 1991 in response to a severe balance of payments crisis, many of which directly or indirectly led to a substantial liberalization of the corporate sector. The reforms aimed at easing restrictions on firms' activities and enhancing overall competition by putting an end to the 'license raj,' liberalizing the foreign trade regime, and opening the financial sector. The freeing of capital markets and entry of foreign investors brought new financing and ownership opportunities and significantly raised the volume of new equity issues. While India withstood the Asian financial crisis of 1997–98 comparatively well, the fallout from the crisis demonstrated that the corporate sector could play an important role in transmitting financial shocks and putting the financial sector at risk. Mismatches in the corporate sector's balance sheet brought to light both domestic and external vulnerabilities. As evidenced in the Asian crisis, the deterioration in creditworthiness of large segments of the corporate sector sharply increased nonperforming loans (NPLs), curtailed new investment, and contributed to capital flight, all of which adversely affected economic activity as a whole. This paper uses firm-level data to examine the performance of India's nonfinancial corporate sector since 1989 and evaluate its financial vulnerabilities. The 1990s were a dynamic period for most Indian companies, especially in the first half of the decade,

which was characterized by high sales growth, improved profitability, and strengthened finances. The second half of the 1990s witnessed some reversal of these trends, with the variation in the performance of Indian companies increasing and the gap between the best and worst performers growing substantially, as firms were forced to compete in the new economic environment. Yet, despite some signs of weakening in the corporate sector, most indicators are still at comfortable levels, and there is evidence of improvement in almost all indicators during 2002, the last year in our sample. However, an examination of the balance sheets of Indian companies suggests that an increasing number of firms could face problems servicing their debt obligations, which may pose some risk to lenders. In particular, the aggregate interest coverage of the nonfinancial corporate sector indicates a share of potential NPLs in total corporate borrowings of as high as 38 percent in 1999, and down only slightly in recent years.² This underscores the need for close monitoring of the corporate sector in the future. The remainder of this paper is organized as follows. Section II gives an overview of India's corporate sector through 2002, including its size and composition, regulatory framework, and recent reforms. Section III analyzes the financial performance of the corporate sector during 1989–2002 using firm-level data, focusing on capital structure, profitability measures, and debt repayment

capacity to ascertain financial vulnerability of Indian companies. Section IV concludes with a discussion of the empirical results and their policy implications.

The performance of the corporate sector during the first half of 2008-09 depicted a modest picture, as corporate earnings growth has begun to slowdown due to growing interest burden and considerable rise in expenditures owing to sharp increases in input costs. Interestingly, while sales have grown at a higher rate, partly reflecting higher prices, the net profit growth has decelerated significantly during the first half of the current financial year as compared with that in the first half of 2007-08. The share of consumption of raw materials as well as that of staff cost in sales has been higher as compared with the previous first half reflecting input and wage cost pressures. The mark-to-market losses by a number of companies on their foreign exchange transactions/loans on fears of rupee appreciation also have contributed to the sluggish profit growth. The half yearly performance varied across sectors, sales growth in several segments witnessed a slowdown in the first half of the current fiscal. Companies of cement, automobiles, auto components and textile industry saw a significant slowdown, while the sectors, which have performed well in terms of sales, are sugar, telecom, entertainment, engineering and paints.

OVERVIEW OF THE CORPORATE SECTOR

The economic reforms since 1991 have brought many changes to the environment in which Indian companies previously operated. The principal aim of these reforms was to strengthen market discipline and promote greater competition by putting an end to the “license raj,” namely through the abolition of the Industries Development and Regulation Act (1951) and amendments to the Companies Act and several other major laws, which had imposed a heavy legal and regulatory burden on the corporate sector. In addition, the foreign trade regime was liberalized through cuts in tariff rates, reductions in nontariff barriers, and a streamlining of import licenses; foreign investment opportunities were increased; and shareholders’ rights were improved. Indian companies were allowed to enter into joint ventures with multinational enterprises more freely, import new technologies and capital goods, expand productive capacity, and introduce new products without obtaining industrial licenses. More recently, steps have been taken to dereserve a number of small-scale industries, particularly those industries with the greatest export potential. A more modern competition law has also been enacted that focuses

more on anti-competitive practices, by giving greater consideration to abuse of market dominance rather than through firm size per se. Further progress is needed in reforming labor laws to allow flexibility in employment decisions in line with market conditions. The financial sector has also experienced a considerable opening. Recognizing the poor health of the financial sector, a host of reforms were implemented (as laid out by the Narasimham Committee on Financial Sector Reforms), including the deregulation of interest rates, easing of restrictions on private and foreign banks, removal of consortium lending requirements, liberalizing of bank branch licensing, and entry of private sector mutual funds and foreign institutional investors. Financial sector reforms, in particular, have acted to induce firms to improve their cash and debt management during the reform period.

The ownership of India’s corporate sector tends to be concentrated in the hands of firm promoters and, to a lesser extent, small investors (Table 3). Focusing on the manufacturing sector, promoters’ share was 48 percent of paid up capital for all companies in 2002 and as high as 71 percent for government-owned enterprises. The prevalence of cross-holdings of ownership, together with heavy owner participation, makes India’s system of corporate control close to an “insider” one, as characterized by Sarkar and Sarkar (1999). While the share of equity held by small (public) investors in India (32 percent) is comparable to that of the United States and United Kingdom (countries with a pronounced “outsider” system), inter-corporate holdings in India are much higher. In addition, financial institutions (FIs) in India hold a much smaller share of equity as compared to other countries and have been characterized as largely passive shareholders, mostly supportive of managements’ positions (Sarkar and Sarkar, 1999). India’s corporate sector is supported by a well-established equity market. Currently, there are 23 registered stock exchanges in India, with total market capitalization of US\$131 billion at end-2002, equivalent to 26 percent of GDP and compared with 21 percent in 1990.⁵ The equity market is dominated by the Bombay Stock Exchange—the oldest in Asia—and the National Stock Exchange (NSE). The NSE began operations in 1994 in response to a government effort to improve the efficiency and transparency of India’s equity market. It quickly established itself as the foremost stock exchange in the country. Efforts are under way to close and/or consolidate a number of regional stock exchanges that have been generally thinly traded but largely

sustained by listing requirements governing publicly traded companies operating in a different region.

FINANCIAL PERFORMANCE OF THE CORPORATE SECTOR

As per the latest business confidence survey conducted by Federation of Indian Chambers of Commerce and Industry (FICCI), the overall business confidence index (BCI) during April-June 2008 has dipped by 5.1% over the previous quarter and 20.3% over the corresponding quarter of the previous year owing to rising raw material costs, increase in interest rates and stricter credit availability. The composite business optimism index for October-December 2008 compiled by Dun and Bradstreet (D&B) has increased by 1.8% as compared with the previous quarter. However, it has declined by 28% as compared with the same quarter of the previous year. The decline in expectation index for October-December 2008 has emanated from lower net responses for major parameters of the survey such as the overall business situation, availability of finance, production, order books, capacity utilisation, employment, exports and profit margins, over the previous quarter. Burgeoning interest costs on account of rising interest rates, considerable increase in expenditure owing to sharp rise in input costs and mark-to-market losses by a number of companies on their foreign exchange transactions/loans have added to negative sentiments of the respondents significantly. The Centre for Monitoring Indian Economy (CMIE) has revised their estimate for overall industrial growth downwards to 8.3% from 9.1% for the current fiscal year 2008-09. According to CMIE, sectors such as electricity, crude oil and petroleum products are likely to show acceleration in growth in the second half of the current fiscal year. The downfall in aggregate sales will be largely on account of a significant slowdown in sales expansion of sectors like chemicals, information technology, commercial vehicles, auto ancillaries, two-and-three-wheelers, aluminum and aluminum products.

During the reform period, India's corporate sector initially strengthened, but in recent years, it has shown signs of weakening in line with the slowdown in economic growth and industrial production. Evidence of this weakening can be seen by reviewing various financial ratios, which provide useful indicators for monitoring corporate sector vulnerabilities.

Indian companies continue to rely heavily on external sources of finance (i.e., outside the firm), averaging 67 percent during 1990-2002 (Figure 1).⁶ While the amount of new equity finance raised has been large in

recent years, Indian companies are still dependent on debt finance, including bank borrowings. For the year ending March 2002, external financing accounted for 56 percent of total corporate funds raised, with slightly more than two-fifths of this from capital markets (including bonds and debentures). In addition, new financial instruments such as commercial paper (including private placements), certificates of deposit, and inter-corporate deposits have gained popularity as a source of financing. More recently, some firms have also begun to raise funds through external commercial borrowing. The dependence on external sources of finance, especially on debt finance, makes India's corporate sector relatively vulnerable to domestic financial shocks. At the macro-level, this vulnerability stems from large fiscal deficits (for the general government estimated at 10½ percent of GDP in fiscal year (April-March) 2002/03) and sizable government debt (estimated at 83 percent of GDP, a majority of which is domestic debt and largely held by government-owned banks and FIs), which has the potential to crowd out private investment and slow growth. Indian companies are also more leveraged and have larger short-term borrowing (as a share of total borrowing) than their counterparts in other Asian countries and elsewhere. Offsetting these risk factors, Indian companies tend to have comparatively low foreign exposure.

Government to Study Impact on India's Corporate Sector

The Union Government has constituted a committee to consider issues raised by the corporate sector on global financial crisis and its impact on India. Apprehending that the impact of the financial crisis in the US will have adverse effect on the India's corporate sector sooner than expected, the government has called for a high-level meeting to discuss way to minimise the damage to key sectors of the economy. According to initial assessments the financial turmoil will definitely have an adverse impact on the Indian IT industry, while exports could be affected due to the slowdown in the US and European economies. The Department of Industrial Policy and Promotion (DIPP) is preparing a note on the impact of the financial sector crisis. The impact on the manufacturing sector would be highlighted by the DIPP and details would be submitted to the cabinet secretary. Recently, the Prime Minister (PM) had met corporate veterans and called upon them to join in with the Table 11.2: Growing Concerns • Bulk of SME sector is worst affected and that its interest cost has gone up by 3.5% to 5.5% over the last one year. • The interest cost of large companies has gone

up by 1.5% to 2.5% over the last one year. • The rise in interest rates is seen as having a direct impact on the investment activity of the companies. Source: The Financial Express, October 6, 2008. 106 government to convert the current global crisis into an opportunity for India. At the meeting with industry leaders, the PM said that steps were taken in the recent weeks to lessen the impact of global financial crisis on India and that further measures would follow to protect the country's economic growth.

IPO Pricing to be Regulated

Amid allegations of over-pricing of initial public offerings (IPOs), the government is planning to set up a statutory body to make it mandatory for companies to get their shares priced by authorized valuers before raising money from the capital market. Currently, the practice of valuation is not regulated and the ministry plans to regulate the system so that investors can take informed decisions. The institution of valuers, being set up by the ministry of corporate affairs, will be a statutory body on the lines of the Institute of Chartered Accountants of India (ICAI) and the entities engaged in valuation work will be required to register with the proposed body. At present, such valuations are done by merchant bankers, chartered accountants, company secretaries, cost and work accountants or any other professional possessing such qualification. There were allegations that various IPOs, like that of Reliance Power, have been overpriced due to which investors got swayed and suffered huge losses as the IPO was traded at price lower than the offer price at its close on the opening day. After the issue of over pricing, the ministry had commissioned a study to ICAI for analysing the methods of pricing. These valuers will also help in fair valuation of shares or properties in case of mergers and amalgamation or allotment of shares for consideration other than cash.

Certified Emissions Reductions (CERs)

Certified emissions reductions (CERs) are carbon offsets of international emission trading schemes implemented to mitigate global warming. At present the CER prices in the international market have declined to €19 from €22 over a month ago. However, Indian companies are likely to unlock the value of their green certificates to release funds in the prevailing liquidity crunch. 107 Recently, Mysore Cements has sold over one lakh CERs issued to the company by the clean development mechanism (CDM) executive board of the United Nations Framework Convention on Climate Change (UNFCCC). If CERs prices are taken at €20 (around Rs 1,300), Mysore Cements is estimated to have

received around Rs 13 crore for the sale of over one lakh CERs. JSW Steel has issued 7.4 lakh CERs by the CDM executive board for generating electricity through combustion of waste gases from a blast furnace and corex units at its Torangallu unit in Karnataka. JSW Steel is planning to sale its CERs.

Corporate Sector, Industrialisation and Economic Development in India

The Indian economic policy has undergone rapid changes during the past few decades, especially since 1991. The policy package is aimed at lesser public intervention, increased competition and greater integration with world economy, and is characterised by far greater freedom to choose the ownership pattern, organisation form, source of finance and technology, areas of production or service and the markets to be serviced. In this new scheme of things, the private corporate sector has been assigned a much larger role in the growth and development process of the Indian economy, in particular the industrialisation effort. Effectiveness of the strategy is thus, of great significance for researchers and policy makers. Viewed in this background, the two-day national conference on the theme, “Corporate Sector, Industrialisation and Economic Development in India”, held at the Institute for Studies in Industrial Development, New Delhi, on March 27-28, 2009 makes a timely and useful contribution by bringing together senior and emerging scholars working in this area to discuss wide ranging issues concerning the contribution and characteristics of the Indian corporate sector. The papers were diverse in terms of the questions they took up and the methodologies they adopted. The papers looked at the corporate sector from different angles, setting it against the background of the liberalisation process. Between them they discussed: what is happening within the corporate sector and through what mechanisms; what is happening to the position of the corporate sector in the Indian economy and its linkages with the rest of the economy and the global economy; what impact these are producing on the larger development and growth processes of the Indian economy; to what extent have the expectations from exposing the corporate sector to greater competition and giving it greater freedom been realised, especially in the manufacturing sector. Two of the presentations underlined the growing importance of the private corporate sector in the Indian economy. They observed that following greater emphasis on the private sector in the new policy regime, the private corporate sector had gained importance, more so since 1999–2000 when its relative significance has

increased compared to both public and household sectors. Also, the private corporate sector has emerged as the main contributor to the GDP growth rates, savings and capital formation in the country. This increasing importance of the sector in the new regime has, however, had some disturbing features as well. While the increased outward-orientation of the Indian economy had not enabled an acceleration of the manufacturing growth, it had also belied the expectation of employment generation. In the corporate sector, in particular, the rise in import intensity has not been accompanied by an adequate rise in export intensity, which has contributed to the problem of rising trade deficit. Foreign companies had also failed to provide the expected impetus in this regard. While the Indian private corporate sector appears to have become more dynamic in technological terms in the new regime, this dynamism is restricted to a few industries like pharmaceuticals. However, the sector has become more dependent on tax concessions for achieving this dynamism, more vulnerable to external shocks and finally, less employment-intensive. Another study observed that technology spillovers accrued due to the presence of foreign firms can be enjoyed by high and medium-high technology industries suggesting that in order to benefit from technology spillovers, firms need to enhance their own technological capabilities. Seen together with the earlier observation, it is likely that the spillovers might have had a limited impact. While there is a significant difference between domestic and foreign firms in terms of production in the engineering industry, the latter being more technically efficient than the former, the difference between the mean efficiency of foreign firms and domestic firms has declined over time. This convergence has not been due to domestic firms trying to catch up with foreign firms, but due to decline in the efficiency levels for both groups of firms with the foreign sector's efficiency declining faster. Many of the papers have an undercurrent in the form of the role foreign direct investment which has been accorded an important place in India's development strategy in the new policy regime. Two of the papers, specifically looked at the pattern of FDI in India. Broadly, the pattern of allocation of activities to India by the TNCs is consistent with what is reflected by India's aggregate international transactions—much greater importance being accorded to India as a location for producing or sourcing services, particularly IT services, rather than manufactured products. There are, however, variations across time, across sectors and across firms

in this regard. A closer examination of the FDI flows during the past four and a half years suggests that reinvested capital, acquisition of domestic companies, inflows which are more akin to portfolio capital flows and round-tripping investments by Indian entities explain a significant portion of the reported FDI inflows to India. Thus, the optimism associated with the rapidly increasing FDI inflows during the recent past could be misplaced and India should place greater emphasis on the qualitative aspects of FDI. Seen together with the foregoing observations on technology, efficiency, exports, etc., this finding further underlines the need for a rethinking on the role and place of FDI in India's industrial development strategy. The new policy regime placed greater emphasis on the corporates raising resources directly from the savers. In the context of the stock markets' ability to allocate resources efficiently, one of the studies, based on an analysis of the initial public offerings, observed that the Indian stock markets suffered from excessive optimism and poor evaluation. On the other hand, another study noted that the stock market played a much smaller role in corporate finance with borrowings and depreciation contributing a major portion of their requirements. The results suggest that there may have been undue emphasis on the stock market in allocation of resources. The other studies looked at the strategies to meet the impact of the global economic crisis by industries dependent on exports, relationship between family ownership and firm value, factors influencing cross-border merger activity, firm performance following mergers, the mechanisms required to make farmers benefit from contract farming by the corporate sector, control of the media by the corporate sector—both directly and indirectly, the relative influences of industrial dispersal policy and economies of agglomeration and finally, notwithstanding the problems with the Chinese strategy what India could learn from the Chinese experience in terms of the adaptability of the state and its capacity and flexibility to review policies. Overall, the studies indicate the need for more direct policy intervention instead of reliance on market forces if India is to develop a healthy and robust manufacturing sector.

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