

Economic Reforms and Corporate Performance in India

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“Global Banking: Paradigm Shift”
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Motivation 1

Corporate Performance – Trends since mid 1990s

End March	Sales Growth	PAT Growth	Working Capital / Sales	Debt / Sales
1995	20.5	59.2	21.7	34.1
1996	23.7	23.9	18.3	31.7
1997	10.4	-26.6	15.7	33.7
1998	7.5	-13.7	12.0	36.6
1999	6.1	-20.9	13.8	39.8
2000	11.2	14.7	11.5	37.6
2001	9.9	8.3	11.3	35.0
2002	-1.3	-17.8	7.9	35.7
2003	8.5	76.2	5.5	31.4
2004	16.0	59.8	3.9	26.4
2005	24.1	51.2	5.2	22.5
2006	16.3	31.7	11.1	20.2
2007	26.2	45.2

Note : Working Capital is defined as Current Asset-Current Liabilities;

* Based on abridged results of the corporates; Source: RBI

Motivation 2

Corporate Performance - Recent Trends

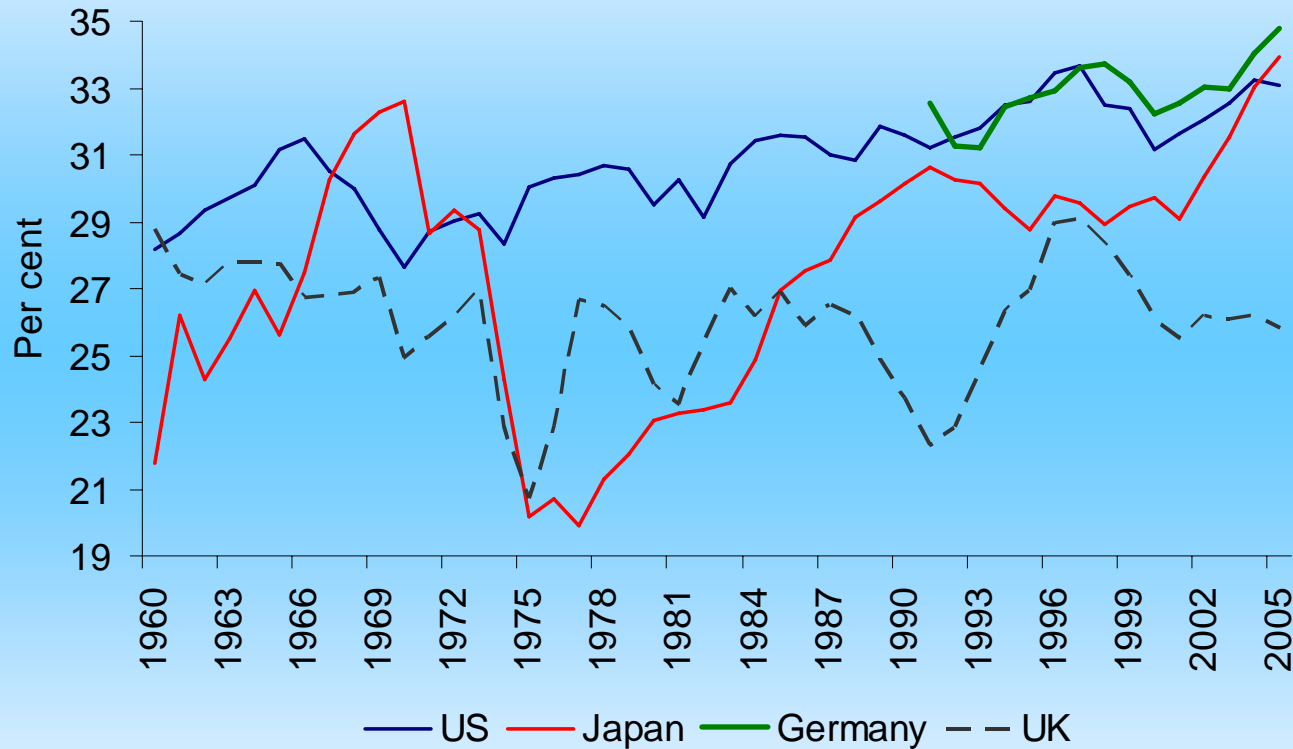
Growth Rates (Per cent)

Item	2005-06				2006-07				2007-08
	Quarter	Quarter	Quarter	Quarter	Quarter	Quarter	Quarter	Quarter	Quarter
	1	2	3	4	1	2	3	4	1*
No. of companies	2,355	2,361	2,366	2,415	2,228	2,263	2,258	2,356	1,364
Sales	18.5	16.4	13.2	19.5	25.6	29.2	30.3	22.5	19.0
Total Expenditure	18.0	16.3	12.7	18.9	24.6	26.6	26.9	19.5	19.0
Gross Profits	32.0	19.1	21.2	16.6	33.9	45.9	51.8	39.2	27.9
Interest Cost	-13.5	-8.0	4.6	3.8	19.9	18.0	11.9	32.3	2.8
Profits after tax	54.2	27.5	27.0	15.1	34.7	49.4	59.5	39.6	32.6

* Provisional; Source: Reserve Bank of India

Profit Shares

(% to GDP)



Note: Data are annual from 1960 to 2005.

Source: Ellis and Smith (2007), BIS Working Paper.

Facts and the Issues

- **Facts**
 - **Initial Growth in 1990s**
 - **Deceleration during the latter part of 1990s**
 - **Remarkable Recovery of Corporate Profitability since 2002**
- **Issues**
 - **Is this sustainable?**
 - **Is this Policy Induced?**

Scheme of Presentation

- Correspondence between
 - Policy
 - Corporate Performance
- Policies
 1. **Industrial Deregulation**
 2. **Trade Liberalization**
 3. **Tax Policy**
 4. **Monetary Policy**
 5. **Financial Sector Strengthening**
 6. **Capital Market Deepening**
- Concluding Remarks

Some Conjectures On “Relating Corporate Performance to Economic Reforms”

1

**Industrial
Deregulation
And
Corporate
Performance**

Industrial Deregulation

- Elimination of Capacity Licencing
- Dereservation of industries reserved for Public Sector
- Removal of MRTP Act and Restrictions on Large Companies
- Termination of Phased Manufacturing Programmes
- Better Access to Foreign Technology
- Revision of Patent Regime
- Freeing of Foreign Direct Investment
- Programme of SSI Dereservation

Industrial Performance

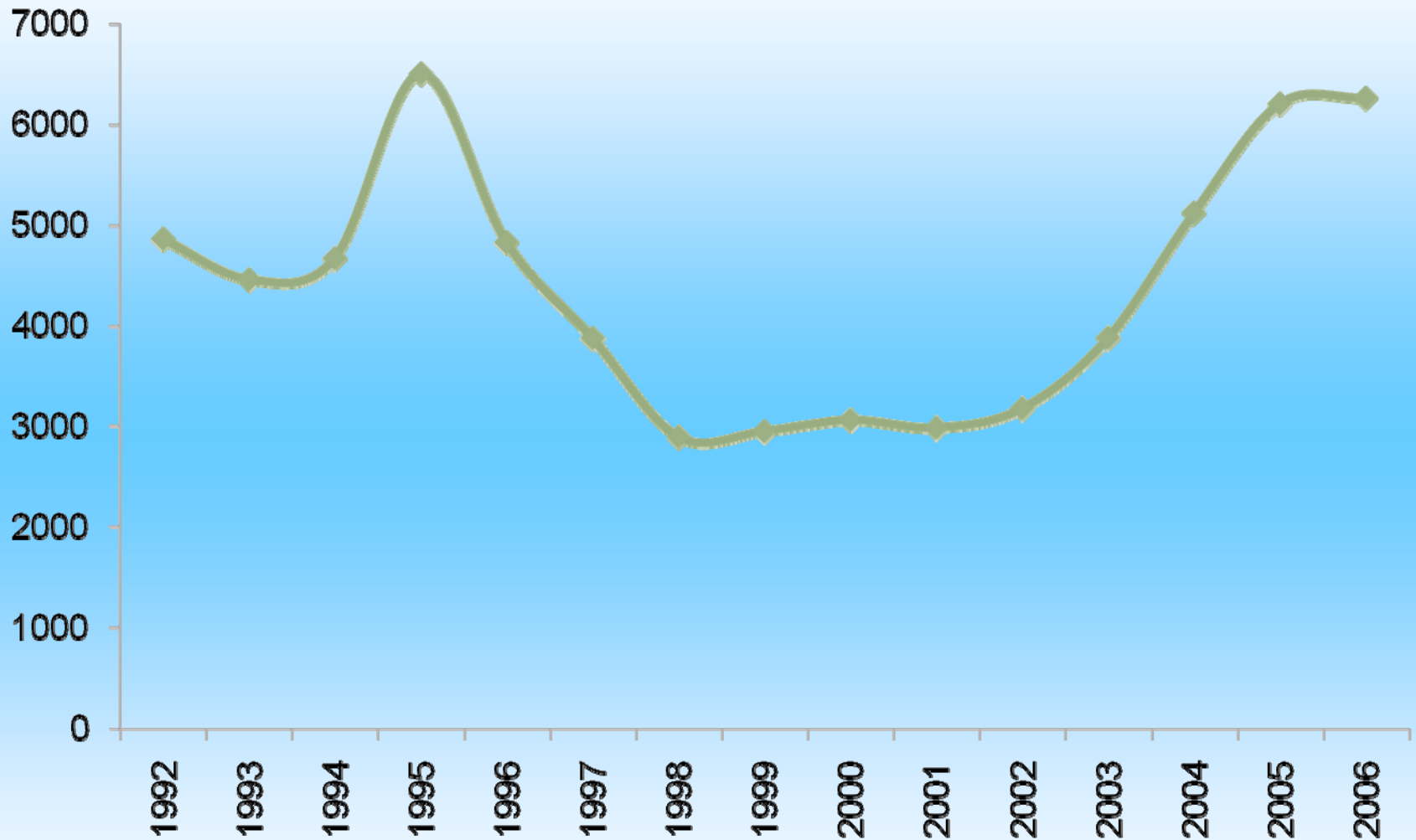


Growth of Corporate Sector: Population

Year ended March	No. of Companies	Estimated Paid-up Capital	
		Rs. Billions	% of GDP
1982	72402	189	11.1
1987	140670	440	14.0
1992	250361	846	12.9
1997	450950	1905	13.8
2002	589246	4058	17.8
2003	612155	4571	18.7
2004	641512	4988	18.1
2005	679649	6540	21.0
2006	732169

Sources: Department of Company Affairs, 50th Annual Report on the Working and Administration of the Companies Act, 1956.

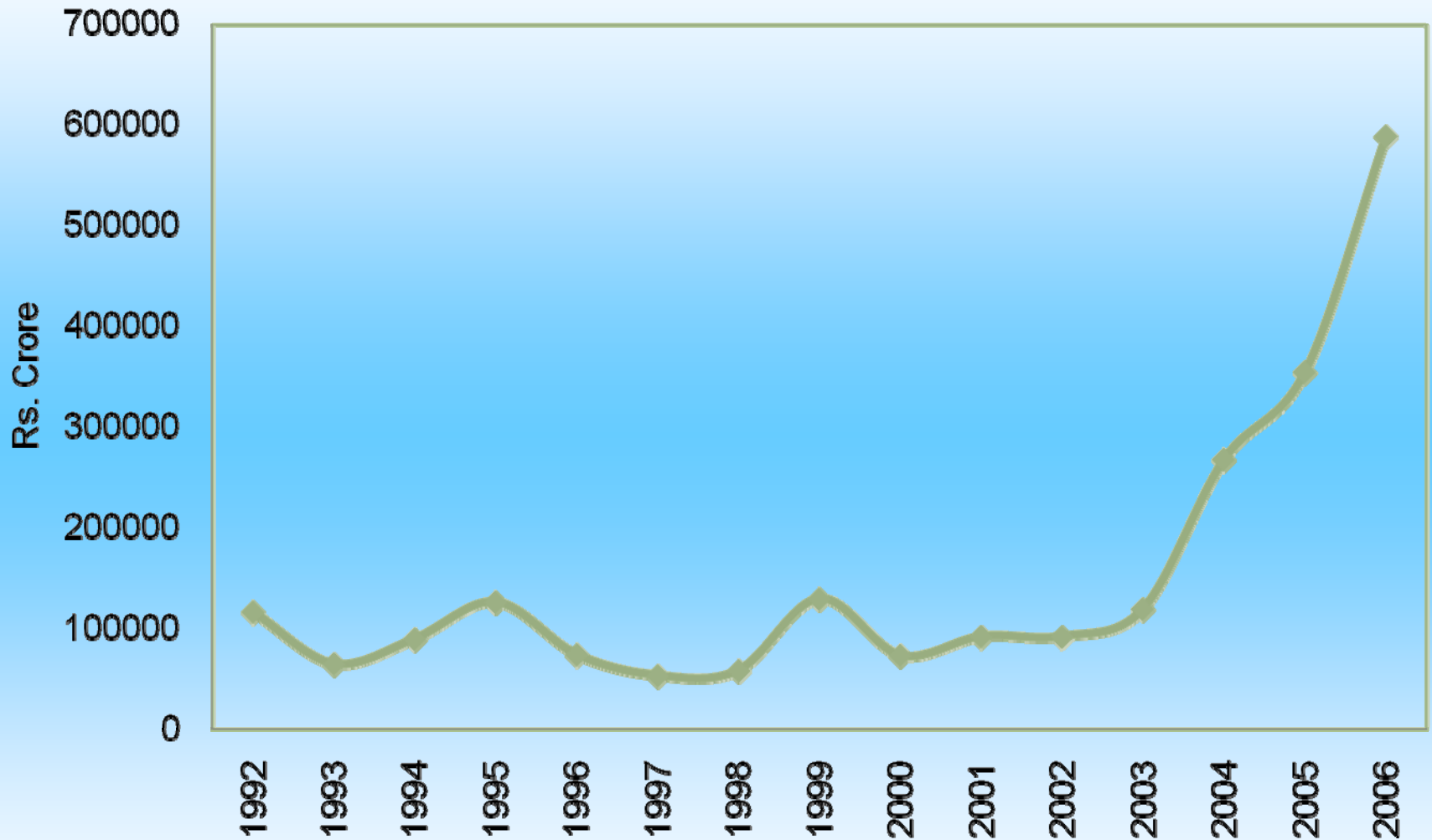
Industrial Investment: Number of Proposals



Marked improvements in investments in recent times

Data are on calendar year basis

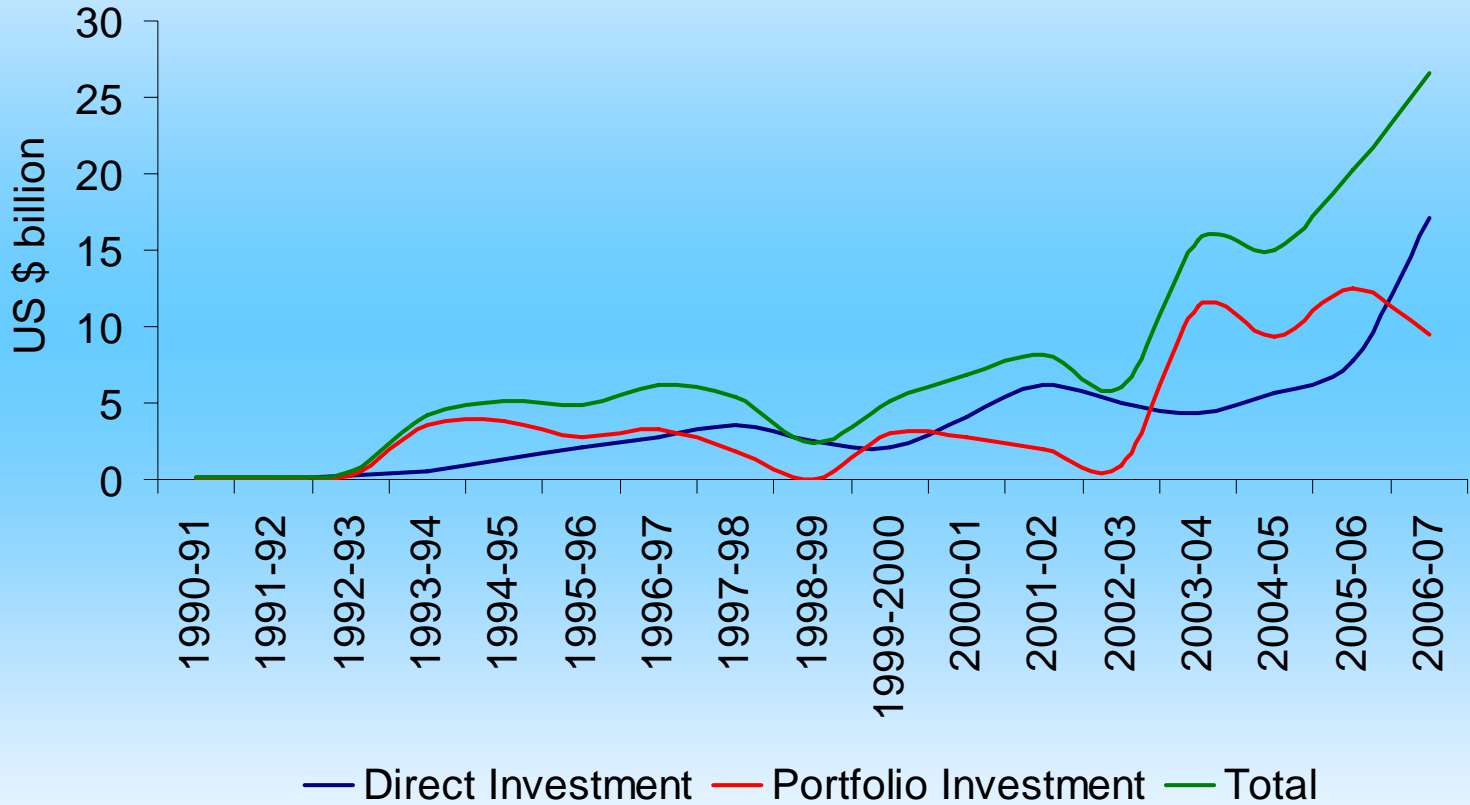
Proposed Industrial Investment: Amount



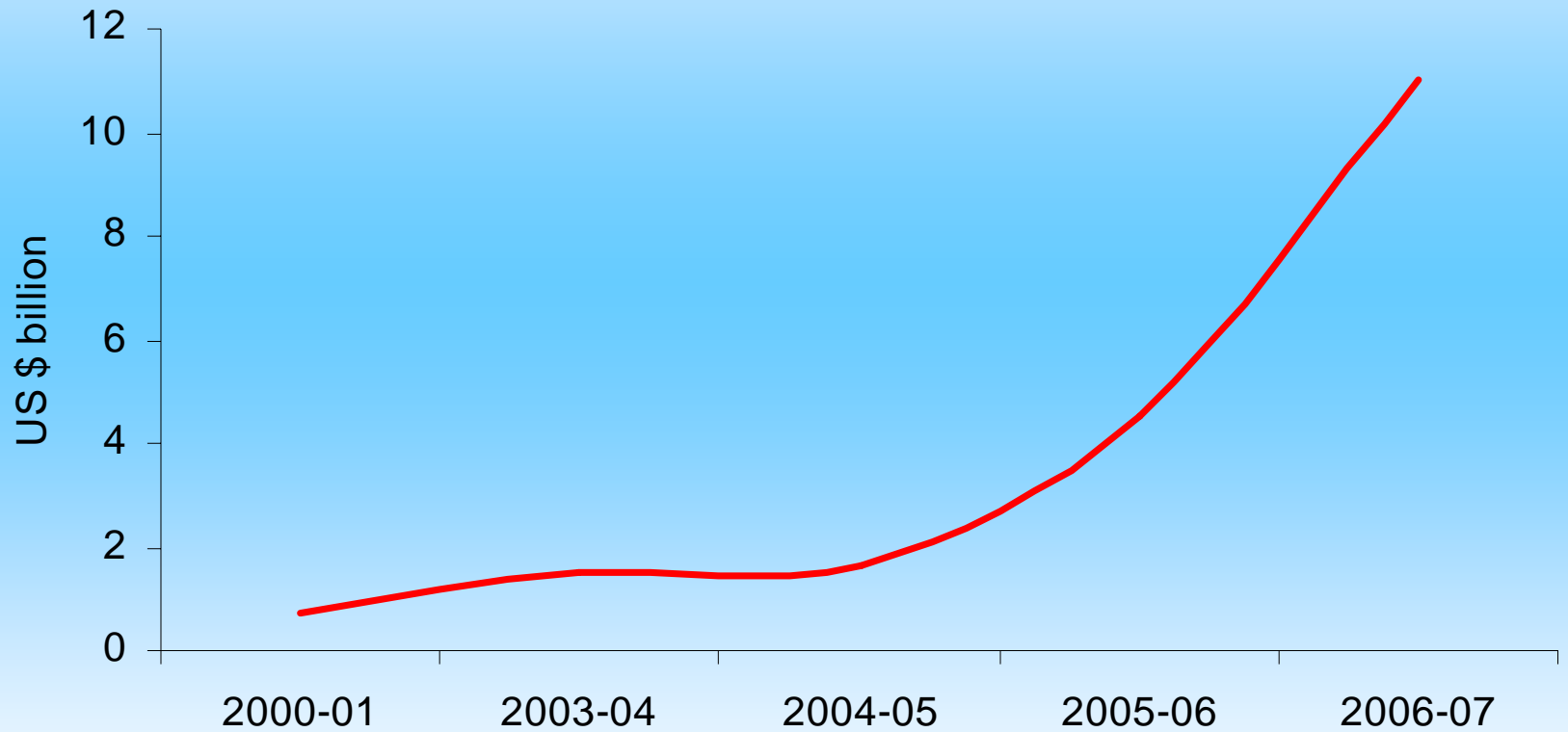
Marked improvements in investments in recent times

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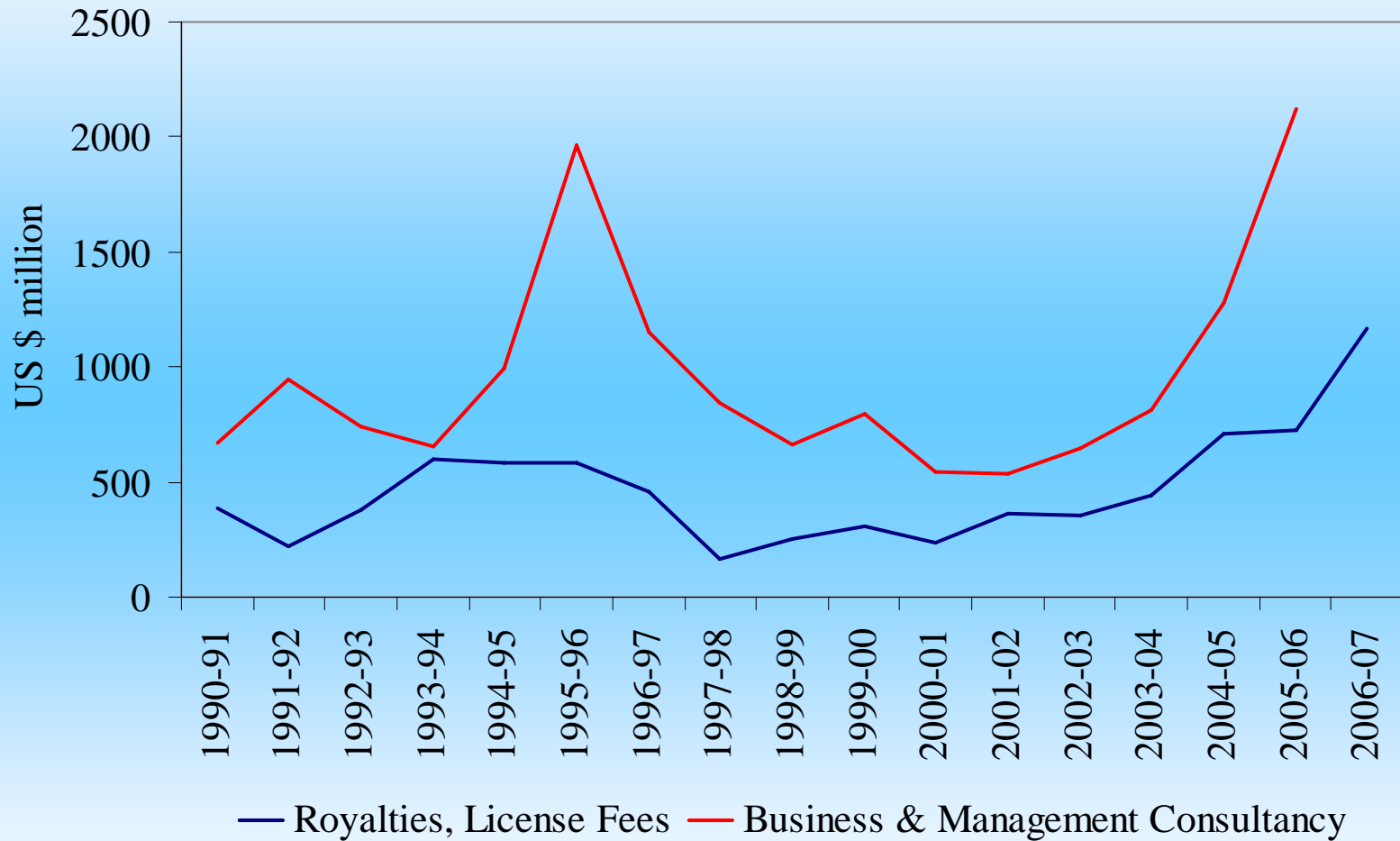
FDI and Portfolio Flows to India



India's Direct Investment Abroad



Technology-related Payments



2

Trade Liberalization And Corporate Performance

Import Liberalization Initiatives- 1

- Moving away from Import Substitution
- Phasing out of Quantitative Restrictions on imports
- Reduction in and simplification of tariff structure

Import Liberalization Initiatives- 2

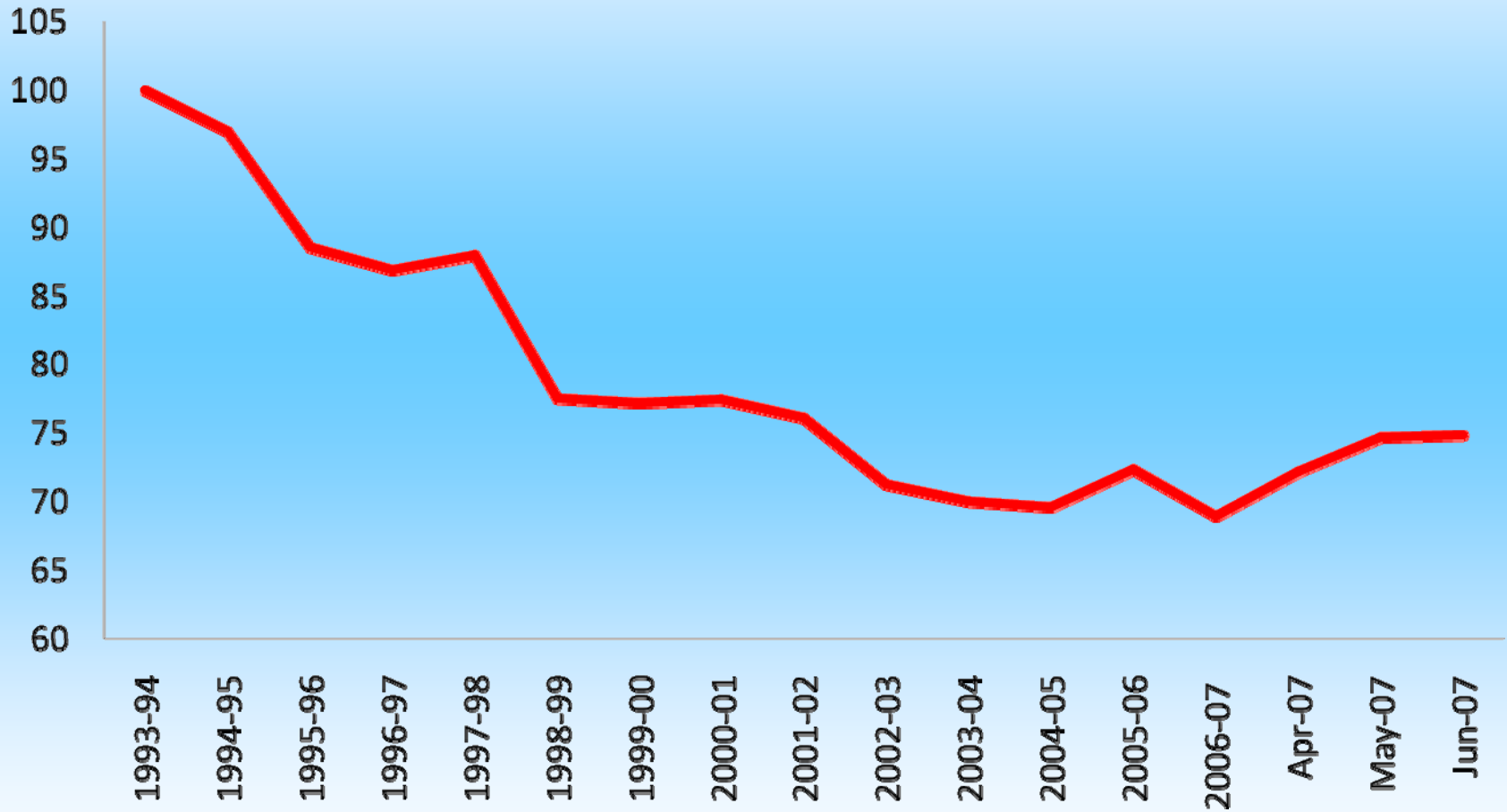
- Sharp Reduction in Customs Duty Rates
- Simple Average of Basic Duty Rates
 - 1991-92: 128 per cent
 - 2004-05: 22 per cent
 - 2007-08: Peak duty reduced to 10 per cent for non-agricultural goods
- Collection Rate (import revenue to value of imports ratio)
 - 1990-91: 47 per cent
 - 2004-05: 11 per cent
 - 2005-06: 10 per cent
- Distribution of Duty Rates Has Changed Remarkably
 - 1991-92: 4100 out of 5200 commodities
Basic Rates above 100 per cent
 - 2004-05: 4261 out of 5144 commodities
Basic Rates Below (BRB) 25 per cent
 - 2007-08: 8537 out of 10084 commodities
BRB 25 per cent

Exchange Rate Management

- Initial Ex Ante Real Devaluation
- Switch to a market determined exchange rate regime since 1993
- Focus on management of volatility without fixed rate target.
- Underlying demand and supply conditions determine the exchange rate movements in an orderly way

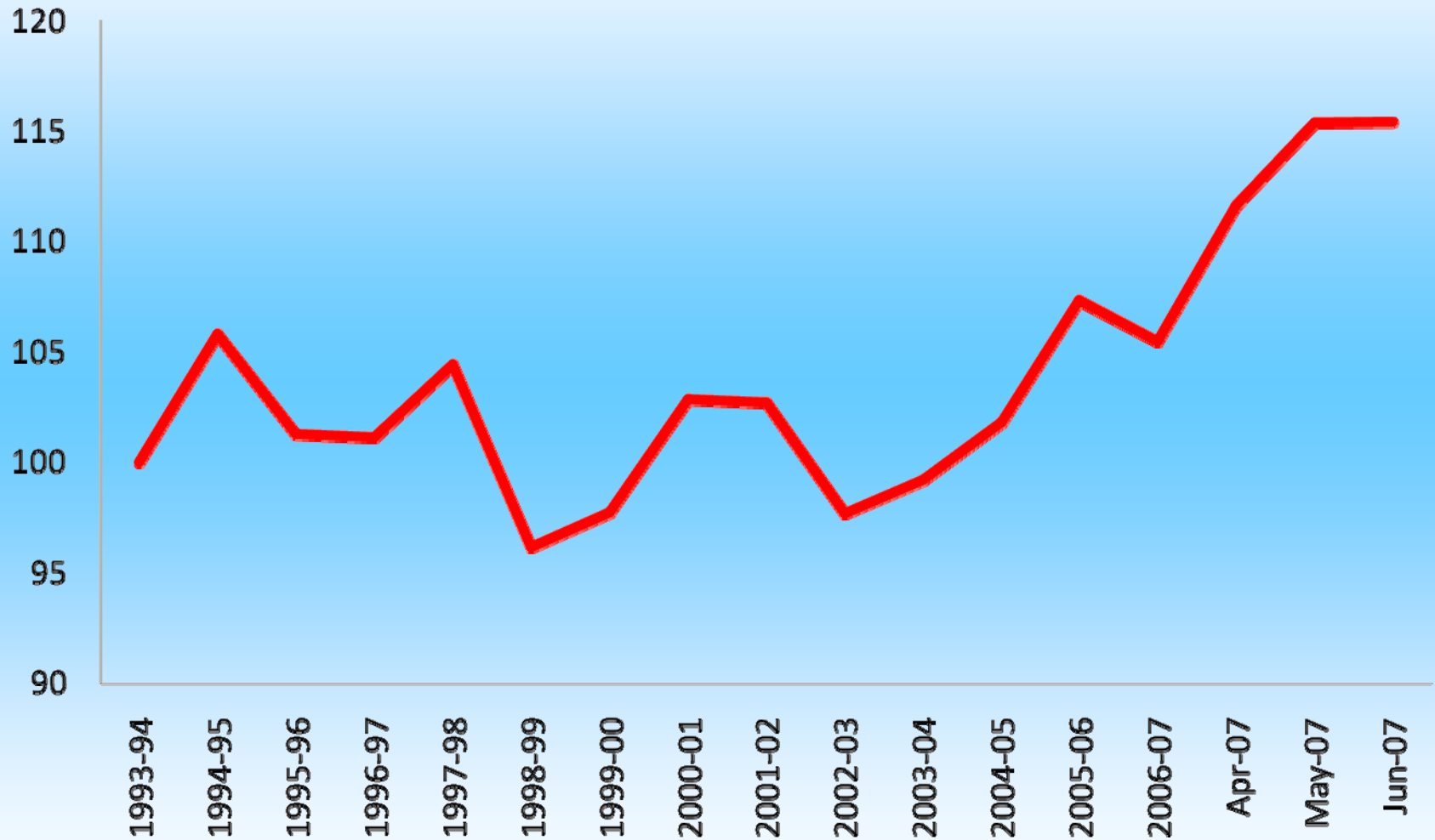
Movement of Exchange Rate

NEER Trade 6 country (1993-94=100)



Movement of Exchange Rate

REER Trade 6 country (1993-94=100)



Ex Ante Real Devaluation in the mid 1990s

Export Intensity and Import Intensity – All Companies

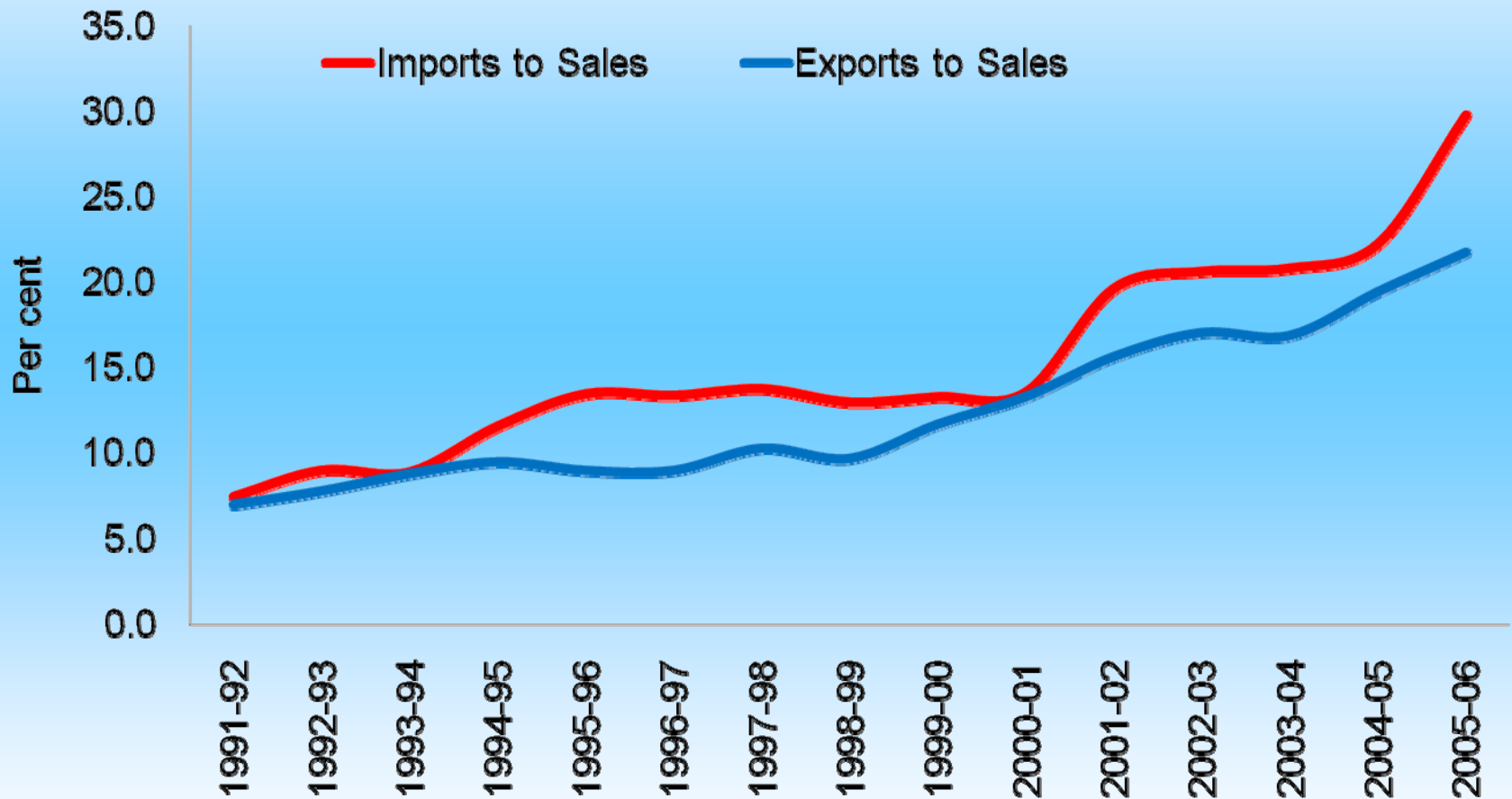
Export Intensity and Import Intensity of the Indian Corporates						
<i>Amount in Rs. crore</i>						
Year	Number of companies	Sales ^{\$}	Earnings in Foreign Currencies	Imports	Forex Income to Sales	Imports to Sales
1991-92	1802	107026	8693	7692	8.1	7.2
1992-93	1802	120120	10902	10350	9.1	8.6
1993-94	1720	127823	13069	11185	10.2	8.8
1994-95	1720	154087	17110	17452	11.1	11.3
1995-96	1930	212241	22643	27792	10.7	13.1
1996-97	1930	234284	26881	30073	11.5	12.8
1997-98	1848	246610	33924	33006	13.8	13.4
1998-99	1848	261553	33664	33361	12.9	12.8
1999-00	1927	284761	40310	38039	14.2	13.4
2000-01	1927	312961	50719	41791	16.2	13.4
2001-02	2031	322151	61142	57471	19.0	17.8
2002-03	2031	349667	71245	64584	20.4	18.5
2003-04	2214	442743	90437	83500	20.4	18.9
2004-05	2214	549449	128721	118608	23.4	21.6
2005-06	1831	565444	137200	147270	24.3	26.0

\$ Net of 'rebates and discounts' and 'excise duty and cess'

Imports/Sales & Exports/Sales Ratio - All Companies



Imports/Sales & Exports/Sales Ratio - Manufacturing Companies



3

**Tax
Policy
And
Corporate
Performance**

Key Reforms Affecting Corporate Performance

- Reduction of Corporate Tax
- Tax on Dividends
- Rationalization of Excise Duties
- Reduction in Customs Duties

Rates of Corporate Tax (Per cent)

Year	Tax Rate on Domestic Companies
1991-92	40* and 50**
1992-93	45* and 50** (15)
1993-94	45* and 50** (15)
1994-95	40 (15)
1995-96	40 (15)
1996-97	40 (7.5)
1997-98	35
1998-99	35
1999-00	35 (10)
2000-01	35 (10)
2001-02	35 (2)
2002-03	35 (5)
2003-04	35 (5)
2004-05	35 (2.5)
2005-06	30 (10)
2006-07	30 (10)
2007-08	30 (10)

* Widely held (in which public are substantially interested); ** Closely held (in which public are not substantially interested)

Note: Figures in parentheses represent surcharge.

Tax on dividends

1998

- Tax on Shareholders Dividends Abolished
- Dividend Distribution Tax (DDT) Introduced

2002

- Tax on Shareholders Dividends Re-introduced
- DDT abolished

2003

- Tax on shareholders Dividends Abolished
- DDT Re-introduced (12.5 per cent)

2004

- DDT Increased to 20 per cent.

2007

- DDT raised from 12.5 per cent to 15 per cent.

Rationalisation of excise duty

1999

- 11 major *ad valorem* rates reduced to 3 rates

2000

- Uniform CENVAT of 16%; SED at 8%, 16% and 24% on specified goods.

2001

- SED at a single rate of 16 per cent.

2002

- SED abolished on all except 8 items.

2003

- SED on select items down from 16% to 8%

2004

- Convergence to a mean CENVAT of 16%

2005

- Of the 5 items attract 24%, duty reduced to 16% for three items

2006

- Duty reduced to 16% for the remaining two items

2007

- No change in the CENVAT rate (16 %).

Customs Duty Rate – Peak Rate (%)

Year	Peak Rate*
1991-92	150
1992-93	110
1993-94	85
1994-95	65
1995-96	50
1996-97	50
1997-98	40
1998-99	45
1999-00	40
2000-01	38.5
2001-02	35
2002-03	30
2003-04	25@
2004-05	20
2005-06	15
2006-07	12.5
2007-08	10

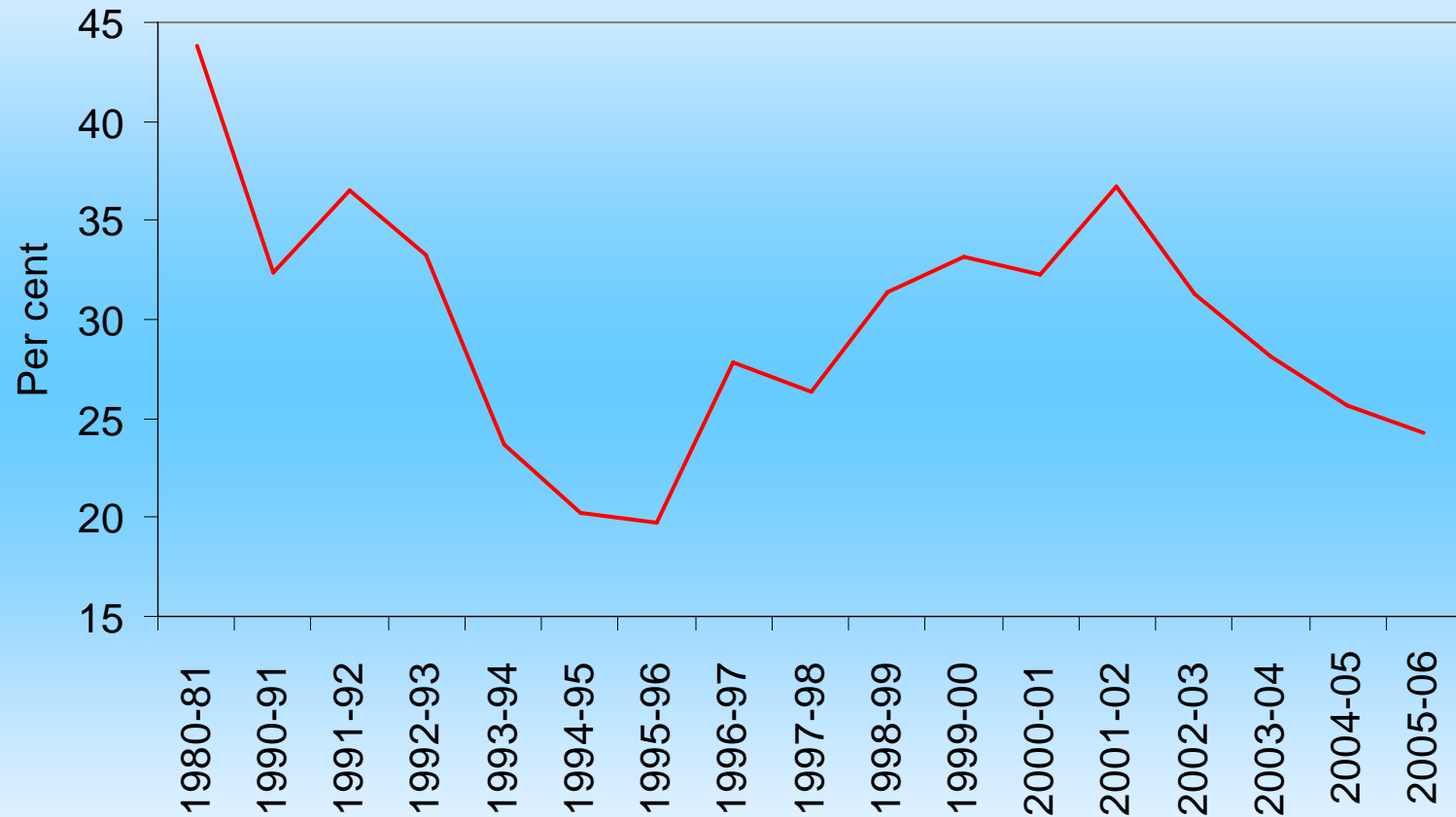
* On Non-Agricultural Goods

@ Reduced to 20 per cent in January 2004.

Impact of Fiscal Policy on Corporate Performance

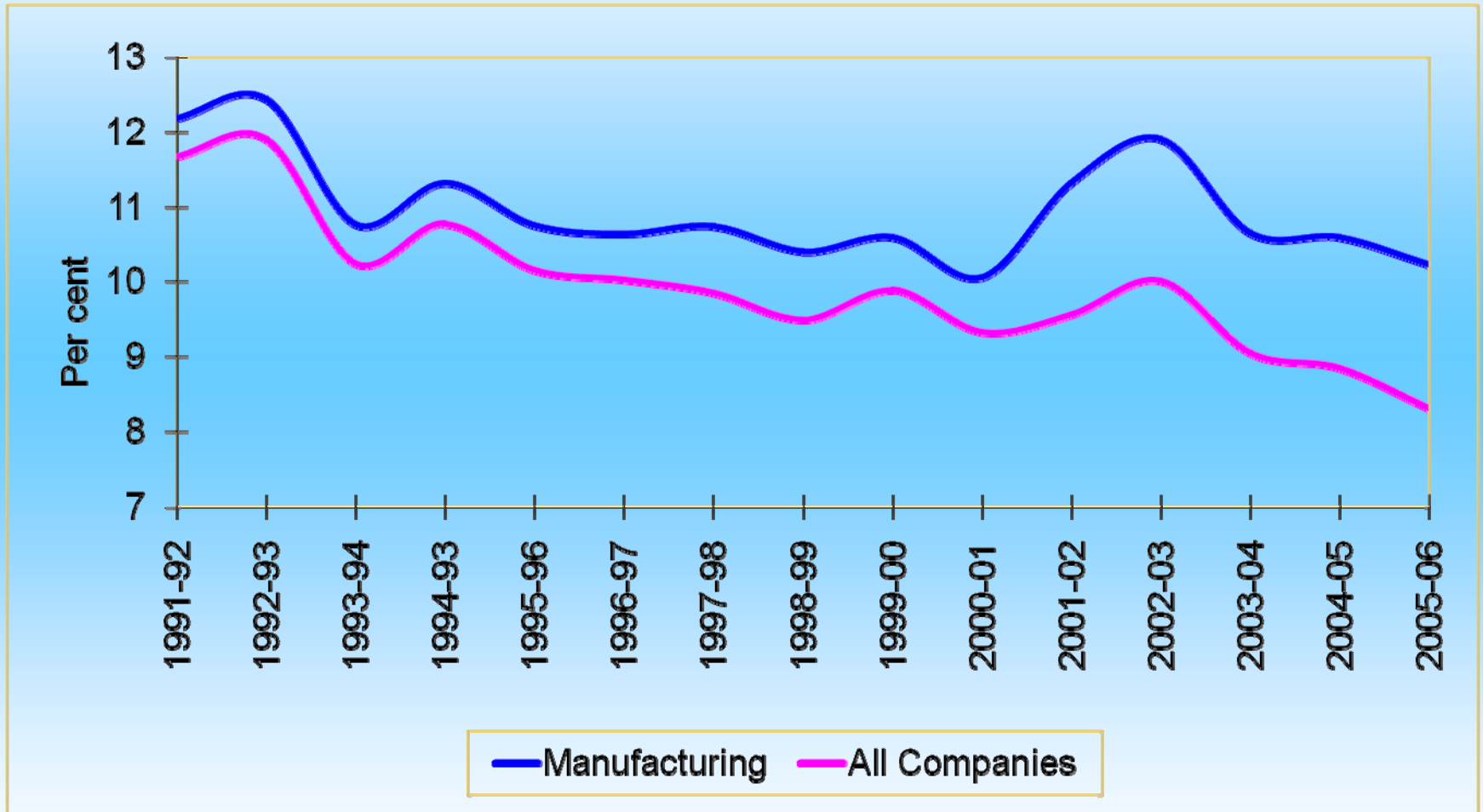
Year	PAT/Net Worth (Per cent)	Tax provision / PBT (Per cent)	Retained Profits / PAT (Per cent)	Dividends / Net Worth (Per cent)
1980-81	14.2	43.8	61.8	5.4
1990-91	13.5	32.4	62.8	5.0
1991-92	12.0	36.5	62.2	4.5
1992-93	8.7	33.3	53.9	4.0
1993-94	12.0	23.7	67.6	3.9
1994-95	14.0	20.2	72.2	3.9
1995-96	14.4	19.7	73.6	3.8
1996-97	9.5	27.8	64.0	3.4
1997-98	7.6	26.3	63.0	2.8
1998-99	5.6	31.4	52.3	2.7
1999-00	6.3	33.2	47.6	3.3
2000-01	6.5	32.3	48.8	3.3
2001-02	5.1	36.7	30.9	3.5
2002-03	8.7	31.3	56.3	3.8
2003-04	13.2	28.1	59.8	5.3
2004-05	16.8	25.7	71.7	4.8
2005-06	16.7	24.3	73.4	4.5

Tax Provision/Profits Before Tax



Any Pattern?

Excise duty to Sales Ratio



Why this Steady Fall?

Note: Sales Include excise duty.

Impact of Tax Policy

- No Obvious Correlation between Tax Policy and Corporate Profitability or Tax Payments
- Business Cycle Appears More Important
 - High Profitability 1992-96
 - Low Profitability 1997-2003
 - Recovery Thereafter
- Puzzle : Steady Fall in Excise Duty Payments

4

Monetary Policy And Corporate Performance

How were the 1980s?

Till the late 1980s:

- Government Raised Funds Below Market Rate
- Automatic Fiscal Accommodation through Ad hoc T-bills
- CRR Used to Manage Liquidity
- SLR Used to Ensure Subscription
- No Depth in G-Securities Market
- Segmented and Under developed Financial Markets
- Paucity of Instruments
- Administered Interest Rate Regime
- Regulation of Deposit Rates

Resulted in:

- Distorted interest rate mechanism
- Automatic Monetisation
- Adversely affected the viability and profitability of banks
- Transparency, accounting and prudential norms could not be strictly followed in banking operations
- Lack of incentive to seek efficiency
- Complex Interest Rate Structure
- Gross inefficiencies at the micro level
- Non-transparent accounting of intra-public sector financial transactions

Interest Rate Deregulation – Deposit Rates

April 1992

- Interest Rates Freed between 40 days and 3 years. But ceiling prescribed

October 1995

- Ceiling removed for Deposits over 2 years

July 2, 1996

- Ceiling removed for Deposits over 1 year

October 22, 1997

- Interest Rates on Term Deposits Completely Deregulated

October 2004

- Minimum Maturity for Term Deposits Reduced to 7 days

Interest Rate Deregulation – Lending Rate I

April 1992

- Six Categories of Lending Rates
 - 5 slabs for below Rs.2 lakh
 - Minimum Lending rate Above Rs.2 lakh

October 1994

- Lending Rate freed for Loans above Rs.2 lakh & Minimum Rate Abolished

October 1996

- Banks to specify Maximum spread over PLR

October 1997

- Separate PLRs permitted for cash credit/demand loans and term loans above 3 years. Floating Rate permitted.

April 1998

- PLR made ceiling for loans upto Rs.2 lakh

Interest Rate Deregulation - Lending Rate II

April 2000

- Tenor Linked PLR Introduced

April 2001

- PLR made benchmark rate; Sub PLR permitted for loans above Rs.2 lakh

April 2002

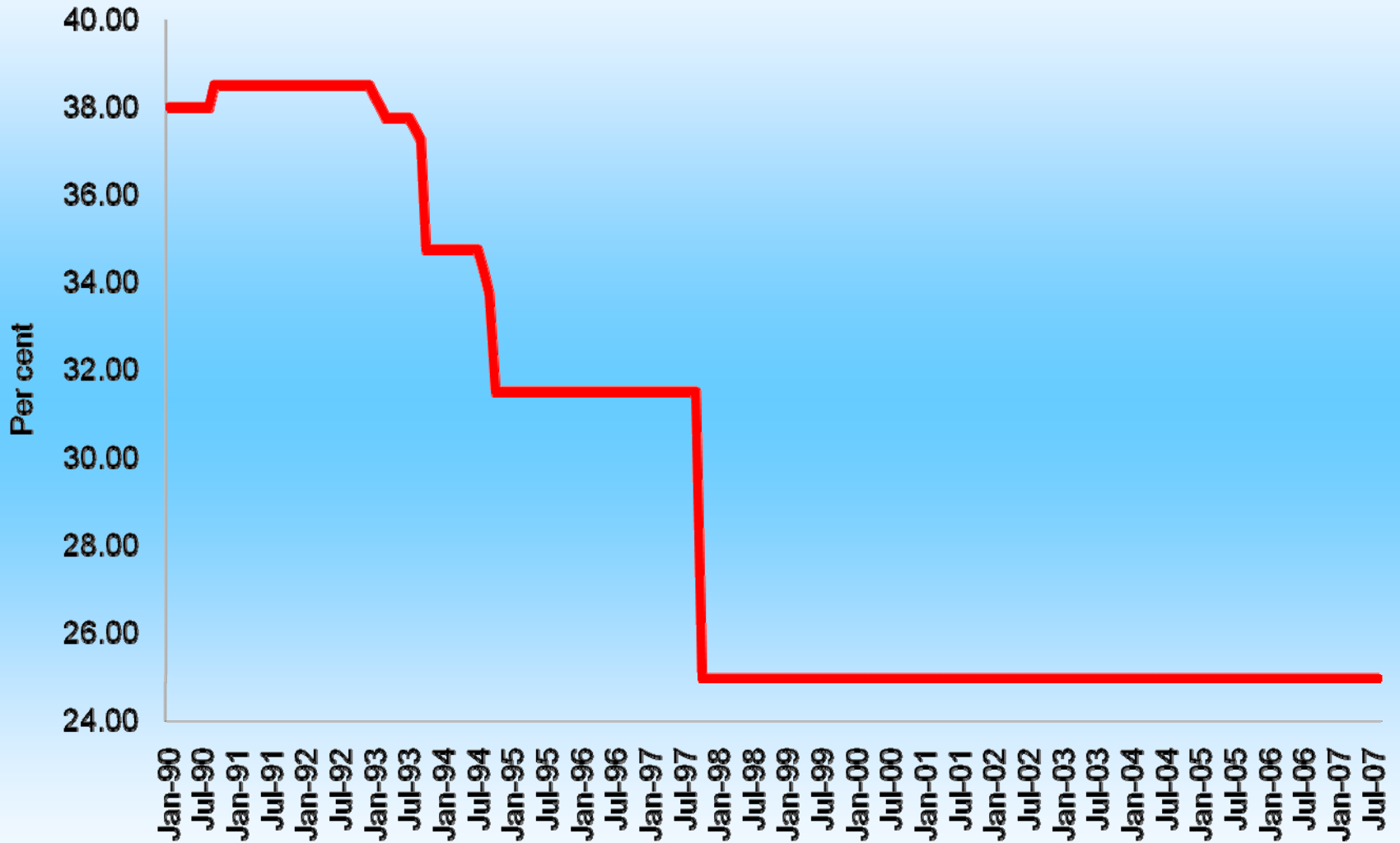
- Bank-wise PLRs made transparent on RBI website

April 2003

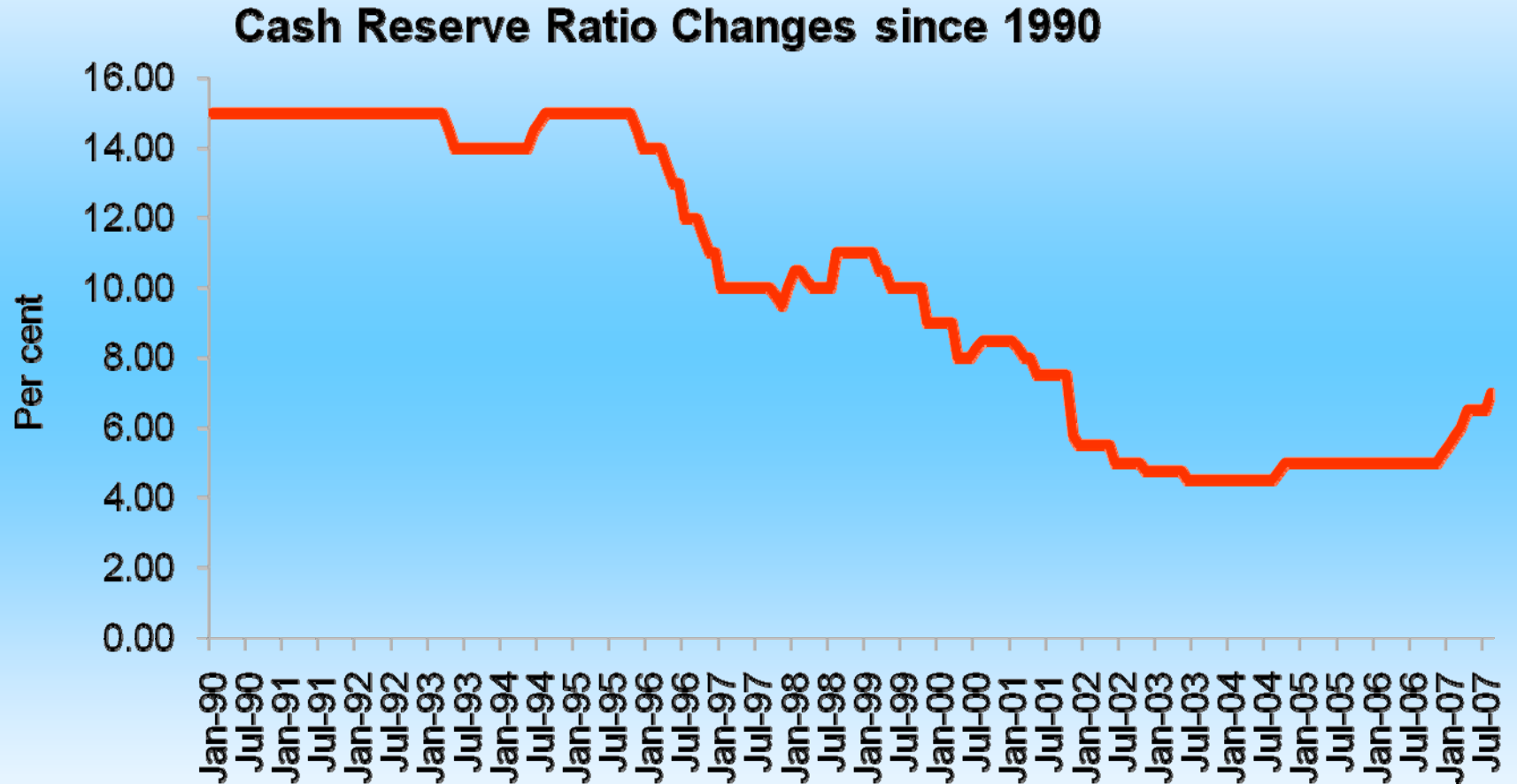
- Computation of Benchmark PLR rationalized; Tenor Linked PLRs abolished

Statutory Liquidity Ratio (SLR) since 1990

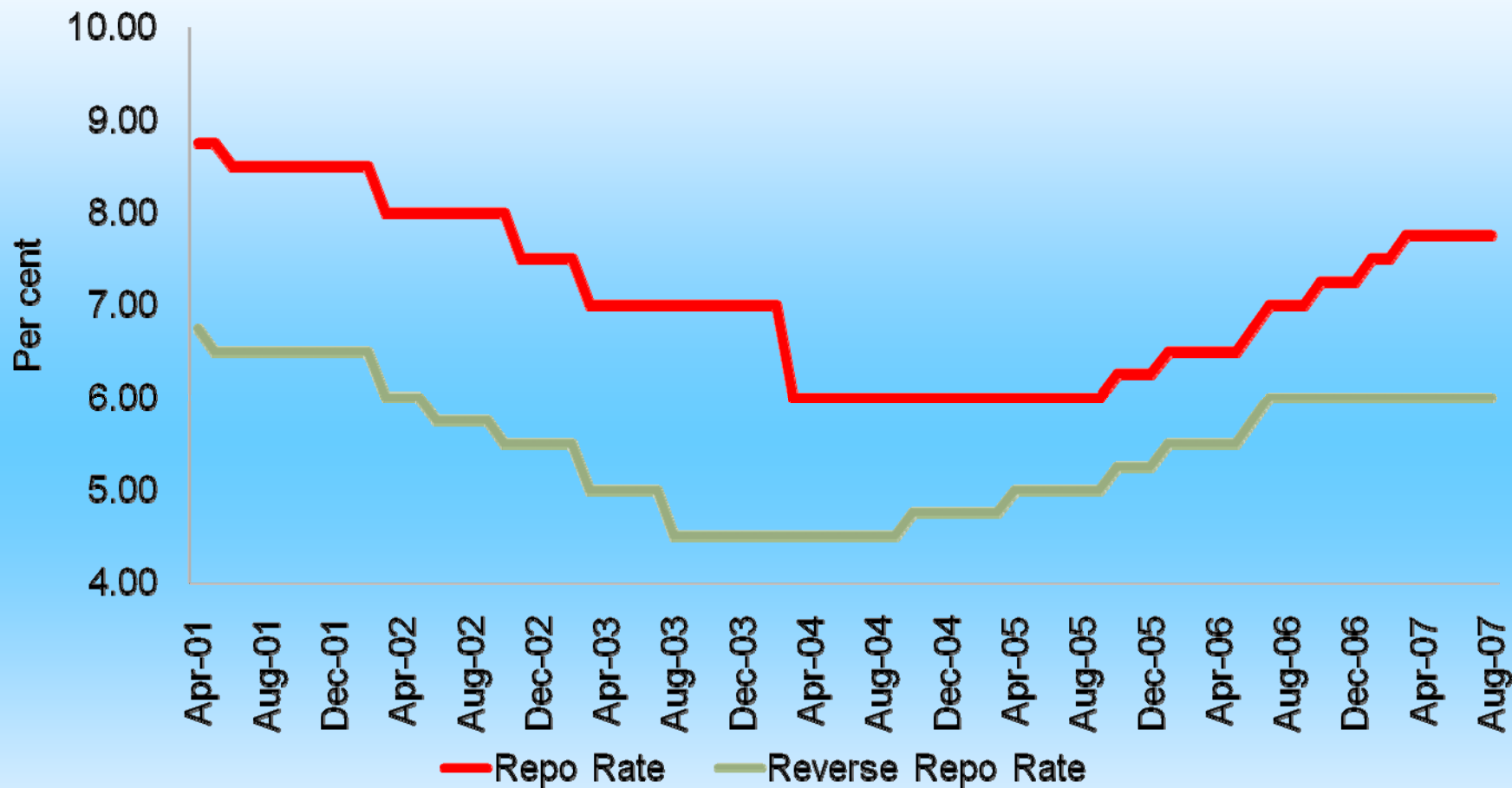
(% of NDTL)



Prescribed Cash Reserve Ratio (CRR) – Per cent of NDTL

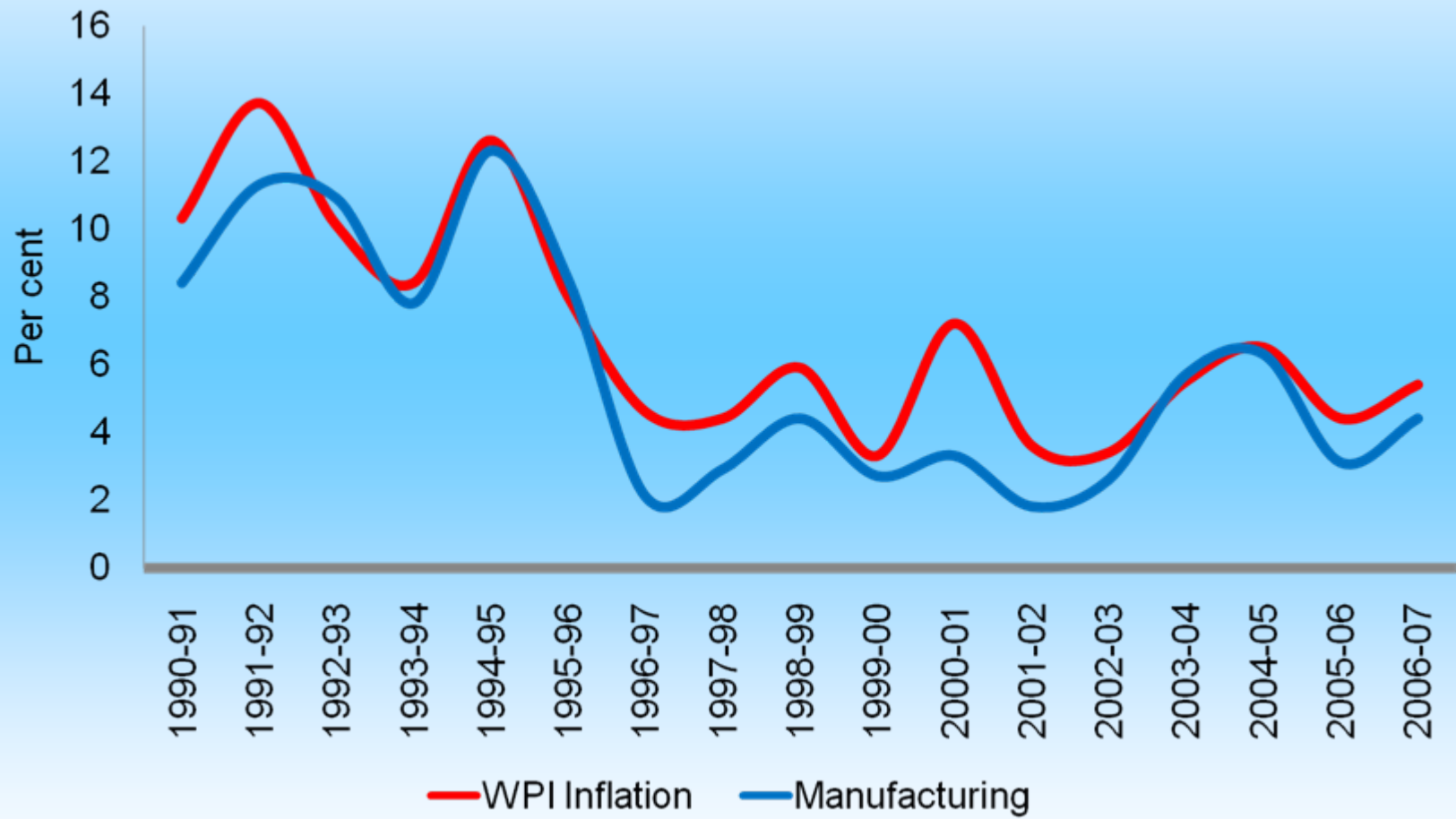


Repo and Reverse Repo Rates



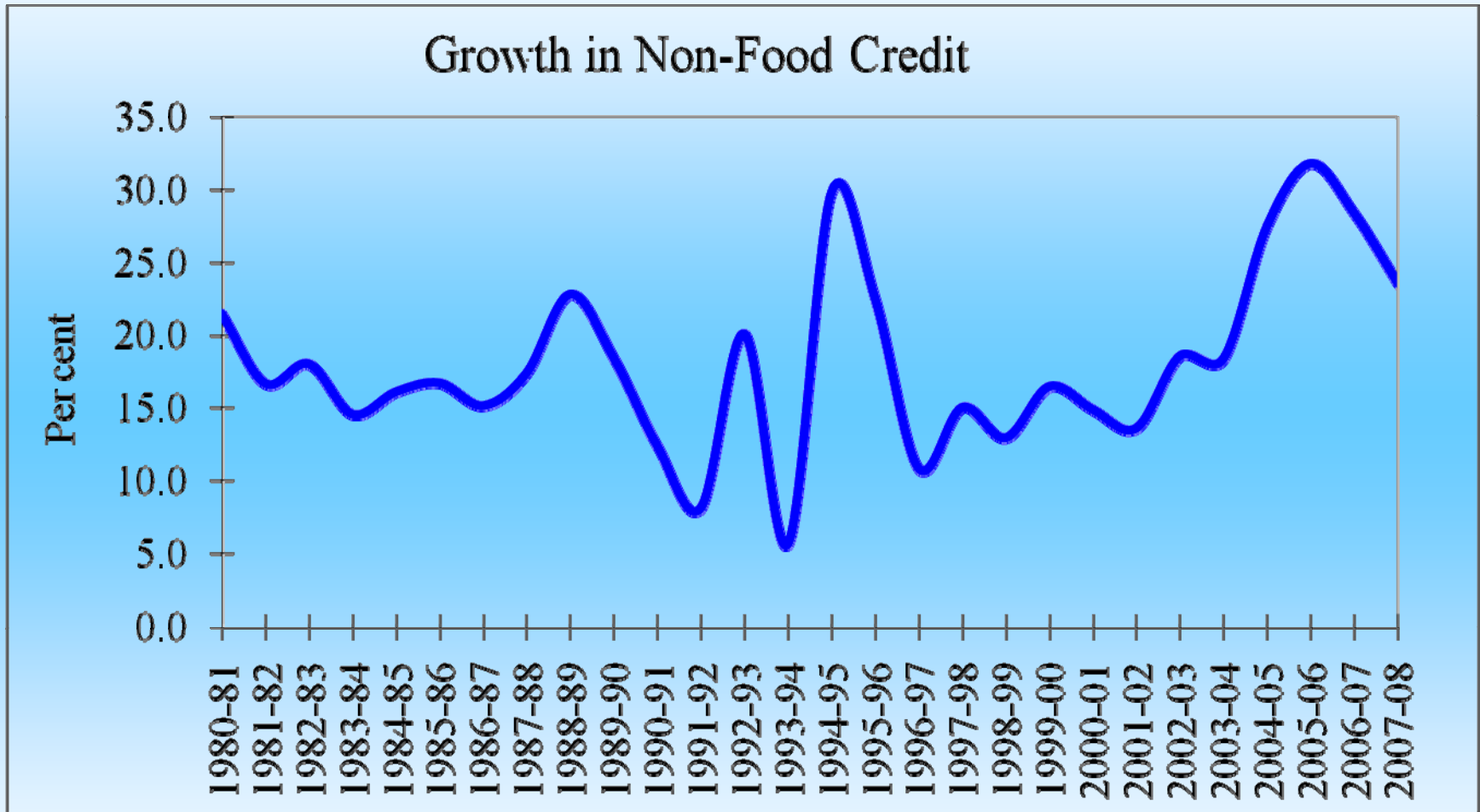
Note: With effect from October 29, 2004, nomenclature of Repo and Reverse Repo has been interchanged as per international usage.

Success on Inflation Front – WPI Inflation



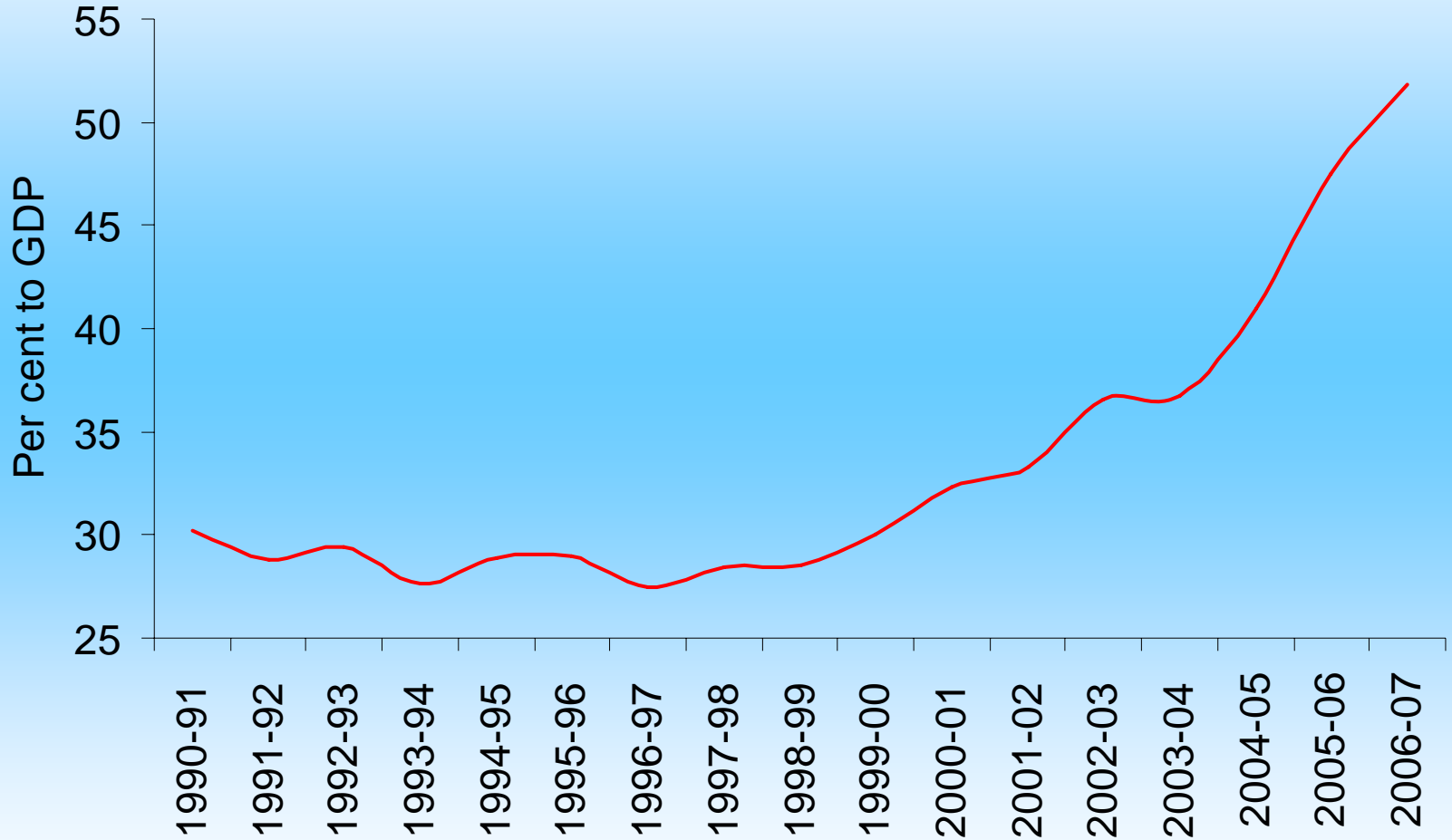
Key Achievement of Monetary Policy

Non-Food Credit

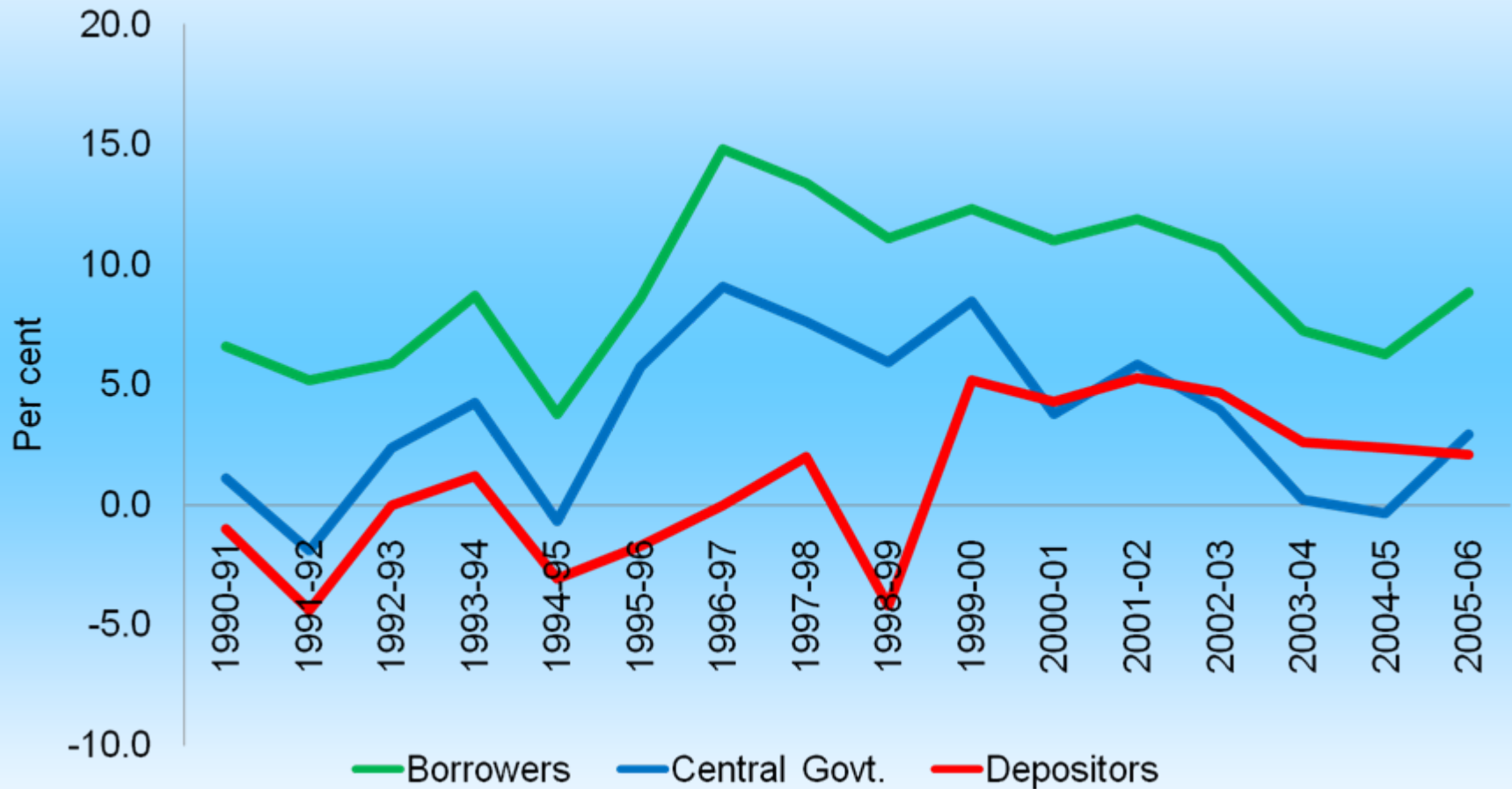


Recovery after 2003

Bank Credit (% to GDP)

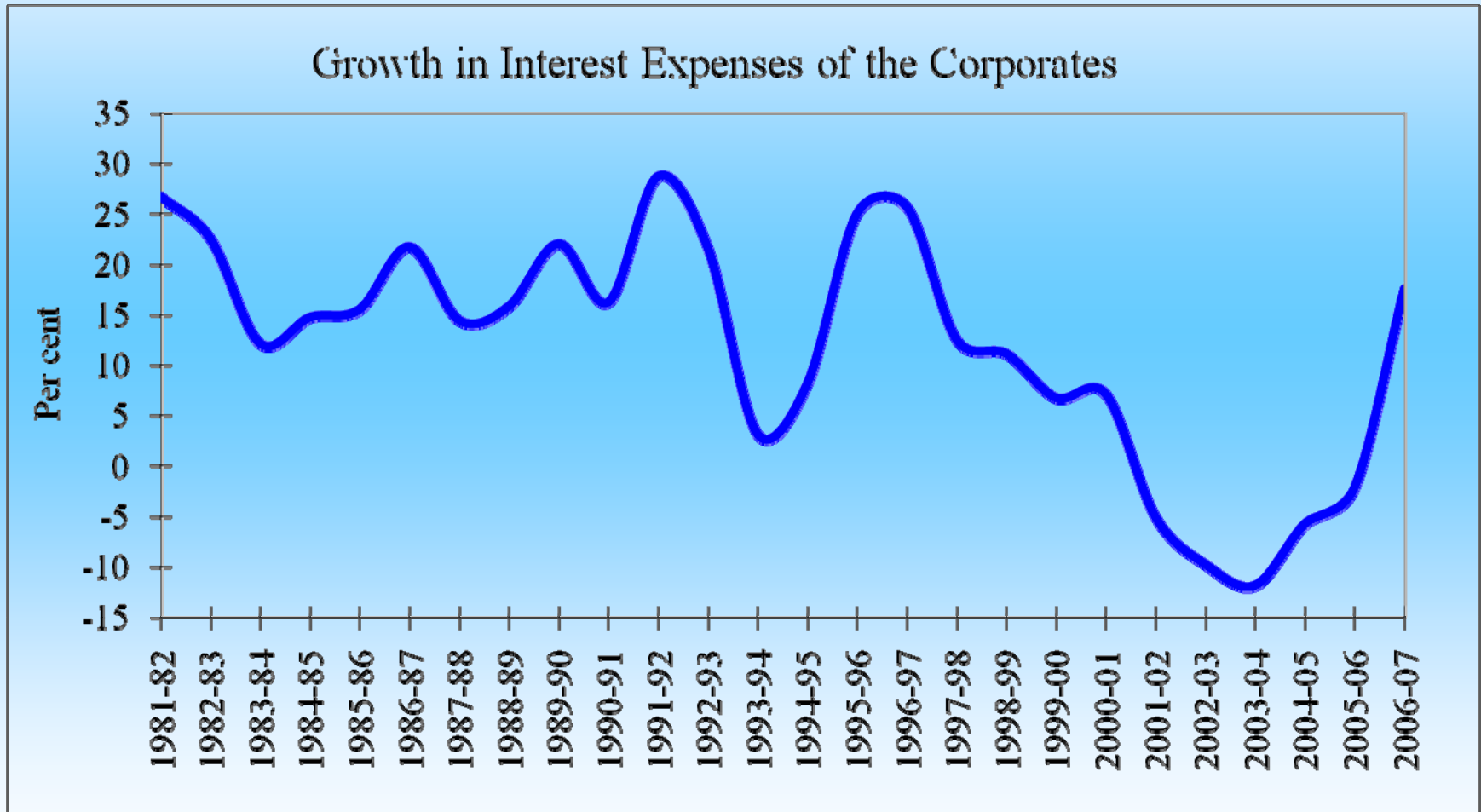


Real Interest Rates



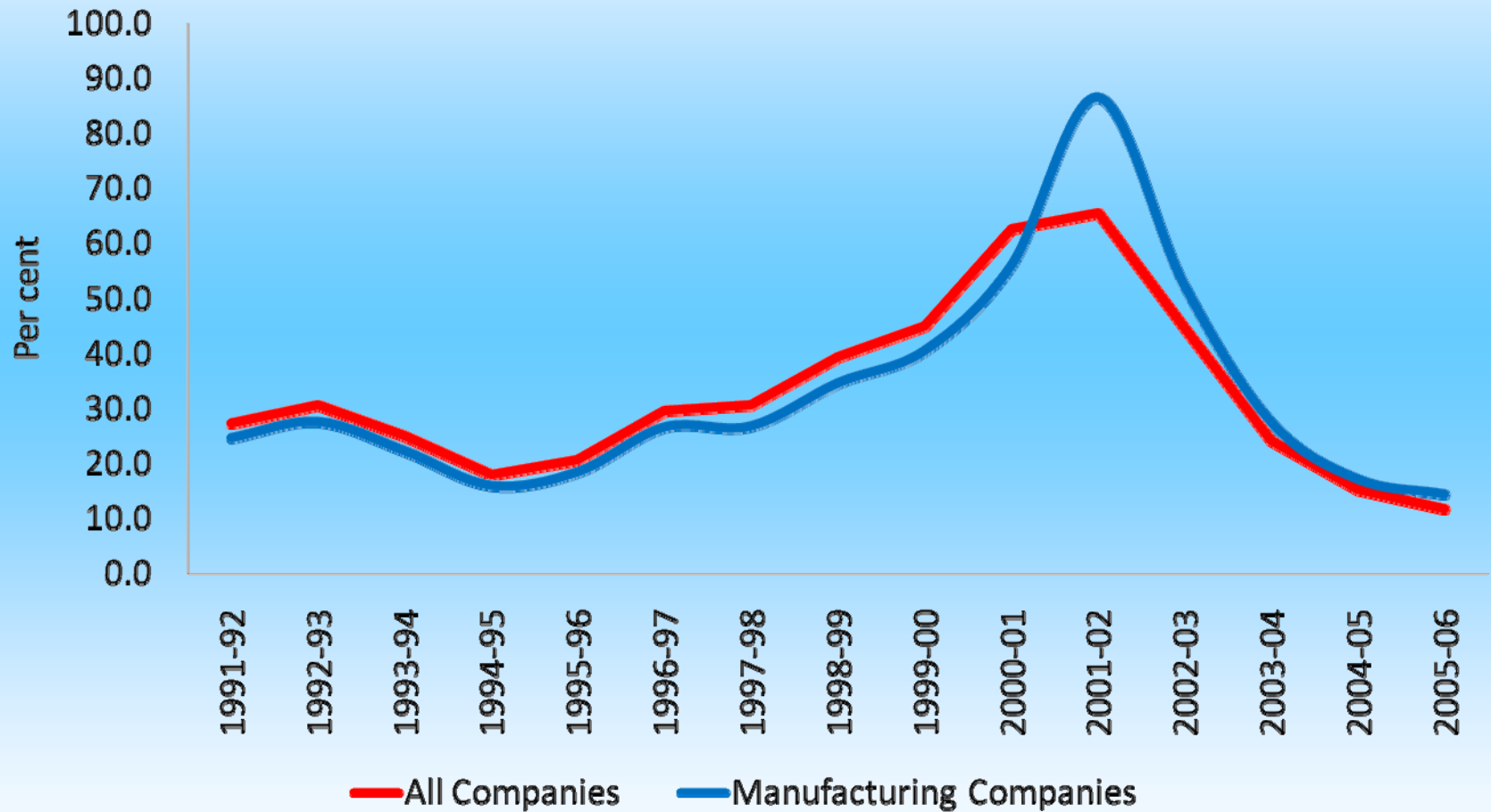
Low Interest Costs -1

Growth in Interest Expenses of the Corporates

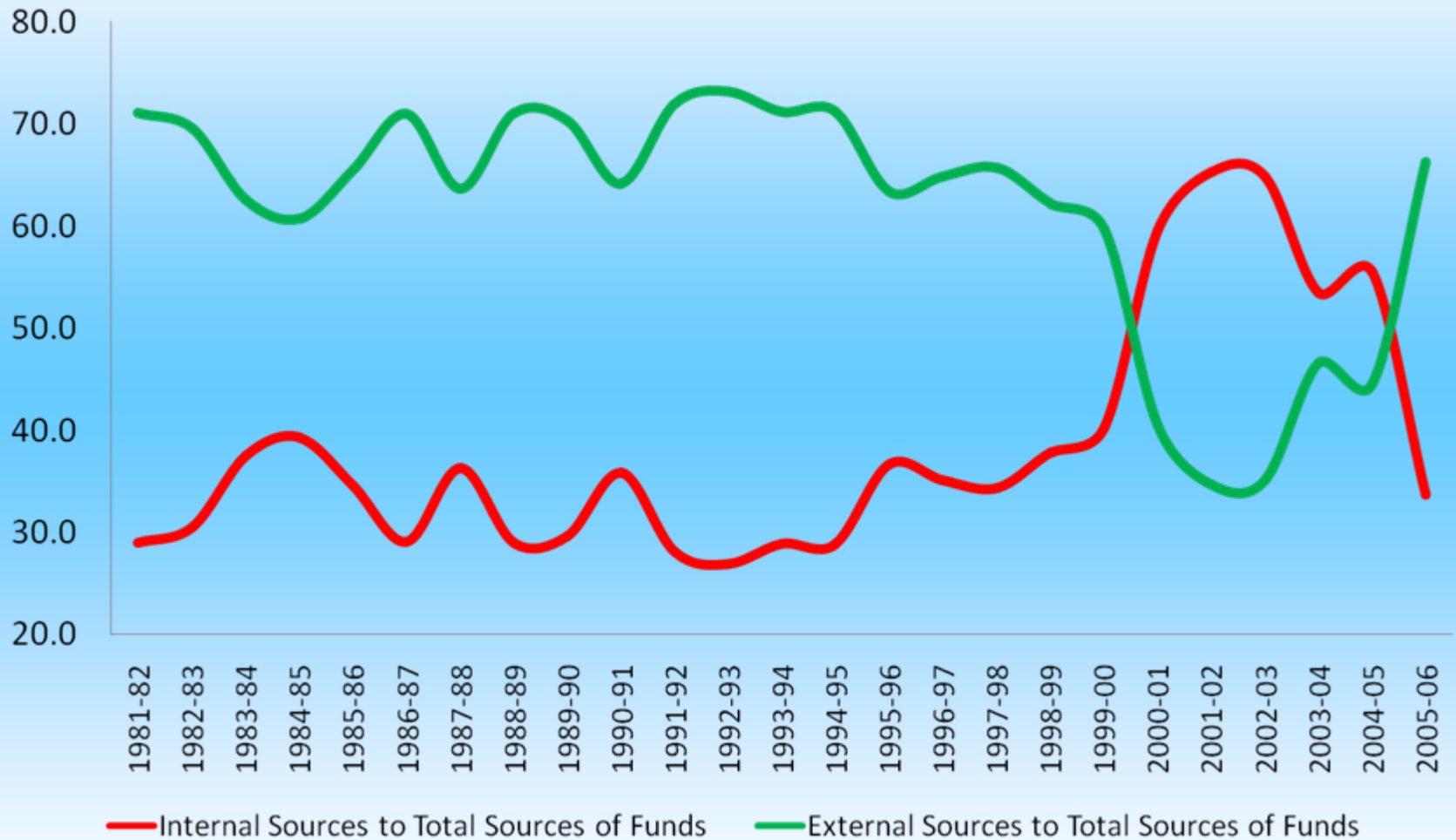


Low Interest Costs -2

Interest Expenses / Sources of Fund Ratio



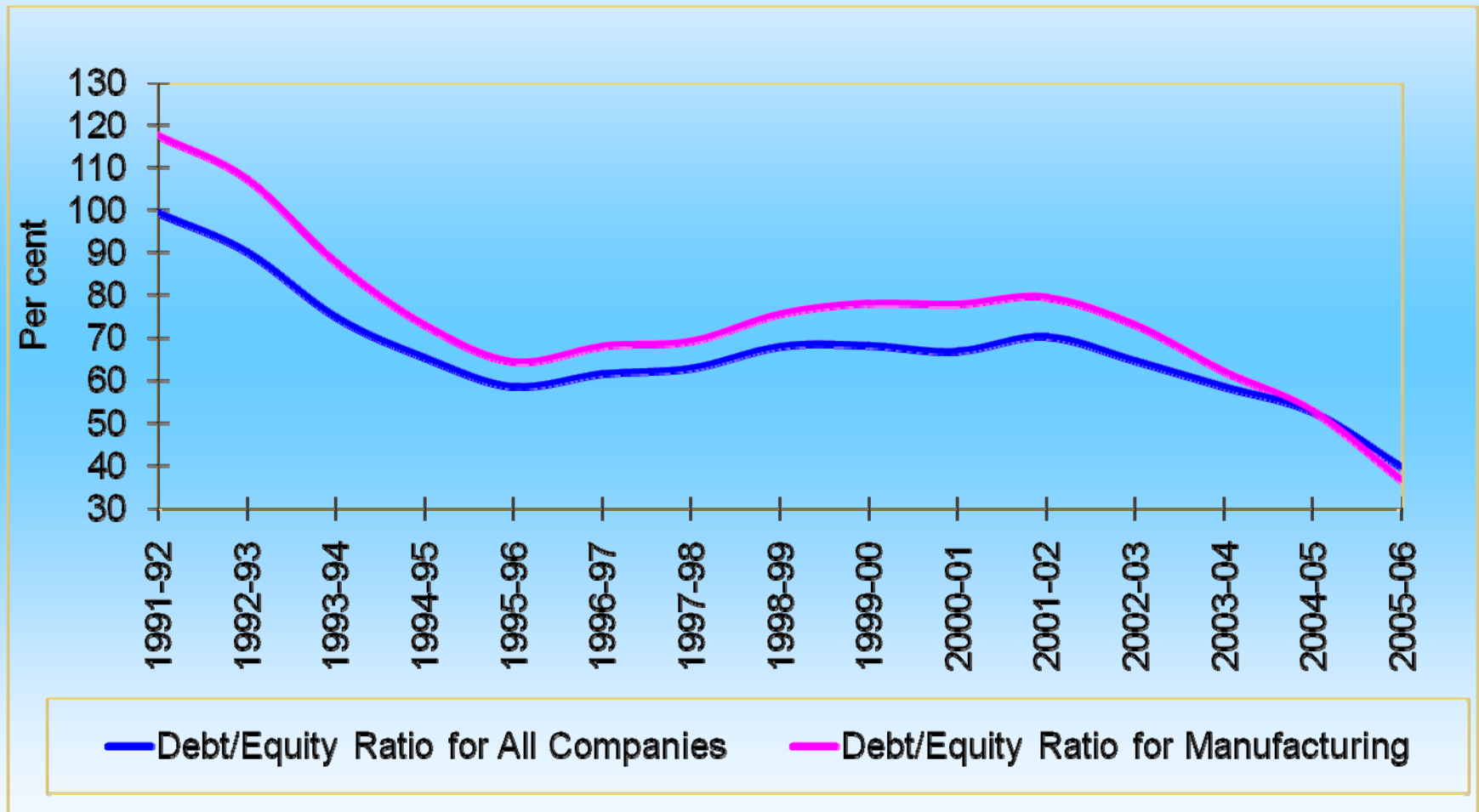
Changing Pattern of Sources of Funds



Increasing Reliance on Internal Financing

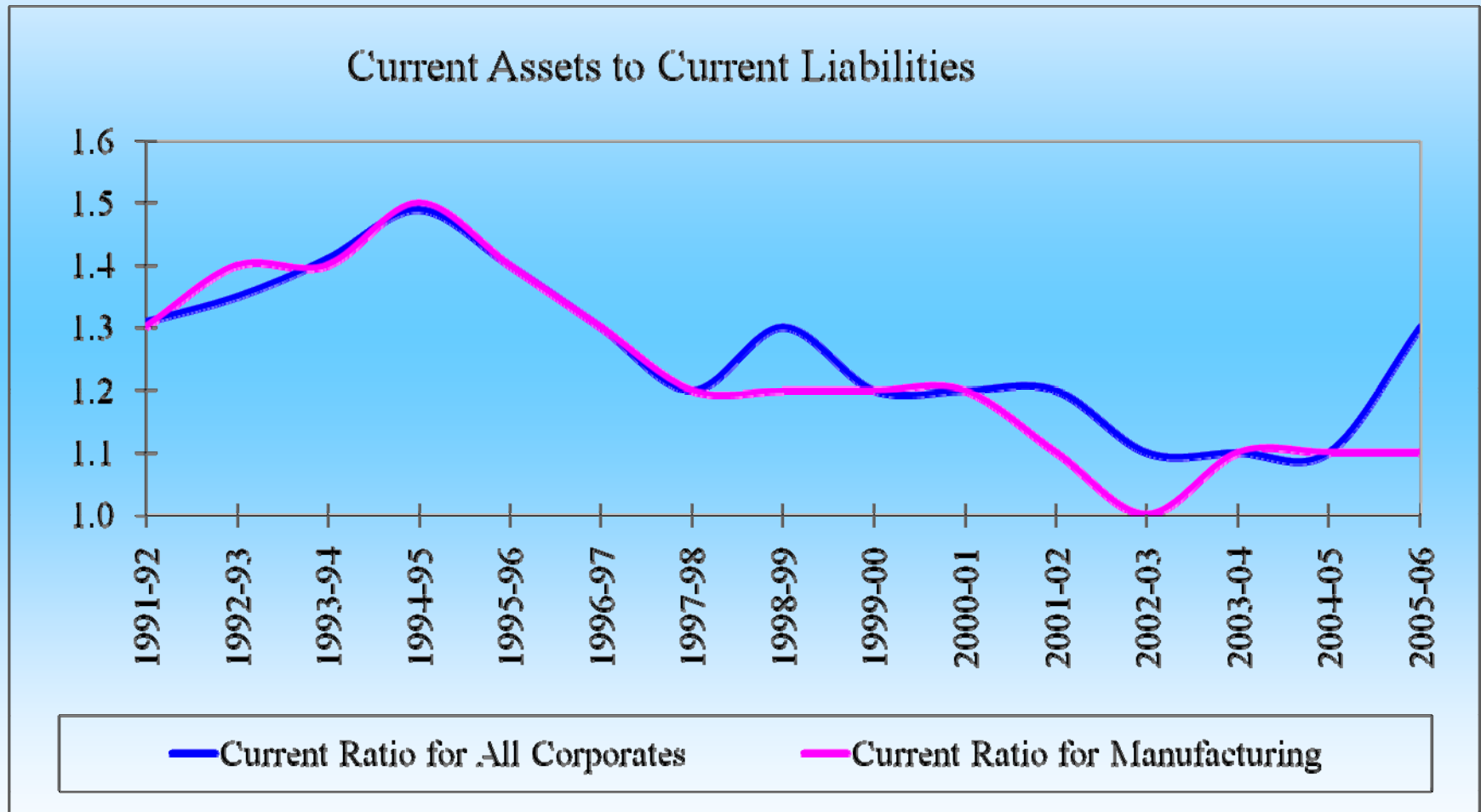
But External Finance Increasing Again: ECB?

Debt Equity Ratio



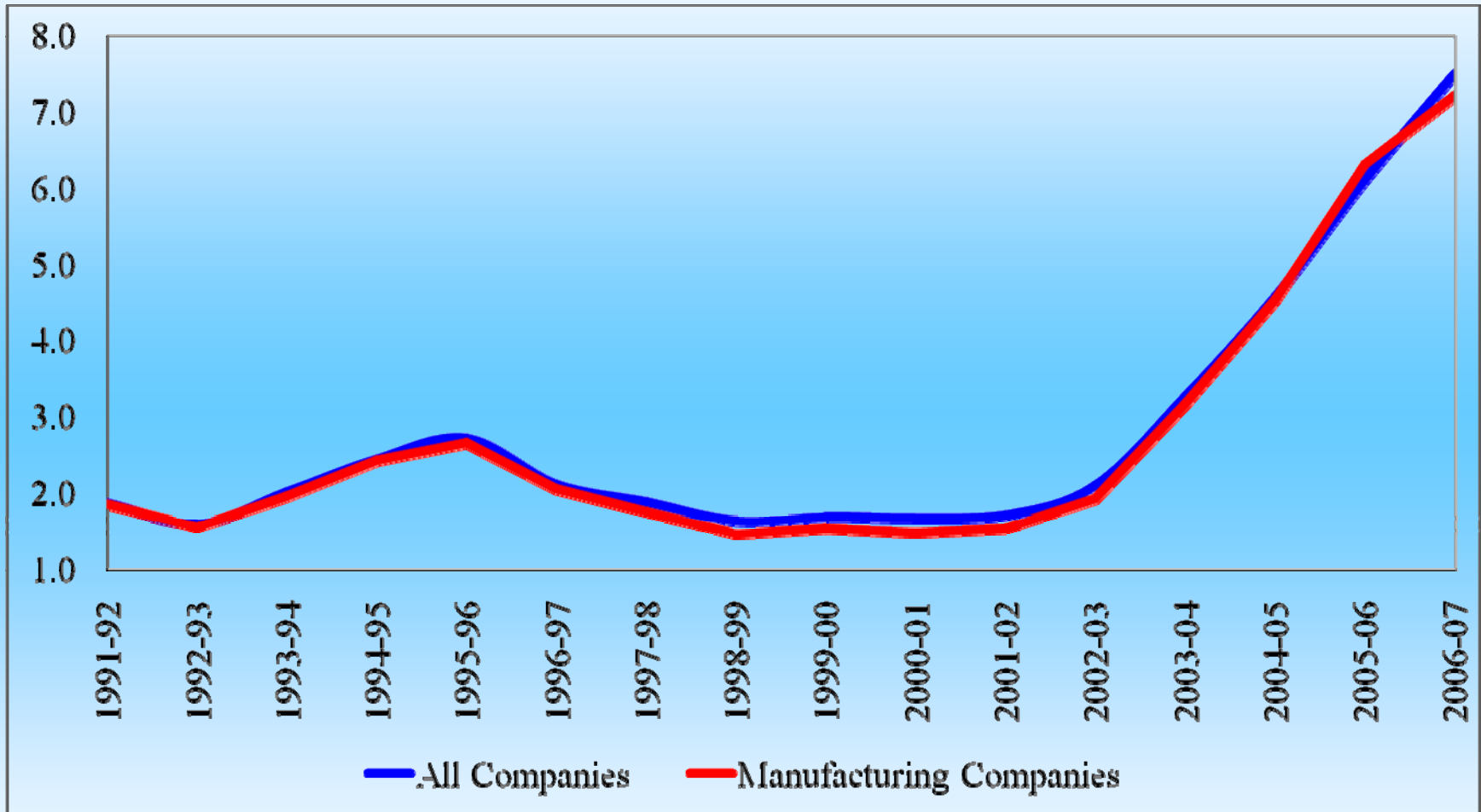
Major Change in Financial Structure of Firms

Liquidity 1: Current Ratio



Danger Signs or more efficient financial management?

Liquidity 2: Interest Coverage Ratio*

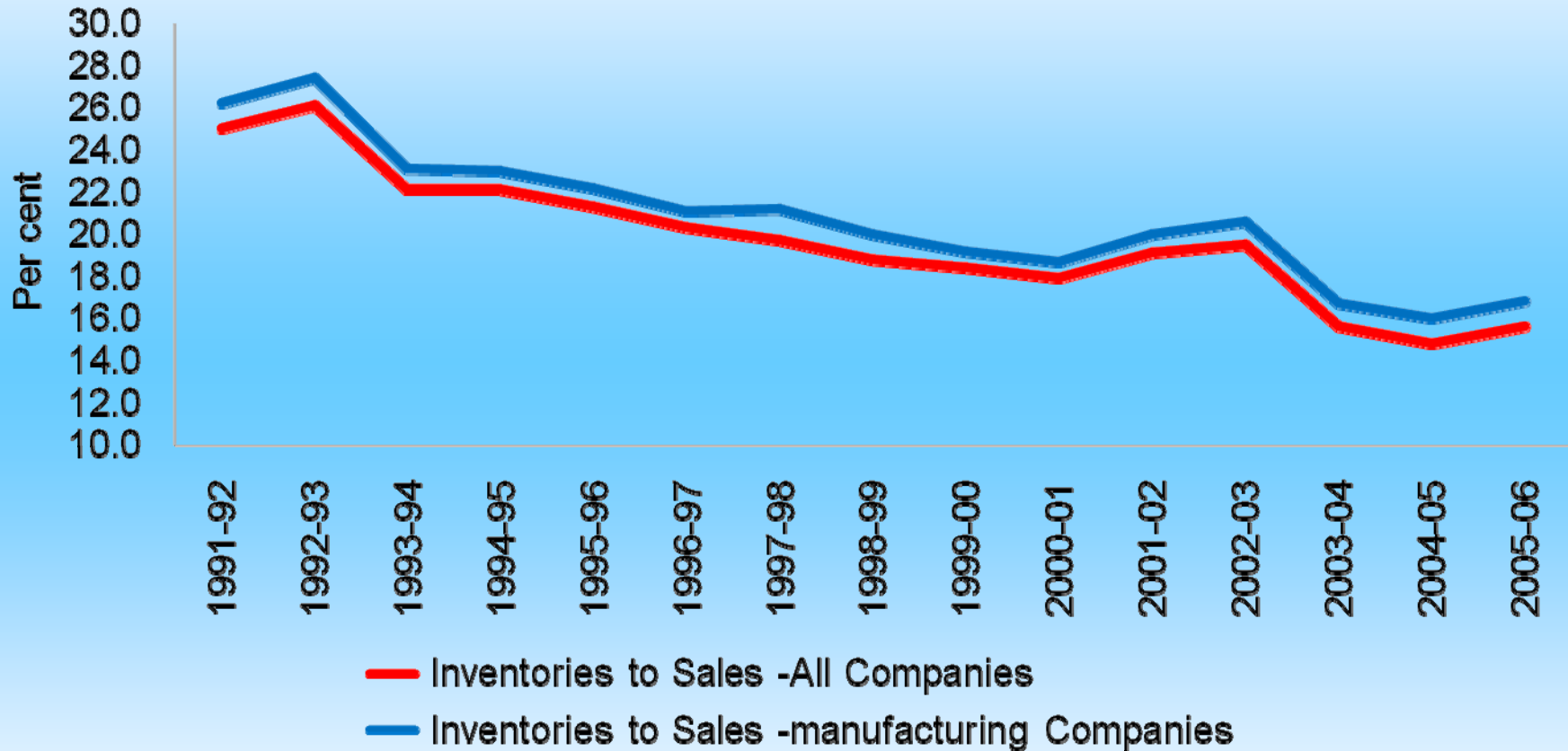


Recent increasing Trend: Recovering from strain to meet debt obligation

* ICR is defined as the ratio of earnings before interest and taxes to interest expenses.

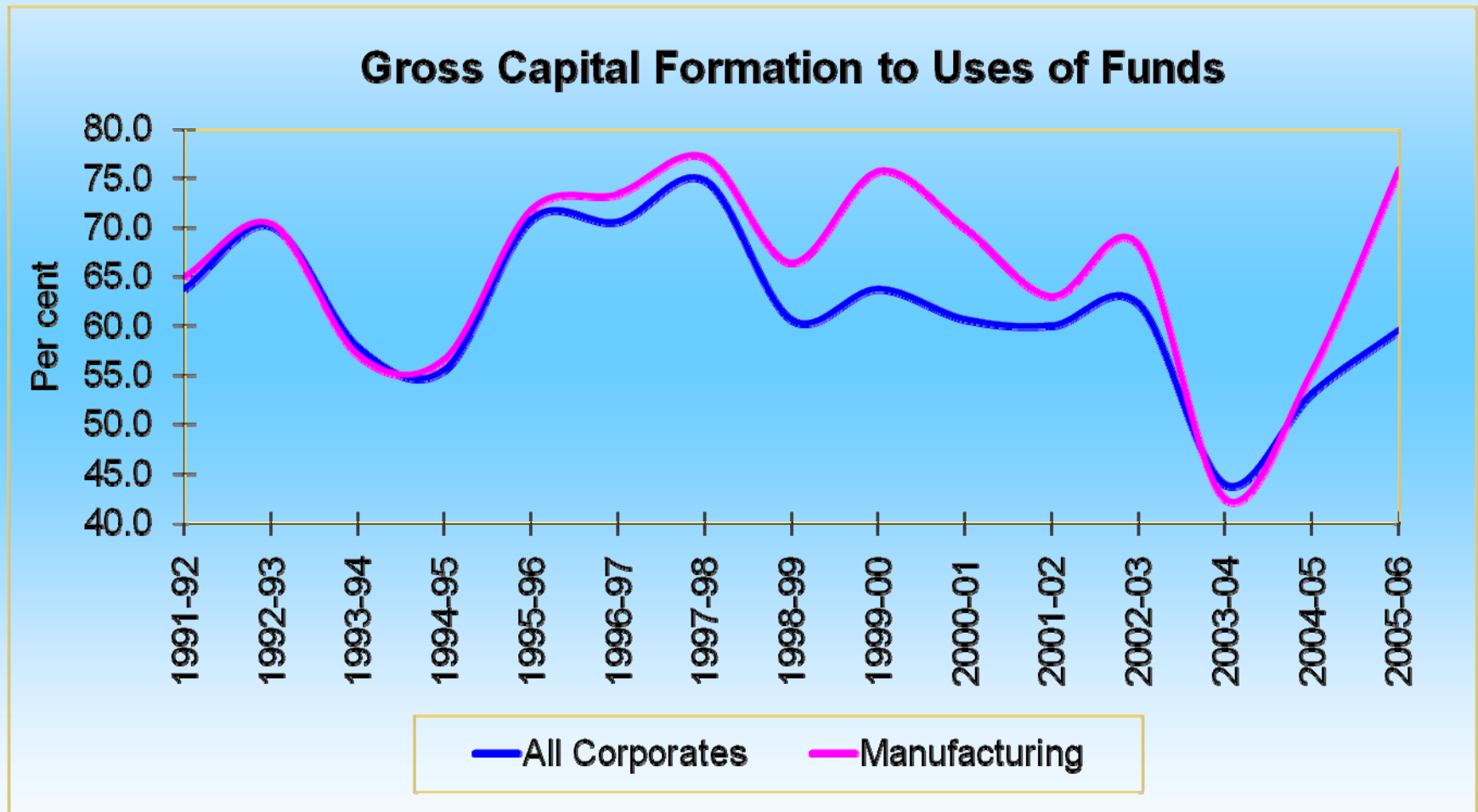
Inventory Management

Inventories to Sales

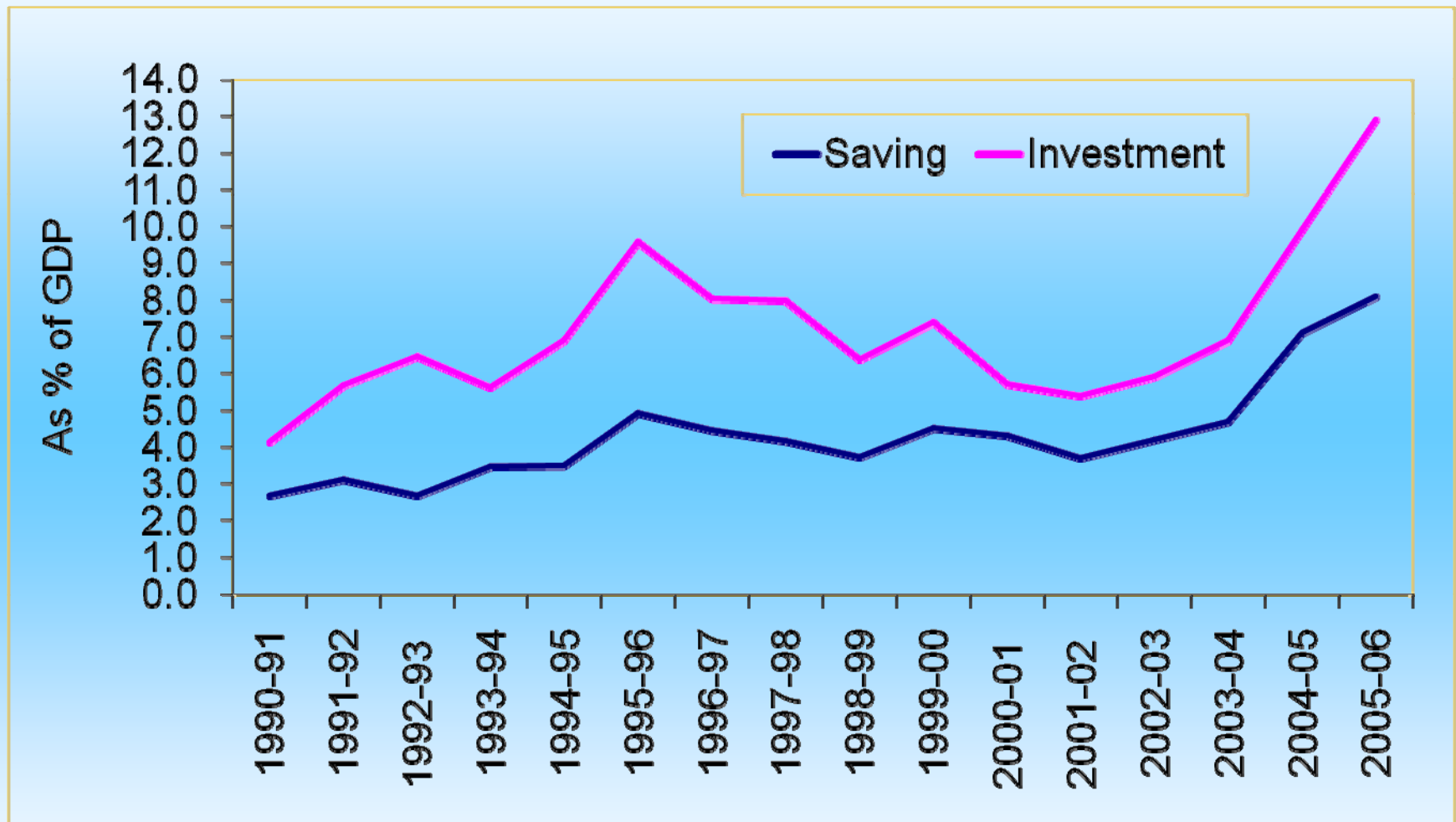


**Indicative of More Efficient Management? or,
Reduction in Demand for Bank Finance?**

Capital Formation



Saving & Investment of Corporate sector



Source: National Accounts Statistics

Monetary Policy and Corporate Performance

- High correlation between real interest rates and corporate behaviour
- Evidence of significant improvements in financial management in response to interest rates movements
- Lower inflation rates and interest rates from 2002 have contributed to improved corporate performance

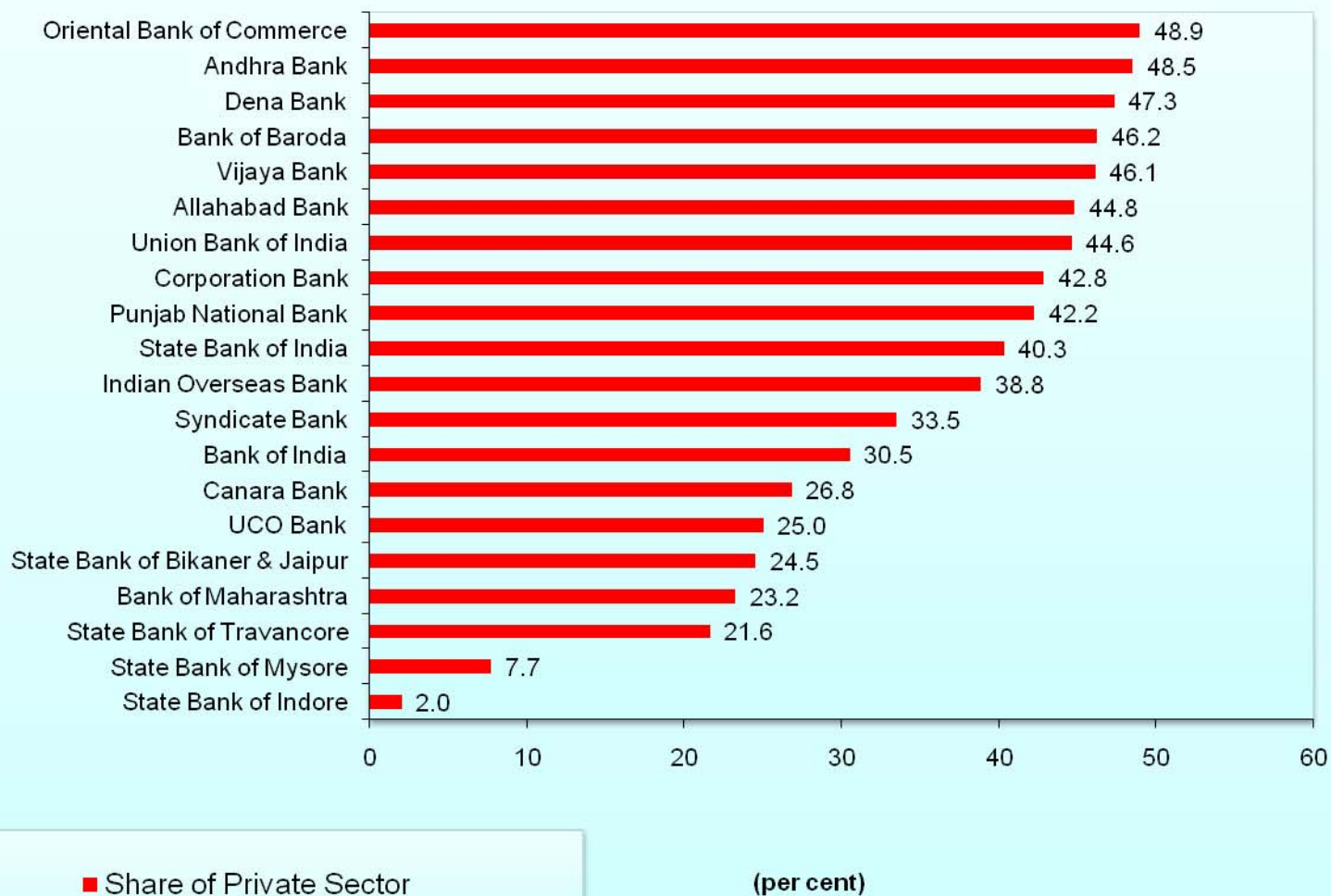
5
Financial
Sector
Strengthening
And
Corporate
Performance

Financial Sector Strengthening

- **Competition Enhancing Measures**
 - Operational autonomy and disinvestment of public ownership in public sector banks
 - Transparent entry norms for private and foreign banks
 - Permission for FDI and portfolio investment in banking
- **Strengthening of Prudential Regulation**
 - Phased implementation of international best practices (CRAR / Provisioning / NPL Norms / Exposure Limits)
 - Measures to strengthen risk management
 - Guidelines on Ownership and Governance
 - KYC and AML Guidelines

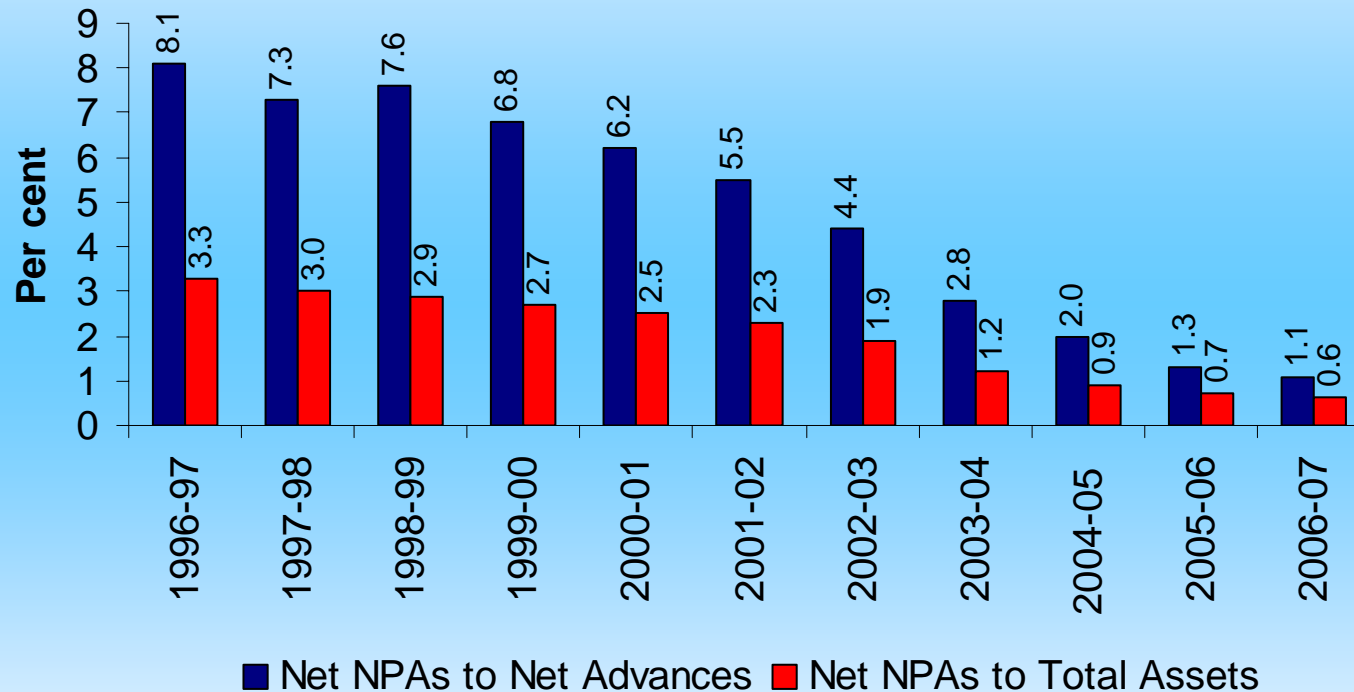
Banking: Capital Structure

20 out of 27 public sector banks raised capital from market up to end-March 2006.



Banking – Asset Quality

Net NPAs of Scheduled Commercial Banks



- Marked improvements in asset quality
- Public sector banks showed more credible performance in NPL management than private sector banks

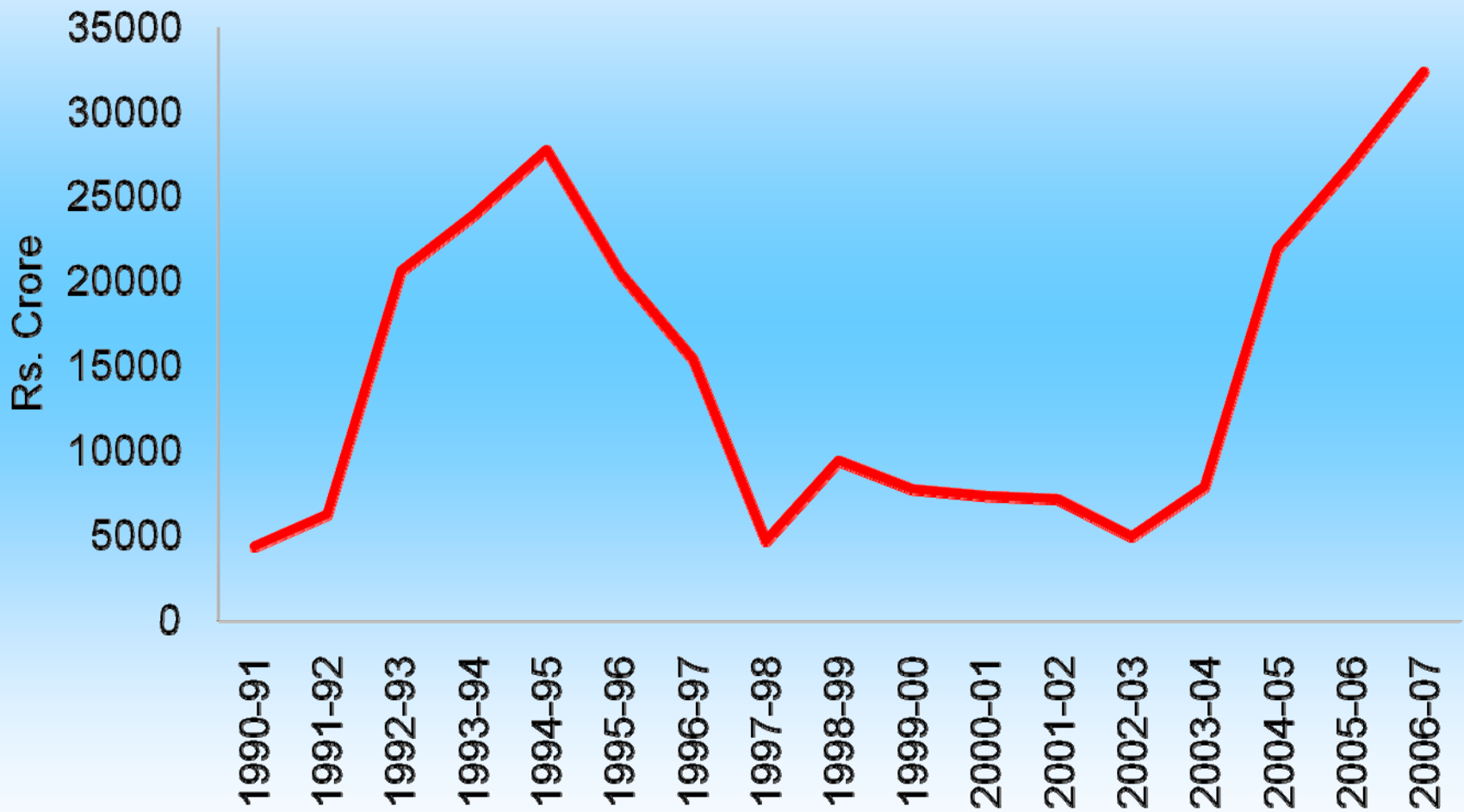
6

Capital Market Deepening And Corporate Performance

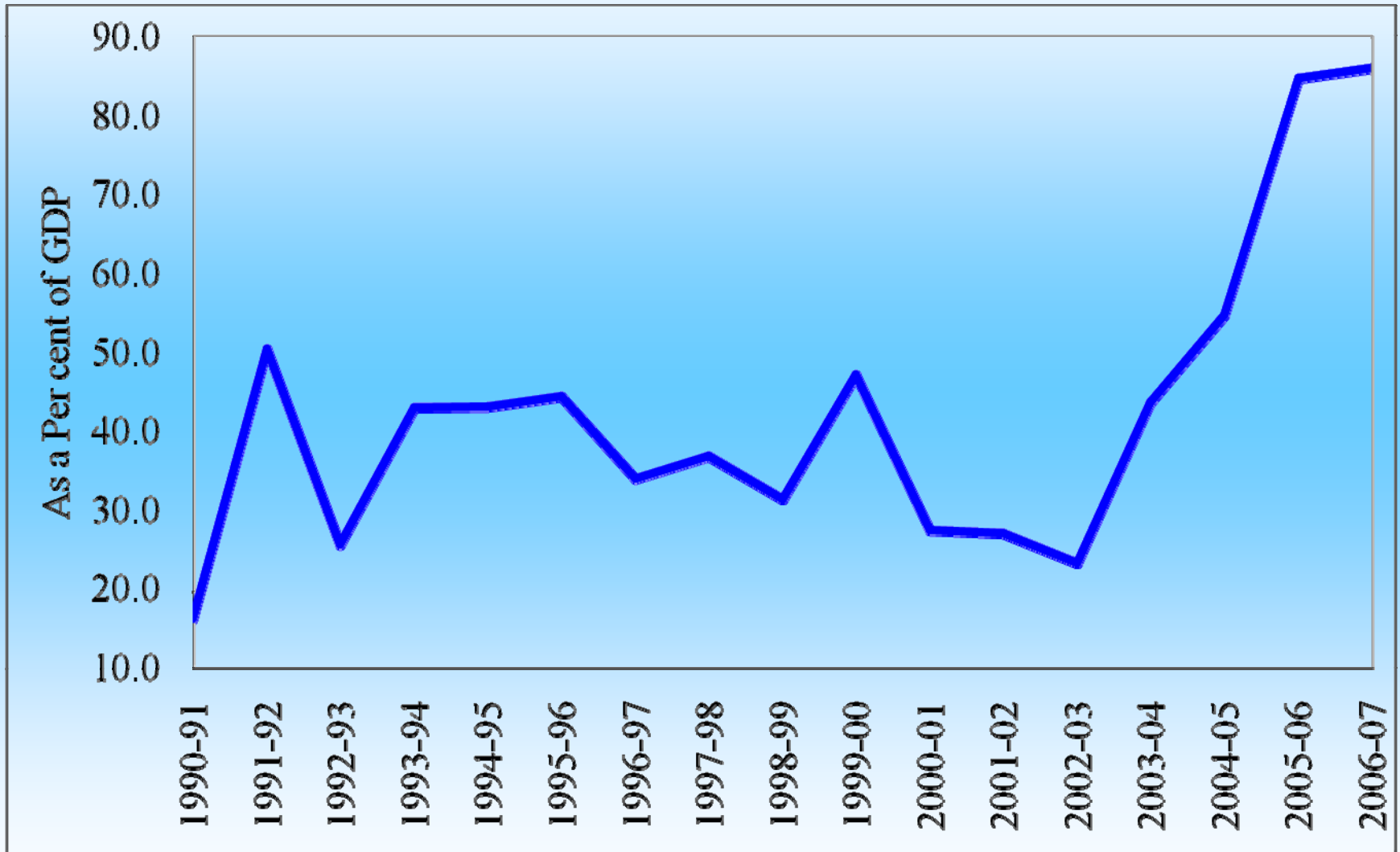
Capital Market Deepening

- Establishment of SEBI
- Abolition of Controller of Capital Issues (CCI)
- Removal of Pricing and Issue Control
- Private Sector Mutual Funds
- National Stock Exchange
- Payment & Settlement Architecture
- G-Sec and Bond Market Development

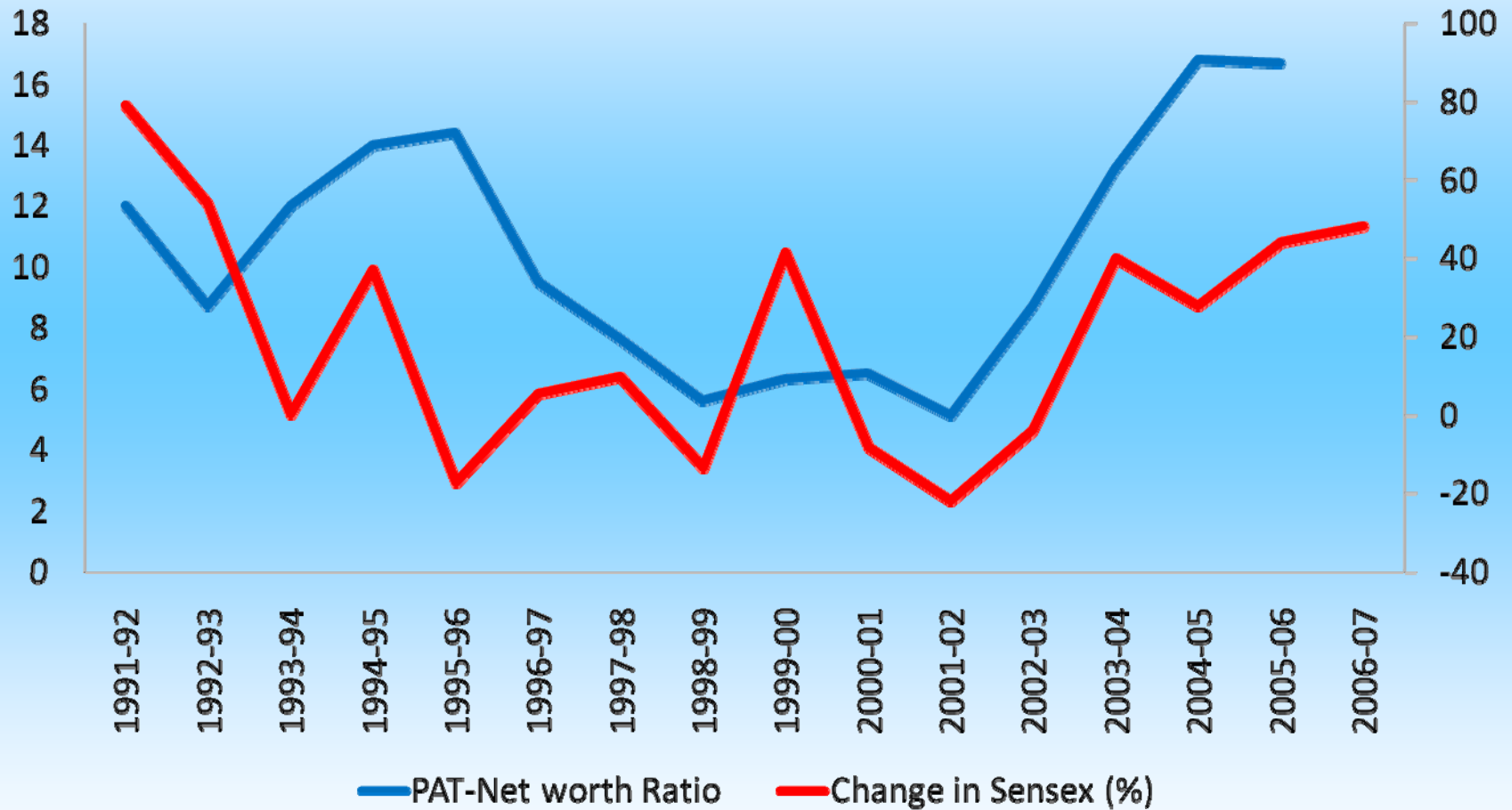
Resource Mobilisation from Primary Market- Public Issues



Market Capitalization

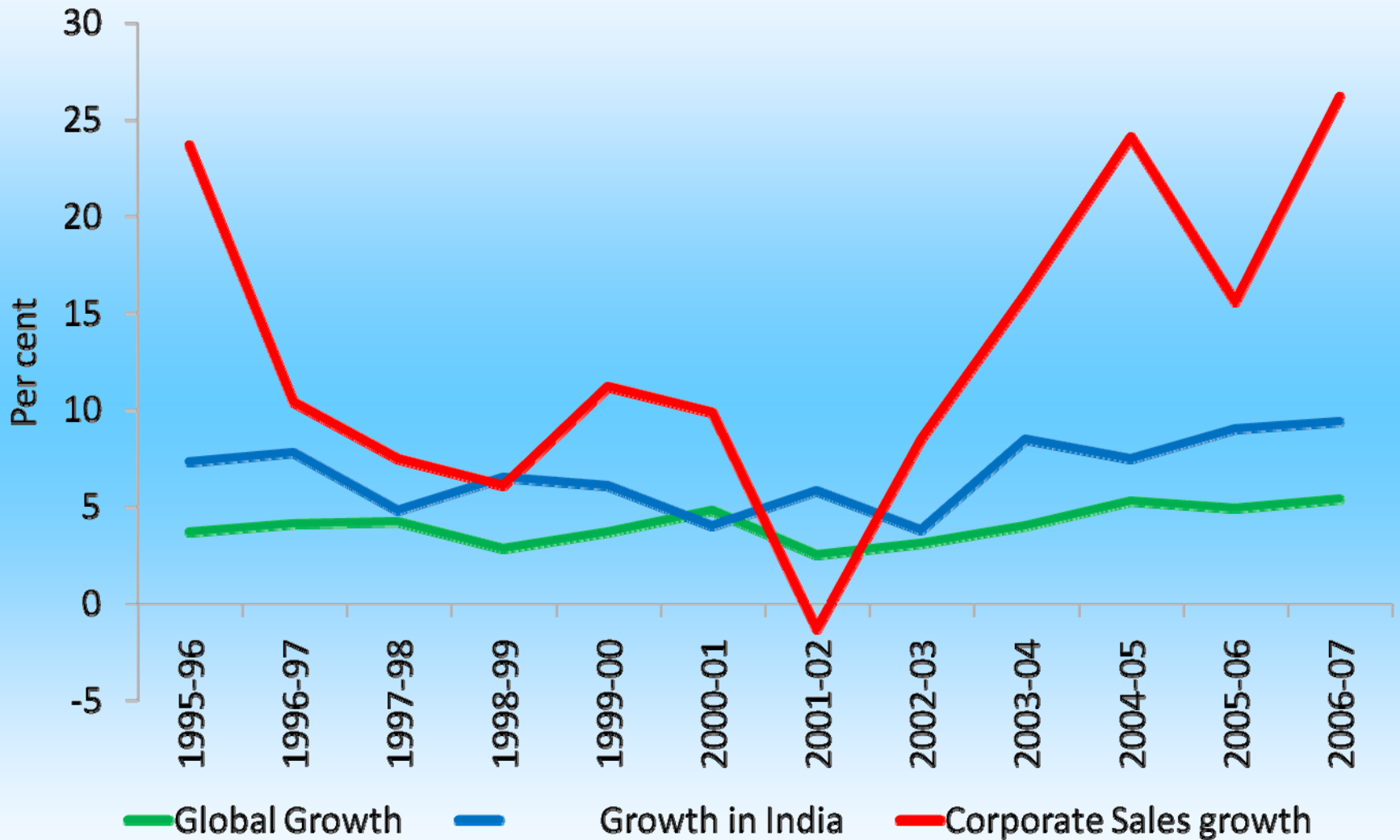


Stock Market and Corporate Profitability: Has the Stock Market Movement been Rational?



**Some Conjectures
On “Relating
Corporate Performance
to Economic Reforms”**

Global Growth, Indian Growth & Corporate Sales



Global Growth rates are on Calendar Year basis, i.e 1995-96 =1995.

Interpreting the Evidence 1

1992-97: Exuberant Response to Deregulation

- Surge in Investment
- New Projects
- Surge in Lending
- Increase in Corporate Profits
- High Industrial Growth

Interpreting the Evidence 2

1997-2002: Loss in Competitiveness

- Significant Slowdown in Industrial Growth
- Investment Slowdown
- Loss in Confidence
- Real exchange rate depreciation catches up
- High Real Interest Rates
- Period of widespread restructuring

Interpreting the Evidence 3

2002-now: Resumption of Growth and Competitiveness 1

- Industrial growth resurfaces
- Boom in Corporate Profitability
- Return of domestic confidence
- Emergence of International Confidence
- Increase in Mergers and Acquisition

Interpreting the Evidence 4

2002-now: Resumption of Growth and Competitiveness 2

- Consequence of restructuring
- Low inflationary expectations
- International business cycles
- Investment buoyant

Thank
You