TRENDS IN CAPITAL STRUCTURE PRACTICES OF PRIVATE CORPORATE SECTOR IN INDIA IN POST-LIBERALISATION ERA

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Abstract

In pre-liberalisation regime, Indian economy was debt-ridden, both internally and externally. Public sector undertakings were running into losses, there was not enough foreign exchange to finance the imports, domestic investments were inadequate to fund the growing needs of the economy and the growth rate of the economy was very low. All this led the country to grave foreign exchange crisis. Capital needs of the large business were not being met by the financial sector due to large number of banks and financial institutions running into losses. Due to closed economy, capital needs of the private sector were not being met, as they were unable to tap foreign capital. High indebtedness of the corporates had become a burden on their profits due to exorbitantly high rates of interest on debt capital. When economic reforms were initiated, it was desired that globalisation and liberalisation would absolve the corporate sector from high indebtedness, integrate with the world economy, improve the financial performance as well as bolster the cost effectiveness of capital structure. The present paper examines the achievement of the above goals after 15 years of Economic Reforms.

Key words: *Capital structure, Trends, Private corporate sector, Economic reforms and Perceiving- Judging.*

The extensive liberalisation of the Indian economy since the beginning of the nineties implies assigning a far more important role for the private sector than the one it had been playing in the regulated regime. Within the private sector, units organized as corporate bodies have a special significance, as they are capable of attracting domestic savings from the household sector as well as foreign direct investment (FDI) for taking up capital-intensive projects. The process of economic liberalisation, initiated in 1991 encompassed many aspects having a bearing on expansion and financing patterns of the corporates. It included industrial de-licensing, de-reservation for public sector, external trade, anti-monopolies legislation, capital issues, income tax etc (Rao, Chalapati, S.K., 1999).

Capital structure decisions, which are related to appropriate blend of debt and equity, are significant financial decisions of the corporate firms as they influence both the return and risk of investors. While excessive use of debt may endanger the very survival of the corporate firm; in contrast, the conservative policy may deprive its equity holders from the advantages of debt as a cheaper source of finance to magnify their rate of return via tax deductibility advantage of debt. The importance of an appropriate capital structure, is thus, very obvious from the perspective of corporate enterprises and its owners and other stakeholders – creditors, suppliers, investors etc.

The principal objective of the paper is to study the major trends in the capital structure practices of private sector manufacturing companies in India. The paper also seeks to examine the role of financial intermediaries in capital structure practices of the said companies.

The capital structure of a company is represented by the relationship between equity capital and loans. Capital structure is different from the financial structure, in that, while financial structure includes the proportion of all sources of finance, the capital structure includes the long-term sources only. For the purpose of calculation of capital structure, it has been defined as ratio between long-term debts and net worth of a company. The period of the study is from March 1988 to March 2006. Companies have been selected on random basis out of CMIE PROWESS database.

Many changes have taken place in the economic and regulatory environment in India and the world over during the last one-and-half decade. With the initiation of financial sector reforms, the avenues for raising long-term finance for the Indian corporates are undergoing major shifts. While corporates now have increased access to international capital markets, raising of long term funds from the traditional sources i.e., development financial institutions (DFIs) have been slowing down. After the South-east Asian crisis, a view has emerged worldwide according to which a multi-agency approach for meeting the demand for long-term funds would be both effective and efficient since it diversifies the risks in the system and increases efficiency through enhanced competition. Under such an approach, the equity market, the debt market, banks and financial institutions tend to meet the long-term financing needs of the corporates.

Any study of corporate financing requires a detailed analysis of financial markets because financial markets perform an important function of mobilizing financial savings and canalizing them into the most productive uses. Well-developed financial markets enhance the efficiency and reduce the transaction cost of financing. Changes in the financing patterns of Private Corporate Sector also hold special significance for the financial markets because with the deepening and broadening of financial markets, their allocative efficiency is enhanced (RBI, 1999). Furthermore, study of corporate finances is also instructive for appraising the relative importance of capital markets vis-à-vis financial institutions (FIs) as source of funding for the corporates.

Major Policy Developments During Nineties Having an Impact on Corporate Financing

Well-developed financial markets are essential for a balanced economic growth of a nation. This is underscored by the financial crises erupted in South-east Asia in mid-nineties, where lack of well developed money and capital markets was one of the major causes of crisis (RBI, 1999). To make financial markets deeper and liquid, various policy initiatives have been taken during nineties, some of which are as under:

Though some measures were initiated to reform the capital market in the eighties yet major reforms altering the face of the capital market were initiated in 1992. In the primary market, all controls relating to pricing and the timing as to when they should be issued have been removed, while in the secondary market, the traditional outcry system has been replaced with transparent screen based computerized trading system. Physical securities are increasingly been dematerialized. The settlement period has been shortened to T+1 (i.e., transaction + 1 day) uniformly across all stock exchanges. The domestic capital market is also fast integrating with the international capital markets. Some of the major developments and changes radically transforming the structure of capital market since 1992 are detailed below:

Primary Capital Market

1 The Securities and Exchange Board of India (SEBI), popularly known as market regulator, which was set up in early 1988 as a non-statutory body under an administrative arrangement, was given statutory powers in 1992 through the enactment of the SEBI Act, 1992 for regulating the securities market. The two objectives mandated in the SEBI Act are investor protection and orderly development of capital market.

2. The Capital Issues Control Act, 1947 was repealed in May 1992

allowing issuers of securities to raise capital from the market without requiring any consent from any authority either for floating the issue or for pricing it. Restrictions on rights and bonus issues were also removed. Interest rates on debentures also freed. However, the new issue of capital has been brought under SEBI's purview and issuers are required to meet the SEBI's guidelines for disclosure and investor protection, which have been reviewed from time to time to protect investors' interest.

3. The infrastructure of the primary market has become fairly diversified over the years with the setting up of large number of merchant bankers, investment and consultant agencies, and registrar to the issue, among others.

4. The primary market has also widened and deepened, with public sector banks, financial institutions and public sector enterprises in the infrastructure sectors increasingly raising resources from the market both by way of debt and equity.

5. Although the process of institutionalization of the market on the supply side started from 1987-88 when many mutual funds sponsored by banks and financial institutions (FIs) were set up, it gained considerable momentum in the early nineties as most of the mutual funds were set up in the private sector. Of the mutual funds registered with the SEBI as on 31st March 1999, as many as 31 were set up in the private sector in the nineties.

Secondary Capital Market

1. The open outcry trading system, which was prevalent a few years ago, has now been replaced by on-line screen-based electronic trading. In all, 23 stock exchanges have approximately 8000 trading terminals spread all over the country. Trading and settlement cycles have been shortened from 14 days to 7 days uniformly in all stock exchanges. All the stock exchanges in the country have established clearing-houses.

2. With a view to maintaining integrity and ensuring safety of the market, various risk containment measures have been strengthened, such as market-to-market margin system, intra-day trading limit, exposure limit and setting-up of trade guarantee fund. The clearing and settlement process in the Indian stock markets in the past lacked a system to reduce counter-party risk. For this purpose, SEBI has been emphasizing the need for setting up trade/settlement guarantee fund to provide the necessary funds and ensure the timely settlement of obligations in case of default on part of member brokers. So far 10 stock exchanges have set up Trade/ Settlement Guarantee Funds. The National Stock exchange (NSE) has a separate clearing corporation, which acts as counter-party to all trades executed in the capital market segment of the Exchange.

3. To enhance the investors' protection, process of dematerialization of securities through depository system and their transfer through electronic book entry is being pursued vigorously.

4. With a view to protecting investors' interest, disclosure standards have been strengthened. Issuers of capital, apart from disclosing information on various aspects, such as, track record of profitability, risk factors, etc. are also required to make continuing disclosure under the listing agreement at the time of issuing capital. All listed companies are required to furnish the stock exchanges and to publish un-audited financial results on a quarterly basis. Disclosure of material information, which may have a bearing on the performance or operations of company, also required to be made available to the public.

5. One of the significant steps towards integrating Indian capital markets with the international capital markets was the permission given to foreign institutional investors (FIIs) to operate in the Indian capital market. FIIs, which were initially allowed to invest only in the equity shares, were later allowed to invest in the debt markets, including dated government securities and Treasury Bills.

6. Indian Companies have also been allowed to raise capital from the international capital markets by issuing Global Depository Receipts (GDRs), American Depository Receipts (ADRs), Foreign Currency Convertible Bonds (FCCBs) and External Commercial Borrowings (ECBs).

7. Stock markets have also undergone some major structural reforms. The Boards of various stock exchanges have been made broad-based so that they represent different interests and not just the interest of their members. Brokers and sub-brokers have been brought under the regulatory supervision of market regulator, and it has started undertaking inspection of the stock exchanges.

8. Companies have been allowed to buy back their own shares for capital restructuring, subject to the condition that no such buyback would exceed 25% of paid-up capital plus free reserves of the company concerned.

9. Although the capital market grew rapidly over the years, there was no regulation in the country to prevent insider trading. Therefore in 1992, SEBI formulated insider trading regulations prohibiting insider trading and making it a criminal offence punishable in accordance with the provisions of the SEBI Act, 1992. Regulations are also in place for takeover and substantial acquisition of shares to make the takeover process more transparent and protect the interest of minority shareholders. Apart from stock exchanges, stock brokers and sub-brokers, all other intermediaries – mutual funds and merchant bankers, portfolio managers, underwriters, debenture trustees, bankers to an issue, custodian of securities and venture capital funds have been brought under regulatory purview of the SEBI.

Sample

Non-government financial and non-financial corporate enterprises and cooperative institutions constitute the Private Corporate Sector. Non-governmental non-financial corporate enterprises include public and private limited companies registered under the Indian Companies Act, 1956. Non-government financial institutions form commercial banks in the private sector as well as financial and investment companies. Cooperative institutions comprise of cooperative banks, cooperative credit and non-credit institutions. Public limited companies include manufacturing companies as well as financial and non-financial companies including service companies. Over the years, large service sector enterprises are increasingly adopting corporate form.

To study the major shifts in the capital structure practices of manufacturing companies along a period from 1988-89 to 2005-06, two samples comprising of 509 manufacturing companies from 1988 to 2001 and the other of 800 companies from 2002 to 2006 have been taken. As manufacturing companies constitute a larger portion of Indian Private Corporate Sector (Shanta, N, 1999), a sample of this size could be assumed to fairly represent the whole Private Corporate Sector in India. The period has been chosen to correspond with the period of far reaching changes that have taken place in business and industrial environment due to an altogether shift in the economic and policy environment in the nineties. To study the impact of these changes on the corporate financing, the period up to 1992-93 has been taken as pre-liberalization period when first time economic reforms were initiated in July 1991.Though some of the bold initiatives were taken in the year 1991 itself, but the results of these initiatives were visible only after the year 1993-94 (RBI, 1999). Thus, to make a comparison of dependent variables in two samples, the period 1988-89 to 1993-94 has been taken as pre-liberalization period and the period beyond 1993-94 till March 1999 has been taken as first phase of post- liberalization period. As most of the reforms in the corporate taxation front as well as relating to financial sector have been effected after 1997-98, the period from 1999-00 to 2005-06 has been taken as a period of second phase of reforms. To compare the debt-equity ratios during these periods, mean ratios have also been calculated.

In the wake of liberalisation and globalization of economic policies, the Indian business scenario is undergoing a dramatic metamorphosis. Investment opportunities have expanded, financing options have widened and, above all, dependence on Indian capital market has decreased. As a result no participant can afford to be inward looking. Both investors as well as those securing finances have alternative choices now. The scenario is tending to become more competitive in view of multinationals' entry and foreign capital inflow into this country. These changes (economic reforms, since early 1990's) might have influenced the capital structure practices of the private corporate sector in India. Though there have been studies on these lines, still there is a need to study the dynamics of capital structure designing in the changed milieu so that a clear cut picture could be drawn. An added significance could be derived in the widespread slowdown at world level where high interest rates are being blamed for a number of ills afflicting Indian private corporate sector .

Methodology

Data

The study uses random sample of 509 companies for a period from 1988-2001 and 800 companies for a period from 2002-06, covering almost all manufacturing industries whose shares are listed on various stock exchanges. The study has made use of the data available in the PROWESS database of CMIE. Ratio analysis has been used to study capital structure changes and proportion of various sources of finance in total capital structure of companies.

The changes in capital structure are best depicted by the changes in the debt-equity ratios over the period. To study the financing patterns in the non-government public ltd. companies, first of all, one has to look for changes that have taken place in the debt-equity ratios over the relevant period. The long-term debt to net-worth ratios have been calculated of the selected private sector companies for the study period of eighteen years as under:

Table 1
Average Debt-equity Ratios of Private Sector Companies

Year	Number of Companies	Long-term debt (in INR million)	Net worth (in INR million)	Average debt-equity ratios (Percent)
1988-89	509	148126.1	116604.3	127.03
1989-90	509	169863.5	127744.5	132.97
1990-91	509	187624.2	155893.4	120.35
1991-92	509	245083.1	215366.0	113.80
1992-93	509	295127.3	284448.9	103.75
1993-94	509	343823.4	398784.6	86.22
1994-95	509	414773.1	587741.1	70.57
1995-96	509	481882.9	739374.5	65.17
1996-97	509	625937.4	838794.4	74.62
1997-98	509	753745.4	919065.9	82.01
1998-99	509	814726.3	950102.7	85.75
1999-00	509	778178.6	1014029.6	76.74
2000-01	800	882856.4	1210438.2	74.39
2001-02	800	960528.9	1328664.7	72.29
2002-03	800	989917.9	1444517.5	68.53
2003-04	800	980277.4	1682846.9	58.25
2004-05	800	1108626.4	1987018.9	55.79
2005-06	800	1241918.2	2476556.6	50.15
1988-05	**509+800**	**11423016.5**	**16477992.7**	**84.35**
1988-93	**509**	**1045824.2**	**900057.1**	**119.58**
1994-97	**509**	**2620162.2**	**3483760.5**	**75.72**
1998-05	**509+800**	**7757030.1**	**12094175.1**	**67.74**

Source: Compiled from CMIE PROWESS database

Table 1 shows that the debt-equity ratios of the selected companies are in a consistently declining direction. In the initial year, the ratio was 127.03. It increased in the subsequent year but after that it has been showing a consistent decline. Prior to economic reforms the debt-equity ratio was 119.58 but during the first phase, it further dropped to 75.72 per cent. The debt-equity ratios continued even during the third phase of the study wherein the same significantly came down to 67.74 per cent.

Table 2:
Trends in Raising Finance by Private Sector Public Limited Companies

Year	Equity Shares (% of total capital needs)	Preference Shares (% of total capital needs)	Debentures (% of total capital needs)
1981-82	33.67	0.31	66.02
1982-83	26.75	0.24	73.01
1983-84	31.26	0.14	68.60
1984-85	25.57	0.01	74.42
1985-86	33.97	0.05	65.99
1986-87	28.07	0.02	71.91
1987-88	38.11	0.23	61.65
1988-89	24.25	0.08	75.67
1989-90	15.77	0.10	84.13
1990-91	22.89	0.23	76.87
1991-92	23.63	0.02	76.36
1992-93	33.45	0.00	66.55
1993-94	34.00	0.00	66.00
1994-95	39.61	0.30	60.09
1995-96	42.45	0.53	57.02
1996-97	36.81	0.45	62.74
1997-98	27.00	0.10	72.90
1998-99	51.12	1.19	47.69
2000-01	44.82	2.44	52.74
2001-02	15.11	0.00	84.89
2002-03	24.51	0.00	75.49
2003-04	66.39	0.00	33.61
2004-05	87.56	0.00	12.44
1981-05	35.84	**0.27**	**63.89**
1981-90	**28.60**	**0.13**	**71.27**
1991-98	**30.62**	**0.19**	**69.18**
1999-05	**48.99**	**0.52**	**50.49**

Source: Handbook of Statistics on Indian Economy, RBI 2005-06

Table 2 shows that the proportion of equity in total issue of capital by private sector companies decreased and the proportion of debt increased during 1990-91. Issues of preference capital also increased during this period but still the proportion of debt issues dominated the capital structures of companies. Though after 1992-93 debentures became less lucrative and their number of issues dropped significantly, the proportion of debt was much more than that of equity.

To some extent it seems that while the popularity of equity financing declined, preference capital came to be recognized as a popular source of finance. Inter-corporate investments in the form of preferred capital have grown during this period (Sarkar, Jayati, 1999). Besides, foreign investors also preferred preference shares. Particularly after liberalization of the capital markets, most of the foreign investments are coming in the form of preferred capital (Bhole, L .M, 1999).

Further enquiry into it reveals that during this period, companies had secured a heavy premium on their equity issues, which might have enhanced their reserves and helped the fall of debt-equity ratio. Let us examine this fact through analysis of reserves of these companies during the study period through table 3:

Table 3
Components of Reserves of Private Sector Companies

Year	Number of Companies	Profitable Companies	Premium Reserves (% of total reserves)	Return on Net worth (%)	Internal Sources (%)	External Sources (%)
1	2	3	4	5	6	7
1988-89	509	477	14.21	21.55	-	-
1989-90	509	483	17.82	27.79	23.24	76.76
1990-91	509	495	18.99	30.66	26.30	73.70
1991-92	509	497	19.29	24.95	27.03	72.97
1992-93	509	494	28.04	18.28	22.30	77.70
1993-94	509	497	37.22	19.93	23.18	76.82
1994-95	509	497	44.66	21.43	23.40	76.60
1995-96	509	492	41.67	21.48	33.88	66.12
1996-97	509	490	39.78	17.92	23.79	76.21
1997-98	509	469	36.30	16.02	29.69	70.31
1998-99	509	443	34.25	14.37	51.41	48.59
1999-00	509	438	33.94	15.86	67.29	32.71
2000-01	509	426	32.45	17.41	40.19	59.81
2001-02	800	594	35.50	19.68	61.53	38.47
2002-03	800	622	32.33	22.29	64.02	35.98
2003-04	800	664	29.23	26.08	64.20	35.80
2004-05	800	706	24.78	29.57	60.25	39.75
2005-06	800	725	24.32	28.55	49.83	50.17
1988-94		**491**	**25.75**	**23.51**	**24.24**	**75.76**
1995-00		**460**	**36.40**	**17.18**	**41.04**	**58.96**
2001-05		**662**	**29.23**	**25.23**	**59.97**	**40.04**

Source: Compiled from CMIE PROWESS database.

Figures in table 3 signify that premium reserves, which become part of debt-equity ratios and increased net worth of companies, impacted the debt-equity ratios favorably after 1993-94. The consistent decline in debt-equity ratios was sustained first by premium in the first phase. Though in the second phase, both profitability and number of profitable companies increased, yet due to capital market decline, companies had to do with internal sources and in the third and final phase, improved economic conditions enabled the companies to plough back their own profits which is amply reflected by increased return on net worth and the number of profitable companies (RBI, 2006). All this turned ultimately into enhanced retentions by higher proportion of profitable companies in the latter period.

Sources of Funds

To further verify the different source of financing used by the companies to finance their capital structure, Sources and Use of funds statement of companies for the study period have been analyzed. This analysis has been done horizontally as well as vertically. Table gives the sources as internal and external sources and internal sources have been classified between reserves and depreciation. External sources have been further segregated into capital market, borrowings and other sources. Capital market includes issues of equity and debenture and public deposits, borrowings include loans from banks and financial institutions, inter-corporate borrowings and other borrowings including short-term borrowing from non-banking finance companies.

As shown in the table, for the study period, average internal sources have been around 45% while external sources averaged above 55%. During first phase of the study, internal sources declined to around 32% and external sources increased to 68%. The proportion of internal and external sources again changed where internal sources increased to 36% while external declined to 64%. This shifting of sources continued throughout the third phase wherein the internal sources reached to the extent of 62% and external sources remained only 38%. Thus it could be inferred that due to the increasing profitability and reduction of interest rates in successive budgets prompted the companies to retain more and more profits for internal plough back. Reduced interest rates undermine the expectations of equity holders and companies can get equity at lower cost from the markets. Reduced tax rates also tend to lower the temptation of companies to issue more debt in the market. Internal resource generation has become the main source of funding for the companies due to increased profitability also (Ministry of Finance, 2002).

Table 4
Sources of Funds of the Private Sector Companies
(Percent)

Year	Internal Sources			External Sources			Other Sources
	Internal	Reserves	Depreciation	External	Capital Market	Borrowings	
1990-91	**30.59**	40.30	59.70	**69.41**	40.38	29.95	29.66
1991-92	**38.32**	46.15	53.85	**61.68**	21.19	35.21	43.60
1992-93	**30.65**	49.92	50.08	**69.35**	21.09	42.92	35.99
1993-94	**29.64**	37.52	62.48	**70.36**	42.78	40.30	16.92
1994-95	**28.67**	61.55	38.45	**71.33**	66.71	5.27	28.02
1995-96	**26.95**	65.02	34.98	**73.05**	46.36	28.24	25.40
1996-97	**36.47**	66.82	33.18	**63.53**	21.35	48.20	30.45
1997-98	**36.46**	48.11	51.89	**63.54**	25.77	52.72	21.51
1998-99	**37.94**	43.80	56.20	**62.06**	24.98	45.49	29.53
1999-00	**45.57**	23.21	76.79	**54.43**	23.07	35.41	41.52
2000-01	**69.59**	27.55	72.45	**30.41**	21.78	33.72	45.50
2001-02	**66.81**	26.14	73.86	**33.19**	15.00	20.79	64.21
2002-03	**64.02**	48.81	51.19	**35.98**	32.50	20.70	46.80
2003-04	**64.20**	57.49	42.51	**35.80**	31.99	26.72	41.29
2004-05	**60.25**	64.49	35.51	**39.75**	28.56	40.87	30.57
2005-06	**49.83**	65.09	34.91	**50.17**	25.46	49.22	25.32
1990-05	**44.75**	**48.25**	**51.75**	**55.25**	**30.56**	**34.73**	**34.77**
1990-94	**31.57**	**47.09**	**52.91**	**68.43**	**38.43**	**30.73**	**30.84**
1995-99	**36.68**	**49.39**	**50.61**	**63.32**	**28.31**	**42.01**	**29.68**
2000-05	**62.45**	**48.26**	**51.74**	**37.55**	**25.88**	**32.00**	**42.28**

Source: Compiled from CMIE PROWESS database

If we analyze constituents of internal sources from the above table of sources and uses of funs, we can see that in the initial phase of the study, reserves contributed more towards internal sources. It continued its increase during second phase due to companies' ability to secure more premiums on their issues in the capital market. In the last phase, the contribution of reserves declined due to drying up of the capital markets. This is amply verified by the analysis of external sources wherein contribution of capital markets and borrowings was more during first and second phases but during the last phase, the contribution of capital market towards external sources declined due to recession in the capital markets and exposure of companies to other sources of finance like commercial paper, foreign borrowings and euro issues.

In 1992, to boost globalization of Indian economy, the government permitted Indian companies to float their stocks in foreign

markets. Two primary instruments floated by Indian companies in international markets are: Global Depository Receipts and Foreign Currency Convertible Bonds--- both collectively known as euro issues. To study the extent and direction of such issues the following table has been given: This is visible from the following table which shows that after 1992, the issues of ADRs, FCCB's and GDR's have raised a sum of INR 296120 million.

Trends in Borrowings and Role of Financial Intermediaries

After ascertaining that the debt-equity ratios declined due to increase of premium reserves and the decline of debt markets, it has to be examined as to what categories of borrowings have been used of by the selected private sector companies. Capital structure of companies also depends upon the role of financial system operating in a country. Financial system consists of institutional mechanism, the regulatory environment, procedures and traditions followed. For this purpose, total borrowings have been classified into Bank loans, institutional loans, fixed deposits, debentures loans from group and other companies, foreign borrowings commercial paper, sales tax credit and other loans.

Table 5

Borrowings of the Private Sector Companies

(Percent)

Year	Bank Loans	Financial Institutional Loans	Fixed Deposits	Group Co. Loans	Other Co. Loans	Debentures	Commercial Paper	Sales tax Credit	Foreign Loans	Other Loans	Total
88-89	32.63	26.84	9.99	0.11	1.02	22.97	0.00	0.79	0.74	4.91	100.00
89-90	30.30	25.92	8.26	0.12	0.93	28.06	0.13	0.86	0.97	4.46	100.00
90-91	30.93	26.83	7.15	0.16	1.04	26.74	0.26	1.01	1.20	4.67	100.00
91-92	28.82	30.53	5.41	0.22	1.26	25.62	0.76	1.28	1.28	4.83	100.00
92-93	29.44	32.21	4.64	0.15	0.93	24.94	0.84	1.40	1.12	4.33	100.00
93-94	24.92	29.48	4.63	0.30	1.38	30.59	2.61	1.59	1.00	3.49	100.00
94-95	31.36	25.40	3.93	0.12	2.02	27.87	0.68	1.61	3.69	3.33	100.00
95-96	37.26	23.81	3.22	0.10	1.77	22.26	0.04	1.73	6.73	3.08	100.00
96-97	33.50	23.08	3.06	0.32	1.79	21.52	0.40	1.52	10.76	4.04	100.00
97-98	30.85	21.55	3.16	0.14	1.02	22.15	1.30	1.58	12.58	5.66	100.00
98-99	30.04	19.93	3.21	0.19	1.27	22.78	2.82	3.12	11.08	5.55	100.00
99-00	31.28	19.77	3.11	0.31	1.43	22.97	2.80	3.38	8.12	6.82	100.00
00-01	31.95	19.69	2.78	0.25	1.43	23.13	2.73	3.63	6.99	7.43	100.00
01-02	35.82	20.10	2.46	0.37	0.94	23.33	1.92	3.09	7.72	4.25	100.00
02-03	39.32	17.44	2.07	0.49	0.91	24.07	0.60	1.54	4.89	8.67	100.00
03-04	43.65	14.96	1.76	0.55	0.90	21.48	0.46	1.36	5.87	9.01	100.00
04-05	41.58	8.94	1.27	0.55	1.30	16.57	1.02	1.36	18.23	9.17	100.00
05-06	48.91	7.80	0.90	0.45	1.17	11.43	0.34	1.27	19.40	8.35	100.00
88-05	**34.03**	**21.90**	**3.95**	**0.27**	**1.25**	**23.25**	**1.10**	**1.78**	**6.80**	**5.67**	**100.00**
88-94	**29.51**	**28.64**	**6.68**	**0.18**	**1.10**	**26.49**	**0.77**	**1.15**	**1.05**	**4.45**	**100.00**
95-00	**32.32**	**21.89**	**3.21**	**0.21**	**1.53**	**23.24**	**1.54**	**2.37**	**8.56**	**5.13**	**100.00**
01-05											**100.0**

Source: Compiled from CMIE PROWESS database

Table 5 shows that banks have been the dominant lenders to the industry; followed by debentures and financial institutions (Ministry of Finance, 2006). While the proportion of bank borrowings has been 34% and that debentures have also been a major source of loans to companies to the extent of around 23%. The contribution of financial institutions has been of the order of about 22% during the study period. The role of debentures and financial institutions has been decreasing throughout the different phases of the study. The increasing role of banks in funding the corporates signifies a distinct trend because in the liberalization era, the distinction between banks and financial institutions has been blurred. Though the financial institutions were supposed to finance the long-term requirements of the corporate sector before economic reforms but in the changed environment, banks have replaced the institutional finance due to freedom granted to them with respect to funding of the corporate sector. Another important factor, which seems to be working in case of bank borrowings to the corporate sector, is increasing competition within banking industry and non-banking finance companies (NBFCs) and Long-term Financial Institutions (Sarkar, Jayati, 1999). It appears that declining interest rates too have prompted corporates to increase their borrowings from banks (Reddy, Y. V, 2001).

The fall in the Institutional borrowings also stems from the fact that the role of long-term finance is decreasing and these institutions are meant for long-term finance. That is why their proportion in total borrowings has declined. It seems that bank borrowings and institutional borrowings are being interchangeably used (Sarkar, Jayati, 1999) to finance the investments in the private corporate sector.

A look at the above table reveals that most of the borrowings have come from the banks and it seems that the institutional borrowings have been replaced by the bank borrowings. The policy environment in the nineties has been dominated by two primary concerns: In the first half of the decade, the focus was almost entirely on liberalization of the banking sector, as also the rest of the economy. The second half of the decade has witnessed increasing concerns about market risks faced by banks and the required prudential measures for prevention of bank failures. In 1992, Following Narsimhan Committee Report, the focus has been on reduction in statutory pre-emption, dismantling the complex administered interest rate (Chpora, Chanchal, 2003), structure etc. All the reform measures were aimed at equipping the banks with sufficient earning assets to improve their profitability for their survival in competitive environment. Another important factor, which seems to be working in case of bank borrowings to the corporate sector, is increasing competition within banking industry and NBFCs and Long-term Financial Institutions (Sarkar, Jayati, 1999).

To look into the role of banks and other financial intermediaries in financing the companies, borrowings have been reclassified into intermediated borrowings, market borrowings, inter-corporate borrowings, foreign borrowings and other borrowings. Intermediated borrowings comprise of bank borrowings and institutional borrowings; market borrowings comprise of debentures and fixed deposits; inter-corporate borrowings constitute borrowings from group companies and other companies. The following table depicts

the proportions of different types of borrowings as under:

Table 6
Sources of Borrowings

(Percent)

Year	Intermediated Borrowings	Market Borrowings	Inter-corporate Borrowings	Foreign Borrowings
1	2	3	4	5
1988-89	59.47	32.96	1.13	6.44
1989-90	56.35	36.32	1.05	6.29
1990-91	58.02	33.89	1.20	6.89
199192	60.10	31.03	1.48	7.39
1992-93	62.49	29.58	1.09	6.85
1993-94	57.02	35.21	1.69	6.08
1994-95	57.44	31.80	2.14	8.62
1995-96	61.11	25.48	1.88	11.54
1996-97	56.98	24.59	2.11	16.32
1997-98	53.71	25.31	1.16	19.82
1998-99	52.80	26.00	1.46	19.74
1999-00	53.86	26.08	1.74	18.32
2000-01	54.37	25.91	1.68	18.04
2001-02	57.84	25.80	1.31	15.06
2002-03	57.36	26.14	1.39	15.10
2003-04	59.07	23.24	1.45	16.24
2004-05	51.54	17.84	1.85	28.76
2005-06	57.05	12.32	1.62	29.02
1988-05	**57.03**	**27.19**	**1.52**	**14.25**
1988-93	**59.29**	**32.75**	**1.19**	**6.77**
1994-99	**57.25**	**28.48**	**1.79**	**12.48**
2000-05	**55.48**	**22.92**	**1.56**	**20.04**

Source: Compiled from CMIE PROWESS database

Table 6 depicts the role of different types of borrowings in the financing pattern of private sector companies. The intermediated borrowings show the borrowings from the banks and financial institutions and market borrowings from the capital markets. It could be seen that during the period of study institutional financing dominated the company financing, though there have been a declining trend in the dominance of institutional finance during the corresponding phases. On an average basis, about 57 % of funds came from the banks and financial institutions and more than 27% was funded from the market. The institutional finance, which was more than 59% in the first phase, came down to 57% in the second phase and again declined to about 55% in the last phase of the study. This indicates decline of intermediation in corporate financing. The role of capital market also decreased from around 33% in the first phase to around 23% in the final phase. Contrary to it, there has been consistent increase, throughout the period of study, in the foreign borrowings by the corporate sector companies that jumped from 6.77% in the first phase to 12.48% in the second phase and continued to register growth in the third phase and reached to a level of 20% in the final phase.

To verify these changes in the pattern of borrowings, one has to look into the movements in banking variables like growth of bank deposits, money supply and bank credit to commercial sector. The following table gives these variables to show the direction of bank credit to companies.

Table 6
Liquidity and Credit-based Indicators of Financial Development
(As percent of GDP, at current market prices)

□ M3 = Aggregate deposits + Reserve money

Period	Aggregate Deposits	M^*_3	Bank Credit	
			To govt.	To commercial sector
1	2	3	4	5
1970-71 to 1974-75	16.4	25.9	13.3	15.6
1975-76 to 1979-80	24.1	33.0	14.0	21.8
1980-81 to 1984-85	30.0	39.1	18.7	26.9
1985-86 to 1989-90	36.1	45.4	22.9	30.3
1990-91 to 1994-95	39.6	49.3	23.6	29.0
1995-96 to 1999-00	43.8	53.8	21.9	28.6
2000-01to 2004-05	44.2	55.3	18.7	29.5

Source: RBI Annual Reports

The decreasing role of intermediaries in corporate financing can be easily understood by the above table, which shows that even after increase in deposits; they have not been deployed in the corporate sector. The aggregate deposits increased from 36.1 % of GDP in 1985-90 to 39.6% of GDP during 1990-95 but bank credit to commercial sector declined to 29 % of GDP from 30.3 % in the corresponding period. This decline continued during the subsequent period of 1995-2000. One of the reasons behind above decline had been emergence of other avenues like retail financing in housing, banks have withdrawn themselves out of this sector. Moreover more autonomy granted to banks to invest their resources profitably, also contributed towards the said decline.

Resource Mobilization from International Capital Markets

The Indian companies, after having been allowed in 1992-93 to raise capital from the international capital markets, during last few years, huge resources have been raised by them from the international capital markets by way of GDRs/ADRs, foreign currency convertible bonds (FCCB) and external commercial borrowings (ECBs). Private finance is available from private individual and institutional investors in the form of euro issues comprising external commercial borrowings or loans, equity capital, portfolio investments, foreign direct investments, and operations of multinational corporations, deposits and investments by Non-resident Indians and overseas corporate bodies and foreign institutional investors (Bhole, L. M, 1999). Foreign capital could be mobilized by issuing a complex variety of financial instruments, viz., syndicated or traditional bank loans, or Euro credits or euro loans; euro deposits or Eurocurrency or euro money; foreign bonds, Eurobonds; fixed rate notes (FRNs); note issuing facility (NIF); euro commercial paper (ECP); euro certificates of deposits (ECDs); euro equities; and equity related instruments such as American depository receipts (ADRs), global depository receipts (GDRs) and international depository receipts (IDRs). GDRs were initially allowed in the year 1992-93. Resources raised by way of GDRs increased sharply from INR 2510 million during 1992-93 to INR 43240 million during 1994-95. As the table 7 shows resources raised by the private sector.

Table 7
Resources Procured from International Capital Markets
(INR 10 million)

Financial Year (April-March)	Euro-Issues				External Commercial Borrowings	Total (Column 4+6)
	GDRs	FCCB	Total (Column 2+3)	Share in Portfolio Investments (%)		
1	2	3	4	5	6	7
1990-91	N/A	N/A	N/A	N/A	4034	4034
1991-92	N/A	N/A	N/A	N/A	3807	3807
1992-93	251	N/A	251	43.0	-1095	-844
1993-94	4324	3130	7454	70.6	1905	9359
1994-95	5027	1083	6110	56.2	3238	9348
1995-96	496	Nil	496	14.1	4548	5044
1996-97	1625	1651	3275	47.6	10003	13278
1997-98	4330	48	4387	59.9	14557	18944
1998-99	2105	Nil	2105	Nil	3485	5590
1999-00	1675	Nil	1675	12.8	Nil	1675
2000-01 (Mar-Dec)	3859	Nil	3859	N. A.	N. A.	3859

Source: Euro Issues: Emerging Post Liberalisation Phenomenon in Foreign Investment in India by Chanchal Chopra, Deep and Deep Publications, New Delhi ch.8, p 225

A euro issue provides the issuer company the ability to raise funds at a lower cost. Average coupon rates on convertible bonds of five-year maturity in the euro market are 2.5 % to 4% as against the domestic long-term interest rate of 14% or more. The cost of euro approximates to 4% vis-à-vis domestic cost of 8% to 14%, this providing a mechanism for raising equity at a cost winch is lower than the cost of even making a rights issue. During 1992, government permitted Indian companies to float their stocks in foreign markets. Resources worth INR 245600 million have been raised during 1992-93 to 1999-2000 by way of GDR's and FCCB's. The unique feature of these sources is that they are available at a very low cost. Buoyant stock markets provided an opportunity to corporates to raise funds from international capital markets for their investment requirements. During the year 2005-06 these resources increased substantially by 238.7% to INR 113580 million. Out of these INR 97790 million were mobilized in the form of Global Depository receipts (GDRs), followed by American Depository Receipts (ADRs), INR 15730 million and foreign Currency Convertible bonds (FCCBs) INR 6 million). Most of the Euro-issues were made by Non-government non-financial Public companies (RBI, 2005). During 2006-07 (April-June), resources raised by Indian companies at INR 57860 million through euro-issues were substantially higher than those of INR 18340 million during the corresponding period of 2005-06.

It has been observed that Indian corporate sector depended more on loans and credits so far as external sources are concerned. The logic behind raising resources through such issues lies in their cost effectiveness. The share of foreign investments in the corporate sector has increased in the nineties. Looking at the paid up capital of companies operating in India, the share of foreign investors has increased to a very great extent in the post liberalization phase as compared to pre-liberalisation domain (Chopra Chanchal, 2003).

FIIs Participation in Private Corporate Sector

One more important feature of the corporate financing in the liberalized environment has been the FIIs (foreign institutional investors) participation in financing corporate investments via stock markets. FIIs started their operations in the stock markets with token investments of INR 6 million in January 1993(RBI, 1999). However, since then, their investments have grown at a fast pace. During the financial year 1993-94, net FII investments were of the order of INR 54450 million but came down marginally to INR 47770 million in 1994-95. During 1995-96 and 1996-97 these investments grew by 41% and 10.5% respectively. These investments remained positive till November 1997, after that they turned negative for the first time, the trend that continued till January 1998.The net cumulative FII investments as at the end of October 1999 stood at INR 321550 million.

Thus all these trends show that the Indian corporate sector has significantly acquired resources from abroad. All this proves a real globalization of corporate finances taking place.

Table 8
Share of Foreign Capital in the Paid up Capital of Indian Corporate Sector

Year	Paid up capital of Indian Cos. (INR million)	FDI (INR million)	Portfolio investment (INR million)	Share of foreign capital (%)
1972	49408	8164	973	18.5
1977	108797	9202	1106	9.5
1980	146066	9332	1224	7.2
1987	439678	17420	4590	5.0
1992	846523	38400	14830	6.3
1995	1360187	94160	133860	16.8
1996	1640884	240200	366240	37.0
1997	1845428	365100	456190	44.5
2000	3075592	675219	528177	39.1
2002	3356704	703652	556301	37.5
2004	3667595	723691	592635	35.8

Source: RBI, "Census of India's Foreign Liabilities and Assets", Bulletin, October 2000.

Table 9
Debt-repayment Capacity of Private Sector Companies
(Percent)

Year	Gross-interest-coverage ratio	Debt- service - coverage ratio
1	2	3
1988-89	2.00	1.26
1989-90	2.06	1.34
1990-91	2.24	1.49
1991-92	2.16	1.42
1992-93	1.95	1.29
1993-94	2.26	1.44
1994-95	2.85	1.73
1995-96	2.93	1.81
1996-97	2.49	1.54
1997-98	2.34	1.39
1998-99	2.03	1.24
1999-00	2.10	1.35
2000-01	2.11	1.38
2001-02	2.41	1.53
2002-03	3.16	1.88
2003-04	4.51	2.52
2004-05	6.43	3.17
2005-06	7.44	3.43
1988-05	**2.97**	**1.73**
1988-92	**2.08**	**1.36**
1993-97	**2.58**	**1.58**
1998-05	**3.77**	**2.06**

Source: Compiled from CMIE PROWESS database.

An estimate in 1994 by SEBI indicates that for an issue of Rs. 1,500 million, the cost of raising funds in domestic market 9.6% of issue size, while that of raising funds through GDRs was only 4%. RBI has estimated average cost of issue for the period 1986-91 at 8.9%. According to the Informal Group on Primary Market of the Government, issue cost worked out to be as low as 9% in 1998, as indicated in Table No 5 in appendices to ch. 3.

Risk Characteristics of the Corporate Sector

In the reformed environment financing choices have widened for the companies but it poses some challenges too. Increased exposure to international finance may prove to be risky if resorted to without following safety norms. Considering the risk associated with international debt, one has to look into borrower's capability with regard to interest payment as well as repayment of principal debt. While gross-interest-converge ratios indicates the ability of the companies to pay their interest liability promptly, the debt-service-coverage ratio signifies the debt-servicing capacity, which consists of both the obligations – interest as well as principal component. For examining these two dimensions of creditworthiness of borrower companies, the following table has been constructed:

In table 9 gross-interest-coverage ratio has been calculated by dividing the profit before dividend, interest and tax (PBDIT) by accrued interest liabilities, debts-service-coverage ratio has been obtained by dividing the PBDIT by one eighth of long-term loan component plus yearly interest (Babu Suresh, K., 1997). The average interest coverage ratio has been 2.97 times and debt service coverage ratio has been 1.73. Interest coverage improved from 2.08 times to 2.58 times in the first phase to about 3.77 times in the second phase. Debt service coverage has also improved simultaneously. It signifies that notwithstanding increasing losses in the first and second phases, improved profitability in the third phase has helped the companies to come out of the risky situation. It suggests that the corporate sector was unable to cope with the recessionary conditions created by the foreign competition in the initial phase but finally they have adjusted themselves to the circumstances The Debt-service-coverage ratio also showed declining trend in the first and second phases but improved in the final phase. It can be inferred that the companies have been able to manage their risks well in the changed environment.

Conclusion

Consequent upon the economic liberalisation and financial reforms initiated in 1991, there has been a marked decline in the equity financing by private corporate sector companies in India. This is more so after 1995-96. The sources used to finance investments in the private corporate sector have undergone a significant change during the nineties. While in the eighties, the role of internal sources was showing consistent decreasing trend, there has been a complete reversal in the modes of financing during the nineties as a major portion of investments are being sourced from the internal funds despite overall decline in the profitability in the first phase and second phase but in the last phase, improved profitability has contributed to the increased role of internal sources. Internal financing has increased in the private corporate sector mainly due to the incentives provided by the government after the reforms and also due to the fall of capital markets to some extent.

Broadening of the capital market through various reforms in primary and secondary markets has enabled them to integrate with international capital markets. The Indian corporate sector is being encouraged by the government to access global capital markets through the mechanism of GDRs and FCCBs. Yet limits have been stipulated for these sources keeping in mind their prudence levels nevertheless they don't even have the repayment obligations at maturity. Thus, even if these instruments have become popular with Indian corporate sector to raise funds, they have controlled exposure to international capital markets.

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