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Industry and Economic Reforms 1991-1994

S. L. RAO



NATIONAL COUNCIL OF APPLIED ECONOMIC RESEARCH
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**Industry and Economic Reforms
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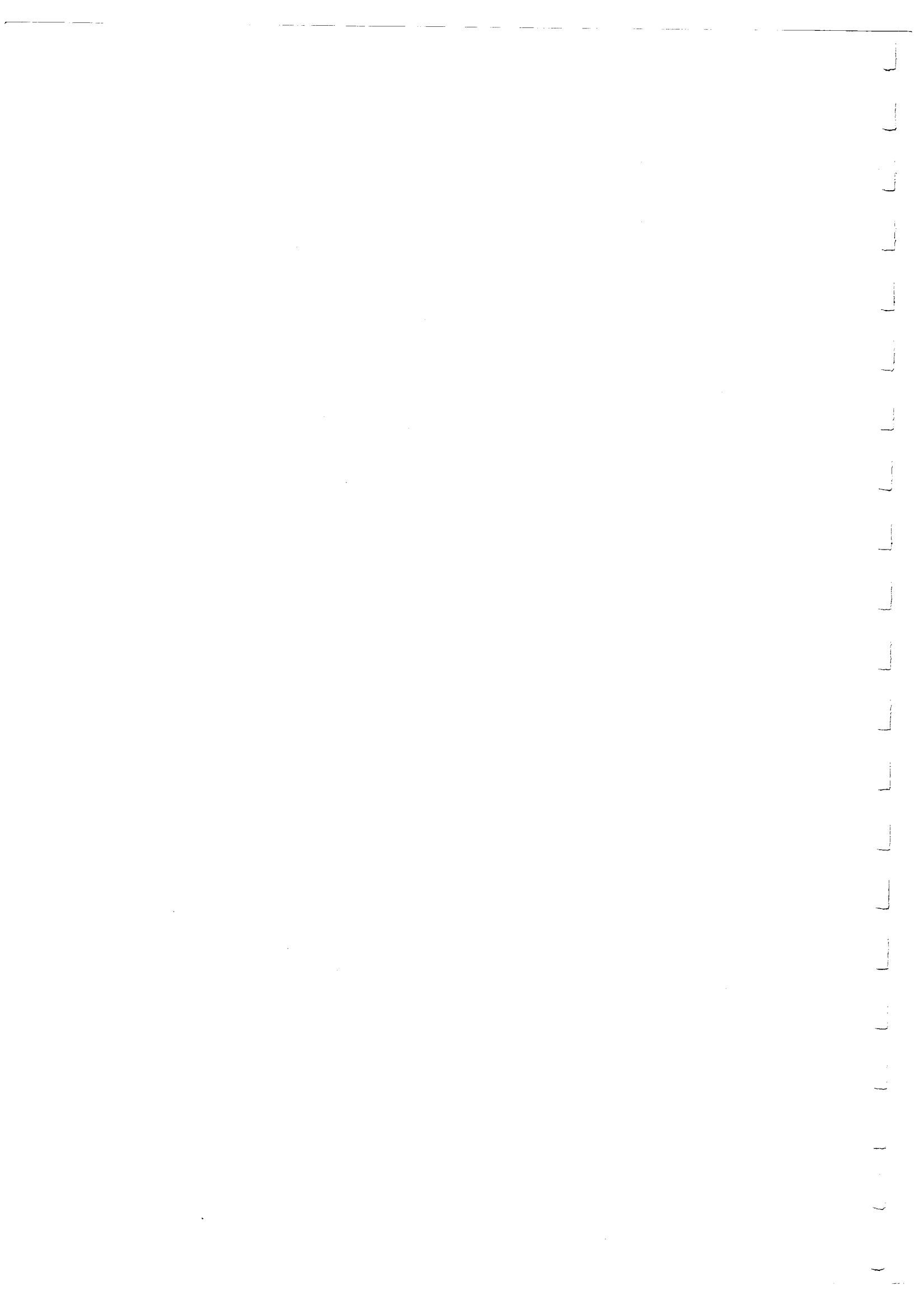
Preface

The most dramatic of the changes in economic policies in India in 1991 related to industry. They were intended to make Indian industry globally competitive. After three years it is legitimate to ask whether there has been enough progress to achieving this intention. There are many individual units that have restructured themselves. Vast funds have flown into the private organised sector. Many foreign investors have expressed interest. The stock markets are euphoric. But there is as yet no clinching evidence that Indian industry as a whole has restructured itself, or even that much of it is getting ready to do so. Many questions of policy at the levels of the central and state governments, and of the operating units, remain to be decided in a coordinated manner. Business confidence in the future appears to be at high levels. It has to be matched by substantial investments and changes in methods of working.

This paper is an attempt to review Indian experience in industry reforms in the past three years. It puts together findings of a number of studies and indicates directions for future policies.

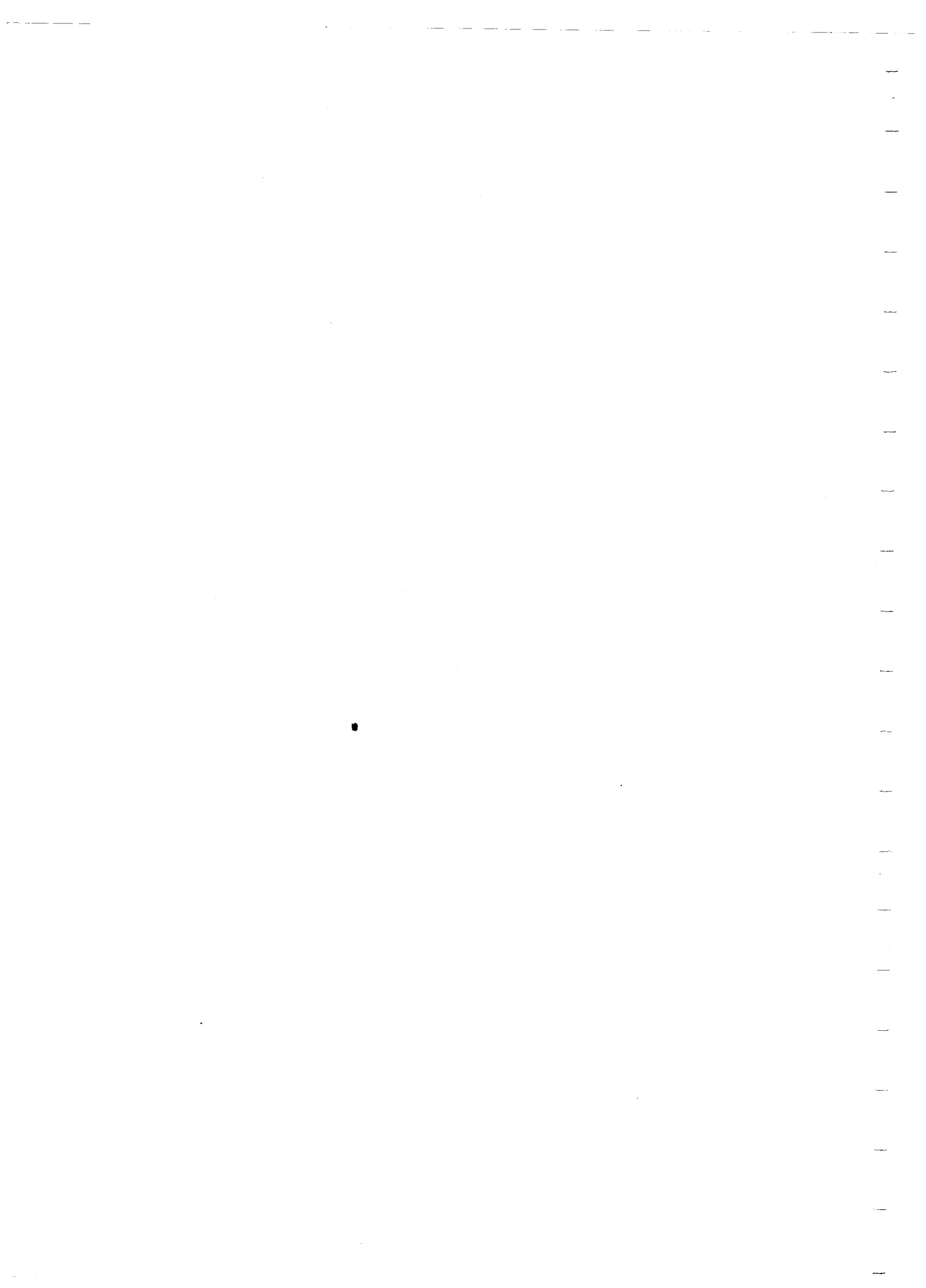
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Chapter 1

Economic Reforms in Indian Industry

THIS paper attempts to review the impact of the changes in economic policies between 1991 and 1994 as they have affected Indian industry. What seems to emerge is that there has been no coordinated set of policies towards industrial reforms. There has been a substantial amount of debureaucratisation and deregulation. However, many old policies which act as constraints on the faster development of industry still remain. Many other actions remain to be taken. At the level of the operating company, managements have yet to adjust to the new situation of competition. If Indian industry is to be competitive, there are actions which require to be taken at the Government policy level, and also at the micro company level. There is clearly need for strategic direction and thinking about Indian industry.

Economic policies affecting industry were being reviewed for the past many years. Marginal modifications like enlarging the definition of monopoly houses, some easing of technical collaboration rules, etc., were introduced in the 1970s and early 1980s. The Rajiv Gandhi government went about this task in a more coordinated way with policies to ease licensing restrictions, foreign collaborations, lower corporate taxation, income tax benefits on export incomes, etc. However most of the policy changes were selective to some industry sectors, and not applicable to the economy as a whole.

The economic policy changes since 1991 have affected all sectors of industry. The changes were many, and of different types. The most significant were those that introduced industrial delicensing. Only 8 out of the earlier 17 areas were now reserved for the public sector – later reduced to 6. Industrial licences and government approvals were abolished “irrespective of the level of investment, except for certain industries related to security and strategic concerns, social reasons, concerns related to safety and overriding environmental issues, and manufacture of products of hazardous nature”. Similarly locational restrictions except to avoid pollution and congestion in the largest cities were also abolished. The concept of “large” and monopoly houses with limitations on the so-called big business houses on their expansion and diversification, have been removed.

The compulsion to substitute imports through a “phased manufacturing programme” applicable to a number of engineering industries were also abolished.

Financial institutions no longer impose a mandatory convertibility clause on their borrowers, thus removing an important irritant, and in some cases, limitation on expansion through borrowing.

The restrictive regulations on purchase of foreign technology were eased, and more generous royalty and lumpsum technology payments were allowed to be made. Along with this, the free hiring of foreign technicians was permitted.

Automatic permission to foreign investors to hold upto 51% equity shares was permitted against the earlier limit of 40% in high priority industries, trading ventures and tourism related areas.

Public sector undertakings also saw some changes in policies. Public investments would be reviewed with greater realism in respect of industries based on low technology, small scale and non-strategic areas, inefficient and unproductive areas, areas with low or nil social considerations of public purpose, and areas where private sector has developed sufficient expertise and resources. Greater management authority through the system of memoranda of understanding, introduction of competition, divestment of a part of government holdings, were proposed for those public sector undertakings (psus) that were in the reserved areas of operation, or were in high priority areas, or were generating good or reasonable profits. Chronically sick psus would be referred to BIFR. Budgetary support to such enterprises would be phased out over a period of years. The National Renewal Fund was to provide a mechanism to protect the interest of workers likely to be affected by such rehabilitation packages.

As far as the small scale, tiny and village enterprises are concerned, government made it clear that there was no intention to relax on the list of 842 products reserved for the small scale sector. Financial support as well as better access to finance was proposed for these units. The organised sector units were also allowed to hold upto 24% equity in small scale units.

The other set of policies that affected industry relate to credit. Reduction of SLR and CRR limitations on banks were intended to ease the availability of commercial credit. The 3% reduction in interest rates over the years also reduced the cost of capital as the interest on term loans by financial institutions also came down, though the lending rates in India were still far higher than in most other countries. Opening of the financial markets to private mutual funds and others has increased the availability of capital and resources. An important change in policy has been the direct access now available to international finance through global depository receipts and Euro-issues, as well as access to loan markets. Further, the interest differentials which used to be kept by the financial institutions and banks in earlier years are now kept by the borrowing companies. This has resulted in access to much lower cost capital from overseas. The increasing interest shown in the equity cult by Indian investors and the mobilisation of such funds by mutual funds, have led to considerable growth in investments in equity and debenture issues, and such other instruments. For the organised and larger private companies, the costs of working

capital as well as long-term capital, have come down considerably. Lifting restrictions on new equity issues and on their pricing, is another major departure from the earlier industrial policies. Mergers, acquisitions and divestments of a part of the business are no longer subject to government approval.

The third set of actions affecting industry relate to direct and indirect taxes. Corporate taxes have come down and there have been quite sharp and sizeable reductions in excise duties and import tariffs. This has resulted in increased competition for customers between domestic manufacturers and also with overseas suppliers. However, duty reduction was preceded by a devaluation of 21.23% and this prevented a massive inflow of imports.

Why Reforms?

The industrial policy reforms were intended to enable Indian industry to develop an outward orientation, and to allow freer play to market forces. Indian industry was to become more competitive, acquire modern and up-to-date technologies so that costs could be controlled and quality improved, establish production capacities that would allow cost advantages, become export oriented, and through investments by international companies tie in with the growing intra-firm trade of multinational companies.

The new policies placed overwhelming reliance on private initiative and enterprise to achieve these objectives. Public investment expenditures would over time play a secondary role.

The success of these reforms depended on the speed with which Indian industry would restructure itself with larger economic capacities, up-to-date technologies and improved productivity and product quality, become more consumer oriented, build its own brands as well as process and product R&D, and on the entry of substantial investments by overseas companies that would look not only at supplying to Indian markets but also other markets in the world from India.

Chapter 2

Performance During Three Years of Reforms

THE index of industrial production combines three groups: the manufacturing sector, mining and quarrying, and power. The index uses 1980-81 as the base. It therefore has a limitation because the decade of the 1980s saw considerable changes in the relative proportions of different sectors of industry. The present index does not reflect those changes, and to that extent, understates performance when the under-represented sectors grow at a much faster rate or the over-represented sectors are in decline. Such variations in one sector get exaggerated in the overall index and the effect is stronger than if adequate weight was given to the other sectors.

IIP Growth % Over Previous Year

1990	8.6
1991	8.3
1992	0.0
1993	2.3
1994	3.0
<hr/>	
Dec. 1993	6.3
Jan. 1994	6.8
Feb. 1994	5.7
March 1994	-0.9
April 1994	8.0

In July 1991, India faced a serious crisis on its external payments, while inflation had reached a level in August 1991 (WPI) of around 16%. The immediate policy response of the Government was to effect a drastic squeeze on imports, massive devaluation of the Rupee which sharply increased the prices of imports, a sharp squeeze on commercial and consumer credit, along with an increase in interest rates. Thus, the minimum lending rate which ruled at 18.15% on 4th July, 1991 increased to 20% on 9th October, 1991. It began to come down in March, 1992 when it reduced to 19% with further reduction to 16% in June, 1993. There was therefore in those years, a sharp decline in industrial production and by 1992, an industrial recession.

Production growth of *basic goods* remained stable in the two years 1990-91 to 1991-92 at 6.4% and 6.6% respectively, declined to about 3% in 1992-93, and rose by 3.1% in 1993-94. The third year was down primarily because of the much lower growth in phosphatic fertilizers, cement, and semi-manufactured non-ferrous metals. The slowdown in the cement sector was a fall-out of macro economic stabilisation measures to keep the fiscal deficit under control, which resulted in lower government expenditures and lower offtake of cement by government agencies. The general recession in most major user industries resulting from import and credit squeeze also affected demand. The decline in phosphatic fertilizers was the fall out of attempts to rationalise the fertiliser subsidy which led to the decision to reduce urea price by 10% and consequent shift of demand away from phosphatic and potassic fertilizers. The decontrol of phosphatic and potassic fertilizer prices led to their sudden sharp rise and decline in consumption. Many manufacturing units had to close down till a subsidy of Rs.1,000 per tonne was assured. This imbalance in usage is also not desirable from view point of efficient agriculture. The steel sector saw liberalization of import and export of steel materials (except a few items), and abolition of price and distribution controls. Though profitability was affected, the industry recorded a sharp increase in production in 1992-93, and though there was a decline in off-take of salcable steel, there was a thrust to the export of finished steel.

Mining and quarrying showed improvement in performance between 1981 and 1983 when the percentage increase over the previous years was in double digits, 18.2, 29.2 and 13.4% respectively. Between 1984 and 1989, the growth was slower but still high, though somewhat erratic (8.6% in 1984 and in subsequent years 4.7, 7.3, 4.5, 5.3 with 8.5% in 1989). However, in 1990, it declined to 1.9%, rising to 3.5% in 1991 and declining again to 1.6% in 1992. Some improvement was to be seen in the month of December, 1993. Coal (including lignite) and crude petroleum account for a weight of 9.1 out of 10.99 for this sector. The single most important factor affecting the growth in this sector has been persistent decline in crude oil production which began to improve only in the closing months of 1993-94. Coal and lignite production grew in the 1970s by 4.53% annually, and in the period 1980-81 to 1992-93 by 6.74% per year with 1991-92 showing 8.13% growth.

A National Minerals Policy was announced in 1993 which liberalises private and foreign investment in this sector. Indeed in 1994, Government of India organised a conference to promote foreign investment in this sector. Captive coal mines have been allowed to the private sector and many areas opened out for foreign and private investment. Some state governments have yet to respond with positive policies especially on land issues.

The electricity sector in the index relates to electricity generation. India has shown substantial growth over the years and the years of economic reforms (from 1991) have also shown increases in power generation. It improved by 8.5% in 1992, and 5% in 1993, but shortages of power as well as poor quality of power continue to

plague the country and particularly industry. The growth over the same month last year were: Dec.93 – 6.2%; Jan.94 – 5.0%; Feb.94 – 6.1%.

While no hard data is available, it is known that captive generators account for a good proportion of the power supply of organised sector industries. The economic policy changes in this sector enable private sector (including foreign) entry into power generation. Foreign investment has been slow to come in and even domestic private investment has not been substantial mainly due to the transmission and distribution being largely a monopoly of State Electricity Boards which in most cases run large deficits and have piled up large unpaid bills with public sector suppliers like NTPC, Coal India, BHEL, Railways, etc. Foreign investment in the sector has been given many inducements, minimum return of 16% on investment at a guaranteed foreign exchange rate and 68.5% PLF, using imported fuel and capital goods.

SEBs	Profit or loss making	PLF of thermal power stations, 1993-94 (RE)	T&D losses as %age, 1993-94 (RE) (%)	Unit cost of power supply, 1993-94 (Paise/kwh)	Consumer categorywise average tariff (1993-94) (Paise/Kwh)		
					Agriculture	Domestic	Industry
Andhra Pradesh	Loss	65.00	18.50	126.58	11.18	90.00	220.00
Assam	Loss	24.00	21.00	282.52	50.00	60.00	89.04
Bihar	Loss	25.00	20.25	204.04	14.76	108.21	202.57
Delhi (DESU)	Loss	54.00	19.50	175.88	34.77	86.54	198.28
Gujarat	Loss	61.00	20.50	166.04	23.00	120.00	241.00
Haryana	Loss	49.00	22.50	150.89	35.00	90.00	177.07
Himachal Pradesh	Loss	N.A.	17.84	147.52	35.00	97.00	40.39
J & K	Loss	N.A.	43.86	178.20	10.55	28.74	43.85
Karnataka	Loss	49.40	18.00	110.64	0.11	106.50	176.84
Kerala	Loss	N.A.	19.00	93.45	25.00	58.63	94.78
Madhya Pradesh	Loss	52.50	19.00	152.41	23.60	52.50	200.78
Maharashtra	Loss	59.70	15.10	156.43	27.00	101.02	220.68
Meghalaya	Loss	N.A.	13.00	146.10	50.00	69.00	120.30
Orissa	Loss	34.50	22.00	98.63	42.00	70.00	98.47
Punjab	Loss	58.30	18.30	143.65	12.21	92.44	147.92
Rajasthan	Loss	77.00	21.50	152.85	33.92	83.28	174.62
Tamilnadu	Loss	65.20	17.25	163.29	0.00	85.00	195.36
U.P.	Loss	50.50	22.00	175.48	33.26	81.52	220.55
West Bengal	Loss	31.10	21.00	89.31	19.23	69.09	150.59
ALL-INDIA		57.10	19.23	149.17	20.09	84.96	185.79

RE – Revised Estimates

N.A – Not Applicable

Sources : – Government of India, Planning Commission, Power & Energy Division, Annual Report on the Working of State Electricity Boards and Electricity Departments, Feb-1994.

etc. However, the response has been slow. The plant load factors, average cost of generation and prices charged to different consuming sectors result in the SEBs showing cash losses at worst and poor returns on capital at best. The SEBs run thermal power plants highly inefficiently in most cases. The problems are made worse because of the transmission and distribution losses which are high due to the theft of power. The other problem is the heavy cross-subsidisation of the consuming sectors with industry having to bear the brunt of the burden, agriculture getting almost free electricity or at very low rates. This has resulted in most of the SEBs having large accumulated losses. The credibility of the SEBs is so low that foreign investors are not willing to trust them to be able to pay the bills for the power sold to them. NTPC, CIL, Indian Railways are mute examples of accumulated receivables from the various SEBs. Obviously, the private sector, particularly the foreign investors are not willing to share this fate.

Without subsidy every SEB was in the red in 1993-94. During the year a subsidy of the level of Rs.2,030.71 crores was given to the SEBs. Out of the 19 SEBs, 10 SEBs were the beneficiaries. Even with this heavy dose of subsidy, only Karnataka, Maharashtra and Orissa could swing to the positive side and that too marginally.

Commercial Profit/Loss, 1993-94(RE)

(Rs. crores)

SEBs	With subsidy	Without subsidy
Andhra Pradesh	(-) 1.78	(-) 1.78
Assam	(-) 284.55	(-) 284.55
Bihar	(-) 294.80	(-) 294.80
Delhi (DESU)	(-) 204.13	(-) 204.13
Gujarat	(-) 598.00	(-) 598.00
Haryana	(-) 377.16	(-) 437.16
Himachal Pradesh	(-) 61.44	(-) 61.44
J & K	(-) 212.41	(-) 212.41
Karnataka	(-) 33.87	(-) 0.06
Kerala	(-) 29.49	(-) 29.49
Madhya Pradesh	(-) 13.16	(-) 246.16
Maharashtra	(-) 139.04	(-) 58.81
Meghalaya	(-) 13.92	(-) 20.92
Orissa	(-) 26.10	(-) 47.10
Punjab	(-) 846.27	(-) 846.27
Rajasthan	(-) 125.65	(-) 279.38
Tamilnadu	(-) 29.80	(-) 379.80
U.P.	(-) 232.43	(-) 1110.43
West Bengal	(-) 252.21	(-) 296.21
TOTAL	(-) 2961.65	(-) 4992.36

Source: Government of India, Planning Commission, Annual Report on the Working of SEBs and Electricity Departments, Feb. 1994.

Capital goods have been hardest hit by reform measures – the industrial squeeze, the tariff reductions, freer import, and to some extent, new foreign investment containing imported rather than locally made capital goods. The effect was moderated in 1991-92 by the import squeeze, and by the industrial recession in 1992-93. In the next year this sector was to a large extent responsible for the overall poor IIP growth and to the poor growth of the manufacturing sector.

Capital Goods	
	<i>% Growth Over Previous Year</i>
1990-91	17.4
1991-92	- 4.5
1992-93	- 0.1
1993-94	- 5.3

Intermediate goods have a significant weight in the IIP. Their production declined by 0.3% in 1991-92, grew by 4.5% in 1992-93 and 11% in 1993-94. This group probably benefited by the boom in exports of yarns, textiles and garments, and in the buoyant revival of the automotive industry leading to improvement in demand for tyres. To the extent that devaluation improved export motivation, the performance was related to reform policies.

In the category of *consumer goods* (with low weight for durables and almost 10 times as much for non-durables), results were erratic and show no pattern.

	% Growth	
	<i>Consumer durables</i>	<i>Consumer non-durables</i>
1991-92	- 10.0	- 1.2
1992-93	- 0.1	+ 6.1
1993-94	+ 14.6	- 0.9

Durables were affected in the first two years by inflation and the initial squeeze on consumer credit. They began to recover with the budget of 1993 which brought about steep reduction in excise duties and consequently the prices of many durables, also a part of the reform measures. The performance of non-durables is more difficult to understand because many of them have high rural shares and rural markets prospered through this period as will be seen from NCAER Household Survey results given a little later. It appears that major declines in production have taken place primarily in sugar and mill-made cotton fabrics, and not in many other manufactured consumer non-durables.

Chapter 3

The Manufacturing Sectors

Small Scale Sector

THE performance of the *small scale sector* of industry is difficult to estimate. Only provisional figures are available from the DC, SSI for 1991-92 and they show a healthy growth – in nominal terms by over 16% and in real terms by over 3%. The latter was a little lower than in earlier years because of the high levels of inflation in 1991-92. The Economic Survey shows output growth at 17.5% in 1992-93 (provisional) over 1991-92, a growth in real terms of 5.6%. The reliability of production figures for the small scale has been questioned and we are not in a position to comment on how it has been affected by reforms. To the extent that broad-banding permits the organised sector to produce items for captive consumption that might have been procured from the small scale sector (SSS), there might have been some negative effect.

Very little has been done so far to change policies towards the small scale sector. A recent NCAER study shows clearly that the result of these policies towards SSIs is that small scale industries have become a separate category which have been encouraged to develop an adversarial relationship with the large and organised sectors instead of a collaborative one. Small industries in India have because of government policy, been encouraged to remain small, and when they grow, to split so that they remain within the definition of small scale units, as a result of which they enjoy special protection and incentives. At the same time the special advantages conferred on SSIs are available to possibly only around 2% of the total number of SSI units. The majority do not enjoy the price preferences, reservations, etc. The small scale sector has also not developed in the rural areas, unlike in China and has been concentrated in cities and small and medium towns.

Some other observations arising out of the NCAER study are reproduced below:

1. During the past four decades the small scale sector has grown manifold and diversified considerably, is making significant contribution to employment generation and exports, and to a considerable extent meeting the consumer demand of the Indian masses. But it is still considered to be weak, in need of Government help and protection. It is beset with several problems, such as sub-optimal scale of operations, sickness and morbidity, technological obsolescence and poor market image. A bandwagon approach leads to

overcrowding in the same lines of production. Consequently, there is intense *inter se* competition, lower capacity utilisation and compromise on quality and standards to make way for price cutting. The SSS has not been encouraged to grow vertically and face competition from medium and large enterprises.

2. There is no doubt that small scale enterprises have made a major contribution in the generation of additional jobs. But the capacity of the sector to create new jobs has gone down in recent years due to decline in employment intensity. Locational dispersal has taken place but only to a limited extent. The SSI conglomerations are significantly confined to bigger cities and satellite towns around them. Ancillary, sub-contracting, processing and job work units are gaining ground on account of the realisation of large scale units that farming out means reducing costs and labour relations problems. But delayed payments has become a big problem.
3. The bigger the SSE the larger the contribution it makes to income generation. Many a smaller small scale entrepreneur only gets wage employment. It is significant to note that these units are not generating surpluses. Yet they do need to exist as the alternative for such entrepreneurs and workers would be to become unemployed. In a country like India it may be necessary to protect this employment even if it may mean less than optimal factor use, some wastage of inputs, etc. There is plenty of scope to enhance productivity of micro units.
4. The trend growth in the 1980s – early 90s, of production of the SSS has been pretty good at 8-9% but 11-12% growth rate given by the official statistics seems exaggerated. The growth rate corresponds to the growth rate in the non-SSI factory sector. Over the years the percentage share of small factories and their output in the factory sector has shrunk moderately. This shows that bigger small units in terms of number of units and output have grown at a slower pace than the non-factory SSEs. It is these smaller small units which need focused attention.
5. The size of the SSS as estimated by the NCAER-FNF Study team works out to 16 lakh enterprises in 1991-92 instead of 21 lakh enterprises estimated by the 'Small Industries Development Organisation'. It seems they do not take into consideration the mortality or closure (the term used in the second SSI Census) rate. An one-fifth reduction in the number of units means substantial reduction in the overall investment, employment and production estimates of the sector made by the GOI.
6. The argument that what can be produced in the small scale sector must only be so produced, which was voiced and acted upon vigorously in the late seventies, is no longer being heard. The over-riding basis for protecting and supporting small scale industries at the start of the development programme in mid-fifties was its weak structure. However, even after four decades the

continuation of a vastly extended protective umbrella is being sought on the same plea. This seems to be coming in the way of developing a healthy, efficient and competitive SSI or rather SMI in India. In a liberalised ambience, the medium and long term interests of SSI may be hurt if commensurate measures are not taken to meet the forces of competition which are bound to increase from within the country as well as from abroad. In many products the sector can stand on its own due to its intrinsic strength. In fact, a very large segment of the enterprises do not depend on protective measures, many are not even aware of them. A large number of viable industries can be identified in the small sector if such analyses are made at a more disaggregated level than has been done hitherto.

7. The relationship between LSEs and SSEs had not developed to such an extent as to expect the former to provide technical and managerial support, not to speak of financial assistance. There is sufficient anecdotal evidence available to confirm that middle-level and bigger SSEs expand horizontally rather than vertically to continue availing of exemptions and subsidies as a SSU. A big small entrepreneur may own a few small enterprises, having a common product line. Thus, it appears that growth of SSEs to achieve optimal size and have the benefit of appropriate scale has been checkmated.
8. The vast network of Government run organisations providing promotional and extension services, apart from not being cost effective, have to a large extent lost utility for small scale units. Private sector consultants, are not always equipped to keep pace with changes in technology and other developments. The SSI associations, by and large, do not pay adequate attention to developmental activities. Thus, small entrepreneurs, generally speaking, have to fend for themselves. The lack of appropriate and timely information may come in the way of running a unit on sound lines.

(From NCAER-FNF Study, 1993)

No major policy changes have occurred in this sector nor in the *Khadi & Village industries* which also continued to show growth as in earlier years. They do not seem to have been affected in any way in the years of economic reforms.

Manufactured Goods Output

The production of *manufactured goods* as a whole showed significant improvement in the second half of the 1980s. The decadal growth was at an annual rate of 6.3% in the 50s, 5.3% in the 60s, 4.2 in the 70s, and 6.3% in the 80s. However, between 1984-85 and 1990-91, the annual growth in this sector was 8%. Subsequent years, however, show a different picture. In 1991-92, there was a decline of 1.5%; in 1992-93 the growth is estimated at 1.2%; in April-October, 1993 the growth was 1% but 1993-94 is expected to have ended with a growth in manufacturing of about 3% because of the very low performance of the early months of 1992-93 against which the same months this year show much higher growth leading to a higher average for

the year than indicated by the growth in earlier months.

Public Enterprises

The following table compares the performance of a large sample of private enterprises with the central public enterprises. The private enterprise companies include the major companies. We have to assume that the trends shown by this group are valid for other companies not included in this sample.

	Private enterprises*				Central public enterprises**		
	1990-91	1991-92	1992-93	1993-94	1990-91	1991-92	1992-93
No. of enterprises	945	945	945	1200	246	246	245
<i>Growth over previous year (%) :</i>							
Sales	18.65	20.14	13.65	20.42	11.2	11.3	11.0
Other income	26.07	31.56	23.90	6.20	64.46	15.01	12.93
Profit after tax	44.21	8.24	6.37	83.64	-4.1	3.6	44.2
Interest	11.8	13.1	12.8	4.87	14.3	12.7	11.1
Depreciation	16.43	17.54	19.47	-1.09			
<i>Ratios</i>							
Other Income/Sales	1.73	1.90	2.07	2.61	3.51	3.58	3.69
Assets/Turnover	1.172	1.111	1.041				
Current ratios	2.14	2.10	2.29				
Average FG Stock	45	46	50				
<i>Debtors/Average</i>							
Daily Sale	49	51	57				
PBDIT/Sales	14.13	14.38	14.38		9.5	10.2	10.9
PBDIT/Total assets	16.56	15.98	14.97				
Return on net worth	18.97	16.63	13.37		3.77	3.67	4.59
PAT/Sales	4.48	4.04	3.78		1.92	1.76	2.31

* From CMIE: November 1993 : *Corporate Finance: Industry Aggregates for 1990-93.*
For 1993-94, CMIE, *Corporate Results : 1993-94, June 1994.*

** From CMIE: April 1994 : *Statistical Profile of 200 Public Sector Enterprises.*

Figures for the performance of central public enterprises are available only for the year ending March, 1993. These show growth on all fronts – sales, investment, capital employed, net worth, additions to fixed assets, net profit, and dividend. Over the period from 1990 to 1993, the profit growth has zoomed from -4.1% in 1990-91 to +44.2% in 1992-93. Interest costs have declined over the three-year period. The ratio of profit before interest and taxes to sales shows an upward trend. Sales show a steady growth of around 11% per year. The public sector benefited from interest rates of 8 to 9% which were systematically lower than for the private sector of 12 to 13%. This also helped profit to grow along with increases in administered prices (Petroleum products, coal, electricity and steel). "Other Income" showed growth in

1991-92 over 1990-91, but in 1992-93 the rate of growth has declined. This is so particularly in 1990-91 when 'other income' showed over 64% growth over the previous year, perhaps reflecting the profit from the 'portfolio management scheme' and other such financial activities. In subsequent years the growth rate has declined. In the private sector, the growth probably reflects sales of assets undertaken in order to shore up declining profit growth.

As percentage to sales, however, 'other income' has been much more important for public than for private enterprises. For both, it is a growing percentage to sales. The jump in 1992-93 in the private sector perhaps reflects the earnings from investment of the large funds raised in domestic and overseas markets but not fully utilised.

It will be noted that for three key ratios, viz.,

PBDIT to sales,

Return on net worth, and

PAT to sales,

the performance of public enterprises shows improvement over the three years but lags behind the ratios for the private enterprises. Indeed on two ratios the private sector shows a decline in 1992-93 and is static in the third.

The drain on central government resources (and in the case of the state level public enterprises, on state government resources) due to the poor returns on investment is well-known. Return in terms of dividends and interest payments to the central government have been far below the interest paid by government on its internal market borrowings.

The companies in which there was also disinvestment of government shareholding did not show any special improvement in performance – indeed they did worse than the others in 1992-93. Clearly the disinvestment exercise makes no difference to the way in which the enterprises function. There has been no fundamental difference in the government – PSE relationship, structure, management or systems because of disinvestment.

Chapter 4

Performance of Private Enterprise Sector

THE CMIE performance figures for 1,200 companies in the private sector for 1993-94 showed a dramatic change over previous years. This change can also be corroborated by a different set of figures for 1,000 companies compiled by 'Capital Markets' (June 20 to July 3, 1994).

*Figures from
'Capital Market' -
1993-94 over 1992-93*

No. of companies	1,000
Sales Growth	+ 18%
Profit after tax	+ 71%
Interest payment	+ 8%

Sales have improved but profits after tax have improved by much more. This is due to three factors: reduced depreciation, higher 'other income' and lower interest costs. The changes in depreciation providing for a reduced rate, announced in December 1993, on plant & machinery used in continuous process industries, came with retrospective effect from that year. This was a major contribution to improved profits for many companies. This is a one-time improvement, and percentage improvements due to this factor will not be seen in future years. 'Other income' has been analysed earlier. As the ratios of PBDIT to sales show, the figures have not changed much over the three years. Yet profit after tax has gone up by manifold. It is fair to conclude that there have been no significant cost improvements due to new investments that account for the better performance. At the same time, in order to maintain these levels of performance in coming years, such investments are essential and must now be imminent. Further, companies have become far more dependent than before on the market for their funds. The market will expect to see improving performance each year - in terms of rising dividends, and stock appreciation.

The decline in interest payments by private enterprises in 1993-94 is much more significant than the decline for public enterprises. One important reason is the 3% decline in interest rate over the three years. It must be also seen in relation to the moneys raised in the market for investments in plant, equipment, etc., and used instead of bank funds for working capital.

CMIE (June 1994) gives the following figures

	1993	1994	(Rs. crores)
Capital issues (Project cost)	29,551	32,175	
Foreign investment			
Approved	2,971	859	
Actual (Jan 91 to Apr 94)		3,556	
Amount raised from Euro issues (May 92 to June 94)			2,192 million US Dollars = Rs. 6,300 crores (approximately)
Bond Sales (July 93 to May 94)			994 million US Dollars = Rs. 3,000 crores (approximately)
Disbursements by Financial Institutions	21,304		

Thus the additional resources available to the private sector – in the three years from 1992 to 1994 averaged to over Rs. 80,000 crores. This does not include disbursements of loans by financial institutions. This sum of over Rs. 80,000 crores is at very low costs compared to the borrowing costs from banks and financial institutions in India. We do not know what part of it has actually gone into productive investment. The increasing gap over the last year between the growing sanctions¹ perhaps implies that companies are prepared for investment but waiting for the right time to do so.

This large addition to capital and the expansion plans of companies which will come back to the market for even more funds, has also resulted in substantial increases in dividend declarations. Unless the operating profits improve considerably, due to operations and not other measures, sustaining these dividends in the future could pose problems.

Bank credit to the commercial sector appears to have grown at a declining rate since April 1993. The rate of growth has come down from 14.74% (compared to a year earlier) on April 30, 1994 to 7.53% on April 29, 1994. Since neither inventories nor receivables (in terms of number of days' sales) have gone down, it is clear that there have been other funds which displaced bank credit. This can only have been

¹ It must be noted that during 1993-94, competition between financial institutions appears to have led companies to apply for loans and get sanctioned from all of them, and then try to get reduced interest rates.

the funds raised at much lower cost by companies, in India and overseas and that has substantially reduced the interest costs in 1993-94. To that extent, productive investment has been delayed.

It would appear therefore that interest rate policies have little effect on funds availability to the commercial sector and might as well be brought down so as to match more closely the costs of external capital. It is also desirable of industry is to be competitive.

Further, the rise in the average daily turnover of BSE listed companies between August 1973 and March 1994 compared to the earlier months of April to July 1993 by 3 to 4 times, is perhaps indicative of some of these funds having flown also into the stock markets along with the large inflow of foreign institutional funds.

At the same time, NCAER business expectation surveys in February and May, 1994 show an enormous improvement in business confidence in all industries that were contacted, including the expectations of new investments. An analysis of the results of 10 rounds of business expectations from September 1991 to May 1994 shows the enormous change for the better that has taken place in business confidence, and expectations of substantial improvement in coming months in sales, production, capacity utilisation, and investments. This is so across all the sectors of organised manufacturing industry that were studied. The index of business confidence which rose from 110 in Sept. 1993 to 140 in Feb. 1994 has removed these in May 1994 as well.

We might therefore see in the rest of 1994-95, what perhaps did not take place to the expected levels in earlier years, namely, investment by industry in expanding capacities, and introducing new processes, technologies, and products. A boom in private investment expenditures in industry appears to be in the offing in 1994-95. NCAER's macro model is forecasting 31% nominal growth in private investment in 1994-95 against 16% last year and 8% in public investment vs. 5% last year. The upsurge in private investment expenditure is therefore crucial for the growth of the economy and the future competitiveness of industry.

Productivity, Quality and Capacity

Very little recent information is available about any productivity improvements in industry. ICICI has studied productivity changes in the private corporate sector among companies financed by it. The study shows that for the ICICI sample, there was a turnaround in productivity performance during the period 1987-88 to 1991-92, which showed substantially improved performance in the growth rate of real output, along with high growth of real capital stock. We can at this stage only presume that since fresh investment has taken place since 1991, the private manufacturing sector must be witnessing faster growth in productivity.

There is newspaper evidence that organised companies are becoming more

quality conscious. The number of companies that have been approved under different ISO categories has expanded, as have the number participating in programmes run by apex chambers to help companies know how to achieve these international standards of quality. There is no hard data on improvement in costs, productivity and quality. As of February 1993 about 30 companies are believed to have been certified with the international standard of ISO – 9000 and 100 or more were in the process of implementation. This is believed to have since grown rapidly.

Data on capacity is now scarce because of broad-banding and delicensing and we are unable to say to what extent industry has taken advantage of delicensing of industrial capacities bring their factory capacities to economic sizes. This is a way to improve productivity and reduce costs. NCAER's expectations surveys show improving capacity utilisation. The rate of capacity expansion can be expected to rise with increased investment expenditure.

Chapter 5

Competitiveness

THE World Competitiveness Reports rank India at No.13 among 15 newly industrialised nations in terms of overall rankings on competitiveness. In 1993, India has gained on very few counts and slipped in relative terms, on many, in relation to 1992.

<i>Rankings</i>	<i>1993</i>	<i>1992</i>
Domestic economic strength	9	8
Internationalisation	15	14
Government	10	11
Finance	15	11
Infrastructure	14	13
Manpower	12	11
Science & Technology	12	12
People	13	9

The relatively low ranking and slippage of ranking, for economic strength reflects the fact that both 1992 and 1993 were poor years for the Indian economy as it suffered thorough macro-economic adjustment. The foreign exchange reserves were still low and exports were not growing fast enough. There was only a trickle of foreign investment. Internationalisation includes the growth of tourism which was slow after the Ayodhya debacle. The sharp decline in the ranking on finance is inexplicable since primary issues were healthy, and the stock market was doing quite well. However it was clear that the asset position of most banks was faulty. Management was ranked on the basis of compensation levels, and other factors leading to enterprises being managed in an innovative, profitable and responsible manner. Indian industry continued to enjoy high levels of protection. The Department of Company Law continued to exercise great authority over the private sector as the Department of Public Enterprises did on the public sector. "People" describes the status of human development, among women, in terms of training, unemployment, labour flexibility, etc

It is only under the heading of Government that there is an improvement in India's ranking in 1993 perhaps because of the macro-economic adjustments that were then under way.

Thus in terms of how the world industry perceives India, even two years after the start of economic reforms, there is little change for the better, because of the many things that remain to be done.

Foreign Direct Investment

Beginning June 1991, the Government of India introduced a stabilization-cum-structural adjustment program that relied heavily on the interplay of market forces to promote efficiency and high productivity in the industrial sector so as to make it globally competitive. The impact of the micro-economic reforms related to Industry and Trade, Licensing and Direct Foreign Investment during the post-reform period has been significant as shown below.

<i>Foreign Investment</i>	<i>1991</i>	<i>1992</i>	<i>1993</i>
Approved (Rs. billion)	5.34	38.9	88.6
Actual inflow of FDI (Rs. billion)	3.5	6.75	17.9

Source: Reserve Bank of India and Secretariat for Industrial Approvals.

An analysis of the FDI approvals sought during the first four-month period of 1994 indicates a significant declining trend vis-a-vis the approvals effected during 1993. The annualized investment approvals for 1994 (based on the four-month period data) is compared with the approvals effected during 1993, for major investors (shown in the table below).

Foreign Investment Approved in Rupees Billion

<i>Country</i>	<i>Jan-Apr 1994</i>	<i>Annualised 1994</i>	<i>Actual 1993</i>	<i>Difference</i>
USA	5.73	17.2	34.6	- 58%
UK	1.3	3.9	6.2	- 37%
Germany	0.6	1.8	1.8	0%
Japan	0.19	0.6	2.6	- 77%
France	0.19	0.6	1.3	- 54%
UAE	0.5	1.5	4.0	- 63%
ALL COUNTRIES INCLUDING ABOVE	13.1	39.3	88.6	- 55%