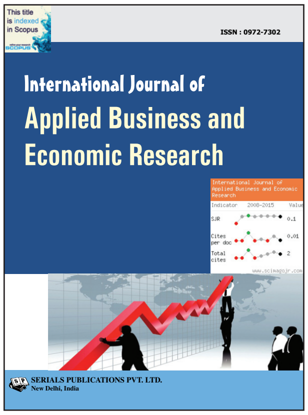

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Implications of Financial Sector Reforms on Small and Medium Scale Industries in India

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ABSTRACT

The financial sector reforms and globalization of economy in 1991 invited many foreign institutional investors in India. The global economy focused its concentration on India's economy and found their viable earning domains in India. This induced the rapid increase in Small and Medium scale industries (SMES) in India and mutual economic developments of foreign countries and India. Several research papers conspicuously noted implications of financial sector reforms in the Indian capital market, the growth of IT, steel and pharmaceutical industries. The changes in Primary, secondary, instruments and their changes return on investments and predominant in determining the potentiality of SMES in India.

The main aim of this research article is to estimate the factors influencing SME entrepreneurs to invest in various portfolios in Indian capital market. In particular the total investment, total assets and total sales in Indian capital market are also analyzed systematically. The methodology is on the basis of secondary data, trend analysis, numerical cluster approach are systematically employed to derive the flow of SMES in the span of 10 years since 2006-16.

1. INTRODUCTION

The financial sector reforms and globalization of economy in 1991 invited many foreign institutional investors in India. The global economy focused its concentration on India's economy and found their viable earning domains in India. This induced the rapid increase in Small and Medium scale industries (SMES) in India and mutual economic developments of foreign countries and India. Several research papers conspicuously noted implications of financial sector reforms in the Indian capital market, the growth of IT, steel and pharmaceutical industries. The changes in Primary, secondary, instruments and their changes return on investments and predominant in determining the potentiality of SMES in India.

The main aim of this research article is to estimate the factors influencing SME entrepreneurs to invest in various portfolios in Indian capital market. In particular the total investment, total assets and total sales in Indian capital market are also analyzed systematically. The methodology is on the basis of secondary data, trend analysis, numerical cluster approach are systematically employed to derive the flow of SMES in the span of 10 years since 2006-16.

The capital market is an important constituent of the financial system. It is a market for long term funds both equity and debt. It mainly deals with financial assets, excluding coin and currency. The financial assets comprise shares, debentures, bonds, mutual funds, fixed deposits, pension funds, provident fund, insurance policies, and derivatives. The Indian Stock Exchanges, as they are well-regulated, function smoothly, and it is an indication of healthy capital market. Stock exchange provides a good leverage to the capital market and it helps investors to maximize their returns. India has multi-stock exchange system. Regional and National Stock Exchanges (NSE) are functioning across the country. The political changes in the country and the economic policies of the Government affect the trends of capital market.

Financial Sector Reforms

The need for financial reforms has arisen because the financial institutions and markets were in a bad shape. The banking sector suffered from lack of competition, low capital base, low productivity and high intermediation costs. The role of technology was minimal, and the quality of service was abysmal. Proper risk management system was not followed, and prudential norms were weak. Developmental financial institutions operated in a over-protected environment with most of the funding coming from assured sources. Financial markets were characterized by control over pricing of financial assets, barriers to entry, and high transaction costs. The banks were running either at a loss or on very low profits, and, consequently were unable to provide adequately for loan defaults, and build their capital. There had been organizational inadequacies, weakening of management and control functions, the growth of restrictive practices, the erosion of work culture, and flaws in credit management. The financial sector reforms have been operating in conjunction with a larger set of goals relating to economic stability and growth. The reforms which have been introduced at a gradual pace combines with effective and appropriate regulation and intervention policy. Efforts have also been made to fulfill the "commandments" of financial sector reforms, namely, carrying out a macro-economic stabilization programme, introducing supportive fiscal and external sector policies, and implementing wide-ranging reforms in other sectors simultaneously.

Objectives of Financial Reforms Introduced in 1991

The main objectives of financial reforms are:

1. To develop a market oriented, competitive, world-integrated, diversified autonomous transparent financial system.
2. To increase the allocative efficiency of available savings, and to promote accelerated growth of the real sector.

3. To increase the rate of return on real investment.
4. To promote competition by creating level-playing fields and facilitating free entry and exit for institutions and market players.
5. To reduce the levels of resource pre-emption and to improve the effectiveness of directed credit programs.
6. To build a financial infrastructure relating to supervision, audit, technology, and legal matters.
7. To modernize the instruments of monetary control so as to make them more suitable for the conduct of monetary policy in a market economy i.e., to increase the reliance on indirect or market – incentive based instruments rather than direct or physical instruments of monetary control.
8. To increase effectiveness, accountability, profitability, viability, vibrancy, balanced growth, operational economy and flexibility, with professionalizing and depoliticisation in the financial sector.

Major Reforms After 1991

The reforms have had a broad sweep comprising operational matters, banking, primary and secondary stock markets. Government securities market, external sector policies and the system as a whole. They have been classified into three areas: issues relating to creating a resilient banking system; secondly development of institutions such as private sector banks and mutual funds; and thirdly, monetary policy instruments such as interest rates, reserve ratios, and refinancing facilities. While presenting a list of reforms, it needs to be pointed out that sometimes a distinction between normal policy changes which are specific in time and economic conditions and reforms proper are not maintained; the former are included in the latter, which makes the list of reforms unduly and unmanageably long. It is primarily in this sense that the major reforms are listed in terms of certain categories – systematic and policy reforms, banking reforms, primary and secondary stock market reforms, government securities market reforms, external financial market reforms.

SMES Dependence on Securities Market

The 1990s witnessed the emergence of the securities market as a major source of finance for trade and industry in India. A growing number of companies have been accessing the securities market rather than depending on loans from financial institutions (FIs)/banks. The corporate sector is increasingly depending on external sources (domestic market borrowings and loans) for meeting its funding requirements.

Governments Due to the increase in fiscal deficits of the governments, their dependence on market borrowings to finance fiscal deficits has also increased over the years. During the year 1990-91, the state governments and the central government financed nearly 14% and 18%, respectively, of their fiscal deficit by market borrowing. In percentage terms, dependence of the state governments on market borrowing did not increase much during the decade as it ranged between 13.8% and 23,.0%. In 2013-05, the state and the central government market borrowings financed 27.3% and 65.8% of the fiscal deficit respectively (ISMR, 2014).

International Scenario

Following the implementation of reforms in the securities market during the last decade, Indian stock markets have stood out in the world ranking as well as in the developed and emerging markets. As may be seen from table 1.7, India has a turnover ratio of 113.7%, which is quite comparable to the other developed market like the US and UK which have turnover ratios of 126.5% and 140.5% respectively. As per the Standard and Poor's Fact book, India ranked 18th in terms of market capitalization (17th in 2012), 18th in terms of total value traded in stock exchanges (16th in 2012) and 15th in terms of turnover ratio (6th in 2012) as on December 2013. India ranked second in terms of the listed securities on the Exchange next to the USA. These data, though quite impressive, do not reflect the full Indian market, as Standard & Poors (S&P) (even other international publications) does not cover the whole market. For example, India has approximately 9000 listed companies at the end of March 2014, while S&P considers only 4,730 companies. If whole markets were taken into consideration, India's position vis-a-vis as compared to other countries would be much better.

Table 1
International Comparison: End of December 2016

Particulars	*USA*	*UK*	*Japan*	*Germany*	*Singapore*	*Hong kong*	*China*	*India*
No. of listed Companies	5,231	2,486	3,220	660	489	1,086	1,384	4,730
Market Capitalisation ($ Bn.)	16,324	2,816	3,678	1,195	172	861	640	388
Market Capitalisation Ratio (%)	148.2	167.6	84.3	57.3	190.1	488.8	45.2	68.0
Turnover ($ Bn.)	19,355	3,707	3,430	1,406	81	439	748	379
Turnover Ratio (%)	126.5	140.5	103.5	123.7	51.2	55.7	113.3	113.7

Source: S&P Global Stock Markets Factbook, 2016

A comparative study of concentration of market indices and indices stocks in different world markets is presented in Table 1. It is seen that the index stocks' share of total market capitalization in India is 73.7% whereas US index accounts for 92.6%. The ten largest index stocks share of total market capitalization in 33.4% in India and 14.7% in the case of US.

Table 2
Market Concentration in the World Index as on End 2016
(In Percent)

Market	*Index Stocks Share of Total Market Capitalization*	*10 largest Index Stocks' Share of Total Market Capitalization*
Japan	97.1	18.2
Singapore	94.6	34.2
France	75.1	35.6
Germany	87.1	45.1
Italy	98.8	57.2
United Kingdom	95.9	40.9
United States	92.6	73.7
India	14.7	33.4

Source: S&P Global Stock Markets Factbook, 2016

The stock markets worldwide have grown in size as well as depth over the last decade. As can be observed from table 2, the turnover on all markets taken together though have grown from US $ 37.75 trillion in 2011 to $39.31 trillion in 2013, though it witnessed a decline and stood at US $ 29.6 trillion in 2012. It is significant to note that US alone accounted for about 49.24% of worldwide turnover in 2013. Despite having a large number of companies listed on its stock exchanges, India accounted for a meagre 0.96% in total world turnover in 2013. The market capitalization of all listed companies taken together on all markets stood at US$ 38.90 trillion in 2013 ($32.01 trillion in 2012). The share of US in worldwide market capitalization decreased from 44.54% as at the end of 2012 to 41.96% at the end of 2013, while Indian listed companies accounted for 1.00% of total market capitalization in 2013.

Globalization

Indian securities market is getting increasingly integrated with the rest of the world. Indian companies have been permitted to raise resources from abroad through issue of ADRs (American Depository Receipts), GDRs (Global Depository Receipts), FCCBs (Foreign Currency Convertible Bonds) and ECBs (External Commercial Bodies). Further, foreign companies are allowed to tap the domestic stock market. Indian companies are permitted to list their securities on foreign stock exchanges by sponsoring ADR/GDR issued against block share holdings. FIIs (Foreign Institutional Investors) have been permitted to invest in all types of securities, including government securities. The investments by FIIs enjoy full capital account convertibility. They can invest in a company under portfolio investment route up to 24% of the paid-up capital of the company, which can be increased up to the sector cap/statutory ceiling, as applicable. The Indian stock exchanges have been permitted to set up trading terminals abroad. The trading platform of Indian exchanges is accessed through the Internet from anywhere in the world. The two-way fungibility for ADRs/GDRs has been permitted by RBI, which means that the investors in any company that has issued ADRs/GDRs could freely convert them to ADRs/GDRs into underlying domestic shares. They could also reconvert the domestic shares into ADRs/GDRs, depending on the direction of price change in the stock. This is expected to bring an improvement in the liquidity in ADR/GDR market and elimination of arbitrage opportunity. This will better align ADR/GDR prices and domestic share prices of companies that have floated ADRs/GDRs.

Objectives of the Study

Based on the above observations, facts, and information this study has been undertaken with the following specific research objectives:

- To study the various reforms in capital market and its influence on small and medium scale industries and their preference,
- To analyse the enhanced awareness of the entrepreneurs with regard to the latest developments in the capital market after 1991 and to assess and predict the extent of return on investment.

Methodology

The data collected from all the sources are scrutinized, edited and tabulated. The data are analyzed using SPSS (Statistical Package for Social Sciences) packages. Financial analysis techniques like, Ratio Analysis, Fund

Flow Statement, Common Size Statements, Comparative Statements and Trend Percentages are executed to analyze the financial data. Numerical Cluster Analysis is exploited to classify the different financial ratio units based on the different financial elements. The ratio analysis is performed by the mathematical formula a/b. Karl Pearson's co-efficient of correlation and trend analysis is used to study the oscillations in the data for ten years. The measures of Central Tendency, Covariance, Percentage Analysis and Diagrammatic Representations are also used to establish the contribution of the data in the study

2. ANALYSIS AND INTERPRETATIONS

Net Worth and Equity Share Capital

The details of Net Worth and Equity Share Capital are shown in the table for analysis. Net Worth to Share Capital = (Net Worth / Share Capital) times Net Worth consists of share capital plus reserves and surplus of a concern. The purpose of compute this ratio is, to test the effective utilization of share capital in a business. If it is effectively utilized then the volume and percentage of reserves and surplus must be in the positive trend and vice versa. In this ratio the reserves and surplus is an indicator to spell out the performance of share capital.

Table 3
Showing the net worth and share capital - SMES in India

Year	*Net worth (in crores)*	*Index*	*Equity share capital (in crores)*	*Index*	*Ratio*	*Ratio Clusters*
2008	2717.94	100.00	206.95	100.00	13.13	L
2009	3292.67	121.15	208.55	100.77	15.79	L
2010	4292.98	157.95	221.44	107.00	19.39	M
2011	5037.21	185.33	225.59	109.01	22.33	H
2012	5771.69	212.36	338.75	163.69	17.04	L
2013	6486.27	238.65	338.77	163.70	19.15	M
2014	5897.68	216.99	338.81	163.72	17.41	M
2015	6678.85	245.73	338.83	163.73	19.71	M
2016	7742.81	284.88	338.90	163.76	22.85	H
2008	8440.85	310.56	338.93	163.77	24.90	H
Sum	56358.95	2073.59	2895.52	1399.14	191.69	
Mean	5635.90	207.36	289.55	139.91	19.17	
SD	1837.02	67.59	63.85	30.85	3.53	
CV	32.59	32.59	22.05	22.05	18.42	
Trend	11271.55	73.95	1767.05	971.25	109.28	
ACGR	11.999	11.999	5.057	5.057	6.608	
Co-relation			0.87			

Source: Annual Reports of RBI

Table 3 shows the details of net worth of SMES for a period of 10 years from 2008 to 2008. It is found that the net worth in 2008 is ₹2717.94 crores and it has consistently increased, but once dropped from ₹6486.27 crores to ₹5897.68 crores but regained its growth path to ₹8440.858 crores in the year 2008.

The index number analysis considering the base year as 2008 and the value as 100, showed that it had consistently increased but for once dropping down. It reached double the value in 2012 and ended more than thrice the value in 2008. The mean net worth of the firm is ₹5635.90 crores and the standard deviation is ₹1837.02 crores. The coefficient of variation is 32.59 per cent. The annual compounded growth of the net worth is ₹11.999 crores and it is significant from the point of the view of the growth. If there is the same trend continuing then the net worth of the firm will be ₹11271.55 crores by the year 2010 and it is approximately 12 times of the base figure.

Analysis on the details of equity share capital of SMES for a period of 10 years from 2008 to 2008 is done. Equity share capital in 2008 is ₹206.95 crores and has consistently increased to ₹338.93 crores in the year 2008. The index number analysis considering the base year as 2008 and value as 100 showed that the value reached as high as 163.77 and likely to reach a value 971.25 by 2020. The trend valued at an increase of share capital is to the extent of ₹1767.04 crores five times the base value by 2010. The annual compounded growth of the share capital is ₹5.057 crores and it is significant from the growth point of view.

Analysis of the ratio of net worth and equity share capital of SMES for a period of 10 years from 2008 to 2008 is also carried out. The ratio of the net worth is calculated. The ratio in 2008 is 13.13 times and it has increased to 22.33 times in 2011. It got reduced to 17.04 times by 2012 due to increase in share capital and gained an increase constantly and reached 24.90 times by 2008 in spite of the increase in share capital. This shows that the firm has a consistent surplus through out the period. Trend is calculated and it is found that if there is the same trend is continuing then the net worth of the firm will be ₹11271.55 crores in the year 2010 and the ratio of the net worth to equity share capital will be 5.057 times in the year 2010. Analysis also revealed that there is high positive correlation between the net worth and the equity share capital in the firm during the study period at 0.87 per cent.

3. NET WORTH TO INVESTMENTS

The ratio of Net Worth to Investments is calculated and shown in Table 4.

Net Worth to Investments = (Net Worth/Investments) times

The objective of deploying this ratio is to bring out the relationship between the net work and investments. There is a perfect correlation between these two, whenever there is positive sign and output in the investments, accordingly the net worth will be strengthened. So it is an suitable tool to judge the financial performance of a concern.

Table 4
Showing the net worth to investments – SMES of India

Year	*Net Worth (in crores)*	*Index*	*Investments (in crores)*	*Index*	*Ratio*	*Ratio Clusters*
2008	2717.94	100.00	282.47	100.00	9.62	M
2009	3292.67	121.15	283.83	100.48	11.60	H
2010	4292.98	157.95	1640.99	580.94	2.62	L
2011	5037.21	185.33	940.88	333.09	5.35	M
2012	5771.69	212.36	586.96	207.80	9.83	M
2013	6486.27	238.65	627.29	222.07	10.34	H

Year	*Net Worth (in crores)*	*Index*	*Investments (in crores)*	*Index*	*Ratio*	*Ratio Clusters*
2014	5897.68	216.99	2133.43	755.28	2.76	L
2015	6678.85	245.73	2015.22	713.43	3.31	L
2016	7742.81	284.88	2048.42	725.18	3.77	L
2008	8440.85	310.56	1756.84	621.96	4.80	M
Sum	56358.95	2073.59	12316.33	4360.23		
Mean	5635.90	207.36	1231.63	436.02		
SD	1837.02	67.59	760.29	269.16		
CV	32.59	32.59	61.73	61.73		
Trend	11271.55	73.95	14557.71	711.58		
ACGR	11.999	11.999	20.054	20.054		
Correlation			1			

Source: Annual Reports of SMES

Table 4 shows the details of Net Worth and Investments of SMES for a period of 10 years from 2008 to 2008. The performance of net worth is depicted in the Table 1.1. The performance of investment is discussed. Analysis of investments showed that it has been increasing and decreasing year after year and ended up at ₹1756.84 crores from ₹282.47 crores in 2008. The annual compounded growth rate figure expected is ₹14557.71 crores to capitalize the market demand.

The numerical ratio comparison identified that the ratio values are high in the first four years from 2008 to 2012 and low in the last four years from 2013 to 2008. The covariance of investment (₹61.73) is significantly high. This shows that in the initial four years SMES moderately was interested in various investment avenues. In last four years from 2013 to 2008, they identified the fascinating avenues of investment in a diversified manner. The covariance of investment (₹61.73) is high; this implies that the continuous change of plan of SMES in their investment process.

4. FINDINGS AND CONCLUSIONS

The cost efficiency studies revealed the meticulous and careful approach of SMES on investments criteria. It is concluded that the cost efficiency of SMES is totally influenced by their investment process and expected profitability. The continuous planning and strategies aided them to control their cost efficiency system.

Similarly, it can be concluded that the total assets of SMES increased considerably due to profit in the initial moves. But in the continuous effort, the SMES diversified its profits on various financial elements. Total asset acquired is not enormous in a span of considerable time. The sales volume really helped SMES to acquire total assets. But at the same time, increased number of FIIs did not aid SMES to increase its assets. It is further found that the profitability obtained is not used by the SMES to accumulate more assets.

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