CHAPTER I
INTRODUCTION

In today’s world of cutthroat competition, growth is an ambiguous phenomena and it can be measured and interpreted in a variety of different ways (Bains, 1951; Mehta, 1955; Kakani et al., 2001; and Jones et al., 2006). For an economic planner it is efficient utilization of resources (Miles and Snow, 1978), while a welfare economist views it as equitable distribution of gains apart from the efficient utilization of resources. From the national viewpoint, growth indicators are conceived as a multidimensional process involving major changes in social structure, national institutions, reduction of inequality, eradication of absolute poverty as well as in the acceleration of economic growth etc (Todaro, 1977; Zahra, 1993 and Jennings, 2000). Thus, growth is viewed differently from different perspectives.

1.1 MEANING OF CORPORATE GROWTH

The definition, measurement and improvement of corporate growth are of critical importance to companies today. The recession, both international and national, experienced over the last fifteen years has undoubtedly increased the importance of growth measurement both at inter and intra companies levels. Growth measurement within companies is based on both public and non-public financial and management accounting information. On the other hand, an external assessment of growth is based on information which is obtained from published (annual and interim) financial reports mainly.

Corporate growth simply reflects the degree of success achieved in terms of stated objectives and as the objectives differ widely so does the concept of growth (Pandey, 2006, p.245). That is why it cannot be put into the tight framework of a definition.

As per U.S. Department of Commerce, growth provides a summary measure of corporate success or failure and thus serves as an essential indicator of economic performance. It sometimes denotes merely increase in output i.e. when one speaks of ‘growth’ in output, exports, and sales. At other times, however, it is used in its primary meaning implying an
increase in size or an improvement in quality because of a process of development, akin to natural biological processes in which an interacting series of internal changes lead to increase in size accompanied by changes in the characteristics of growing objects. ‘Growth’ in the second sense means ‘natural’, or ‘normal’ – a process that will occur whenever conditions are favourable (Whittington et al., 1975; Kumar, 1982; Geroski, 1997; Kaur, 1997; Glancey, 1998; Kakani et al., 2001; Rao and Rao, 2003). Drucker (1994b, p. 135), for example, describes the meaning of corporate growth as ‘Growth, after all, is the result of success, of offering what the market wants, buys and pays for, of using economic resources effectively, and of making the profits for expansion and for the risks of the future.’ Starbuck (1970) has given a list of 10 possible general motives for corporate growth i.e. organizational self-realization; adventure and risk; prestige, power, and job security; executive salaries; profits; cost; revenue; monopolistic power; stability; and survival. Some researchers claim, the entrepreneurial characteristics to be most important (Gundry and Welch, 1997), while others favour the firm strategy (Baldwin et al., 1994; Harrison and Taylor, 1996), networks (Larson, 1992) where as Porter (1990) said institutions in society. Firms’ growth is frequently used in measuring the rate of return of investment and relationship between earnings and equity valuation (Fenny and Roger, 1999). It also exhibits retained earnings (Kaur, 1997), providing much of the funding in plant and equipment that raises productive capacity (Kakani et al, 2001). Corporate growth is also used to evaluate the effect of changes in policy or in economic conditions of corporations (Mehta, 1955; and Esposito & Esposito, 1975). It is also an important component of the nation’s overall income and plays a role in measuring the total income resulting from production and the distribution of income across the sectors (U.N. Committee Report, 1963). Thus, a firm’s growth path affects corporate performance significantly.

There are a number of factors that affect firms’ growth process; an industry in which a firm operates (Bains, 1951; Ito and Fuka, 2006), size (Mehta, 1955; Camanor and Wilson, 1969), and leverage (Bothwell et al., 1984; Kakani et al., 2001). The lowest cost of debt magnifies shareholders earnings subject to the condition that the cost of debt is less than the returns earned by a firm. Capacity utilization also leads to better asset utilization resulting in firm’s good performance (Kumar, 1982; and Kaur, 1997). Firms
with higher market share are also able to take advantages of product differentiation and have higher profits due to lower break-even points (Bothwell et al., 1984; Nagarajan and Barthwal, 1990). Similarly advertisement and marketing expenditure helps in promoting growth by helping a firm to build and cash its intangible assets at its brand name (Camanor and Wilson, 1969; Esposito and Esposito, 1971; Kaur, 1997; Kakani et al., 2001) but such an expenditure must also lead to economies of scale by spreading them to multiple product lines and take their full advantage. The most important variable affecting the growth of firms in this ever changing business environment is that of R&D that helps firms to achieve benefits of innovation and uniqueness (Nagarajan and Barthwal, 1990; Fenny and Rogers, 1999). Thus, all these variables and many more are assumed to affect growth significantly. Therefore, from the preceding arguments provided in the empirical research, it could be postulated that a firm growth can be analyzed along multiple dimensions.

1.2 APPROACHES TO CORPORATE GROWTH

There are a large number of conceptual frameworks which have attempted to capture aspects of corporate growth. Approaches to the study of corporate growth have been divided into six broad groups based on the literature reviewed i.e. stochastic; descriptive; evolutionary; resource-based; learning; and deterministic (Esposito and Esposito, 1971; Rama, 1998; Kakani et al., 2001; Barringer and Jones, 2005; Ito and Fuka, 2006 and Zhou and Wit, 2009).

Stochastic models of firm growth, developed mainly in the field of economics, suggest that there are a large number of factors which affect growth, thus explaining the absence of any dominant theory (McMahon, 1998). The stochastic approach stems from Gibrat’s (1931) i.e. the “Law of Proportionate Effect” which has been a useful benchmark for many previous studies on the determinants of corporate growth. This law predicts that the size of a firm at a future point in time is independent of its present size or, in other words, a firm past growth cannot be used to predict future growth. Gibrat's Law is the formal acceptance that there are a large number of causes behind the change in size of a business, but none which exert a major influence over time. The growth or decline of a firm's will depend on the quality of its management, the tastes of its customers,
government policy and a range of other forces, but each variable accounts for only a very small portion of the proportionate growth of businesses. There are a large number of these variables, some making for growth, others causing decline, but together acting randomly on the size of firms. As it has been indicated in the review of literature¹, there are many studies incorporating Gibrat’s hypothesis and, for the most part, these have tended to reject the basic proposition with evidence that smaller firms have higher subsequent growth rates (Evans, 1987; Reichstein and Dahl, 2004).

In the **descriptive approach** business growth stems from a flurry of stage of development models that first appeared in the literature between 1969 and 1972 and which continued to emerge in more refined forms (Steinmetz, 1969; Filley and House, 1969; Greiner, 1972; 1998; Churchill and Lewis, 1983; Scott and Bruce, 1987). Some may regard these contributions as deterministic by assertion, but noting the criticisms that have been levelled at them; economists have opted to classify them as “descriptive”. This type of model does not attempt to explain what causes a business to grow. Rather, they are concerned with how a business adapts internally in order to continue its growth and most of the criticism that they have attracted is because they postulate a growth process through a sequence of stages or crises without offering any supporting evidence (e.g. see the recent critique of such models in Bessant et al., 2005 and Phelps et al., 2007). These models assert a similar growth process in which the phases tend to be relatively long and smooth but which are perturbed by a number of crises that have to be resolved within the firm before the growth can continue on its way. Complicating issues such as the observed periodicity of firm growth are assumed away, for example, Filley and House (1969, p. 400) specifically exclude from their three-stage model “… the firm that has grown, declined, and regrown”. Despite criticisms of the stage models, it is found that such models are still featured in many business courses and there are some well-known empirical studies that do go some way to validating specific stage models (Miller and Friesen, 1984; Kazanjian, 1988).

The idiosyncratic nature of firm growth is addressed in the **evolutionary models** stemming in particular from the work of Aldrich (1999). In this approach, the growth of a

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¹ See Table 2.2 i.e. Empirical Studies incorporating the relationship between Size and Growth of Firms.
firm over a period of time is contingent on the interaction of a number of internal and external forces. Hence, the nature and timing of a firm's growth will be a resultant of its own unique circumstances: there is no standard model or sequence of stages to be observed (Vinnell and Hamilton, 1999). The resource-based view of corporate growth is not a new approach stemming as it does from the influential work of Penrose (1959, pp. 215-228). The essence of this theory is that growth depends on the managerial resources available over time to plan and manage growth in addition to maintaining current operations (Orser et al., 2000). In addition to this, a critical requirement of small firm founders is the strategic capability to identify opportunities for growth in the “interstices” (Penrose, 1959, pp. 222-225) where large firms have left scope for small firms to grow. Empirical studies have also begun to explain business performance – measured as growth in profitability – in terms of the degree of fit between the resource-base and the strategy of the business (see Edelman et al., 2005).

The idiosyncratic nature of corporate growth is also the challenge for those from the learning perspective (Deakins and Freel, 1998; Dalley and Hamilton, 2000). While some might subsume the learning school with (or between) the evolutionary and resource-based approaches, it does have enough momentum of its own to justify separate discussion. It is through learning that the critical resource of sufficient knowledge is created in the decision-makers which in turn facilitate the subsequent evolution of their business. At the risk of over-simplification, the growth path of each business will mirror to some extent the dynamics of learning within the business or, more succinctly, “organisational growth is ultimately dependent on satisfactory resolution of the crisis of “knowing” (Macpherson, 2005, p. 1138). The emphasis here then is to understand how and when individual entrepreneurs can learn most effectively in order to obtain and apply the “knowing” or “absorptive capacity” (Bessant et al., 2005, p. 32) that will allow their business to grow.

In the deterministic approach, the objective is to identify a stable set of explanatory variables, relating to the people, the firm, and its industry environment, that can explain a major proportion of the observed variation in corporate growth rates. This is the converse of the stochastic approach described above (Becchetti and Trovato, 2002). It is an approach which is interpreted as distinct from the descriptive approach because the
emphasis now is on what causes growth rather than on how a business adapts to accommodate growth. There are many studies in this genre, with researchers typically applying multivariate techniques to large cross-sectional, time series and panel data sets to test the significance of associations between a wide range of determinants and the growth rates of businesses (Barnes and Hershon, 1994; Smallbone et al., 1995; Delmar and Davidsson, 1998; Deakins and Freel, 1998; Davidsson et al., 2002 and Barringer and Jones, 2004).

To sum up, the approaches to corporate growth of a firm implies that not only the price-output decisions, but also finance and expenditure decisions must be incorporated in the analysis. The firm should focus on itself as an organization, able to manipulate the competitive environment in which it finds itself. It must also encompass the characteristics of modern industrial enterprises, i.e. the predominance of large-size multi product firms, divorce between ownership and control and its implications and performance in the product and capital markets. In addition, Hanon (1978) emphasised that in the twenty-first century, management would have to make a new accommodation to growth. Slow and steady growth, which has won many races in its day, is no longer good enough to serve as the universal role model. It is too speedily and too surely overtaken. Accelerated profit making, striking responsively when an iron is hot and bringing home premium revenues (before the economic, competitive, legislative, technical or marketing environment change,) has become the order of the day.

1.3 CORPORATE GROWTH IN INDIA

India has undergone a paradigm shift owing to its competitive stand in the world. The Indian economy is on a robust growth trajectory and boasts of a stable 8 plus annual growth rate, rising foreign exchange reserves and booming capital markets among others. The industrialisation process in India dates back to the British rule (Ray, 1979). But major structural and technological changes in the industry started with the planned development of the economy since 1951. Nehru (1953) had remarked, “Real progress ultimately depends on industrialization”.

According to U.N. Committee Report (1963), “Only rapid industrialization will govern the economic development of a country, in which growing part of the national resources
is mobilized to develop technically up-to-date, diversified, domestic economic structure characterized by dynamic manufacturing sector having and producing means of production and capable of assuming high rate of growth for the economy as a whole and of achieving economic and social progress”.

Thus, industrialization can be regarded as the consequence and means to generate higher income, which leads to higher production. The rationale of industrialization was also fully accepted in India. Rapid industrialization of the country became one of the important objectives of five-year plans since the second plan. This brought structural changes in the under developed country like India which began with the transfer of surplus population from agriculture to non-agriculture sector. In agricultural economies the ratio of population in agricultural sector is generally around 70:30, where as in the advanced industrialized economies the ratio is 20:80 or even less. So, the speed at which an under developed country can convert 70:30 ratio into 20:80 ratio (or less) will determine the rate of development (Kirloskar, 1981). Therefore, the development of an economy is characterized by changes in the structure of the economy in general and that of industry in particular. Some sectors of the economy grow faster than others, so that over time, there are marked changes in their relative importance. Again, within individual sectors and industries, there are changes in the relative importance of firms. The causes of such changes are complex and include changes in the pattern of demand, the innovation, and introduction of new products and processes and the differing opportunities for technical progress in individual industries, the growing importance of the economic functions of the government and the changing pattern of international competitiveness.

Further, the private corporate sector in India has played an important role in the industrial development of the country (Nair, 1975). During its growth from tiny to multi dimensional sector, it has passed through a varied environment ranging from liberal atmosphere of 1950’s to restrictive one of the 1970’s, beginning with the promulgation of the Monopolies and Restrictive Trade Practices Act, 1969 (Oza, 1969; Paranjape, 1974) and again to a more liberalised and globalised environment since 1991. Even though in the decades of 1970’s Indian industry grew by 4.6 percent a year, yet in the midst of this lack-lustre performance, there are companies which have consistently grown in size, (Ninnan, 1982, p. 94). For instance, Reliance Textiles increased its sales from Rs. 13

Thus, despite controls, big business was able to register tremendous growth (Venkataraman, 1980). This has been made possible because they have been able to manage both the requisite resources and markets necessary for their expansion. The GDP at factor cost at constant (1999-2000) prices in the year 2008-09 is likely to attain a level of Rs. 33,51,653 crore, as against the Quick Estimate of GDP for the year 2007-08 of Rs. 31,29,717 crore, released on 30th January 2009. The growth in GDP during 2008-09 is estimated at 7.1 percent as compared to the growth rate of 9.0 percent in 2007-08. The growth rate of 7.1 percent in GDP during 2008-09 has mainly been due to the growth rates of over 5 percent in the sectors of construction, trade, hotels, transport and communication, finance, insurance, real estate and business services and community, social and personal services. The agriculture, forestry and fishing sector is likely to show a growth rate of 2.6 percent in its GDP during 2008-09, as against the previous year's growth rate of 4.9 percent, mainly on account of anticipated growth rates of 6.0 percent in horticultural crops, 5.5 percent in the livestock products and 6.0 percent in fisheries.

According to the latest estimates available on the Index of Industrial Production (IIP), the index of mining, manufacturing and electricity registered growth rates of 3.4 percent, 4.0 percent and 2.9 percent respectively during April-November, 2008-09, as compared to the growth rates of 5.1 percent, 9.8 percent and 7.0 percent in these sectors during April-November, 2007-08. The key indicators of construction sector, namely, cement and steel have registered growth rates of 7.0 percent and 2.7 percent, respectively during April-December, 2007-08 (Press Information Bureau, Government of India, February 9, 2009). The GDP at factor cost at constant (1999-2000) prices in the year 2008-09 is likely to attain a level of Rs. 33,51,653 crore, as against the Quick Estimate of GDP for the year 2007-08 of Rs. 31,29,717 crore, released on 30th January 2009. The growth in GDP during 2008-09 is estimated at 7.1 percent as compared to the growth rate of 9.0 percent in 2007-08. The growth rate of 7.1 percent in GDP during 2008-09 has mainly been due to the growth rates of over 5 percent in the sectors of construction, trade, hotels, transport and communication, finance, insurance, real estate and business services and community,
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Further, the 10 sectors attracting highest FDI into India are: electrical equipments (including computer software & electronics); services sector (financial & non-financial); telecommunications (radio paging, cellular mobile, basic telephone services); transportation industry; fuels (power plus oil refinery); chemicals (other than fertilizers); construction activities; drugs & pharmaceuticals; food processing industries and Housing and Real Estate. The 10 top investing countries in India are: Mauritius, USA, UK, Netherlands, Japan, Germany, Singapore, France, South Korea and Switzerland.

Thus, the quality of business environment in India has improved manifolds in the recent years and this is evident by the fact that India has improved its position to the 49th rank in the World Economic Forum's Global Competitive Index (GCI) rankings for 2009-10 (The Global Competitiveness Report, 2009-10). The strong fundamentals underlying the Indian economy (i.e. progressive movement towards delicensing and deregulation; large pool of young skilled labour force, cost effective production facilities and large domestic market; capacity upgradation in infrastructure, industrial base and intellectual capital; progressive tax reforms and opening of the economy to FDI; liberalized portfolio investment and technology regime; investor friendly polices; good network of research and development; acceleration of the privatization process and restructuring of public enterprises) have made it an obvious choice for investors all over the world.
1.4 SIGNIFICANCE OF CORPORATE GROWTH

An assessment of a firm’s growth at the corporate level is of particular importance to a number of interested groups. For example, shareholders of profit-making firms have a growing interest in identifying the performance of those companies within which they invest resources (Weeks et al., 1987; Geroski et al., 1997; Glancey, 1998; Feeny and Roger, 1999; and Bonn, 2000). Moreover, fund managers, acting on behalf of clients, are expected to invest in firms with good performance prospects (Porter 1990; Larson, 1992; Baldwin et al., 1994; Harrison and Taylor, 1996). Firm strategists are also concerned with the performance of their firms, as well as the general performance trends within the industrial sector in which they operate (Claver et al., 2006). It also helps the management in preparing budgets and assessing the performance of various department heads (Dunne and Hughes, 1994). Trade unions are interested in firm’s growth for negotiating the wages or salaries or bonus agreement with the management (Brusco et al., 1979; Kumar, 1985; Evans, 1987; Hall, 1987; Lotti et al., 1999, 2001). The stock exchange members take interest in corporate growth for the purpose of analysis as they provide useful financial information about companies (Hart and Oulton, 1996; Shanmugham and Bhaduri, 2002; Rufin, 2005; and Choi, 2006).

1.5 NEED OF THE STUDY

The review of literature reveals that a large number of studies have been carried out all over the globe on analyzing the determinants of corporate growth, but still there is a dearth of literature on this subject in the Indian context\(^2\). Only ten studies i.e. Barthwall, (1977); Kumar, (1982); Nagarajan and Barthwal, (1990); Bharatwaj et al., (1993) Kaur, (1997); Narayan, (1998); Shergill and Sarkaria, (1999); Kakani et al., (2001); Shanmugan et al., (2002); Kalirajan and Bhide, (2003) and Chander and Aggarwal (2007) have been carried out to analyze the determinants of corporate growth in India. Seven of these studies Barthwall, (1977); Kumar, (1982); Nagarajan and Barthwal, (1990); Bharatwaj et al., (1993) Kaur, (1997); Narayan, (1998); Shergill and Sarkaria, (1999) have covered either pre or initial liberalisation period when the Indian economy was a controlled economy. The studies conducted by Kakani et al., (2001) and Kalirajan and Bhide,

\(^2\) For details see Table 2.1 Empirical Studies on Determinants of Corporate Growth.
(2003) have focused on the post liberalisation period and that too up to 2000. However, Chander and Aggarwal (2007) has covered the period from 1995-96 to 2004-05 of only few selected companies of Indian drugs and pharmaceutical industry.

Thus, the foregoing discussion reveals that no comprehensive study has been conducted in India, which essentially covers a longer post-liberalisation period, to analyze the different determinants of corporate growth. No single study has covered the impact of a large number of variables on corporate growth i.e. size of firm, age, profitability, research and development, retention ratio, liquidity ratio, turnover ratio, market share, advertising intensity, long term finance, export ratio, diversification and valuation ratio. Besides, a longer time span of 15 years i.e. from 1993-94 to 2007-08 covering the post liberalised era has also not been included in the past research.

This period witnessed radical changes in public policy in India that affected the macroeconomic environment within which firms operate. Such changes in business environment have been brought about by liberalisation, privatisation and globalisation policies adopted by government of India in 1991, which were followed by financial sector reforms, internationalization of capital and financial markets, heavy investment in the equity of Indian companies by FIIs, listing of securities of Indian companies on the foreign stock exchanges, mandatory status of the accounting standards, internationalization of accounting profession, and India emerging as a most competitive nation of the world.

Keeping into consideration these facts, it becomes inevitable to analyze the different determinants of corporate growth in India during the post liberalisation period. Hence, the proposed study has been undertaken.

1.6 OBJECTIVES OF THE STUDY

The present study is intended to uncover some of the important aspects of growth. The study has the following specific objectives:

1) To examine the extent of corporate growth in India (firm wise and industry wise) during the period 1993-94 to 2007-08.

2) To study the relationship between Gibrat's Law and growth of firms in India.
3) To identify the determinants of corporate growth in India (firm wise and industry wise) during post liberalisation period i.e. 1993-94 to 2007-08.

4) To examine the inter-temporal variations in the determinants of corporate growth in India. In order to study the variations in growth overtime, the entire period of 15 years has been divided into three sub periods from 1993-94 to 1997-98, 1998-99 to 2002-03, and 2003-04 to 2007-08.

1.7 ORGANISATION OF THE STUDY

Besides the present chapter i.e. Chapter I, the study consists of seven chapters. Synoptic view of the review of literature, uncovering some of the important aspects of corporate growth has been presented in Chapter II.

Chapter III explains the universe of the study, sampling, the underlying data, time period of the study, the variables used in analysis and various statistical and econometric techniques.

In Chapter IV extent of growth of the companies under study has been analysed.

In Chapter V size and growth relationship among companies and industries based on Gibrat’s Law i.e. Law ofProportionate Effect has been analysed.

Chapter VI deals with determinants of corporate growth. It has been divided into two sections, Section I of the chapter deals with the growth behaviour of selected Indian companies for the period during 1993-94 to 2007-08 while section II deals with both expanding and stagnant industries to examine inter industry determinants of corporate growth by building multivariate models.

In Chapter VII the inter-temporal variations in the determinants of corporate growth have been examined. In order to examine variations in growth overtime, the entire period of 15 years has been divided into three sub periods from 1993-94 to 1997-98, 1998-99 to 2002-03, and 2003-04 to 2007-08.

A summary of findings along with the concluding remarks have been presented in Chapter VIII.
1.8 LIMITATIONS OF THE STUDY

No study is an ever complete in every respect. There are always certain grey areas. The following are the limitations of this study:

1) One of the limitations of the study was its sample having a bias towards better performing and large firms since the universe consisted of BT- TOP 500 Companies ranked on the basis of market capitalisation.

2) The measurement of firm related and unrelated diversification through Entropy measure could bring objectivity to the study, but remained unexplored, due to data limitation.

3) The analysis in this study was carried out at the firm level – which is the usual practice, particularly with respect to developed economies such as United States. However, there are arguments that ‘business groups’, rather than the firm is a better unit of analysis in the case of India. More than two – third firms in India have an affiliation to a business group (even by market capitalisation) and important decisions, particularly financial, are always taken at the group level rather than at the level of firm.

4) Further, there might be some limitations of using financial ratios for measuring the corporate growth. The financial ratios do retrospective examination of the companies and not prospective; do not capture significant off-balance sheet items; can be manipulated through acceptable alterations of accounting policies (e.g. LIFO/FIFO) based on accounting and not economic data.