CHAPTER-I

INTRODUCTION

All the developing nations of the world are striving for this magic term of ‘rapid economic development’. It has been realized by all economic thinkers and policy makers that economic development is a panacea for all economic problems of the underdeveloped countries, if initiated and continued in a planned manner. Economic development is a multifaceted phenomenon. It involves many economic variables such as exploration and efficient utilization of natural resources, capital formation, technological advancement, capital/output ratio, investment pattern, utilization of manpower resources, industrialization, export promotion, import substitution etc. and non-economic structural changes such as urge for development, social and institutional changes, education administration etc. But the most important phenomenon is industrialization i.e. development of industrial sector which is directly or indirectly linked to all economic and non-economic factors of economic development.

Industrialization is regarded as one of the world’s greatest revolutions. Industrialization has played a very significant role in the process of economic development of almost all the countries of the world. Industry is one area in which man has benefited most by the scientific and technological developments. In Western hemisphere, industrialization has drastically changed not only the living standard of the people but also their social customs, traditions and beliefs. Though late, but the developing regions of Asia and Africa also realized the importance of industrialization as a wonderful source of ‘rapid economic development’.

Economic history demonstrates that to eliminate a country’s techno-economic backwardness, it is necessary to develop industrial sector and then to diversify it over a wide range of area and activities. Industrialization is the key to restructuring of the economy, as it involves a number of structural changes, such as rise in the share of industrial output and employment, changes in production techniques, factor intensities, increase in productivity, changes in import and export composition, pattern of demand etc. It helps to develop technically up-to-date and diversified domestic economic structure characterized by a
dynamic manufacturing sector, producing means of production and consumer goods (Govt. of India, 1980).

Manufacturing industry represents, in a sense, a higher stage of production. In advanced countries the development of manufacturing industry has been concomitant with these countries’ spectacular economic growth and rise in levels of living. Therefore industrialization and the growth of that part of the working population that is engaged in industry are a means of rising per capita national income. In countries like India and Japan, with a high ratio of population to natural resources and, in particular, to land, the manufacturing industry represents virtually the only hope of greatly successful exploitation of a more favourable relation between population and natural resources; and that requires mostly the growth of manufacturing industry (Myrdal, 1956).

Industrialization is a process in which changes of a series of strategically production functions, involving those basic changes that accompany the mechanization of an enterprise, the building of a new industry, the opening of a new market and the exploitation of a new territory, are taking place. This is in a way a process of deepening as well as widening of capital (Chang, 1960).

Industrialization accelerates economic growth; affects structural changes in the economy particularly in respect of resource utilization, production functions, income generation, occupational pattern, population distribution and foreign trade; and induces social changes. Industrialization is also treated as a process in which the economic gains of industrial progress, mainly in the form of increasing returns, are continuously created and wholly or partially realized. Moreover, Industrialization lifts the margin of diminishing returns. Increasing returns may be realized because of internal economies, or external economies, or both. Under a particular state of technology, there is a certain scale or range of increasing return for an industrial enterprise or an industry. But a new technological innovation will prolong the scale, or enlarge the range, or create a new scale or range. Thus, Industrialization is a process in which scales and ranges of increasing return are continuously created and frequently prolonged and enlarged (Cherunilm, 1984).
Hence, the development of industries leads to increase in relative share of industry in income and employment. Occupational structure shifts towards secondary sector and there is redistribution of rural-urban population. The growth of industries also leads to infrastructural development and helps in correcting adverse balance of payments. Development of industries has positive effect on development of agriculture as both sectors are related economically and technically. Thus industrial sector play a vital role in achieving rapid economic development through its forward and backward linkages with the other sectors of the economy. Therefore, industrialization brings economic, social, political, occupational, cultural, institutional, infrastructural and many other strategic transformations in the economy.

For a developing country like India development of industries is a pre requisite for rapid economic development. For achieving its various socio-economic objectives like raising national income and standard of living of the people, economic equality, capital formation, through increased savings, generation of employment opportunities for its ever increasing labour force, technical progress, promotion of exports for its better balance of payment position etc., rapid industrialisation is imperative. “Industrial development of the underdeveloped countries has become one of the great world crusades of our times. It is a campaign in which the advanced countries compete with one another to meet the rising claims of the non-industrialized countries for help in becoming industrialized. It is an effort in which the underdeveloped countries place in major hope of finding solutions to their problems of poverty, insecurity and over-population and ending their newly realized backwardness in the modern world” (Bryce, 1960).

Indian thinkers and economists from times immemorial recognized industrialization as a means of accelerated development. Elaborate discussions are found on the role of industry in the treatise of Kautilya. No country, which aspires to be reasonably self-supporting, can do without agriculture. At the same time, no nation in modern times has grown rich through agriculture alone. With the growth of civilization, the occupations associated with industries and manufactures have increased in importance and are found to be more remunerative than agriculture; and industrialization has come to be regarded as a
necessity and more or less as synonymous with civilization and its development (Visvesvarayya, 1937).

In the pre independent India, there was no deliberate attempt to develop an industrial sector in the economy. The period of Second World War saw a beginning of the industrial development, but still it was small and limited and its share in the national income and employment was negligible. In the post independent India, the planners immediately recognized industrialization as a source of rapid economic development. In 1948, the government of India introduced the Industrial Policy Resolution to outline the approach to industrial growth and development. The resolution emphasized the need of industrialization for constant increase in production and its equitable distribution. The process of Industrialization was launched in India as a conscious and deliberate policy under Industrial Policy Resolution, 1956 and was implemented under the Second Five Year Plan by making huge investments in a spectrum of industries. Since then industrial development played a crucial role in India’s development strategy, particularly with regard to the objectives of structural diversification, modernization and self-reliance. The progress of industrialization over the last fifty five years has been a striking feature of Indian economic development. With substantial changes that have been taking place in the social, political and economic environments of the country, India’s industrial structure has widely diversified, covering entire range of consumer, capital, basic and intermediate goods accompanied by a corresponding growth of other sectors of the economy like agriculture, tertiary sector and foreign trade etc.

Without denying the achievements of the industrialization in India in last 60 years, it may also be noted that the share of industry in national income has though increased over time, but it continued to be low as compared to industrially developed countries. In spite of huge investments, the process of industrialization has not been able to generate enough employment to absorb the ever increasing labour force in the economy. The medium and small-scale industries remained neglected. The industrial structure remained lop-sided towards luxury goods at the cost of essential consumer goods. The industrial productivity has remained low and as such the sector largely uncompetitive. Another repercussion of industrialization in India is the large regional disparities in industrial development. From the
very beginning, there were regional disparities in industrial activity in and around big ports and commercial centres of India. During the pre-independence period, most of the industries in India were developed in Bombay and Bengal. Even after independence, most of the industries developed in some regions of the country comprising states like Maharashtra, Gujarat, Tamil Nadu and West Bengal. This sort of unbalanced growth is not at all conducive to the interest of the country rather it is responsible for various socio-economic problems like congestion and slums, regional imbalances, industrial pollution, easy target for enemy during war, underutilization of development potential of backward regions and unbalanced industrial and economic development of the economy (Dhar, 2002).

Another important dimension of industrialization process in India is the increasing trend of industrial concentration and the concentration of economic power in the hands of big business houses. Concentration of economic power did not initially occupy the attention of the policy makers, though section 39, chapter IV of Constitution of India refers to concentration in general. Private corporate sector was not thought as the centre of concentration of economic power rather state was thought as the real emerging centre of concentration of economic power. But, in 1955 Hazari Committee Report on Industrial Licensing Procedures revealed that the working of licensing system in India had resulted in disproportionate growth of some big business houses. Concentration in the private corporate sector really came under the scanner in the 1960s beginning with the appearance of the Mahalonobis Committee Report (1964) on Distribution and Level of Income in which it was mentioned that the top 10% of the population cornered 40% of income. It was followed by reports of a number of important Government Commissions—The Monopolies Enquiry Commission (1964), The managing Agency Enquiry Committee (1967) and the Industrial Licensing Policy Enquiry Committee (1969).

The Government of India appointed Monopolies Inquiry Commission in April 1964 to enquire into the existence of monopoly power and restrictive trade practices of the large business houses and big corporations and to examine their socio-economic consequences and also suggest the various legislative and other measures to contain such tendencies. Monopoly Inquiry Commission measured concentration with reference to large business groups, each having assets in the companies under the control of not less than rupees five crore in 1964 and
found that 75 groups had 46.90 percent of the total assets of all the non-banking and non-government companies in 1964. The Commission mentioned the existence of two types of consequences of concentration of economic power, i.e. monopolistic practices and restrictive practices and made a distinction between them. Commission observed “Every practice whether it is by action or understanding or agreement, formal or informal, to which persons enjoying monopoly power resort in exercise of the same to reap the benefits of the power and every action, understanding or agreement tending to or calculated to preserve, increase or consolidate such power should properly, be designated monopolistic practice” and on the other hand, the restrictive practice indicate, “Practices other than those pursued by monopolists which obstructs the free play of competitive forces or impede the free flow of capital or resources into the stream of production or of the finished goods in the stream of distribution at any point before they reach the hands of the ultimate consumer” (Government of India, 1965)

The empirical fact that generated much of the discussion on private corporate concentration was that the concentration was not exhibiting a downward trend despite the process of industrial expansion and a few large business houses had maintained a steady dominance. There were a variety of causes of such inevitable concentration. Considerations of efficiency, economies of scale, scarcity of talented entrepreneurs and ability of the big business houses to mobilize large finances made this phenomenon inevitable and also tolerable to an extent. Both the Monopoly Inquiry Commission and Industrial Licensing Policy Inquiry Committee found that the system of control and regulation became instrument for increasing the industrial concentration. The committees also highlighted financial assistance by big business houses to the political parties, manipulations of licensing system as causes of the increasing concentration though licensing authorities, which were interested in ensuring the effective utilization of scarce resources favoured firms with greater goodwill, established & experienced and can handle large investment projects. The control and influence of big business houses over banks and other financial institutions probably through their representation in their managements also did well to the cause.

Concentrated economic power involves control of large resources, and also of large areas of production and of the economy as a whole. Those who have this control are in a
position to influence the economic policy in a large measure. A programme for industrial expansion, for instance, must depend to a large extent on the willingness of the corporate sector to invest their savings for such expansion. Those who control the savings can influence the incentives required for investment and therefore, the whole set of economic decisions (GOI, 1969). As far as planning and control are concerned, they are by themselves neutral in their effect on concentration. They can certainly be utilized to increase concentration. At the same time they can be equally effectively be utilized to reduce or prevent further concentration. The influence which those who control large sectors of the economy have on the economic policies and decisions of the government can to some extent determine the manner in which the economic controls are exercised by government and account for the fact that these controls have not been actively utilized to prevent increase of concentration (GOI, 1969).

The strongest argument against concentration of economic power in a mixed economy is that, in the absence of checks and balances with which a political democracy safeguards itself against the power of government, it can and is likely to act to the common detriment. On purely economic reckoning by the strength of its power, big business houses can influence both the market and the government to secure large resources. In other words, it was the ability that it gave to a few large business groups to significantly influence state policy that made concentration a relevant phenomenon.

Therefore, to curb the monopolistic and restrictive trade practices the Government of India adopted a series of measures in the late 1960s and 70s— passed the Monopolistic and Restrictive Trade Practices (MRTP) Act in 1969, set up MRTP Commission in 1970, abolishing of managing agencies, nationalization of major commercial banks, general insurance and the core sectors of the economy like oil sector in the first half of 70s. The preamble of the MRTP Act described it as “An Act to provide that the operation of economic system does not result in the concentration of economic power to the common detriment for the control of monopolies, for the prohibition of monopolistic and restrictive trade practices and matters connected therewith and incidental thereto” (Government of India, 1972). Foreign Exchange Regulation (FERA) Act (1973) and other regulatory measures were also adopted by the Indian Government. Most of the formal manufacturing sectors were subject to
licensing requirements and capacity controls. Many sectors were reserved for public sector or for small scale sector. Controls and tariffs on imports protected Indian industry from foreign competition. Some private groups were hard hit by some of the changes.

Therefore, the process of undermining of the measures adopted to curb private corporate concentration began at the stage of the framing of the laws themselves, with various loopholes being left in the system of regulation which large business groups could exploit to their advantages (Chandra, 1979; 81). Even after the abolition of the Managing Agency System business groups retained centralized control over their companies through inter-corporate investments. Public sector institutions also became the financers of the private investment projects resulting into large public sector holdings of the share capital of major private sector companies but without much interference in management. Big business houses were allowed to take advantage of incentives and concessions that were actually meant to encourage small businesses (Goyal et al, 1984). Despite the hype about the high tax regime in India, numerous tax concessions were also granted to big businesses as a result of which there was a huge gap between the statutory and the effective rates applicable to the corporate sector (Goyal, 1988).

The Industrial Policy Statement of 1980 focused attention on the need for promoting competition in the domestic market, technological upgradation and modernization. By the mid-80s, a long period of industrial stagnation, especially technical stagnation, created pressure for deregulation. As the 6th plan emphasized on productivity and removal of impediments to industrial growth and expansion, amendments were made in MRTP Act in 1982 and 1984 to introduce some limited liberalization of industrial policy and import policy. The Government introduced ‘Broad-banding’ of industrial licenses which allowed the firms to use their existing licensed capacity to manufacture a broader range of related products. Though licensing requirements were retained but their granting was made easy. In 1985, the Government introduced legislation to increase the threshold limit of the assets and to enable the exit of inefficient or sick firms which increased concentration in the concerned sectors.

In the regulated phase, the pattern of industrial concentration was the direct outcome of industrial policy. Every regulation was guided by a perceived need to conserve scarce capital in order to prevent ‘unnecessary duplication of investment’. In many sectors,
production licenses were cornered by a handful of firms. Market shares were determined largely, though not entirely, by capacity allocation at the level of individual firms and plants. Sectors subject to such licensing requirements and capacity regulations were, quite often, relatively concentrated (Athreye & Kapur, 2004). Level of concentration in Indian industry was also influenced by the policy towards foreign investment and imports. In the wake of the foreign exchange crisis of the 1960s, the economic regime became relatively hostile to new investments by foreign firms. This tended to preserve the relatively concentrated structure in some industries that were dominant by incumbent foreign firms (Athreye & Kapur, 2001). On the whole, the pattern of industrial concentration during the regulated phase was a product of Government design than the one determined by market forces.

The New Industrial Policy 1991 carried the process of liberalization further and reversed many of the earlier restrictive policies. The reforms initiated since 1991 were on a much broader scale and scope. The Industrial Policy Statement of 1991 emphasized the attainment of technological dynamism and international competitiveness. It noted that the Indian industry could scarcely be competitive with the rest of the world if it had to operate within an over regulated environment.

The Government reduced the number of industries requiring license to only 18 and steadily decreased them further with time, the number of industries in public sector gradually reduced to 3, MRTP approval for capacity expansion by large firms was no longer required, EXIM scrips i.e. import entitlements linked to export earnings were introduced, infrastructure industries like telecom and power were opened to private sector and foreign ownership, limit on foreign equity increased to 51% and many more liberalized policies were introduced by the Government during post-1991 period. Hence, liberalization created an environment in which market structure was fashioned more by market structure than the Government policy.

Further reform of trade policy substantially reduced the tariff & non tariff barriers to domestic industry. The exchange rate regime was relaxed and rationalized particularly on current account. The rules relating to foreign direct investment and foreign technology agreements have also been liberalized. In the financial sector, banking, stock market, insurance and other areas witnessed major policy reforms. The common thread running through the economic reforms, particularly those since 1991, has been to free the economy
and the sector from the governmental controls and allow market forces to determine economic activity.

Since 1991, India has gradually abolished most of the internal controls and by the time the WTO came into force in 1995, the Indian economy has become much more liberalized in comparison to what it was half a decade before. External liberalization policies following WTO reforms while on one hand involve own tariff liberalization as well as liberalization of the entry of foreign firms in the domestic market, it includes reciprocal tariff reductions by other countries simultaneously on the other. The WTO induced policy measures to liberalize the external relationships of the country in terms of both trade and investment can be termed as “external liberalization” measures. In contrast to this, the liberalization measures which attempted to dismantle the shackles of various domestic industrial controls such as the industrial licensing and other entry regulations will be termed as “internal liberalization” (Barua and Chakraborty, 2006).

Though the liberalization process started in 1991, but as industrial concentration is not a short term phenomenon and therefore the liberalization process started to show its effects on industrial concentration more after 1994-95 because of different reasons especially the deregulation of barriers to foreign trade and investment. There were several reasons for it. The mergers & acquisitions wave that started after 1991 gathered momentum in the second half of the 1990s as number of mergers & acquisitions were 743 during 1995-2000 (out of which 236 were MNCs related deals) as against 291 during 1990-95 (EIS, various issues). Mean import tariff of consumer goods and capital goods was reduced from 142 % & 109 % in 1990-91 to 59 % & 42 % in 1994-95 and further to 39.8 % & 29.7 % in 1997-98, respectively. The nominal rates of tariff were reduced sharply in mid-nineties i.e. from a weighted average rate of 72.5 % in 1991-92 to 24.6 % in 1995-96, for bringing further liberalization, openness and transparency in most of the industries under study (Balakrishna et.al, 2002). For liberalizing the access to Indian companies of foreign capital through Global Depository Receipts and American Depository Receipts, numbers of schemes were announced every year since 1995. External Commercial Borrowings rules and procedures were liberalized as well since 1995. Foreign Portfolio Investment was liberalized in 1995-96, permitting NRIs, Overseas Corporate Bodies and Foreign Institutional Investors (FIIs) to invest up to 24 % equity in
Indian companies which was further raised to 30% in 1998-99. In 1996 13 more sectors were included under the 51% equity automatic approval route, expanding up to 50% equity participation in three new areas relating to mining and enhancing the equity limit to 75% for automatic approval in nine priority areas. Foreign Institutional Investors (FIIs) were permitted to invest in the Indian Government’s dated securities from March 1997 and treasury bills from April 1998 (Srinivasan, 2000). The government’s export-import policy plan (1992-97) dramatically reduced the use of quantitative restrictions. The share of the products subject to quantitative restrictions decreased from 87 percent in 1987-88 to 45 percent; all 26 import-licensing lists were eliminated. Restrictions on exports were also relaxed, with the number of restricted items falling from 439 in 1990 to 210 in 1994 (Topalova, 2004).

Liberalization does have an impact on the industrial concentration. With deregulation and decontrol the pattern of industrial concentration changes and can be determined by the interaction between the technical characteristics of the industry and the normal competitive processes. Deregulation may increase or decrease the level of concentration. In sectors where deregulation allowed the incumbent firms to increase their market dominance, concentration could increase. In other sectors, deregulation may erode the advantage of incumbency, resulting in lower concentration. While liberalizations are believed to transform economies through competition and the removal of distortions, the effects of liberalization may not be uniform. Some industries may be better equipped for change while others are not. Within industries, new entrants may gain market share, while incumbents go bankrupt. Restrictions may linger in some sectors and for some firms.

In the post-liberalization era in India, in general, with the removal of many internally and externally imposed constraints, a conducive environment has been created for the expansion of larger firms, facilitating increase in the levels of concentration. A very prominent form of the industrial concentration is the Mergers and Acquisitions (M&A). It was a prominent phenomenon in the advanced capitalist countries since the late nineteenth century. But only in recent times has it become a regular phenomenon in ‘developing’ countries. The striking feature of the present wave of M&As at the global level is that it includes many cross-border deals (UNCTAD, 2000). The Indian evidence suggests that the new economic environment of the nineties has facilitated M&As. Mergers of firms belonging to the same
business groups operating in similar product-lines appeared to dominate the Merger-wave in India. The participation of foreign controlled firms in the M&As process has increased significantly during the second half of the nineties. Around 37.7 per cent of the total Foreign Direct Investment (FDI) made by multinational corporations (MNCs) during 1991-1998 was financed through cross-border M&As activity, either through Acquisition of substantial equity stakes in existing ventures or through buy-out of real assets through asset-sales (Beena, 2004).

**NEED OF THE PRESENT STUDY**

There is a growing body of empirical economic literature on the effects of post liberalization industrial and trade reforms in India on the performance of industrial firms, especially on industrial productivity (Goldar, et al, 2004), Aghion, et al (2003), Balakrishnan, et al (2002), Goldar and Kumari (2003), Topalova (2003), Barua and Chakraborty (2006) and apart from these there are numerous studies which have examined the effects of post-liberalization industrial and trade reforms on the industrial performance and productivity in India. Though so many studies has been done from time to time, like Tyagi (1960), Gupta (1968), Ghosh (1974 and 1975), Sandesara (1979), Siddharthan (1981), Maharatna (1989), Dhawan and Saxena (1990) in the pre-liberalization period and Kambhampati (1996), Ray, et al (1999), Singh (2000), Kambhampati and Kattuman (2003), Kambhampati and Parikh (2003), Atherye and Kapur (2004), Alfaro, et al (2009) in post-liberalization period to analyze the pattern of concentration in Indian industries. But a much lesser research work has been done on the study of impact of liberalization on industrial concentration of Indian industries. Therefore, the present study aims at the analysis of impact of post liberalization policies on the industrial concentration in Indian industries and its relationship with their performance.

The unevenness in the relative sizes of the different industries make the task of assessing level of concentration in Indian manufacturing industries complicated. On one hand, a large number of industries are fairly concentrated in the sense that there are few domestic players in them. But on the other hand, the majority of the few relatively larger industries are also among the least concentrated. This suggests the need for an industry specific study rather than general examination of the impact of liberalization on industrial concentration. Keeping this in view, the present study is planned as an industry specific study.
covering industries of India where large number of mergers has taken place or which have grown in size after liberalization viz. Automobiles, Chemicals & Allied, Food & Beverages, Electricals, Electronics, Steel etc. and some conventional agro-based industries like Sugar and textiles for the time period 1988-89 to 2004-05.

**OBJECTIVES OF THE STUDY**

Specifically, the objectives of the study are:

1. To measure the industrial concentration in selected industries in India during pre and post liberalization period.

2. To study the change in trends in industrial concentration from pre to post-liberalization.

3. To bring out the effects of post liberalization industrial concentration on corporate performance like size, growth, profitability, leverage, liquidity etc in the selected industries.

4. To suggest policy measures for industrial development of the economy in light of industrial concentration.

**HYPOTHESES OF THE STUDY**

In the light of the above mentioned objectives, the study attempted to test the following hypotheses:

1. There has been an increase in the industrial concentration in the post liberalization period.

2. There has been a positive relationship between level of concentration and size of firms.

3. There has been a positive relationship between the level of concentration and growth of firms.

4. There has been a positive relationship between the level of concentration and profitability of firms.
5. There has been a positive relationship between the level of concentration and short term solvency of the firms.
6. There has been a positive relationship between the level of concentration and long term solvency of the firms.

CHAPTER SCHEME

To meet the objectives, the study was organized in seven chapters, including the present one. The first chapter introduced the topic. The second chapter dealt with the theoretical issues relating to the industrial concentration and its relationship with the performance of the firms and industries. The third chapter reviewed the past studies on various aspects of the concentration, its measurement and relationship between structure and performance. Data base and methodology used in the study have been explained in the fourth chapter. In fifth chapter, the concentration in the selected industries has been measured by using various measures of concentration both for the pre and post-liberalization period and also the trends in concentration in both the periods has been examined. Sixth chapter deals with the analysis of effects and relationship of Industrial concentration on performance of the firms. The last chapter presents the summary of the study and brings out policy implications of the study.