CHAPTER I

INTRODUCTION AND DESIGN OF THE STUDY

1.1 INTRODUCTION

Indian economy stands today as one of the influential and attractive economies. The liberalization move by the Indian Government in 1990s has given a boost to the Indian economy and put her into a fast track economic growth route. With the beginning of the new millennium, India was considered as an emerging super power. In 2009, Indian GDP based on purchasing power parity (PPP) stood at USD 3.5 trillion making it the fourth largest economy. The industrial sector contributes 20 percent to the GDP. The agricultural sector which was the backbone of post-independence Indian economy took a back seat in the 21st century and contributed only 17.5 percent to the GDP while India’s service industry accounted for 62.5 percent of the GDP. Indian service sector has witnessed a major boom and is one of the major contributors to both employment and national income in recent times.

Among all the major service sector industries, information technology industry is undoubtedly a vital sector for Indian economy. Information technology industry in India is among the fastest growing segment of Indian industry compounding with an annual growth rate exceeding 50 percent. India has built up valuable brand equity in the global markets. The liberalization of the Indian economy in the early nineties has played a major role in the growth of the IT industry of India. Deregulation policies adopted by the Government of India have led to substantial domestic investment and inflow of foreign capital to this industry. The potential of high capacity to generate wealth, foreign exchange and employment has already caught the consideration of India’s businessmen, citizens, economists, bureaucracy and politicians. Software-driven IT industry is today at the top of India’s national agenda as an instrument and model for the modernization of India’s economy.

The last twenty years of the 20th century were the most significant period for Indian economy. During this period the nation identified its economic destiny with great clarity. The most precious achievements of this period are the development of Information Technology. The IT industry of India has registered a huge growth in recent
years. India's IT industry grew from 150 million US Dollars in 1990-1991 to 69.4 billion US Dollars in 2008-2009. According to the annual report 2009-10, prepared by the Department of Information Technology (DIT), the IT-BPO industry has earned a revenue aggregate of US $ 73.1 billion in 2009-10 as compared to US $ 69.4 billion in 2008-09, growing at a rate of over 5 per cent. The report predicts that the Indian IT-BPO revenues may reach US $ 225 billion in 2020. In the last ten years the Information Technology industry in India has grown at an average annual rate of 50 percent.

Profit earning is the aim of any business. A business will be able to survive under unfavorable situation only if it has some past earnings to rely upon. Profit is the main source of finance for the growth of a business.

1.2 NEED FOR THE STUDY

The growth of the corporate sector in India has been rapid. The economic growth of a nation largely depends on the growth and development of its corporate sector. The corporate sector is not only an institution for the maximization of shareholders wealth, but also an administrative and social organization possessing the capacity for initiating its own growth and thereby contributing to the economic growth of the country. The growth of an enterprise is based on its success and profit is the primary test of the success of the enterprise.

The growth of the company can be measured in terms of changing investment, sales, profit and profitability. Thus, growth in the profitability means all-round growth of a business enterprise. No doubt, a change is observed in the profitability trend of corporate sector. But it is not uniform in all the companies working in the country. While the companies functioning in the advanced region prospered remarkably, the companies working in the relatively backward region were found lagging behind. In the region again the trends of profitability were different depending upon the size, age, and nature of the industrial activity of the companies. Hence, an analysis of profitability and liquidity is felt relevant.
1.3 STATEMENT OF THE PROBLEM

IT industry is one of the successful industries in India. Measured by the age of many industries, the IT industry in India is still in its infancy. Its rapid growth and development has caught the attention of the world, so that India is now being identified as the major powerhouse for incremental development of computer software. The reason for this attention is not the actual size of the industry but its rapid growth rate over the nineties and the subsequent decade. It has grown from US $ 150 million in 1991-92 to US $ 73.1 billion in the year 2010.

The Indian information technology (IT) industry has played a major role in placing India on the international map. The industry is mainly governed by IT software and facilities for instance System Integration, Software experiments, Custom Application Development and Maintenance (CADM), network services and IT Solutions. According to Nasscom's findings Indian IT-BPO industry expanded by 12 percent during the Fiscal year 2009 and attained aggregate returns of US $ 71.6 billion. Out of the derived revenue from IT industry, US $ 59.6 billion was solely earned by the software and services division. Moreover, the industry witnessed an increase of around US $ 7 million in the Financial Year 2008-09. The industry’s contribution to India’s GDP has grown significantly from 1.2 percent in 1999-2000 to 6.1 percent in the Financial Year 2010, and has crossed 6.5 percent in the Financial Year 2011. The sector has been growing at an annual rate of 28 percent per annum since the Financial Year 2001.

Rapid growth of this sector gets the attention of research people in the field of Finance, Marketing, and Human Resource Management etc. Therefore, it would be an attention-grabbing task to study the profitability position of this sector and the various factors influencing the profitability ratio of the sunshine sector of the Indian economy.

Finance is regarded as the life blood of a business enterprise. This is because in the modern money-oriented economy, finance is one of the basic foundations of all kinds of economic activities. Profit earning is the main aim of every economic activity. No business can survive without earning a profit. Profit is a measure of efficiency of a business enterprise. Profits also serve as a protection against risk. So, the researcher wants to analyze the profitability of selected IT companies listed in BSE and NSE in India.
The following questions are raised for the analysis.

1. What is the quantum of profit earned among the select IT companies in India? Is there any significant change taking place over a period of time?
2. What is the variability in profit rates among the select IT companies in India?
3. What is the liquidity position among the select IT companies in India?
4. Is there any relationship between liquidity and profitability position among the select IT companies in India?
5. What are the factors that influence the profitability among the select IT companies in India?

1.4 OBJECTIVES OF THE STUDY

The following are the main objectives of the study.

1. To analyze the growth and profitability position among the select IT companies in India.
2. To analyze the liquidity position among the select IT companies in India.
3. To study the relationship between liquidity and profitability position among the select IT companies in India.
4. To ascertain the determinants of profitability among the select IT companies in India.

1.5 HYPOTHESES OF THE STUDY

1. Overall profitability of a company does not depend on the age, size and the region it belongs to.
2. There is no significant relationship between liquidity and profitability among the select IT companies in India.
3. There is no significant linear effect on Return on investment by the dependent variables.
1.6 METHODOLOGY

Sources of Data

Secondary data were used in this study, which were collected from the Prowess of the Centre for Monitoring Indian Economy (CMIE). Variables pertaining to the behavior of profitability and liquidity were collected from the Balance Sheet and Profit and Loss account of the selected IT companies for a period of 10 years from 1st April 1999 to 31st March 2009. Besides that, the corporate database reports were collected from RBI bulletin, annual survey of industries and research publications.

Selection of the sample

The study is confined to only the IT industry in India. As many as 34 IT companies were selected for the study on the basis of the following criteria:

- The companies’ shares were actively traded in BSE and NSE.
- Companies which were started before 1999-2000 and had been functioning till the end of the study period.
- Complete data available for ten years from 1999 to 2009 and their accounting year starting from 1st April to 31st March.

Classification of Sample Companies

The sample companies have been classified into different groups on the basis of region, age and size of the companies for the purpose of groupwise analyses. The classifications of total sample companies into different groups give an overall idea on the coverage of the sample.

Classification by Size

Size has been determined on the average total income of the sample companies during the period of the study. The sample companies have been divided into three groups, the details of which are presented below.
TABLE 1.1
CLASSIFICATION OF SELECTED COMPANIES - SIZEWISE

<table>
<thead>
<tr>
<th>Size</th>
<th>Criteria</th>
<th>No. of companies</th>
<th>% to total</th>
</tr>
</thead>
<tbody>
<tr>
<td>LARGE</td>
<td>&gt; 1000 crores</td>
<td>9</td>
<td>26</td>
</tr>
<tr>
<td>MEDIUM</td>
<td>500 -1000 Crores</td>
<td>14</td>
<td>42</td>
</tr>
<tr>
<td>SMALL</td>
<td>&lt; 500 crores</td>
<td>11</td>
<td>32</td>
</tr>
<tr>
<td>TOTAL</td>
<td></td>
<td>34</td>
<td>100</td>
</tr>
</tbody>
</table>

Classification by Region

Based on the states in which the companies are incorporated, the sample companies have been classified mainly into two regional groups, namely the Northern Region and the Southern Region. The states of Andhra Pradesh, Karnataka, Kerala, Tamilnadu and Goa have been categorized as Southern Region and the remaining states as Northern Region.

TABLE 1.2
CLASSIFICATION OF SELECTED COMPANIES –REGIONWISE

<table>
<thead>
<tr>
<th>Regionwise</th>
<th>No. of Companies</th>
<th>% to total</th>
</tr>
</thead>
<tbody>
<tr>
<td>SOUTH</td>
<td>16</td>
<td>47</td>
</tr>
<tr>
<td>NORTH</td>
<td>18</td>
<td>53</td>
</tr>
<tr>
<td>TOTAL</td>
<td>34</td>
<td>100</td>
</tr>
</tbody>
</table>

Classification by Age

The sample companies are also classified into two age groups viz. Old and New. The Old Companies are those incorporated prior to liberalization in 1991 and those incorporated after liberalization have been classified as New Companies.
TABLE 1.3
CLASSIFICATION OF SELECTED COMPANIES –AGEWISE

<table>
<thead>
<tr>
<th>Agewise</th>
<th>No. of companies</th>
<th>% to total</th>
</tr>
</thead>
<tbody>
<tr>
<td>OLD</td>
<td>17</td>
<td>50</td>
</tr>
<tr>
<td>NEW</td>
<td>17</td>
<td>50</td>
</tr>
<tr>
<td>TOTAL</td>
<td>34</td>
<td>100</td>
</tr>
</tbody>
</table>

1.7 PERIOD OF STUDY

The study covers a period of ten years from 1999-2000 to 2008-2009 and the accounting years of the company consisting of twelve months starting from 1st April to 31st March of the next year.

1.8 TOOLS USED IN THE STUDY

To analyze the profitability and liquidity position of selected IT companies in India, various accounting and statistical techniques have been applied. Accounting techniques including ratio analysis adopted to analyze and interpret general financial statements to assess the profitability and liquidity position.

Further a comprehensive analysis is carried out by applying statistical techniques namely

- Mean
- Standard deviation
- Coefficient of variation
- Annual compound growth rate
- Analysis of variance
- Correlation
- Multiple regression
- Stepwise multiple regression
- Path analysis.
1.9 SCOPE OF THE STUDY

The study aims to make an analysis of the growth, profitability and liquidity of IT companies in India. The efficiency of the management in accomplishing its goal of profit maximization is measured by the profitability of the business. The scope of profitability and liquidity is very wide and this study is based only on accounting information. Thus, the determination of profitability of a company and analyses of overall trend and pattern of profitability of the total sample companies will help to understand the performance of IT companies. The present study has analyzed only the commercial or accounting profitability and the analyses of social profitability and value-added profitability is beyond the scope of this study.
1.10 LIMITATIONS OF THE STUDY

1. The research considers only secondary data which are at least of financial character. Qualitative information could not be included for the analyses under the study and it may carry all the limitation inherent with secondary data and financial information.

2. The study is restricted to the period of ten years from 1999-2000 to 2008-2009 only.

3. The standard norms of ratio to justify the profitability and liquidity as compared to other IT companies are not available.

4. The researcher being an outside external analyst obviously has no access to internal data. Therefore, inside view of the organization cannot be characterized in this study.

1.11 SCOPE FOR FURTHER RESEARCH

Any research study can explore only a limited field of knowledge. Every attempt has been made to make the study more intensive but due to lack of time and resources there exists a certain gap in the present study also. From this point of view, this part specifies further scope of research work in the same IT industry.

The present study is based on secondary data. Efforts can be taken to study the determinants of corporate capital structure, cost of capital, risk and return analyses, technical analyses, market analyses, and shareholders value creation, measurement of economic value added, market value added and dividend practices.

On the basis of primary data employees salary survey, job satisfaction, study on attrition rate, stress management, labour turnover to be closely examined for further research work.
1.12 ORGANIZATION OF THE THESIS

The study has been organized into seven chapters.

Chapter 1: The first chapter covers Introduction, Need of the Study, Statement of the Problem, Objectives of the Study, Hypothesis Framed, Sources of Data, Selection of the Sample, Period of Study, Framework of Analysis, Scope of the Study, Limitations of the Study and Scope for Further Research.

Chapter 2: The second chapter reviews brief literature available in the area of the study.

Chapter 3: The third chapter studies the profile of IT industry and its contribution to Indian economy.

Chapter 4: The fourth chapter analyses the Growth and Profitability of selected IT companies in India.

Chapter 5: The fifth chapter analyses the Liquidity position and its relationship on profitability.

Chapter 6: The sixth chapter studies the Determinants of Profitability-Industry wise and Groupwise analysis.

Chapter 7: The Last Chapter Deals with Summary of findings, suggestions and conclusion.