KERALA'S INDUSTRIALIZATION THROUGH THE CAPITAL MARKET ROUTE: A SWOT ANALYSIS

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CHAPTER 6
KERALA’S INDUSTRIALIZATION THROUGH
THE CAPITAL MARKET ROUTE: A SWOT ANALYSIS

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CHAPTER 6

KERALA’S INDUSTRIALIZATION THROUGH THE CAPITAL MARKET ROUTE: A SWOT ANALYSIS

SWOT Analysis is a modern management technique for self-discovery and problem solving. The essence of SWOT analysis is that every institution, be it an individual, business firm, industry or even a society, has its strengths and weaknesses; and at any given point in time, threats and opportunities emerge. An institution that understands its strengths and weaknesses, can strengthen its strengths, weaken its weaknesses and thereby avoid threats and exploit opportunities. It is even possible to convert threats into opportunities. History is replete with examples of institutions that became successful by converting threats into opportunities.

6.1 Strengths and weaknesses of the ‘Kerala Experience’: A brief note

Kerala’s achievements in the social sector and failures on the economic front have been much debated. The ‘Kerala experience’ of ‘social development despite economic stagnation’, though a paradox, is a situation brought about by the inter-play of many factors. Kerala stands first in the country in Human Development Index (HDI); this achievement has been made possible, by the rapid strides she made in the field of education and public health. ‘Public action’ initiated by Christian missionaries, enlightened rulers, social organizations and social reform movements and political activism played a crucial and positive role in this achievement (Dreze and Sen1989). ‘Public action’, therefore, has been, historically, Kerala’s strength. Similarly, the improvement in living standards witnessed in the eighties and nineties, have
been primarily brought about by the massive out-migration of Malayalees to the Middle East and the huge remittances it facilitated. In fact, migration has been an area of strength for Kerala, even before the formation of the State. Actually, out-migration began, though in a small way, during the colonial period, when Keralites migrated to colonies such as Malaysia, Singapore, Burma and Sri Lanka to work as labourers, traders and contractors etc. The 1960s witnessed migration of Keralites to African countries, mainly to work as teachers there. The Seventies witnessed migration to the U.S. and Europe in response to the demand for doctors and nurses. With the Yom Kippur War of 1973 and the consequent oil boom, migration to the Middle East started. This boom is still on, though with slightly reduced intensity. The 90s witnessed migration to the U.S. again; this time the magnate pulling Kerala’s human resources has been the software boom. In brief, emigration has always been Kerala’s strength. This strength can also be seen as a weakness of Kerala, since, migration has been, to a large extent forced by lack of employment opportunities at home, which, in turn, has been caused by poor investment and industrial stagnation. Public action and social activism has now degenerated into too many unnecessary agitations, adversely affecting the image of Kerala as an investment destination. Nevertheless, it is an indisputable fact that public action contributed substantially to Kerala’s social development, particularly in empowering the vulnerable, the voiceless and the marginalized sections of the society.

‘Social development in spite of economic stagnation’ becomes a paradox when one views it as ‘economic stagnation despite social development’. The industrial stagnation in Kerala can be attributed to many reasons, but the fact
remains that Kerala failed in attracting investment. Kerala failed to recognize entrepreneurs as wealth creators and income generators; instead, they were looked down upon as exploiters. This attitude cost the State dear. Even though Travancore was one of the most industrialized princely states of the country at the time of independence, after the formation of Kerala State in 1956, the tempo of industrialization could not be sustained; and Kerala came to be perceived as a poor investment destination. Though Kerala did not succeed in exploiting opportunities, Keralites did. Keralites spread forth all over the world, looking for greener pastures and flourished in them. Annual remittances to Kerala currently stands at a whopping Rs.18000 crores a year. But, it has to be appreciated that keralites could exploit opportunities thrown up by the world because they could built upon the strengths provided to them by investment in education and health.

Against this backdrop, it would be appropriate to do a SWOT Analysis of Kerala from the perspective of industrialization through the capital market route.

6.2 Kerala’s Strengths

Without doubt, Kerala has some areas of strengths in resource mobilization for industrialization. These strengths include:

6.2.1 High level of Savings

Industrialization needs capital formation. The source of capital formation is savings. A high level of savings implies big potential for stepping up capital formation, which can give a big push to industrialization. Here, Kerala has a major ‘strength’.

Household’s account for 83 percent of India’s net domestic savings; financial savings constitute 53 percent of the total household saving (RBI Handbook
Since financial savings constitute the major part of domestic savings, it can be taken as a proxy of savings in the economy. Kerala has a high level of financial savings as reflected in the huge and fast growing deposits of commercial banks. See table 6.1

### TABLE 6.1
GROWTH OF BANK DEPOSITS IN KERALA

<table>
<thead>
<tr>
<th>Year</th>
<th>Domestic Deposits</th>
<th>Year</th>
<th>Domestic Deposits</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Amount</td>
<td>Annual Growth (%)</td>
<td></td>
</tr>
<tr>
<td>1991</td>
<td>5554</td>
<td>20.5</td>
<td>1997</td>
</tr>
<tr>
<td>1993</td>
<td>7613</td>
<td>14.8</td>
<td>1999</td>
</tr>
<tr>
<td>1994</td>
<td>8926</td>
<td>17.2</td>
<td>2000</td>
</tr>
<tr>
<td>1995</td>
<td>10572</td>
<td>18.4</td>
<td>2001</td>
</tr>
<tr>
<td>1996</td>
<td>12068</td>
<td>14.2</td>
<td>2002</td>
</tr>
</tbody>
</table>

Source: Economic Review 2003

The big leap in bank deposits experienced in the nineties is evident from the table. During the 10-year period from 1991 to 2000, bank deposits in Kerala grew at an average annual rate of 19.28 percent. This period also witnessed steep fall in the Credit-Deposit Ratio (C.D. Ratio) of banks from 59 percent to 41.28 percent (Economic Review: Various issues). The implication of this is that, there are substantial savings in the State waiting to be mobilized for capital formation.

For the year ended March 2000, total deposits in the scheduled commercial banks of Kerala stood at Rs.38619 crores. For India, the corresponding figure was Rs.8,13,345 crores. This means that Kerala accounts for 4.75 percent of
the total deposits in the country (Handbook of Statistics on Indian Economy, 2002 and Economic Review 2002). Considering the fact that Kerala’s population is only 3.1 percent of Indian population, the share of Kerala’s savings (as reflected in bank deposits) at 4.75 percent of the national savings, is revealing.

It is true that financial savings through deposits in commercial banks constitute only one segment, though the major segment of savings. In certain regions, Non-Banking Financial Intermediaries (NBFIs) play an important role in financial mobilization. Kerala has her unique NBFIs, prominent of which are the Chitties and Kuris (Miscellaneous Non-Banking Financial Intermediaries). The annual business transactions of these chitties come to around Rs.8000/- crores (Kerala chitties Foremen Association and Kerala State Financial Enterprises 2003). If these figures are also included in the calculation of financial savings, the share of Kerala’s financial savings is likely to increase further. Thus, the high level of financial saving, is a strength of the Kerala economy.

6.2.2 Huge remittances

An important sector of the Indian economy that grew substantially in the 1990s has been her external sector. India succeeded in achieving a current account surplus in 2001 after a gap of 22 years. This was mainly made possible by the surging remittances to India from NRIs. India is the largest recipient of remittances in the world accounting for 15 percent of the total. In India, Kerala leads in remittances accounting for 25 percent of the total. Burgeoning remittances are getting reflected in the rising NRE deposits of commercial banks. See table 6.2
While the decade of the nineties (1991 to 2000) witnessed a 386.7 percent growth in total bank deposits in Kerala, the same period saw a whopping 712.7 percent growth in NRE deposits (Economic Review 2003). The average annual growth in NRE deposits during the period 1990-2000 has been a phenomenal 25.6 percent.

An exhaustive study on migration and its economic consequences came from three economists at the CDS, Thiruvanathapuram (K.G.Zachariah, E.T.Mathew and S.Irudaya Rajan 1998). According to this study, the annual remittances to Kerala were around Rs. 3530 crores in 1998. The latest study by the same authors (forthcoming) put the amount of remittances at around Rs.18000 crores a year. Regarding the expenditure pattern of remittances, major part went into consumption, construction and education. In the late eighties, a big part of remittances were invested in private finance companies. Soon, these ‘blade companies’ collapsed. In the first half of the nineties, huge amounts were invested in the real estate business. Declines in the fortunes of
these markets, together with declining interest rates have created a situation where substantial NRE funds are available within the State economy, waiting to be productively mobilized. Whenever opportunities for productive and profitable investments arose, Non-resident Keralites had responded positively. The best example is that of the Cochin International Airport.

In short, the huge flow of remittances from abroad, particularly from NRKs working in the Middle East, has made Kerala, a ‘cash surplus’ economy. An undesirable consequence of this phenomenon is the transformation of the state into a consumer economy: Kerala has become a huge shopping mall on a ‘titanic economy’ afloat on gulf remittances. Unless steps are initiated to productively channelise these resources, there is a danger that this ‘titanic economy’ with a fragile production base, might sink.

Attractive opportunities like the one provided by the oil boom and Middle East migration, do not come often in history. It has been Kerala’s good fortune that Keralites could exploit this golden opportunity. It would be realistic to surmise that migration and remittances of the last quarter century, contributed more to addressing Kerala’s problem of poverty, than all other programmes of public action, including the much acclaimed land reforms. It is indeed a pity that Kerala failed miserably in channelizing these huge resources provided by migrants into investment, and productive economic activity capable of generating sustainable growth. It is not yet late to exploit this unique strength of Kerala.
6.2.3 High level of awareness of and exposure to financial markets

Kerala has a track record of a high level of financial development. Financial products like chitties and kuries have been in existence in certain parts of Kerala like Trichur for more than a century. Four of the leading private sector banks in the country - The Federal Bank, The Catholic Syrian Bank, The South Indian Bank and The Dhanlakshmi Bank - have their head quarters in Kerala. The Lord Krishna Bank and The Nedungadi Bank, which were merged with the SBI and Punjab National Bank respectively, also had their origins in Kerala. This track record of a long history of financial institutions stood the people of Kerala in good stead, giving them good exposure to financial markets.

With this background of financial development, capital market development happened quickly and spontaneously in Kerala. The Cochin Stock Exchange (CSE) was established in 1978 with 14 stockbrokers. Within the next twelve years it grew at a scorching pace overtaking Ahmedabad, Delhi and Bangalore stock exchanges in terms of number of stockbrokers. The volume of securities traded also grew manifold. By 1990, the CSE became the biggest stock exchange in South India. This facilitated the spread of the 'equity cult' of the late eighties and the early nineties.

The initial doze of liberalization and market oriented reforms of the late eighties led to a stock market boom. Again, the boom of 1991-92, in the background of economic reforms, created a favourable climate for stock market development. The booming stock market also created a booming primary issue market. A series of public issues were launched; and the Kerala middle class, flush with funds, positively responded to these issues. However, the investors who subscribed to these public issues in the nineties were in for
disappointment. Many issues were made by ‘fly-by-night’ operators who capitalized on the euphoria created by the abolition of the office of the Controller of Capital Issues and the consequent freedom given to issuers to price their issues. This aberration has since been corrected by the SEBI, through the introduction of Disclosure and Investor Protection (DIP) guidelines. Now, only quality IPOs are hitting the market and investor response is positive. When the ONGC IPO opened for public subscription in March 2004, with the largest ever single issue worth Rs.10000crores, the response was enthusiastic: the issue was fully subscribed within ten minutes.

6.2.4 Highly Developed Infrastructure for Capital Market Development
Kerala can boast of having the entire modern infrastructure for capital market development. The existence of a well-developed secondary market that can provide the much-needed liquidity to investors is an essential requirement for capital market development. Now, stock market transactions are done through the depositories. Among the major States of India, Kerala has the highest spread of National Securities Depositories Limited (NSDL) accounts. This is evident from table 6.3. This high level of spread of NSDL accounts indicate a well developed capital market infrastructure.
TABLE 6.3
STATE-WISE BREAK-UP OF THE INVESTOR ACCOUNTS WITH N.S.D.L

<table>
<thead>
<tr>
<th>States/UTs</th>
<th>No. of Accounts at 2.5 million plus mark</th>
<th>Spread**</th>
<th>States/UTs</th>
<th>Accounts</th>
<th>Spread</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>No. of Accounts</td>
<td>Spread**</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Andaman &amp; Nicobar Islands</td>
<td>78</td>
<td>29</td>
<td>*****</td>
<td>*****</td>
<td>****</td>
</tr>
<tr>
<td>Madhya Pradesh</td>
<td>45937</td>
<td>28</td>
<td>Pondicherry</td>
<td>1485</td>
<td>86*</td>
</tr>
<tr>
<td>Andhra Pradesh</td>
<td>119399</td>
<td>42</td>
<td>Punjab</td>
<td>27796</td>
<td>56</td>
</tr>
<tr>
<td>Arunachal Pradesh</td>
<td>19</td>
<td>22</td>
<td>Rajasthan</td>
<td>47691</td>
<td>37</td>
</tr>
<tr>
<td>Assam</td>
<td>5388</td>
<td>26</td>
<td>Sikkim</td>
<td>219</td>
<td>37</td>
</tr>
<tr>
<td>Bihar</td>
<td>29646</td>
<td>35</td>
<td>Tamil Nadu</td>
<td>160971</td>
<td>41</td>
</tr>
<tr>
<td>Chandigarh</td>
<td>7626</td>
<td>100*</td>
<td>Tripura</td>
<td>108</td>
<td>14</td>
</tr>
<tr>
<td>Daman &amp; Diu</td>
<td>23</td>
<td>100*</td>
<td>Uttar Pradesh</td>
<td>143243</td>
<td>38</td>
</tr>
<tr>
<td>Delhi</td>
<td>200806</td>
<td>100*</td>
<td>West Bengal</td>
<td>202962</td>
<td>66</td>
</tr>
<tr>
<td>Goa</td>
<td>7893</td>
<td>87*</td>
<td>India</td>
<td>2528044</td>
<td>46</td>
</tr>
<tr>
<td>Gujarat</td>
<td>501658</td>
<td>64</td>
<td>Maharashtra</td>
<td>794198</td>
<td>48</td>
</tr>
<tr>
<td>Haryana</td>
<td>22386</td>
<td>54</td>
<td>Manipur</td>
<td>75</td>
<td>2</td>
</tr>
<tr>
<td>Himachal Pradesh</td>
<td>1531</td>
<td>27</td>
<td>Meghalaya</td>
<td>295</td>
<td>33</td>
</tr>
<tr>
<td>Jammu &amp; Kashmir</td>
<td>1227</td>
<td>16</td>
<td>Mizoram</td>
<td>2</td>
<td>5</td>
</tr>
<tr>
<td>Karnataka</td>
<td>138513</td>
<td>54</td>
<td>Nagaland</td>
<td>64</td>
<td>3</td>
</tr>
<tr>
<td>Kerala</td>
<td>57178</td>
<td>86</td>
<td>Orissa</td>
<td>9627</td>
<td>34</td>
</tr>
</tbody>
</table>

Source: National Stock Exchange, Mumbai

Spread denotes accounts as percentages of total Pincode numbers.
It can be seen from the table that among the States, Kerala has the highest spread of Depository accounts in India. This is a distinct advantage in capital market development and can be gainfully used for the State’s industrialization through the capital market initiative.

6.3 Kerala’s Weakness

If, despite the formidable strengths that Kerala has, she has not exploited this opportunity, it is obvious that there are some major weaknesses that constrain Kerala’s industrialization through the capital market initiative. Let us examine what these possible weaknesses are.

6.3.1 Poor image of an investor unfriendly state

Kerala is one of the least industrialized states in India. Even though there is a consensus that industrial stagnation has to be broken to achieve economic growth and development; scholars disagree on the reasons for industrial stagnation. The reasons cited for poor industrialization include:

a) highly unionized and militant labour
b) relatively high wages, particularly for casual and head load workers
c) frequent hartals/bandhs etc that disrupt production and economic activity
d) high cost of land
e) power shortage
f) deficiency of entrepreneurial talent
g) Deficient industrial structure with poor capacity to create inter-industry demand and agglomeration economies.

Most of these factors might have contributed in varying degrees to Kerala’s industrial backwardness. But one fact is indisputable, viz. Kerala failed to project itself as a good investment destination. In this age of liberalization,
privatization and globalization, states are competing with each other to woo capital—both domestic and foreign. Even though successive governments in Kerala rolled out the red carpet for investment in the reform period, the response from entrepreneurs has been poor. An important reason for this poor response is the negative image of Kerala as a poor investment destination. Studies have shown (Sunil Mani 1996) that many entrepreneurs are shying away from the state due to psychological fear caused by recalcitrant labour. The number of days lost due to strikes and lockouts might have decreased, but the psychological fear remains, due to the track record of labour and unions that has not been favourable to investment.

Surveys conducted (Sunil Mani 1996) among different strata of entrepreneurs viz., entrepreneurs from outside Kerala who have invested in Kerala, entrepreneurs from Kerala who have invested outside Kerala particularly Tamil Nadu and Karnataka and entrepreneurs from outside Kerala who wanted to invest here but finally chose not to, have shown that there is a consensus among all of them that the militant nature of trade unions and high wages of casual and head load workers were the major constraints inhibiting investment in Kerala. Coming as this does from entrepreneurs, this opinion has to be given due respect and importance.

The survey conducted as part of the present study also indicated a very unfavorable investment climate in the state. The study found the investment climate in Kerala very unfavorable. The Investment Climate Index constructed using Likert Scale indicates a very negative image of Kerala as an investment destination. The Consistency Index constructed using Summated Ratings
yielded a value of 0.64, which is statistically significant. An important finding of the survey was the unanimous opinion of all the respondents that the societal attitude in Kerala towards business, industry and entrepreneurs in general is not positive. Yet another important finding is that majority of entrepreneurs regard the work culture in Kerala unfavorable to industrialization.

Frequent hartals and bandhs have vitiated Kerala’s investment environment and brought disrepute to the state as a poor investment destination. When the Kerala High Court banned life-paralyzing ‘bandhs’, the same emerged in its new avatar as ‘hartals’. Too many agitations, even for frivolous causes, have become the order of the day in Kerala today. In 2003 a total of 123 hartals – both statewide and region specific- were organized in Kerala. This is driving out potential investment into the state. NASSCOM (National Association of Software Service companies) has rated Cochin as the second best destination in the country for setting up software service projects. But, unfortunately, investment in these sunrise IT and ITES projects has by passed Kerala: Bangalore, Delhi, Mumbai, Chennai and Hyderabad have emerged as the preferred destinations of investment. This is, despite the fact that it was Kerala, which set up the first software technology development park at Trivandrum – the TECHNOPARK. Most of the ITES like call centers operate on a 24/7 mode: they work 24 hours a day, 7 days a week and 52 weeks a year. These services have zero tolerance for disruption. The Kerala environment, where disruption due to frivolous agitations, bandhs and hartals are too frequent, is not friendly to investment in these emerging areas. According to G. Vijaya Raghavan (2004), the first CEO of Technopark, Kerala stands to
lose tens of thousands of potential jobs in these emerging areas, because of its undesirable environment and poor work culture characterized by hartals, bandhs and work-to-rule.

6.3.2 Poor track record of corporate entities

It is a fact that industrialized states/regions attract more investment. As the saying goes, 'nothing succeeds like success'. Successful companies have attractive share price valuations. This enables them to raise more capital with seasoned offerings (rights issues). Indian corporate history is replete with examples of successful companies raising capital through rights issues for financing ambitious investment projects. The classic case is that of Reliance Industries, promoted by the legendary Dirubhai Ambani, which set up the World's largest greenfield refinery-Reliance Petroleum Ltd - with a capacity of 27 million tones at Hazira in Gujarat, mainly through the capital market initiative. Dirubai Ambani could easily raise resources form the capital market because Reliance Industries had an excellent investor-friendly track record.

Unfortunately, Kerala does not have a corporate sector with many successful and investor-friendly corporates. Listed companies that have rewarded share holders with attractive dividends and bonus issues are very few. This is not the case of other states. For instance, Tamil Nadu has a corporate sector with many companies having excellent track records. This enabled Tamil Nadu companies with excellent track records, to raise huge resources through seasoned offerings. Between 1992 (September) and 1995(November), Tamil Nadu companies made 123 bonus issues and 229 rights issues (Madras stock exchange official year Book 1996)\textsuperscript{11} while only one Kerala based company-
Kerala Chemicals and Proteins- made bonus issue to investors, during this period.

One reason why Kerala does not have many investor friendly high profile companies is that Kerala's corporate sector itself is very weak. Kerala does not have many large companies with a turnover of, say, more than Rs.1000 crores. The big companies are in the public sector and some large private sector companies promoted by Keralites like MRF and BPL are operating mainly outside Kerala. With the exception of Apollo Tyres, and scheduled commercial banks like the Federal Bank, South Indian Bank and Dhanalakshmi Bank, Kerala cannot boast of any major public limited company in the private sector. Majority of the companies are medium sized outfits without much professional managerial competence, operating in niche markets. Consequently, their financial performance also is far from satisfactory. The present study found that Kerala, does not have a single company with a market capitalization in excess of Rs. 1000 crores (India has106); has only one company with a turnover of more than Rs. 1000 crores (out of 85 at the all India level); and only one company with a turnover in excess of Rs. 500 crores (out of a total of 197 at the all India level)12.

6.3.3 Adverse impact caused by ‘fly by night’ operators

Credibility and confidence are crucial attributes in investment. Once credibility and confidence are lost, it takes a long time to repair the damage. During the hay days of the market boom in the nineties, when the new issue market was thriving, a large number of businessmen without any track record what so ever, made hay, while the IPO sun shone. Exploiting the prevailing (purely short-term) favorable sentiments, these fly-by-night operators mobilized the savings of gullible investors. As revealed by the present study,
the promoter contribution in most of these issues has been very low; and the funds were invested in doubtful projects; the result was that investors were cheated of their precious savings. The present study reveals that out of 48 companies that mobilized capital through IPOs, 4 have become sick or closed down, only 9 companies (20.45 percent of the total) have paid dividend to share holders during the last two years, and only eight companies have their shares quoting above their issue prices (as on July 2004). The introduction of the new Disclosure and Investment Protection (DIP) Guidelines as part of the capital market reforms, now, precludes the possibility of such ‘fly-by-night’ operators capitalizing in the capital market. However, a large number of such operators swindled investors during the primary market boom of the mid-nineties; this did a lot of damage to the capital market in general and investor sentiments in particular. As the saying goes, “once bitten, twice shy.” Many investors who burnt their fingers investing in inferior issues, never returned to the market.

6.3.4 Reluctance of good companies to tap the capital market

An interesting feature of Kerala’s corporate sector is the reluctance of some well performing companies to tap the capital market. The success stories of Kerala’s corporate sector in the nineties include famous names like V.Guard Industries of Kochouseph Chittilappilly and Jyothy Laboratories (Ujala brand) of Kandanasserry Ramachandran. V.Guard Group and Jyothy Lab had turnovers of Rs.130 crores and Rs.600 crores respectively, in 2003-04. Surprisingly, these successful entrepreneurs who could have boosted Kerala’s business image in the country through a public issue and listing, chose not to tap the capital market. Jyothy Lab’s Ramachandran says (in an interview with the Researcher) that the company will come out with on IPO in 2006.  

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6.4 Opportunities

According to the principle of SWOT Analysis, at any given point of time, there will be opportunities waiting to be seized. Old and existing opportunities may disappear, but new ones emerge. This is true of industrialization today. Many powerful corporates of the fifties, sixties and seventies have faded away from the industrial landscape. Blue chips of the stock market twenty years ago like Binny, DCM, Alembic, Orkay Mills, J.KIndustries, Oswal Agro Mills, Ambalal Sarabhai, Metal Box, Modi Tyres etc. are not heard of these days. Companies which did not even exist 20 years ago like Infosys, Satyam Computers, Divis Laboratories, Biocon etc are making waves in the stock market and have become much sought after investment picks by domestic as well as overseas investors.

Perhaps, India’s most outstanding success story, post-reforms, has been the spectacular performance of the computer software industry. This sunrise industry grew from a mere $150 million industry in 1991 to a phenomenal $12500 million behemoth by March 2004. Entrepreneurs like Azim Premji (Wipro) Narayana Murthy (Infosys) and Ramalinga Raju (Satyam) became familiar names and symbols of success. The capital market played a crucial role in their success enabling them to raise the required resources through capital issues within the country and abroad [Wipro, Infosys and Satyam made American Depository Receipts (ADR) issues and are listed at NASDAQ]. The exposure and publicity which stock market listing gave them was so great, so much so that, many visiting Heads of States visited their campuses. The U.S. President Clinton during his whirlwind tour of India in 2000 took time to visit the Infosys Campus.
Many I.T companies started by first generation entrepreneurs, initially relied mainly on the meagre resources of their promoters. Later on I.P.Os and Stock market listing gave fillip to these companies. Excellent performance and attractive stock prices enabled these companies to raise capital abroad through the issue of American Depository Receipts (ADRs). Now, India has more than a dozen listed I.T. companies which are world class (CMM level 5) and which export more than 90 percent of their production. The phenomenal success of these companies has been made possible by a combination of factors like the opening up of the economy in the early 1990s and stock market reforms like allowing Indian companies to raise capital abroad, permitting foreign portfolio investment by Foreign Institutional Investors (FIIs) etc.

Theoretically, Kerala has all the necessary requisites to exploit the boom in this sunrise industry. Highly land intensive and polluting industries are unsuitable for Kerala. Knowledge intensive, ‘clean industries’ which are environment friendly are ideal for Kerala’s unique socio-political-economic ambience. The I.T. industry presented, precisely this; and Kerala, with the first state sponsored Techno Park (Thiruvananthapuram) was ready. Theoretically, the setting was perfect; but practically Kerala’s performance in this industry was at a snail’s pace. While States like Karnataka, Tamil Nadu and Hyderabad galloped away, Kerala was left far behind. India’s software exports touched a record $12.5billion in 2003-04.

Karnataka, India’s Silicon Valley, led the Indian states with an export turnover of Rs.19000crores, followed by Tamil Nadu, Delhi and Andhra Pradesh. Kerala’s performance was dismal, with exports of a mere Rs.185crores (Economic Review 2003). 14 Why did Kerala miss this great opportunity?
This brings us to the last part of SWOT, - threats.

6.5 Threats

What are the threats to kerala’s industrialization through the capital market initiative?

Today, globalization is no longer an option: it is a fact of our times, a phenomenon sweeping across the world. Globalization has its pains and gains. The ideal response to globalization should be to formulate policies that can maximize its gains and minimize its pains. Globalization has to be managed, not resisted. In a globalizing economy, only globally competitive businesses would survive.

What is Kerala’s status in this emerging Scenario?

6.5.1 Absence of globally competitive business enterprises

The performance of India’s industrial sector during the post reform period has been creditable. Indian industry survived and prospered even while protective walls were dismantled (peak import duties on non-agricultural products have been brought down from 165 percent in 1991 to 20 percent in 2003). Indian exports and remittances surged enabling her to achieve a current account surplus in 2001 after a gap of 22 years. Foreign Exchange Reserves are now around $129 billion (December 2004), exceeding total foreign debt for the first time in the history of independent India. In many industries like computer software and BPO, pharmaceuticals, textiles, steel, cement, aluminium, petrochemicals, automobiles, auto ancillaries, gems and jewellery etc, Indian companies are globally competitive and now have a global presence. In computer software, gems and jewellery and textiles, India’s exports have crossed the $10 billion mark. Dozens of Indian companies are doing extremely well in the domestic and global markets: Hero Honda, (produced 20 lakh
motor cycles in 2004) is the world's largest producer of motor cycles; Tata Steel is the lowest cost producer of H.R coils in the world; Hindalco is one of the lowest cost producer of alluminium in the world; Moser Baer (exports in 2002, Rs 1000crores) is the world's lowest cost producer of C.D.recoders; Bharat Forge is Asia's largest manufacturer of forgings; Essel Propack is the world's largest producer of laminated tubes; Asian Paints with production facilities in 22 countries is the market leader in paints in 12 countries (Arun Shourie 2003)\textsuperscript{15}. The list is growing. Indian pharmaceuticals industry is the 6\textsuperscript{th} largest exporter of pharmaceuticals in the world. In computer software exports, India's performance has been phenomenal, leapfrogging from $150million in 1991 to $12.5 billion in 2004. As regards resource mobilization, 106 Indian companies raised Rs.33984.14crores through the issue of GDRs/ADRs in the European and American Markets (RBI Handbook 2000).

The million-dollar question is:
Where does Kerala fit in, in this emerging industrial landscape?

The simple answer to the question is that Kerala is nowhere in the picture.
There is not even a single Kerala company among India's star exporters.
There is not even a single Kerala company among the 106 companies, which mobilized capital abroad.
This, itself, is the major threat.

\textbf{6.5.2 Herd instinct of investors}

In capital formation, the propensity to invest is as crucial as the availability of savings. Keralites' propensity to invest has been characterized by 'herd instinct'. In the eighties, the private finance companies (popularly called 'blade companies') because of the usurious rates of interest they charged on
borrowers) were the main avenues of investment. Large number of NRKs was drawn into this racket. When these companies met with their inevitable collapse, investors flocked to the ‘goat’ and ‘maanchiyam’ companies, which fleeced investors by promising them very high returns from investment in goat farms and ‘maanchiyam’ plantations. This bubble, too, met with its inevitable destiny. Soon, another bubble emerged, viz, the real estate bubble. Starting from around 1992 it boomed till around 1997 when, that too collapsed.

Investment in Kerala has been characterized by this ‘herd instinct of investors’. They jump on to the bandwagon when it comes, without looking into the economic rationale of investment and later come to grief, when the inevitable collapse happens. This herd instinct is an unhealthy trend for the investors as well as the economy.

In the backdrop of this SWOT Analysis done at a theoretical plane, an enquiry was conducted into the operational and managerial constraints in Kerala’s industrialization through the capital market route.

**6.6 Operational and Managerial Constraints in Kerala’s Industrialization**

To study the operational and managerial constraints in Kerala’s industrialization, particularly industrialization through the capital market route, a sample survey was conducted among selected entrepreneurs of Kerala. The economic logic behind this approach is simple: theoretically Kerala is favourably placed to embark on industrialization through the capital market route; but practically this has not happened. If entrepreneurs are not forthcoming to invest in Kerala, it would be logical to enquire their perspective about the issue; particularly it would be relevant to enquire the state of the industrial investment climate in Kerala and its ramifications for entrepreneurs.
With this end in view a questionnaire with 20 statements was prepared for obtaining responses from a sample set of entrepreneurs.

**Selection of the sample**

The sample consists of 24 entrepreneurs from Kerala. According to the K.S.I.D.C. Dossier\(^{16}\) Kerala has 16 ‘mega companies’ with a gross block in excess of Rs. 50 crores. One fourth (four in number) of these companies, were included in the sample. Apart from this, 50 percent of Kerala companies, with a turnover of Rs. 100 crores and above, were also included. The sample also includes successful N.R.K. entrepreneurs operating in the big league with turnover in excess of Rs. 1000 crores and employment generation in excess of 10000 persons. The sample selection was done in such a way that the entrepreneurs selected had some correlation with the capital market with regard to capital mobilization. Thus the sample selected consisted of representatives of the following groups:

- Entrepreneurs who tapped the capital market and succeeded in business
- Entrepreneurs who tapped the capital market, but did not succeed
- Successful entrepreneurs who do not intent to tap the capital market
- Successful entrepreneurs who are planning to tap the capital market

In the case of a couple of companies where a particular promoter or entrepreneur could not be identified, their C.E.O.s were treated as entrepreneurs. In order to evaluate the attitude of entrepreneurs towards the investment climate in Kerala and ascertain their views regarding the constraints in Kerala’s industrialization, the sample entrepreneurs were directly contacted by the researcher and their responses to the statements were recorded.
Methodology

A questionnaire with 20 statements covering almost all aspects related to investment in Kerala, viz., constraints and prospects associated with land, labour, capital, entrepreneurship, infrastructure, work culture, societal attitude etc was prepared (the questionnaire is given in the appendix). The sample entrepreneurs were personally contacted by the researcher and their responses to the statements were taken. The Principle of Likert Scale\(^\text{17}\) (Method of Summated Ratings) was used for analysis. The responses were converted into indices. Since there were positive and negative statements, the scores were reversed wherever necessary for standardization and appropriate interpretation.

The Investment Climate Index was constructed using the following formula:

\[
Z = \frac{(f_1 x - 2) + (f_2 x - 1) + (f_3 x 0) + (f_4 x 1) + (f_5 x 2)}{F \times \text{Maximum score}}
\]

Where,

\(f_1, \ldots, f_n\) are the respective frequencies

n is total number of items

Z is the respective index

The Investment Climate Indices based on entrepreneurs responses to statements are given in table 6.4
### TABLE 6.4

**INVESTMENT CLIMATE INDEX BASED ON ENTREPRENEURS’ RESPONSE TO STATEMENTS**

<table>
<thead>
<tr>
<th>Statements</th>
<th>Score</th>
<th>Index</th>
<th>Statements</th>
<th>Score</th>
<th>Index</th>
</tr>
</thead>
<tbody>
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<td>xi</td>
<td>-23</td>
<td>-47.91</td>
</tr>
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<td>iii</td>
<td>-6</td>
<td>-12.5</td>
<td>xiii</td>
<td>-22</td>
<td>-45.83</td>
</tr>
<tr>
<td>iv</td>
<td>-2</td>
<td>-4.16</td>
<td>xiv</td>
<td>3</td>
<td>6.25</td>
</tr>
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<td>9</td>
<td>18.75</td>
<td>xv</td>
<td>-1</td>
<td>-2.08</td>
</tr>
<tr>
<td>vi</td>
<td>20</td>
<td>41.66</td>
<td>xvi</td>
<td>-3</td>
<td>-6.25</td>
</tr>
<tr>
<td>vii</td>
<td>32</td>
<td>66.66</td>
<td>xvii</td>
<td>-21</td>
<td>-43.75</td>
</tr>
<tr>
<td>viii</td>
<td>7</td>
<td>14.58</td>
<td>xviii</td>
<td>2</td>
<td>4.16</td>
</tr>
<tr>
<td>ix</td>
<td>-19</td>
<td>-39.58</td>
<td>xix</td>
<td>-5</td>
<td>-10.41</td>
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<td>-25</td>
<td>-52</td>
<td>xx</td>
<td>5</td>
<td>-37</td>
</tr>
</tbody>
</table>

Calculated by the Researcher based on responses to questionnaire

The indices were classified into three zones, based on values, as follows:

- **Below 33.33:** least favourable
- **33.33 to 66.66:** moderately favourable
- **Above 66.66:** most favourable

It is important to note that sometimes negative responses become favourable and positive responses become unfavorable depending on whether the statements are positive or negative. Appropriate adjustment for standardization has been done in such cases.

Out of the twenty statements, eight elicited positive responses and twelve elicited negative responses. The best of positive responses related to statement numbers 6,7,and 12. The statements that ‘bandhs, harthals etc are major constraints on investment;’ ‘the labour situation has improved in recent times;’
and ‘tapping the capital market is beneficial’ have elicited very high positive scores.

Conversely, twelve statements elicited negative responses. The best of the negative responses relate to statements 10,11and 13. Statements like ‘it is difficult for Kerala companies to raise capital from the capital market;’ ‘it is difficult for Kerala companies to grow beyond a particular level and enter the big league;’ and ‘transparency, accountability and procedural hassles stand in the way of tapping the capital market route,’ elicited strong negative responses. It is important to note that these statements have positive connotations for industrialization through the capital market route. Similarly statements 1 and 2 elicited strong negative responses. These negative responses have negative implication.

An attempt was also made to assess the extent of agreement among the various respondents. Coefficient of agreement was computed using the methodology of Summated Ratings on a five-point scale as follows:

\[
F = (\sum_{ij} f_{ij}^2 - m \sum f_{ij}) + (mc_2)(nc_2)
\]

Where,

\[
\sum_{ij} f_{ij}^2 = \text{the sum of the squared } f_{ij} \text{ entries below the diagonal}
\]

\[
m = \text{number of judges}
\]

\[
\sum f_{ij} = \text{the sum of the } f_{ij} \text{ entries below the diagonal}
\]

\[
mc_2 = \text{the number of combinations of the } m \text{ judges taken 2 at a time or } m(m-1)/2
\]

\[
nc_2 = \text{the number of combinations of the } n \text{ stimuli taken 2 at a time or } n(n-1)/2
\]
The rank correlation for measuring judgment consistency yielded a value of 0.64, which is statistically significant.

To study the responses of sample entrepreneurs towards selected statements, the consolidated attitude scores were calculated. This is given in table 6.5

**TABLE 6.5**

CONSOLIDATED ATTITUDE SCORE OF SAMPLE ENTREPRENEURS TOWARDS SELECTED STATEMENTS

<table>
<thead>
<tr>
<th>Entrepreneurs</th>
<th>Score</th>
<th>Index</th>
<th>Entrepreneurs</th>
<th>Score</th>
<th>Index</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>2</td>
<td>10</td>
<td>13</td>
<td>-2</td>
<td>-10</td>
</tr>
<tr>
<td>2</td>
<td>-12</td>
<td>-60</td>
<td>14</td>
<td>-6</td>
<td>-30</td>
</tr>
<tr>
<td>3</td>
<td>8</td>
<td>40</td>
<td>15</td>
<td>-3</td>
<td>-15</td>
</tr>
<tr>
<td>4</td>
<td>-1</td>
<td>5</td>
<td>16</td>
<td>2</td>
<td>-10</td>
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<td>6</td>
<td>-9</td>
<td>-45</td>
<td>18</td>
<td>-9</td>
<td>-45</td>
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<tr>
<td>7</td>
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<tr>
<td>8</td>
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<tr>
<td>9</td>
<td>0</td>
<td>0</td>
<td>21</td>
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<td>12</td>
<td>-3</td>
<td>-15</td>
<td>24</td>
<td>-1</td>
<td>-5</td>
</tr>
</tbody>
</table>

It is important to note that only six out of the sample of 24 entrepreneurs got positive scores. There are 3 zero scores while the vast majority of 15 (63 percent) got negative scores. Again it is significant to note that only 1 respondent (Mr. Roy Mathew of Mini Muthoot Group) got a reasonably high positive score of 40; and that he belongs to the non-banking financial sector.
and not from manufacturing. Conversely, the three entrepreneurs with the highest negative scores are from manufacturing. This difference in the perception of entrepreneurs can be explained by the fact that the investment climate and business conditions are different in financial services and manufacturing.

The survey revealed some very interesting pointers relating to the investment climate in Kerala. These are as follows:

- 79 percent of the sample entrepreneurs regard the work culture in Kerala as unfavourable to industrialization; only 4 percent regard it as favourable and 17 percent consider it neutral.
- The entire sample (100 percent) regard bandhs, hartals and other work stoppages as constraints and 87.5 percent strongly feel that it is a major constraint on investment and spoiler of the investment climate.
- None of the entrepreneurs regard the societal attitude in Kerala towards business, industry and entrepreneurs in general as positive. 62.5 percent regard it as negative and the rest consider it indifferent. This is a very significant reflection on the mindset of the Kerala society at large.
- An important positive indication is that majority (62.5 percent) of entrepreneurs recognize the improvement in the labour situation in recent times.

An attempt was made to group the extreme statements and also to assess the relative deviations based on the following formula:
where,

\[ t = \frac{X_H - X_L}{\sqrt{\frac{s_H^2}{n_H} + \frac{s_L^2}{n_L}}} \]

\[ n_H \quad n_L \]

\( X_H \) = the mean score on a given statement for the high grade
\( X_L \) = the mean score on a given statement for the low grade
\( s_H^2 \) = variance of the distribution of the high grade
\( s_L^2 \) = variance of the distribution of the low grade
\( n_H \) and \( n_L \) = number

If \( n_H = n_L = n \)

\[ t = \frac{X_H - X_L}{\sqrt{\frac{\sum(X_H - X_H)^2}{n} + \frac{\sum(X_L - X_L)^2}{n-1}}} \]

The best and least statements were taken by applying the above formula.

Two major conclusions emerge from the analysis. They are:

- There is a positive response from entrepreneurs towards industrialization through the capital market route. The desirability of this strategy and its advantages are clearly recognized.
- Entrepreneurs feel strongly about the unfavourable investment climate prevailing in Kerala.

The study validates the observations made by many entrepreneurs of Kerala, some of them highly successful, about the investment climate as well as attitude towards entrepreneurs. To quote some of them:

"In the early stages of a small-scale venture, when there is no union, the hero of the workers will be their own proprietor. Workers will talk highly about
their organization and its proprietor. But once there is interference by union leaders from outside, their attitude will turn upside down. After that the proprietor will be seen as the greatest enemy of the workers. I am writing this from my own experience.”(Kochousph Chittilappilly, Founder Chairman, V.Guard Group18)

“ You cannot attract industrial investment to Kerala unless you change the culture which sees employment generators as exploiters.”(M.E.Meeran, Founder and Chairman, Eastern Group of Companies19)

“An environment favourable to industrial investment will emerge in Kerala only when the attitude of Keralites undergoes a fundamental change.”(M.Joy Varghese, Chairman M.C.V.Group of Companies20)

“ It is the attitude of Keralites that stand in the way of Kerala’s industrialization. Once we cross the Kerala border the attitude changes.”(N.Sreekumar, Former Vice President Apollo Tyres21)

“Kerala society does not recognize entrepreneurs. Entrepreneurs are seen as smugglers and criminals. This is not the case in other states.”(Isac Joseph, Chairman, Lunar Rubbers22)

The study found most of the above observations of some of Kerala’s most successful entrepreneurs and technocrats to be true for the entire class of entrepreneurs.

Test of the Hypothesis

This Study started with the hypothesis that Kerala could not exploit the large number of favourable factors that could have facilitated her industrialization through the capital market route and that many factors might have acted as constraints in this process. The study found this hypothesis to be largely true. The study found that there is one major constraint in Kerala’s industrialization
through the capital market route: this is the poor stock market perception of Kerala companies as reflected in their poor P.E.ratios. Other constraints are the general constraints in Kerala's industrialization. The Investment Climate Index, as worked out in the study, reflects Kerala as a poor investment destination. Particularly, Kerala's work culture, societal attitude etc. have strongly constrained her industrialization. Signs of a favourable attitudinal change and improvement on the labour front are indeed, positive trends.

***
Notes and References:

1 Jean Dreze and Amartya Sen(1989): *Hunger and Public Action*, Oxford University Press, Clarendon Street, Oxford. Particularly, the authors draw attention to the fact that as early as 1817, the ruler of Travancore, Rani Gouri Parvathi Bai had issued a rescript that the State would ‘defray the entire cost of education of its people’.


3 Economic Review, Government of Kerala, State Planning Board, Thiruvananthapuram, various issues


5 Report of the Working Group on NBFCs, State Planning Board, Thiruvananthapuram, forthcoming


7 The Cochin International airport which made a profit of Rs. 21.11 crores out of a total turnover of Rs. 85.26 crores for the year ended 2003-04, is a classic example of highly successful public-private participation. NRIs hold 32.01 percent in the equity of CIAL.

8 Information obtained from the official records of the Cochin Stock Exchange.


11 Maras Stock Exchange Official Year Book 1996, Madras Stock Exchange, 11 Beach Lane, Chennai


13 Ramachandran said in an interview with the Researcher that the I.P.O. is planned for early 2006. He added that F.I.I.s have already invested a sizeable sum in Jyothi Lab. through the private placement route.


16 The list of Kerala’s Mega companies was given to the researcher along with the Dossier on Kerala companies (1998) by the K.S.I.D.C., Thiruvananthapuram.

17 Edwards (1932): Attitude Scale Construction, Brown and Brown


19 As told in interviews to Dhanam Vyavasaya Vanijya Dwaivarika, vol.xiv No.11 and 12, p.4

20 Ibid., p.5

21 Ibid., p.5

22 Ibid., p.6