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Financialisation and corporate investments: the Indian case*

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Financialisation creates space for transactions in the financial sector of economies, and, in doing so, helps to raise the share of financial assets in the portfolios held by market participants. Largely driven by deregulation, the process works to make financial assets relatively attractive as compared to other assets, by offering both better returns and potential capital gains. Against the backdrop of the prevailing analysis of corporate investments under financialisation in the advanced economies, this paper attempts to analyse the pattern of investment by corporates in an emerging economy like India during the 2000s. By analysing the sources and the use of funds of India's corporate sector in further detail, this paper highlights a similar phenomenon of financialisation in the Indian economy which, ceteris paribus*, adversely affected real investments during the 2000s along with a process of Ponzi financing during the post-crisis period.*

Keywords: *corporate investments, financialisation, Ponzi finance, speculation*

JEL codes: *E44, G32, L21*

1 PROLOGUE

Financialisation, by creating space for finance in economies, helps to raise the share of financial assets in portfolios held by agents in markets. This is because, driven by deregulation, the former usually makes financial assets relatively attractive, with offers of better returns as well as potential capital gains. As a consequence, financialisation is found to provide incentives to corporate managers to invest larger sums in financial assets, which results in the share of the latter growing relative to other assets held in their portfolio.

Relying on the prevailing analysis of corporate investments under financialisation in the advanced economies, we deal, in this paper, with the pattern of investments by corporates in an emerging economy like India, which has been subject to a similar pace of financialisation in the domestic economy.

Before proceeding further, we would like to draw attention to what we identify as a gap we notice in the literature on corporate investments in advanced economies. While the existing analyses point at tendencies on the part of corporates to use smaller

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proportions of profits on physical investments, there is no attempt to analyse the pattern of disbursement for the remaining part as financial investment. Nor is there any analysis of the sources of funds used by the corporates. Both aspects, as we analyse in the context of India, provide useful insights into the prevailing pattern of corporate finance, not only in explaining the records of their asset growth rates and profitability but also in affecting their capacity to generate investment and accumulation in the domestic economy.

The present paper bridges the above gap in the available literature, first by extending the analysis to cover an emerging economy like India, and second by utilising additional information relating to the use and sources of funds – which respectively include the composition of assets and liabilities of the corporates.

The analysis, as we point out, has significant implications both in terms of the corporate sector's sustainability and in terms of its contribution to aggregate investment and growth in the economy. The paper consists of two major sections which follow this Prologue. Section 2 surveys the analysis in the literature on corporate investments in advanced economies under financialisation while pointing out the gaps that have remained in neglecting the details of asset holding and the related liabilities to source their funding. The analysis highlights the ongoing tendencies for corporate capital in advanced economies to hold an increasing share of profits as financial assets, largely as a result of a shareholder–manager alliance to favour short-term profits as against long-term growth. Section 3 relates the findings as above in advanced economies to the pattern of investments by the Indian non-financial corporates. Dwelling on the empirical evidence at an aggregate level as well as with firm-level statistics relating to the corporate sector, our analysis arrives at a scenario which is similar to the corporate investment pattern in the advanced countries. We also point out the added degrees of vulnerability faced by the corporates which dampen the prospects of real growth in the economy. Section 4 sums up the paper while drawing attention to the investment behaviour of the corporates under financialisation as seems to prevail across countries.

2 INVESTMENT BEHAVIOUR OF CORPORATES IN ADVANCED ECONOMIES

In available literature attention is drawn to the investment pattern of large corporates in advanced economies, pointing to an 'owner–manager' conflict in the portfolio decisions of the corporate managers. The reasoning behind this relates to 'the postulation of a growth–profit trade-off at the firm level' (Hein 2012, p. 37) which goes with the shareholder preferences for short-term profitability along with a diminished capacity of firms to raise capital for investments. While shareholders express a strong preference for short-term profits (as compared to long-term growth of firms), the firms in turn are faced with the escalating financial cost of leveraging, especially in attempting higher growth rates when internal inefficiencies tend to crop up. Aspects as above are held responsible, in the literature, for a growth–profit trade-off in business decisions of corporate firms (Crotty 1990, p. 534–536).

As shareholders typically prefer short-term profitability and low investments in capital stock, firms, if aligned with shareholder interests, follow strategies that are opposed to long-term investments for growth over time.

Looking at the behaviour of corporate managers at the level of firms, it has been observed that their interests often get aligned with those of shareholders, which is for 'downsize and distribute' instead of what used to be 'retain and invest' in earlier patterns of traditional managerial policies. As it is pointed out, 'share-holder value orientation has had a significant effect on corporate behaviour' (Stockhammer 2005/2006, p. 199).

In addition, managers respond to the currently popular market-oriented remuneration schemes, with bonuses and/or salaries paid in terms of the Employees' Stock Options (ESOPs) being fixed on the basis of the balance-sheet performances of the firms at which they are employed. Incentives are thus provided to the firm managers to invest in assets that would fetch higher returns in the short term. By following a strategy as above, corporate managers are found to be rewarded by the financial market in terms of higher shareholder-value of the respective firms.

Facts as above have been empirically verified in the available literature by using available data for the advanced economies (see Stockhammer 2004; Orhangazi 2006; van Treeck 2008; also Palley 2013, pp. 17–41). The econometric exercise indicates a rising share of interests and dividends in profits earned by the non-financial business firms in the area. Treating the rising component as above in profits as an indicator (or proxy) of an underlying short-termism in corporate investments, the authors come to the conclusion that the outcome, largely related to financialisation, has been responsible for a simultaneous drop in investment and accumulation by firms.

Dwelling on the post-Keynesian theory of firms which rest on their institutional setting (which include the shareholders, the managers and workers), it has been observed that the final decision of corporates to use a share of profits for investment depends on the relative weight of the above three major cohorts within firms in shaping such decisions. As for the respective interests, the shareholders remain interested in high profits and rising share prices, the workers in output growth with employment, while for managers it remains a better deal when both profits and share prices are high, which often adds to their performance-related receipts. Dwelling on the sequence as a 'shareholder revolution' which lends greater power to shareholders, it is not difficult to explain why firms, led by managers, adopt a business strategy which caters less for long-term investment as compared to those which help share prices and profits in the short term (Stockhammer 2005/2006, pp. 193–194).

Observations as above have also been verified in the literature on the basis of the statistics relating to the steady decline in the ratio of investment to profits in the major advanced economies (Stockhammer 2005/2006, p. 197). With financialisation generating the climate for 'shareholder value orientation', as described above, it can be a logical corollary that financialisation has caused a slowdown in accumulation. Thus there emerges a distinct pattern in the distribution of corporate profits across different stakeholders engaged with the firms, especially with the rising share of profits distributed as dividends and interest payments. A large fraction of profits generated by corporates thus reach out to the 'rentiers' who live on income they earn on past savings. As pointed out in a study of the distribution of GDP in the OECD during 1960–2000, financialisation and shareholder orientation of firms as above has gone with the 'rising share of interest and dividends in profits of non-financial business', confirming the emergence of rentiers who live on past rather than on current activities (Epstein and Power 2003, p. 235)

Developments as above provide an indication that preferences for short-term investments, as reflected in corporate decisions in the advanced countries, are also negatively associated with real investment (Epstein and Power 2003; Hein 2012, p. 125). This counters the view that the rising rentier income shares in corporate profits earned by corporates may not generate a 'finance-led-growth' in the real economy, unless, of course, the rentiers have a consumption propensity which is higher than that of the national average, which is unlikely (Boyer 2000).

Before we end this section, we put on record a limitation that we notice in the above analysis on investment behaviour of corporates in advanced economies. This concerns an absence of the relevant details in the pattern of disbursements as well as sources of funds that are handled by the corporates. The above aspects, as we bring out in the context of India, provide useful insights into the prevailing pattern of corporate finance, not only in terms of sustainability in aggregate terms but also in terms of the limits on fostering investment and accumulation in the domestic economy.

3 FINANCIALISATION AND CORPORATE INVESTMENTS IN THE INDIAN ECONOMY

3.1 The broad pattern

In India there has been, in recent years, a drop in investment as a proportion of gross domestic product (GDP). This can be observed from the declining share of gross capital formation (GCF) to GDP, from 38.2 per cent to 32.3 per cent between 2011–2012 and 2013–2014. Of this, the corporate sector's contribution as GCF also fell, from 13.3 per cent to 12.6 per cent of GDP between these years (Economic Survey 2004/2005, p. 10). The above got reflected in the share of aggregate Gross Fixed Capital Formation (GFCF) in GDP, which has fallen from 33.6 per cent in 2011–2012 to 28.6 per cent in 2014–2015 (ibid., p. 8). Going by the same data sources, the share of 'dwellings, other buildings and structure' in the total GFCF had been as large as 59 per cent on average while that of machinery was only around 35 per cent over the same years between 2011–2012 and 2014–2015. As pointed out in the official report, 'construction of dwelling units can not be perceived to make a direct permanent addition to the productive capacity of the economy' (ibid., p. 10). It can be further pointed out that the proportion of GFCF to GDP contributed by the households (primarily comprising construction activities) has also declined by 4.5 per cent in recent times between 2011–2012 and 2013–2014. (ibid., p. 11).

With households having not much of a role to add to productive capacity in the economy, and with public expenditure drastically cut with measures of austerity (see Sen and Dasgupta 2014), the Indian non-financial corporates (NFCs) thus remain as major agents behind further accumulation in the Indian economy. We draw attention, in this paper, to investments by the Indian NFCs under the prevailing pattern of financialisation, which, as pointed out, provides a parallel to the pattern observed for corporates in the advanced economies under financialisation.

Looking back to available literature, not much is available on current investment pattern of the Indian corporates. A paper available on the related subject has drawn attention to the rising debt of corporates for an earlier period which ends in 2009 (Beena 2011, p. 15). There remain a couple of other papers which dwell on the broad impact of financial liberalisation on corporate investments, without, however, dealing with the significance of the evolving composition under financialisation (see Mazumdar 2008; Rajakumar 2014).

We observe in the following pages that large shares of corporate profits in India are invested in short-term financial assets, a pattern similar to what prevails in the advanced economies. As we point out, investment decisions as above on part of the NFCs are generally influenced by the growing state of uncertainty under deregulation, which is a driving force behind speculation. With financialisation, much of the investable funds are deployed in short-term assets, the returns on which are risky while offering prospects of high returns as well as capital appreciation. The pattern is similar to a Minskyan paradigm where uncertainty in deregulated capital markets generates short-termism in investments. We offer, in the following pages, an empirical investigation of the propositions as above in terms of their relevance for the Indian economy (Minsky 1986).

3.2 The data

The present study relies on both official statistics, occasional reports and on data sources available online, with details as follows. The official sources include the data released by the Reserve Bank of India (the central bank) on aggregate investments and their composition by the Indian NFCs along with their borrowings (external or domestic) as well as the debt and equity, which together comprise the sources of their funds. The online source of the data set is at the firm level, available from the Prowess online data sources provided by the Mumbai-based Centre for Monitoring Indian Economy (CMIE). The data set relates to the NFC firms in India. Looking at the firm-level data, the time series constructed is subject to changing coverage of firms, as can be observed in Figure 1. However, the number of firms covered is found to be around a similar level of 6700 between 2005 and 2010, which permits the use of a time series over those years. The coverage of firms is much different for other years.

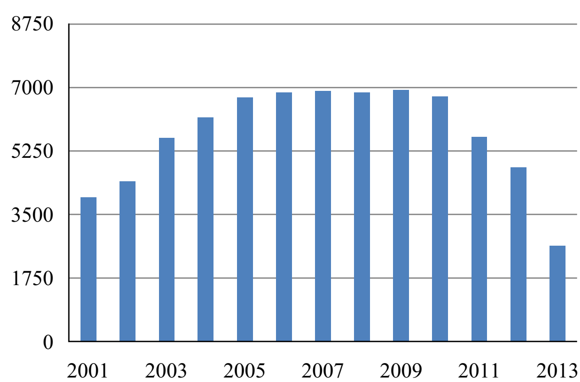
However, while the coverage of firms, as mentioned above, is not uniform beyond a specific period, we have chosen to plot the data set on a time series basis. This is because we do not consider the variations too significant in distorting the observations on a chronological basis.

To provide more details of the Prowess online sources relating to the Indian NFCs, their assets can be classified into five broad parts which include (a) net fixed assets, (b) capital work in progress, (c) financial investment, (d) loans and advances, and (e) cash and bank balances.

Of the above, component (b) consists of funds used to build fixed assets, the completion of which is still outstanding. Components (a) and (b) can thus be clubbed together to define ‘physical assets’. It thus follows that Total Asset = Physical Asset (a + b) + Financial Investment (c) + Loans and Advances (d) + Cash and Bank Balances (e).

Accordingly, Total Assets – Physical Assets = Financial Assets.

We made use of the above classification in the following analysis.



Source: Author’s calculation from https://www.prowess.cmie.com.

Figure 1 Coverage of firms in Prowess data: number of firms

3.3 The analysis

NFCs in India, as in the advanced countries, demonstrate a tendency where the share of financial assets held by them seem to be rising in their portfolio. Asset holdings as above are of short-term speculative category, thus trading-off prospects of growth for short-term profitability. Moreover, short-term assets as above are often sourced by incurring additional debt, a pattern which is unlikely to be sustainable. We provide below an analysis of the pattern, as observed, of assets held and the liabilities incurred by the Indian NFCs.

3.3.1 Assets held by Indian non-financial corporates: the pattern of investments

Data available from the Reserve Bank of India (RBI) indicate that there has been a steady rise in the share of financial components in the total assets held by the Indian NFCs over nearly a couple of decades ending in 2011–2012. Proportion of securities (financial and industrial) in total assets held by the NFCs has thus moved up, from around 21.83 per cent in 1992–1993, 26.80 per cent in 2001–2002 to 46.83 per cent in 2010–2011 (see Table 1 and Figure 2). The rise/drop in respective shares of financial and physical assets had been at a steady pace since 2001–2002, as can be witnessed from Figure 1 which is supported by the data in Table 1. As the latter indicates, financial assets as classified by us include, among others, investments (financial and industrial securities issued by the government and the private sector), loans and advances as well as cash balances and reserves (Reserve Bank of India Bulletins 1993–2013).

This is not to ignore the issue of the sluggish market which started in 2008–2009. Rather, to highlight the point, even for a given sluggish market, the growth rate of physical assets (and hence, real investment) would have been far higher if the physical asset ratio remained unchanged during the entire period. Moreover, with the ongoing financialisation which confronted a sluggish market since the global crisis, corporates seem to have been parking their surpluses in financial assets (such as mutual funds, etc.), as indicated by the data provided.

The pattern of corporate investment behaviour, as can be observed in Figures 2 and 3 and in Table 1, reveals the visible declines/increases in the respective shares of physical/financial assets in total use of funds by the NFCs since the mid 2000s.

We now look at the pattern of asset holdings of the Indian NFCs as available from the firm-level Prowess online data provided by the CMIE. As already mentioned above, the time series on the basis of this data is subject to changing coverage of firms, as can be observed from Figure 1 provided earlier. However, with the coverage of firms being around the same number between 2005 and 2010, the time series plotted in Figure 4 is reasonably consistent for these interim years.

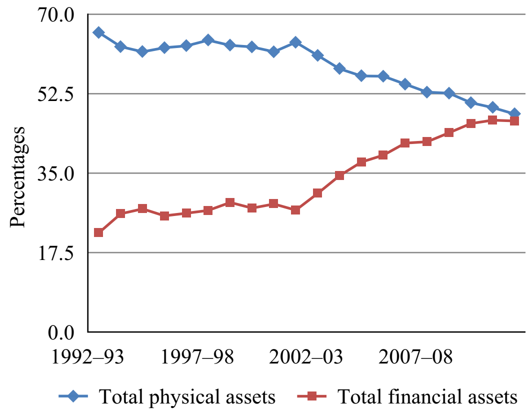
Looking at the asset shares and their changes in Prowess data, except for 2009 (which can be treated as an outlier), shares of physical assets are found to decline continuously between 2005 and 2011. Rising shares recorded for the couple of years ending 2013 are, however, not comparable due to large discrepancies in coverage of data, as mentioned earlier.

As for comparability, of the above findings from the Prowess data set and the RBI sources, despite the possible differences between them in terms of the coverage of firms, both share a *common pattern in terms of the declining share of physical assets held by the NFCs*. However, the drop in stock of physical assets from 36.1 per cent in 2005 to 33.5 per cent in 2011 seems to be relatively less in Prowess data (Figure 4) as compared to the RBI sources, with changing shares of physical capital from 56.3 per cent in 2005–2006 to 48.0 per cent in 2011–2012 (Figure 2). The difference

Table 1 Assets held by Indian non-financial corporations

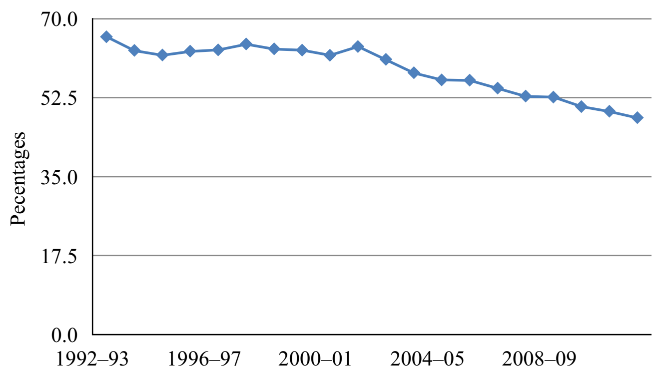
	Net fixed asset	Inventories	Other physical assets	Total physical assets	Sundry debtors	Loans and advances	Investments	Cash and bank balances	Interest accrued on loans and advances	Deposits/ balances with government/ others	Other loans and advances	Total financial assets
	1a	1b	1c	1(=1a +1b+1c)	2a	2b	2c	2d	2e	2f	2g	2=(2a+2b+2c+2d +2e+2f+2g)
1992–93	43.5	21.7	0.8	66.0	15.7	7.8	4.3	3.5	0.2	1.8	0.7	34.0
1993–94	44.9	17.2	0.9	62.9	14.8	8.5	7.4	3.8	0.2	1.6	0.8	37.1
1994–95	44.0	16.9	1.1	61.9	14.2	9.4	8.3	3.3	0.1	1.8	1.0	38.1
1995–96	44.7	16.8	1.3	62.8	14.4	8.9	7.6	2.8	0.1	2.2	1.1	37.2
1996–97	46.8	15.0	1.3	63.1	13.8	8.7	8.2	3.0	0.1	2.3	0.8	36.9
1997–98	49.3	13.8	1.3	64.4	12.8	7.8	7.9	4.0	0.1	2.3	0.8	35.6
1998–99	48.8	12.5	2.0	63.3	12.6	8.3	8.7	4.4	0.1	2.1	0.5	36.7
1999–00	48.7	12.5	1.8	63.0	12.8	8.2	10.5	3.1	0.1	1.7	0.6	37.0
2000–01	46.7	13.2	2.0	61.9	12.9	8.6	11.3	3.0	0.1	1.8	0.6	38.1
2001–02	48.4	13.6	1.8	63.8	12.9	8.0	9.3	3.6	0.3	1.5	0.6	36.2
2002–03	46.5	13.2	1.3	60.9	12.8	9.1	10.8	4.2	0.2	1.2	0.7	39.1
2003–04	43.5	13.0	1.4	58.0	12.4	8.2	13.9	4.8	0.3	1.7	0.7	42.0
2004–05	41.5	13.1	1.8	56.4	13.1	7.8	13.0	7.0	0.3	1.4	0.9	43.6
2005–06	41.8	13.0	1.6	56.3	12.8	8.0	12.0	8.1	0.3	1.4	1.0	43.7
2006–07	39.5	13.4	1.8	54.6	11.5	10.4	13.0	7.7	0.2	1.7	0.9	45.4
2007–08	37.6	13.5	1.7	52.8	11.1	11.6	15.8	5.8	0.2	1.6	1.1	47.2
2008–09	37.7	12.5	2.4	52.6	10.3	10.2	17.1	6.7	0.2	1.8	1.1	47.4
2009–10	35.8	11.1	3.6	50.5	10.4	9.9	20.1	6.8	0.5	0.8	1.0	49.5
2010–11	34.0	11.7	3.7	49.4	10.8	10.4	18.6	6.9	0.8	1.4	1.6	50.6
2011–12	33.1	11.8	3.1	48.0	11.8	10.7	18.8	6.3	0.9	1.5	2.0	52.0

Note: Investments include both industrial and financial securities. While financial securities are the ones which are issued by financial institutions, the industrial securities are issued by the non-financial sector (excluding government/semi government securities).
Source: Reserve Bank of India Bulletins (1993–2013).



Source: Reserve Bank of India Bulletins (1993–2008).

Figure 2 Share of assets held by Indian non-financial corporates



Source: Reserve Bank of India Bulletins (1993–2009).

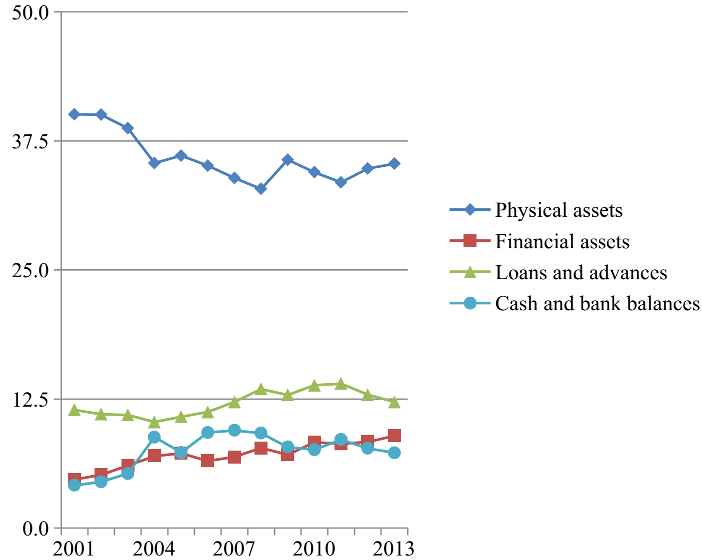
Figure 3 Share of physical assets in total use of funds by NFCs

could be due to the different methodology adopted by the two data sources, especially relating to the coverage of firms for each year.

On the whole, judging by the declining share of physical assets as a proportion of the total assets the NFCs held, contributions of the latter towards accumulation in the real sector seem to have been visibly falling in the Indian economy. Evidently, changes as above indicate a pattern where investments in the real sector assume a lower priority for the non-financial corporates in India's private sector.

3.3.2 A Puzzle

We now look at the growth rates of gross asset holdings as held by the NFCs as well as the profit rates on such assets in terms of Prowess data source. Concentrating on years between 2005 and 2011 (during which coverage of firms is comparable), it is observed that while being positive, especially since 2008, growth rate of gross assets held has



Source: Author's calculation from https://www.prowess.cmie.com.

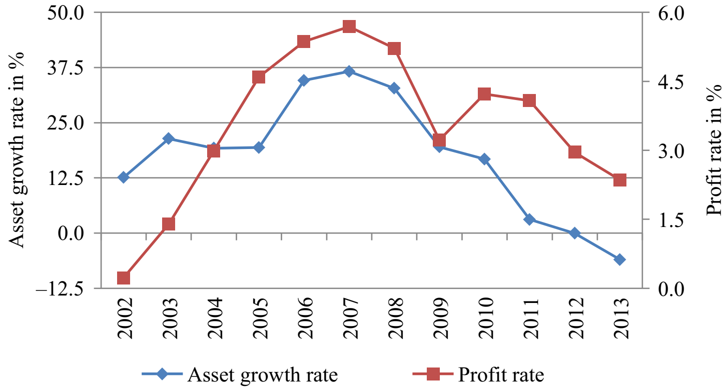
Figure 4 Components of assets held by Indian corporates (as percentage)

been steadily falling since then. As for profit rates, there have also been steady declines since 2008, except for the single year 2010, possibly due to the injection of stimulus packages. One thus observes sharp to moderate declines in the growth rates of gross assets held by the NFCs between 2008 and 2013, along with a consistent drop in profit rates over the same years (see Figure 5).

The overall performances of the NFCs have unmistakably been at a low ebb in India, not only in terms of their relative contribution to real investments but also for overall growth rates of gross assets held and their profitability. With the ongoing financialisation which has confronted a sluggish market since the global financial crisis of 2008, corporates seem to have been parking their surpluses in financial assets (such as mutual funds, etc), as indicated by the data provided above.

Observation as above indicates a puzzle, as to why the rising share of financial assets held by the NFCs failed to generate growth in gross assets held as well as profitability. An answer to the above, in our judgment, may be found in the falling value (as well as volatility of unit prices) of *both* physical as well as financial assets, as had taken place since the onset of the economic slowdown which started with the global crisis of 2008. GDP growth had fallen from 9.3 per cent to 6.7 per cent between 2007–2008 and 2008–2009. Recovery during the next two years was followed by sharper downturns over the next couple of years with GDP growth at 5.9 per cent on an average. The rising proportion, as in RBI data, of financial assets since 2002–2003 has continued in the following years (Figure 2), thus reaching one-half and two-thirds of total assets by 2011 as per the respective RBI and Prowess data (Figures 2 and 4). By any logic, a proportion as above can be considered large enough to make for an impact on the performance of the assets as a whole.

Keeping in view the relative importance of financial assets in the NFC portfolio, we need to find an answer to the puzzle above, as to why, in particular, the rising share of



Source: Author's calculation from CMIE (Prowess) database.

Figure 5 Growth rates: gross assets and profit rates on assets

financial assets held by the NFCs in India failed to contribute to higher rates of growth and profitability of aggregate assets. Was this due to their short-run duration and volatility? For this we pay attention to the pattern of investments in financial assets.

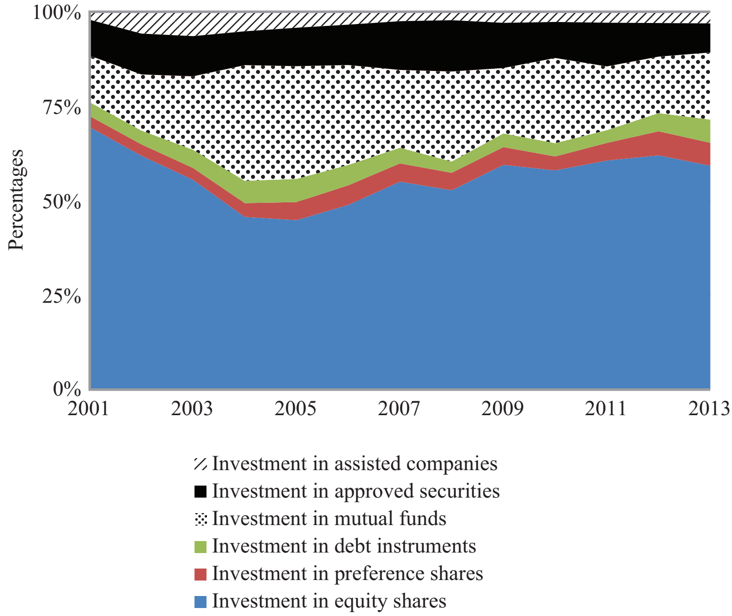
3.3.3 Composition of financial assets held by NFCs

Looking at the composition of the financial assets held by the NFCs, their rising share was primarily driven by equities and mutual funds, especially when we confine our attention to 2005 to 2011 (coverages of firms for those which are comparable, as already mentioned above).

Financial investments by the NFCs, as indicated in Figure 6, was concentrated in equities and mutual funds. Loans and advances, which have been consistently a substantial portion of assets held by the NFCs, was mostly directed to firms in the same group (Figure 7), reflecting a considerable degree of concentration among the operating firms.

We need to mention at this point that financial investments in equity shares as above are primarily those which are transacted in the secondary market for stocks.[1] The above also include the trading of derivative instruments, which, incidentally, has been rising sharply since 2002–2003 when FIIs were permitted to use the domestic stock market for trading in equities. The latter gets reflected in the average daily turnovers as well as in the growth rates of derivative trading in equities over recent years (Figures 8 and 9). Of course it remains true that such trading was also contributed by financial corporates as well as by foreign institutional investors (FIIs) themselves.

1. It is common knowledge that new investments in an economy relate to equities issued in the primary market for stocks in the country as Initial Public Offerings (IPOs). As for remaining transactions relating to equities which are usually listed and traded in the secondary market, those in effect deal with transactions in old stocks which had been issued earlier in the primary market as IPOs. The distinction as above is important in identifying the physical (non-financial) new investments in an economy.



Source: Author's calculation from Prowess Database.

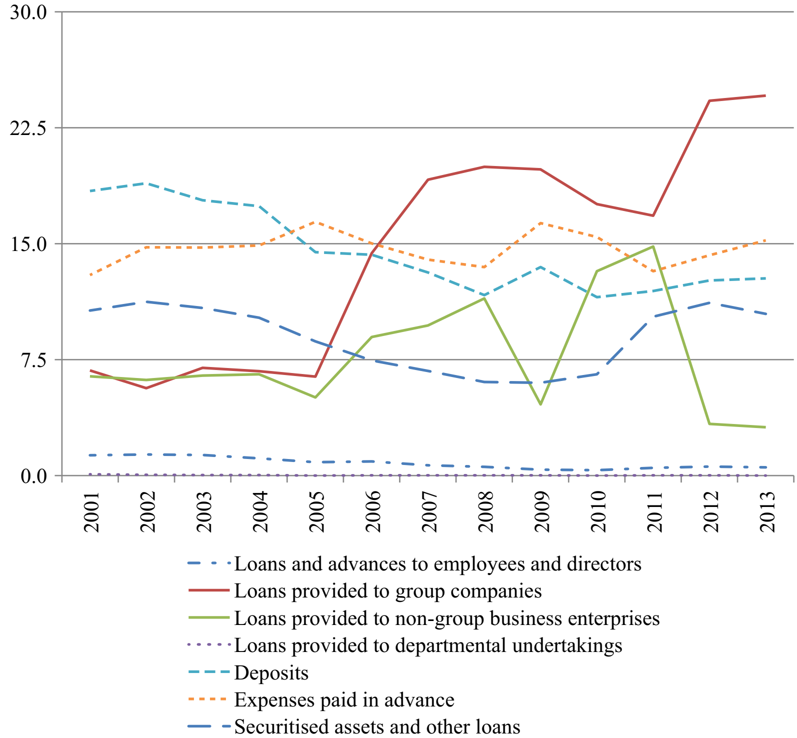
Figure 6 Share of various components in financial investment by NFCs

However, trade in derivatives can still be interpreted as circumstantial evidence to the phenomenon of financialisation as described in this paper.

Prowess sources of data can also be used to separately record the figures for 'current financial assets' held by the NFCs. Consisting of 'cash, bank balances' and others which fetch returns within one year or less, the sum can be treated as a proxy for very short-term financial assets to provide liquidity (Figure 10). If one adds to the above equities and mutual funds, usually held over relatively short durations, one finds an estimate of financial assets held by the NFCs with a short duration (Figure 10 and Table 1).

Propensities, as above, on part of the Indian NFCs to hold short-term financial assets as a relatively attractive form of investment go with the tendencies on the part of the corporate managers to comply with the shareholder preferences relating to short-term profit over long-term growth. As in advanced economies, the trade-off between growth and profits in India thus tends to get aligned with the latter. As we point out, the outcome not only undermines the potential of growth in the real economy, but also dampens the pace of asset growth held by the NFCs. Moreover, tendencies as above to invest in short-term current assets, and, especially, with equity trading in derivative markets, are susceptible to volatility in global markets, an aspect which further erodes the average market value as well as profits on gross assets held by those corporates.

To get a complete picture, especially concerning the capacity of corporate firms to continue on a sustainable basis, it may be useful to look at the sources of funds, which make for the liabilities of the NFCs.



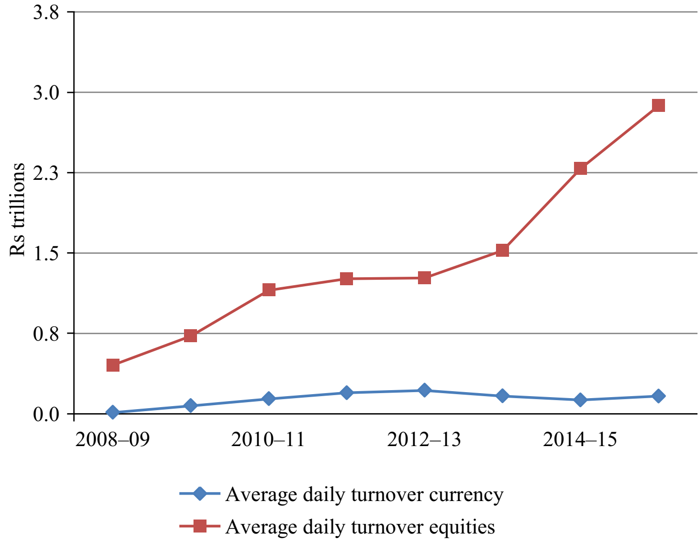
Source: Author's calculation from Prowess Database.

Figure 7 Share of various components in loans and advances

3.3.4 Sources of funds – and the pattern of liabilities held by the Indian NFCs

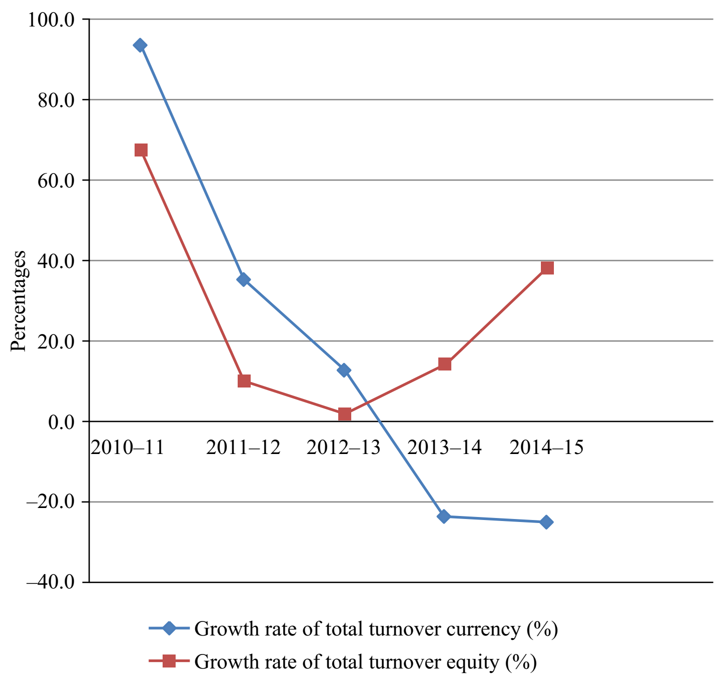
Funds used by the NFCs from different sources indicate a rising share of sources which are external to firms, which consist of share capital and premium shares, borrowings (both domestic and overseas), trade payables and others. Of these, share of domestic (bank) borrowings has been declining (Figure 11), presumably with rising shares of overseas borrowings.

Looking at Prowess sources, the data, however, do not distinguish internal and external sources of borrowings. The three major items in the outstanding liabilities of firms covered in the data set include, in descending order, borrowings, reserves plus funds and their current liabilities (Figure 12). Equities, which could have been a major source of funding for the NFCs, do not feature as much. Thus shares of equities (and convertible warrants) in their total outstanding liabilities did decline from 16.2 per cent in 2001 to 5.9 per cent in 2013. The unabated fall in the contribution of equity-finance, along with a stagnant share of reserves since the global financial crisis of 2008, evidently led those firms to complement their assets by additional borrowings. Shares of the latter, rising from 35.9 per cent in 2008 to 39.6 per cent of total liabilities in 2013, seem to indicate an easier option for corporates to connect their liabilities with additional borrowings. One can even observe a drop in shares of domestic borrowing in externally sourced funds with a corresponding rise in shares of foreign borrowing, which was facilitated by the liberalised norms for external borrowings.



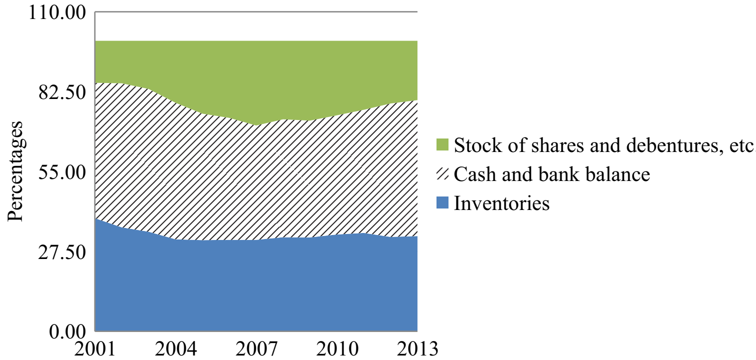
Source: Securities and Exchange Board of India.

Figure 8 Average daily turnover for derivatives



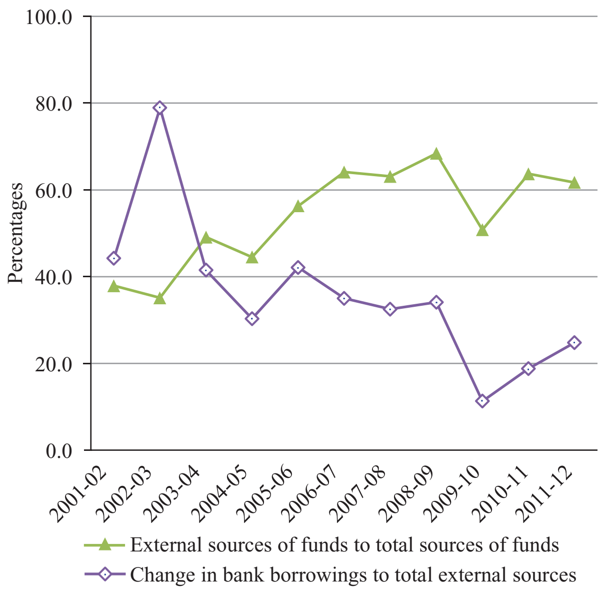
Source: Securities and Exchange Board of India.

Figure 9 Derivative turnover: growth rates



Source: Author's calculation from Prowess sources, https://prowess.cmie.com.

Figure 10 Composition of 'current financial assets'

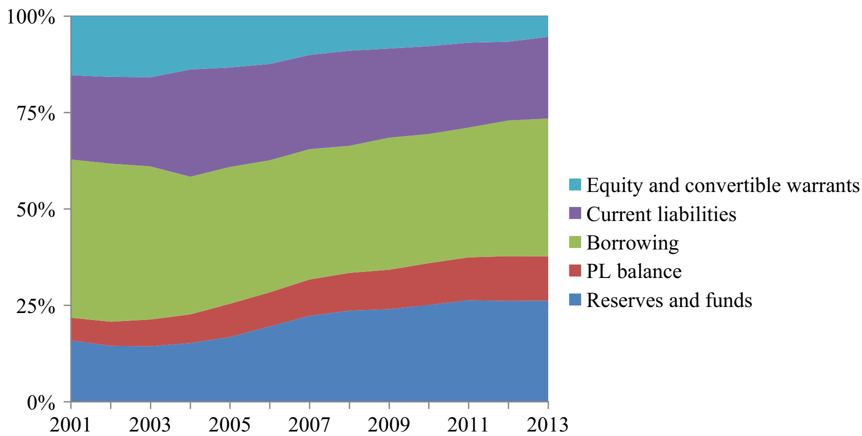


Source: Reserve Bank of India Bulletins.

Figure 11 Sources of funds of Indian NFCs corporates

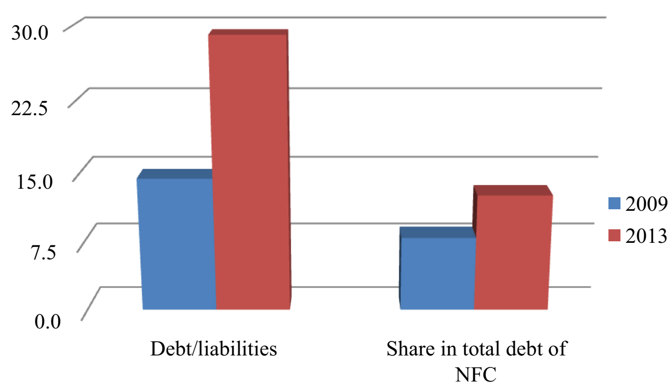
Incidentally, bank credits to industry, as reported by the RBI, have been steadily declining, from an annual growth rate of 24.4 per cent in 2009–2010 to 14.9 per cent in 2012–2013 (Reserve Bank of India 2013). A factor behind this might be the intermittent hikes in bank rates by the RBI till recent years.

Looking more closely at the sourcing of funds as above with the related liabilities for the NFCs, it appears that a large share of such resources, procured from borrowings and use of reserves and funds at the firm level, have been deployed to meet their 'current liabilities', which include dividends, interest payments and related payments. With borrowings making for large portions of current liabilities, one here observes a pattern



Source: Author's calculation from Prowess Database.

Figure 12 Shares of various components in total liabilities



Source: CMIE, Prowess Database.

Figure 13 Firms with ICR < 1 and related ratios

which can be interpreted as a Minskyan 'Ponzi' mode, where fresh borrowings are used to meet the current liabilities related to borrowings and sale of equities in the past.

The issue of Ponzi financing highlights the phenomenon of the rise in the share of debt of firms which had an interest coverage ratio (ICR)[2] less than 1. This is reflected in the following chart, which compares the debt-liability ratio (as a percentage) of such firms along with the share of their debt in total non-financial corporate debt. As is evident from Figure 13, both the ratios increased significantly in the recent period.[3]

2. The interest coverage ratio (ICR) is the ratio between the PBIDTA (profit before interest payments, depreciation, tax and amortisation) and interest payments. If the ICR is less than 1 during any given period, it indicates a situation where the firm is unable to meet its interest payments on outstanding debt through its current level of profits. In other words, a firm has to incur fresh borrowings even to meet the current expense on its liabilities if its ICR is less than 1.
3. This issue has been extensively addressed in IMF (2015).

For the period 2009–2013, we identify the non-financial corporate (NFC) firms whose ICR was less than 1. The share of stock of borrowing in total liabilities of these firms was 14.4 per cent in 2009, which rose to 29.2 per cent during 2013 (Figure 13). Similarly, the share of these firms (with ICR < 1) in total stock of borrowing of all non-financial corporate firms was 8.1 per cent in 2009, which increased to 12.7 per cent in 2013.

The analysis, as above, of the sources of funds and their use on the part of the NFCs in India indicate the problems such firms are likely to face in their sustainable capacity, both with an erosion of their asset base and in meeting their current liabilities by incurring additional liabilities.

4 CONCLUSION

Proclivities on the part of corporates under financialisation to invest in short-term financial assets rather than in long-term physical ones, provide the core of an explanation for the current stagnation in the real economy of the majority of countries in the world economy. Explanations as are available in the literature dwell on the trade-off between long-term growth and short-term profitability in the context of financialisation in the advanced economies. The above is interpreted in the context of the inclinations of the corporate managers, under financialisation, to align with the interests of the shareholders and settle for short-termism in investment decisions.

Studies as above in the literature are further expanded here with an analysis relating to India, a developing country well-integrated with global finance. The analysis dwells on similar tendencies in India for NFCs to hold relatively large shares of financial assets in their portfolios. Large shares of financial assets held as well as their short-term composition (with larger proportions for equities, mutual funds, etc.), as pointed out, not only account for declines in asset growth and in their profitability but also add to vulnerability.

NFCs in India thus seem to follow a path of short-termism in the face of the uncertainty encountered in the deregulated financial markets, with searches for quick returns on the high-risk short-term assets. As we point out, the above considerably dampens the prospects of further investments in physical assets, a familiar Minskyan paradigm where uncertainty in deregulated capital markets under financialisation generates instability with short-termism in investments.

The in-built vulnerability generated by the Indian NFCs with the short-term profile of their assets, as we point out, is further aggravated by the sourcing of their funds and the corresponding liabilities incurred thereby. The latter primarily consist of borrowings (both domestic and foreign), followed by company-level reserves and funds, which, between them, provide the major source of their funding. The above goes with the small share of equities sold as Initial Primary Offers (IPOs) in the primary market for stocks, thus failing to provide a long-term source of liquidity. As pointed out, a sizeable portion of the borrowed funds goes to connect the current liabilities including dividends, interest payments and the like. Tendencies as above on the part of the corporates to lean on the financial sector, with borrowings to meet other liabilities can be identified as a Minsky type of vulnerability crisis as arises with Ponzi finance, with tendencies to borrow further to meet current liabilities on past borrowings The problem is further compounded by external borrowings which contribute to a mismatch by adding to the related liabilities in foreign exchange.

The economy in India is thus getting exposed to problems which are much deeper than they look on the surface. In addition to the absence of a take-off in the real economy which, as pointed out, can be related to the ongoing pattern of corporate finance under financialisation, extensive borrowings on the part of the latter to meet the current dues sow the seeds of potential instability in the economy as are inherent under Ponzi finance.

Discounting the relatively high levels of financial activity as are often achieved with speculation in stock markets, currency trading, commodity markets and real estates, attention needs to be drawn to the related sources of instability within the economy, often due to the ongoing pattern in corporate finance. Clubbed together with a stagnating real sector and the visible disinclination on the part of the corporates to invest therein, the economy cannot expect a turnaround in the near future. The latter needs a complete overhaul of policies which will penalise and discourage speculative finance in the interests of the real economy.

The present paper on the short-term inclinations of the Indian corporates in their investment pattern under financialisation and in their procurement of finance provides messages for the reorientation of policies in both advanced and emerging economies.

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