

VII. CONCLUDING OBSERVATIONS

1. Introduction

In this chapter, we highlight the main findings of the study and give a brief summary of the views of leaders of industry and of financial institutions with whom discussions were held on the subject. This is followed by a discussion of the major policy changes suggested by our findings.

This study of resource mobilisation was based mainly on data relating to two samples of manufacturing companies.

- (a) A specially selected NIPFP sample of 99 large public limited companies; and
- (b) Reserve Bank of India (RBI) samples of large and medium public limited companies.

These two samples had relative merits and demerits. The RBI samples for different time periods contained medium and large companies and might also have contained a number of companies with less than 15 years' life. Hence, the RBI samples may be said to be fairly representative of the private corporate sector. A disadvantage in using the data from these samples arose from the fact that the size of the sample as well as the companies covered were not the same as between different sample periods and further, that the companies covered were not the same in all the years of even one sample period during which the size of the sample was held constant. This heterogeneous nature of the RBI sample posed certain problems for time series analysis, especially when the values of the variables involved were absolute values rather than ratios.

The great advantage with the NIPFP sample was its homogeneity — not only the size but also the companies covered remained the same throughout the period; however, the limitation of the sample was that it did not include more recent companies. To have a representative cross-section of the latter, it would have been necessary to have a sufficient number of them and that would have

increased the size of the sample. Given the limitations of time and resources, a much larger sample was not considered feasible. The result was that the NIPFP sample did not fully capture the experiences of companies which are new today.¹⁶ However, it was used to examine the behaviour of the companies which were 'new' at one stage of their existence. Thus, first, the sample included companies established in different years upto 1961, and secondly, the analysis relating to age-group 4 (companies established between 1956 and 1961), particularly for the sub-period 1962-63 to 1964-65, brought out the pattern of mobilisation of resources of companies when they were fairly new. The sample, however, included only large companies. It would, therefore, be more appropriate to say that the NIPFP sample, at the aggregated level, reflected largely the behaviour of the large established segment of the private corporate sector, which in any case accounted for the bulk of the private corporate capital, output, income and tax revenue.¹⁷ While the econometric exercises were based mainly on the RBI data, the rest of the study was based primarily on the results of the analysis of the NIPFP sample data.

2. Main Findings

(a) *Trends in Total Mobilisation of Resources*

Gross resources mobilised by the NIPFP sample companies increased from about Rs. 50 crore in 1962-63 to Rs. 142 crore in 1965-66. After being more or less stagnant for several years, they rose sharply to Rs. 232 crore in 1973-74 and further to about Rs. 270 crore in 1974-75. Thus we found that, as measured in current prices, gross resources mobilised by the companies increased substantially upto the year 1965-66; after that year there seemed to have been no basic upward thrust in resources mobilised except for the abnormal increases in the two high-rate inflation years of 1973-74 and 1974-75.

The trends in gross resource mobilisation revealed by the RBI sample were similar to those revealed by the NIPFP sample. Gross resources mobilised per sample company, for the RBI sample,

¹⁶After the completion of this study, an analysis was made using more recent data on companies including new companies and this is presented in Annexure I.

¹⁷We used the term "corporate sector" as a short-hand expression for (mainly) the large industrial companies in the private sector.

increased from Rs. 20 lakh in 1962-63 to Rs. 33.3 lakh in 1966-67. The per company resource mobilisation for the RBI sample (as in the case of the NIPFP sample) fell and stagnated, but only upto 1969-70. Unlike in the case of the NIPFP sample companies, the level of gross resources mobilised recovered to some extent after that year. However, sharp increases took place only in 1973-74 and 1974-75 as in the case of NIPFP sample companies.

The increase in gross resources mobilised that we discussed above took place in nominal terms. If gross resources mobilised in different years were measured in real terms (at 1960-61 prices), we found that the volume of mobilisation increased upto the year 1965-66 and then declined significantly till the year 1973-74. In the year 1973-74, there was an increase in real terms but again there was a decline in the next year. Taking the period as a whole, one could say that gross resources mobilised stagnated in real terms except for two sharp upward thrusts in 1965-66 and in 1973-74.

Gross resources mobilised by the NIPFP sample companies during the entire period 1962-63 to 1975-76, aggregated to Rs. 1947.96 crore in nominal terms, whereas they aggregated to Rs. 1153.86 crore in real terms. The annual compound growth rate of gross resource mobilisation in current prices for the 14-year period worked out to 7.8 per cent, whereas it declined at a compound rate of 0.1 per cent per annum in real terms.

(b) *Determinants of Changes in Gross Mobilised Resources*

Among the factors that could be hypothesized to affect the volume of gross resources mobilised, profitability (profits after tax as per cent of net worth) and the price level were seen to be the most significant. The corporate tax rate were also seen to have an impact. It was found that for every 1 per cent increase in profitability, gross mobilised resources were expected to increase by 0.94 per cent and for every 1 per cent increase in prices, gross resources mobilised were expected to increase by 0.91 per cent: that is, the magnitude of the effect of these two factors was found to be almost the same. As regards the corporate tax rate, every 1 per cent increase in it tended to reduce gross mobilised resources by 1.3 per cent. However, it may not follow that a decline in the corporate tax rate would have necessarily led to an increase in the gross resources mobilised.

(c) Blown-up Estimates

The NIPFP sample data for the three years, 1973-74 to 1975-76, were blown-up to estimate total resource mobilisation in the private corporate sector. The resultant estimates were found to be comparable with those derived on the basis of the RBI sample for 1973-74 and 1974-75 (Rs. 1631 crore against Rs. 1877 crore for the former year and Rs. 2580 crore against Rs. 2548 crore for the latter year). On the basis of our estimates, the corporate sector could be said to have mobilised 19.5 per cent of gross domestic savings in 1974-75; the corresponding figure based on the RBI samples was 19.2 per cent.

On the average, the large scale manufacturing segment of the private corporate sector was estimated to have mobilised annually Rs. 541.4 crore of gross resources, built Rs. 355.1 crore of gross fixed assets and undertaken Rs. 601.7 crore of gross capital formation activity.

(d) Composition of Resources Mobilised

The most significant feature of the pattern of resource mobilisation was the large share of corporate savings in gross resources. Corporate savings consisting of depreciation and internal plough-back (including bonus shares) accounted, on the average, for 64.2 per cent of the gross resources during the period under study. Such a high proportion of corporate savings was partly due to the relatively low level of capital formation which did not require much recourse to be made to external resources and partly due to the rising value of new capital assets, which increased the monetary value of chargeable depreciation.

The average share of the other components of long-term resources for the study period were: Long-term loans from financial institutions, 7.2 per cent; debentures, 1.9 per cent; fresh equity capital, 5.7 per cent; the remaining proportion of gross resources, namely, 21 per cent, was of a short-term nature (short-term loans from commercial banks, trade dues and other miscellaneous net current liabilities).

Among the components of gross corporate savings, the most important was depreciation, which provided 59 per cent of gross savings and 38 per cent of the gross resources. "Other reserves" and surpluses contributed 22 per cent of gross corporate savings, develop-

ment rebate reserve 10 per cent and bonus shares 9 per cent. Including development rebate reserve, internal plough-back contributed 41 per cent of gross savings and 26.2 per cent of the gross resources.

The relative contribution of corporate savings improved over the years: As against the average share of corporate savings during 1962-63 to 1964-65 of 51.4 per cent, it was 72.8 per cent in the period 1972-73 to 1975-76. The share fell in some years and was much higher than 73 per cent in certain other years. But the fluctuations were around a rising trend. Depreciation provision contributed to this trend; but more importantly, the average relative contribution of net savings (*i.e.*, development rebate and other reserves and bonus shares) increased from 16.4 per cent to 32.8 per cent between the two end periods.

The growth of the stock market did not keep pace with the requirements of the private corporate sector for funds. There was a fall over the period in the proportion of fresh share capital in total resources mobilised: from 15.2 per cent during 1962-63 to 1964-65, it fell to 2.6 per cent during 1972-73 to 1975-76. Of course, one does not expect established companies to depend on the share market as much as the corporate sector as a whole including new ventures. Nevertheless, it is worrisome that the proportionate contribution of fresh equity capital should have fallen so steeply.

There was an increase in the share of loans from financial institutions in the earlier years of the sample period. Their share in total mobilisation of resources increased from an average of 6.3 per cent during 1962-63 to 1964-65 to 28.5 per cent during 1965-66 to 1968-69. Thereafter, there was a continuous decline in their share. In fact, between 1970-71 and 1974-75, their contribution was negative. This result was obtained because we took borrowings net of repayments. Also, our sample excluded more recent companies.

We may legitimately conclude that the large established companies were not unduly, or even substantially, dependent on financial institutions for financing their capital formation. This could partly be due to the relatively low level of capital formation, the finances for which were largely mobilised from internal sources.

The proportion of short-term funds increased significantly in the seventies. In the years from 1973-74, their share was quite high: for example, 41.6 per cent in 1973-74 and 42.4 per cent in 1974-75. And for the period 1972-73 to 1975-76, the annual average

was fairly high at 28.4 per cent. The major cause of this increase in the importance of short-term funds was the steep rise in the cost of holding inventories, as was revealed by the increase in the proportion of inventories to gross capital formation in the later years. To the extent that the increase in short-term funds was due to the increase in the value of inventory, the improvement in the level of gross resources mobilised was only illusory.

The above findings on trends in gross resource mobilisation and changes in the pattern of mobilised resources based on the data for the NIPFP sample were broadly corroborated by the results of the analysis of the data for the RBI samples.

The conclusion is inescapable: The significant increase in the annual flow of resource mobilisation that occurred during this period was all but neutralised by the rise in the costs of capital formation. And an increasing proportion of these resources, remaining constant in real terms, was absorbed by inventory holdings towards the end of the period. The effect on fixed capital formation was adverse, as will be seen later in sub-section (g.)

(e) *The Dilemma for Equity Investments*

Risk, uncertainty, low returns and low capital appreciation on equity capital discouraged investors from making equity investments, while the low level of capital formation and the high cost of servicing fresh equity discouraged good existing companies from floating fresh issues. New companies, which cannot attract equity capital from investors because returns on them start accruing only after a fairly long gestation period, burden financial institutions and underwriters with their fresh issues as these generally devolved on them. Issues by well-established and reputed companies, which are very popular with the investor, do not come often; also, such companies prefer to make right issues rather than new issues, because, the latter involve obtaining clearances, procedural delays and a higher cost for managing the issue. Hence, the supply of good shares in the market is meagre and intermittent, and equity capital from investors is attracted only to that extent. At the same time, the over-subscription of good issues also leads to blocking of investible funds for long periods of time and this places a restriction on the financial capability of investors, particularly the small investors. Our study brought to light such a situation during the period covered.

(f) *The Issue of Convertible Debentures*

The issue of convertible debentures which, after a specific period of time, can be converted into equity shares, is open to the same objection as convertible loans. There is, however, one point in favour of convertible debentures. One of the leading companies pointed out to us that they preferred to issue convertible debentures to the public rather than equity share capital, first, because the return on debentures was tax deductible, and secondly, because enlarging the equity base could affect the capacity to maintain the dividend rate on the equity capital, old as well as the new. The issue of convertible debentures did not affect the return on existing equity and only when the project financed by the convertible debentures became operational and generated allocable profits, the debentures could be converted into equity. Companies seemed to feel that by allotting the convertible debentures to the existing shareholders, employees, trade associates, collaborators and the promoters, and by not getting them underwritten by financial institutions, to whom they devolved, if not fully subscribed, they restricted the possibility of financial institutions getting large chunks of equity capital in the future. Lately, several leading corporate units have issued convertible debentures with a return comparable to, or better than, that on similar long-term investment outlets (12 per cent to 14 per cent). At times, these bonds are not underwritten but offered partly to existing shareholders, employees, associates, etc., and partly to the public directly.

(g) *Utilisation of Funds*

Gross fixed asset formation by the 99 NIPFP sample companies during the 14-year period amounted to 66 per cent of the gross resources mobilised during that period and 92.8 per cent of the gross resources of a long-term nature. Of the total gross fixed asset formation, plant and machinery accounted for 70.6 per cent; of the gross resources mobilised, they accounted for 46.5 per cent. Over the period, there was a general trend towards a decline in the proportion of gross resources utilised for gross fixed asset formation. In the years 1962-63 to 1964-65, gross fixed assets absorbed 75.4 per cent of mobilised resources, whereas this proportion was much lower at 57.7 per cent during the period 1972-73 to 1975-76.

The fall in the proportion of resources utilised for gross fixed asset formation could be due to several causes : A slow down in the pace of capital formation, the need to divert a larger proportion of resources for inventory financing because of the steep rise in the price of inputs and the credit squeeze applied from time to time.

There used to be a complaint in the early sixties that short-term funds were being used for long-term purposes, *i.e.*, for fixed capital formation. The analysis of our data showed that apart from the period 1962-63 to 1964-65, the amount of gross fixed asset formation fell short of the total volume of long-term resources mobilised. While for the period as a whole, gross fixed asset formation absorbed 92.8 per cent of long-term resources mobilised, in some of the years the proportion of such resources utilised for other purposes varied between 10 and 20 per cent. Here again one has to keep in mind the increase in the cost of inventories that took place after 1973-74.

Among the gross fixed assets, the most important were found to be plant and machinery. They formed, on the average, 70.6 per cent of gross fixed asset formation during the period 1962-63 to 1975-76. This proportion was fairly stable, varying between 65 and 67 per cent, except for one abnormal year. During the period under study, factory and office buildings absorbed 8.9 per cent and miscellaneous fixed assets, such as motor vehicles and office equipment, 8.6 per cent of the gross resources mobilised.

(h) *Trends in Capital Formation in Real Terms*

It was important to know whether annual gross fixed capital formation and its major components had grown in real terms over the years. For this purpose, the annual figures in current prices were deflated by price indices applicable to each of the years and to each of the components concerned. It was found that there was no clear rising trend in the annual gross fixed asset formation at constant prices over the period as a whole. A rising trend could be discerned upto 1968-69; however, there was near stagnation in the early seventies and a decline in 1974-75 and 1975-76. In the case of plant and machinery too, a rise in trend was discernible upto 1968-69, but after that year there was a clear falling trend. The conclusion can then be drawn that the annual rate of fixed capital formation and

additions to plant and machinery in real terms formed a declining percentage of the existing capital stock.

(i) *Sectoral Results*

Sectoral analysis brought out some important results. The size of a company seemed to have a bearing on both the level and pattern of resource mobilisation; with the increase in the size of the company, corporate savings, especially development rebate and depreciation, became particularly high as a proportion of gross resources. Size, however, did not seem to have had any distinct effect on the success of companies in obtaining external funds from financial institutions.

The very nature of operations in the corporate manufacturing sector is such that internal corporate savings, even of a statutory nature, cannot be generated in the absence of net income to which they can be charged: as such, external funds were found to be more important than internal funds when a company was new. In particular, long-term institutional finance was found to be especially higher in new companies than in old companies. With the passage of time, an average company operating under normal economic conditions was able to generate more internal resources and also reduce its outstandings to financial institutions.

The passage of time was found to also change the pattern of use of resources. After a firm or project was well established, a lower proportion of gross mobilised resources was spent on fixed capital formation unless expansion was taking place; consequently, a larger proportion of resources, even of a long-term nature, was spent on financing inventories, the requirements of which seemed to rise as sale and distribution operations grew larger.

The location of a large industrial unit did not seem to have played an important role in determining its success in mobilising resources from financial institutions and the stock market. This finding is subject to the limitation that in the NIPFP sample there was no company which could really be classified as 'small'. The NIPFP sample included companies having paid-up share capital in 1975-76 of Rs. 1 crore or more; companies of such a size are able to afford the recurring expenses for maintaining necessary liaison with the financial and the capital markets. However, location seemed to have played some role in the composition of long-term

and short-term funds; generally, the more distant an industrial unit was from the major industrial centres, the greater was found to be its need for maintaining stocks of materials and also a higher level of stock of finished goods.

The analysis by the level of growth of companies and their effective tax liability showed that companies with a high rate of growth of gross fixed assets and a low effective tax liability, generated a larger proportion of corporate savings than other companies. This may be because a higher growth rate enabled the company to get the benefit of more fiscal reliefs.

It was found that mobilised resources of a long-term nature were less important in the case of private limited companies than in the case of public limited companies. This was due to the difference in the pattern of use of mobilised resources: private limited companies utilised 60.2 per cent of gross resources for fixed capital formation as compared to 66.8 per cent by public limited companies.

There was a noticeable difference in the proportion of resources mobilised through net miscellaneous sources, public limited companies mobilising 6.2 per cent of gross resources from this source as compared to 3.2 per cent by private limited companies. The reason for the difference might be the lower degree of credit worthiness which private limited companies — largely family concerns — had with trade and business associates.

(j) *Factors Affecting Equity to Debt Finance Ratio*

(i) *Corporate tax.* We found that the effective corporate tax rate was an important determinant of the equity to debt finance ratio. The magnitude of the effect of a change in the effective corporate tax rate on the ratio was fairly high: a one per cent increase in the effective-corporate tax rate was found to decrease the ratio by 2.7 per cent, and conversely. Fiscal policy can thus, play through changes in the effective corporate tax rate, an important role in promoting the desirable composition of equity and debt finance.

(ii) *Existing debt-equity ratio.* Significant 'bankruptcy costs' are associated with a temporal increase in the debt-equity ratio. The elasticity of the ratio of equity-debt finance with respect to one year-lagged debt-equity ratio was found to be 0.88, indicating that for every one per cent increase in the debt-equity ratio, the ratio of equity to debt finance increased by 0.88 per cent.

(iii) *Industrial production.* Changes in the growth rate of industrial production have a close bearing on the ratio. It was found that a one per cent increase in the rate of growth of industrial production led to a 0.45 per cent increase in the equity to debt finance ratio, and conversely.

(iv) *Monetary policy.* Our econometric exercise attempting to measure the effect of monetary policy, as measured by the cost and availability of credit, on the equity to debt finance ratio was inconclusive. There is a need to do further studies on this aspect of corporate finances.

(k) *Factors Affecting Retention to Fresh Issues Ratio*

(i) *Mean marginal rate of personal income-tax.* We found that the mean marginal rate of income-tax on dividend recipients had a significant effect on the composition of equity finance. It was seen that for every one per cent increase in the mean marginal rate of personal income tax, the companies tended to increase the ratio of retentions to fresh share capital by about four per cent. It follows that fiscal policy can, through the personal income-tax system, play an important role in changing the composition of equity finance in terms of retentions and fresh share capital.

(ii) *Yield on corporate shares.* The yield on corporate shares had an immediate effect on the ratio: every one per cent increase in the yield decreased the ratio of retentions to equity capital by almost three times.

(iii) *Debt financed investment.* We found that the proportion of investment financed by debt had an inverse relationship with the ratio, a one per cent fall in the proportion of debt financed investment led to an increase in the ratio by 0.7 per cent.

(iv) *Controls on capital issues.* Our econometric exercise attempting to measure the effect of controls on capital issues on the ratio was inconclusive. This might be due to the fact that the proxy variable which we used to represent the restrictiveness of capital issues control, *viz.*, the ratio of consents to applications, was a poor surrogate to the complex structure of capital issues control.

3. Qualitative Assessment

The leaders of industry and financial institutions with whom we held discussions were in general agreement that our findings

presented a fairly realistic picture of the pattern of resource mobilisation by the private corporate sector.¹⁸ We found that fixed capital formation had been at a comparatively low level and stagnant; that was one of the reasons why there was no need to resort to external finances on a large scale. However, the leaders of industry were quick to point out that with the extremely high cost of plant and machinery prevailing in the domestic as well as in the external markets and with the near impossibility of obtaining equity capital from the stock market on any significant scale for new ventures, new projects could be started only with large dependence on financial institutions. Financial institutions pointed out that the long gestation period in the manufacturing sector limited the capacity to generate sufficient plough-back, particularly of new industrial undertakings. This in turn also increased their dependence on the financial institutions, even to meet cost overruns.

There was appreciation among the leaders of industry of the benefits flowing from the fiscal incentives. They felt, however, that the real value of these benefits were substantially diminished because of the steep rise in capital costs since the early seventies. As depreciation was linked to historical costs, in the continuing inflationary conditions, it would not be possible to replace plant and machinery on the basis of depreciation provision, although it was true that if a company was in a position to avail itself of all the benefits provided for — investment allowance, backward area concession, capital subsidy, export market development allowance, tax holiday, etc. — then its tax liability would be fairly low and it would have sufficient resources for expansion. It was their view, however, that the average effective rate applicable to profit-making manufacturing companies taken as a whole was by no means as low as it was sometimes thought.

Because of the fear of consequences that might flow from the convertibility clause insisted upon by financial institutions, the leaders of industry pointed out that there was an inclination among a large number of existing companies to either phase out their long-term capital projects so as to avoid recourse to financial assistance from long-term financial institutions or go to them only for marginal

¹⁸A specially prepared questionnaire was sent in advance to the Chief Executives of selected companies and financial institutions. Discussions were subsequently held with the chairmen, managing directors, finance directors and others from 22 companies, financial institutions and other agencies.

assistance.¹⁹ When, however, large projects had to be implemented and could not be phased out, a number of corporate units preferred to implement such projects through associate companies, which might in turn borrow from the financial institutions. The parent companies could thus avoid the acquisition of their equity capital by those institutions.

Several leaders of industry stressed that the low level of capital formation in the private corporate sector was also due to restrictions on the areas in which companies, capable of growing (such as, the FERA companies and companies belonging to large business houses), could operate and expand their capacity. Thus, according to them, the non-availability of permission to undertake growth programmes by that segment of the private corporate sector which could effectively undertake such programmes and the fear of the convertibility clause together could explain both the low level of capital formation in the private corporate sector and the low proportion of term-loans in gross mobilised resources.

Another important factor that affected the capacity of companies to mobilise resources, according to the general views expressed by the leaders of industry, was the operation of price control in several important industries. The price control formulae that were generally applied yielded only a moderate rate of after-tax profits, while capital costs were rising steeply. This led to a situation in which neither the existing units could generate internal funds for significant expansion programmes nor the new enterprises could find it profitable to enter the areas subject to price control. In some of the capital-intensive industries under price control such as fertilisers, it was felt that it was virtually impossible to bring about any expansion without massive financial assistance either from the financial institutions or from the Government. The above views were expressed by a number of business executives with whom we

¹⁹The convertibility clause irritant was based on the fact that if the public sector financial institutions came to jointly hold 51 per cent or more of the equity capital, then sections 617 and 619 of the Indian Companies Act would become operational: if these sections were invoked, a corporate unit would be liable to have its operations scrutinised by the Comptroller and Auditor General of India and the Parliamentary Committee on Public Sector Undertakings. However, subsequent to the completion of this study, the Government announced in the 1980 Budget, some concessions on the convertibility issue. Also, the financial institutions, while exercising the convertibility option, do it in such a way as to jointly own not more than 40 per cent of the equity stock.

held discussions. Although we did not make any special study of the impact of price control in our study, we draw attention to **this** problem because we concur with the view that price control does have an impact on the capacity to mobilise resources.

4. Some Policy Implications

One of the most important findings of the study was that the level of corporate capital formation in real terms was stagnating since the mid sixties. From independent data supplied by the Central Statistical Organisation (CSO), we also know that the relative contribution of corporate savings to total domestic savings was fairly small and as a proportion of the GNP, such savings were negligible. Although the rate of domestic savings has registered impressive increases in recent years, there has been no improvement in the contribution of corporate savings. As the private corporate sector is expected to play an important role within the overall framework of the national plan, it is of the gravest concern that corporate savings should be at a low level and that its capital formation should result in decreasing percentage additions to the capital stock.

Action would have to be taken on several fronts in order to bring about conditions in which the corporate sector could grow more vigorously so that its contribution to domestic savings and investment could rise over the years. One of the important areas in which remedial action has to be taken relates to the taxation of corporate profits. We have seen that the effective tax rate had an important bearing not only on the volume of resources mobilised but also on the ratio of equity to debt finance and that of retentions to fresh issues. In more recent years, the effective tax rate applicable to our sample companies generally fluctuated between 45 and 48 per cent.²⁰ Under the existing tax system, the effective tax rate comes down only if fresh investment eligible for investment allowance is undertaken; it does not change with such factors as the dividend payout ratio or the ratio of retentions to fresh issues. Another important feature of our corporate tax system is that depreciation is computed on the basis of historical costs and no significant adjustments are allowed for the increase in the cost of capital goods.

²⁰The effective tax rate of the RBI sample companies also fluctuated between 45 and 48 per cent

Given the poor performance of the corporate sector in terms of capital formation and in the light of our findings, it can be argued that a thorough-going reform of the corporate tax structure should be contemplated. In undertaking such a task, one could consider such questions as whether we should opt for an alternative system of corporate taxation such as, the split-rate system or the imputation system, whether the investment allowance and certain other reliefs should be discontinued and the nominal rate of corporate tax should be reduced and whether some form of accelerated depreciation or even 100 per cent instant depreciation should be contemplated with corresponding changes in the definition of the tax base. Under the present inflationary conditions, some adjustments to the system of writing off the value of depreciable assets would also be called for.

The finding that a reduction in the corporate tax rate would have a favourable impact on the equity to debt finance ratio as well as on the capacity to mobilise resources would also indicate that such a reduction in the tax rate should be considered if the aim is to encourage the utilisation of more equity finance and to increase the capacity of the corporate sector to mobilise resources.

We had found that the mean marginal personal income-tax rate applicable to dividend recipients had an impact on the ratio of retentions to fresh issues: The higher the rate, the higher the ratio. A lowering of the marginal income-tax rate or, alternatively, some other device such as the exemption of a part of dividend income upto a ceiling, could be considered.

A lowering of the marginal income-tax rate applicable to individuals and a reduction in the corporate tax rate would tend to stimulate savings and investment and encourage the growth of a more broad-based equity market. However, unless such reductions are accompanied by the withdrawal of certain fiscal reliefs which may not be considered to be very effective now, the Government would stand to lose revenue. Hence, it could be seriously contemplated whether a lowering of the corporate tax rate could not be, at least partially, compensated by the introduction of a moderate tax on indirect expenditures by corporations. Such a tax would redistribute the burden of corporate taxation in favour of the more efficient and more prudent companies and bring in some revenue to the Government on a part of the expense account consumption indulged in by some of the corporate owners.

Our finding was that the market for equity capital had not been growing in line with the requirements of the corporate sector. If the corporate sector is to grow and flourish under healthy conditions, it would be necessary to revive the equity market. In this connection, it is necessary to educate potential investors on the advantages of equity investment, for they now appear to be unduly swayed by what they consider to be the risks of such investment.²¹ Equally important is the need to improve the shareholders' confidence in the corporate sector. For this purpose professional corporate management should be strengthened so as to ensure honest and efficient running of companies.

Another measure which would contribute towards the revival and healthy development of the stock market is the extension of the scope of investment by corporate and individual shareholders. In the case of corporate shareholders, there is some case for relaxing the restrictions on inter-corporate investments, at least when a share issue is under-subscribed; corporate shareholders could be given the first option to subscribe to the shares beyond the level presently permissible under the Indian Companies Act before these are allowed to be taken up by the underwriters. In the case of individual shareholders, there seems to be a case for raising the exemption level of dividend income for computing the tax base, in view of the sharp erosion in the value of money.

In relation to reviving the equity market, we should examine not only the interest of the new issue market, but also of the secondary issue market, as there is an umbilical cord relationship between the two, which cannot be cut. Unless the secondary issue market is buoyant and active, the new issue market cannot become buoyant, because when the investor does not get any return on his investment in the existing companies, he would shy off from investing in any new company.

It is also desirable to create a bond market and to encourage the floating of fully convertible bonds at fixed rates of interest which could be subsequently converted into equity capital in two or three phases.

It would seem that the question of granting an adequate measure of short-term credit for inventory financing by the manu-

²¹In the Ahmedabad, Bombay and Calcutta regions, where there was better awareness of the advantages of equity investment, resource mobilisation through the equity market was seen to be more substantial.

facturing corporate sector should be reconsidered in the light of the steep increase in the prices of inputs that have taken place. While tight monetary policies need to be followed under conditions of inflationary pressures, denial of credit to the manufacturing sector would also accentuate the rise in prices by slowing down the rate of production. Alternatively, long-term funds tend to get diverted for short-term purposes with undesired implications for the growth of investment.