Financing of Firms

4.48 The role played by securities markets in the financing of firms has been analysed on the basis of Centre for Monitoring Indian Economy (CMIE) database for large firms in India. Table 4.14 summarises the characteristics of this database. For the year ended March 31, 2001, the sample size (1730 companies) is small since the annual reports for many of these companies had not been released as of date. At a broad level, the two outstanding regularities in this are (a) the decline in leverage and (b) the declining importance of "other" sources of funding. The debt-equity ratio fell from 1.73 in the early nineties to 0.90 in 2001. Viewed differently, total borrowings were 2.45 times larger than the value added in 1992; this multiple came down to 1.78 times in 2001. This may reflect a combination of a decision by firms to assume lower levels of risk, a shift towards more labour intensive industries, and structural weaknesses in the market for credit.

4.49 The second feature is the shift away from debt obtained from sources "other" than Banks, FIs, and the bond market. This fell sharply from 45 per cent of debt in 1992 to 19 per cent of debt in 2001. Most of this decline was made up by growth in the proportion of debt from banks and FIs, the sum of which rose from 38 per cent in 1992 to 60 per cent in 2001. Corporate bonds also experienced growth. One factor responsible for the growth of importance of corporate bonds has been the rise of the commercial paper market, which went up from 0.16 per cent of borrowings in 1992 to 1.52 per cent in 2001.

4.50 In many countries, the corporate bond market has become very important, as a transparent and liquid alternative mechanism of debt financing, when compared with loans. Table 4.14 indicates that while the share of corporate bonds in total debt has risen, from 15 per cent to 21 per cent, banks and FIs have actually gained ground as a source of debt financing.

Cross-sectional Variation in Debt Financing

4.51 While the above regularities apply for the universe of firms as a whole, there is important variation in these regularities across the size distribution of firms. In order to highlight this, the universe of firms is sorted by value added, and broken up into ten groups, each of which has an equal number of firms. These results, using the most recent accounting year (2001), are shown in Table 4.15. The results show a strong pattern whereby smaller firms seem to have higher debt/equity ratios. This suggests that the phenomenon of small firms suffering from credit rationing is not strongly applicable in this data set.

4.52 Turning to the sources of debt financing, two strong regularities may be noted. The largest one-tenth of firms have the least dependence (17 per cent) on institutions. At the same time, they have the highest dependence on corporate bonds (25 per cent). This suggests that for the largest firms, the securities markets have become a major source of capital, and that they are able to

TABLE 4.14
Summary Statistics on Debt Financing

(Rs. crore)

Characteristic	1992	1993	2000	2001
No. of firms	2,799	3,408	4,584	1,730
Gross Value Added	71,351	82,009	1,96,347	1,52,700
Total Borrowings	1,74,790	2,07,554	4,21,494	2,72,283
Debt-Equity Ratio	1.74	1.72	1.10	0.90
Source of Borrowing (per cent)				
Banks	22	26	33	37
Institutions	16	18	23	23
Corporate bonds	15	15	17	21
Others	45	39	24	19

Source: CMIE

TABLE 4.15
Debt financing across size deciles (2001)

	All	Large	2	3	4	5	6	7	8	9	Small
Debt-Equity Ratio	0.90	0.76	1.06	1.42	1.44	1.08	1.20	2.82	2.52	2.61	
Sources of borrowing (per cent)											
Institutions	23	17	34	42	33	26	36	29	27	35	31
Corporate bonds	21	25	15	10	10	11	6	7	4	2	11

Source: CMIE

disintermediate financial institutions by directly accessing the markets. However, as one goes beyond the top decile of large firms, the fraction of debt funding that comes from corporate bonds drops off very rapidly. This suggests that the corporate bond market is an effective venue only for the largest 10 - 20 per cent of firms.