Industry

8

CHAPTER

Though the growth of the industrial sector started to slowdown in the first half of 2007-08, the overall growth during the year remained as high as 8.5 per cent. The industrial sector witnessed a sharp slowdown during 2008-09 as a consequence of successive shocks, the most important being the knock-on effects of the global financial crisis. The pace of slowdown accelerated in the second half of 2008-09 with the sudden worsening of the international financial situation and the global economic outlook. The year 2008-09 thus closed with the industrial growth at only 2.4 per cent as per the Index of Industrial Production (IIP).

Developments that impacted the industrial sector

8.3 In view of the fact that industrial growth started to moderate from the first quarter of 2007-08, its growth performance needs to be viewed in light of the developments during that year and during the preceding year (Table 8.1 and Figure 8.1).

Raw material costs

8.4 The period January 2006 to July 2008 witnessed persistent increase in the price of crude oil. The fiscal 2008-09 began with the price of crude oil (Indian basket) at US$ 105.77 per barrel (April 2008 average). By July 2008, Indian crude oil basket was priced at US$ 132.47 per barrel. The increase in the price of imported crude was passed on into the domestic market in June 2008, but, in a very limited way through a hike in the price of motor spirit, HSD and LPG. However, the persistent rise in the price of crude had started to impact petro-based industrial inputs adding to fuel costs. That apart, the rise in the price of other commodities, particularly metals and ores from the latter half of 2006-07 to the second half of 2008-09 also had its effect on the cost side of the manufacturing sector. Though some units engaged in the extraction or exports of commodities (like iron ore) realized higher profit margins, the commodity price inflation had an adverse impact on the profit margins for the manufacturing sector in general.

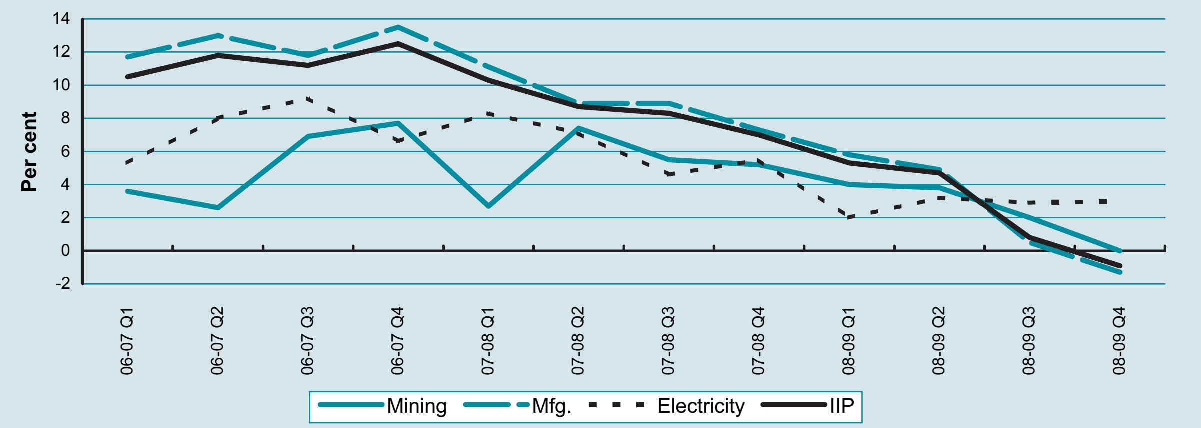
Table 8.1 : Growth of IIP. March 2009

(per cent)

Industry Group	Weight	2007-08	2008-09
Mining	104.7	5.1	2.3
Manufacturing	793.6	9.0	2.3
Electricity	101.7	6.4	2.8
Growth by use-based industrial groups			
Basic goods	355.7	7.0	2.5
Capital goods	92.6	18.0	7.0
Intermediate goods	265.1	9.0	-2.8
Consumer goods	286.6	6.1	4.4
Durables	*53.7*	*-1.0*	*4.4*
Non-durables	*233.0*	*8.6*	*4.4*
General Index	1000	8.5	**2.4**

Source : Central Statistical Organisation

Figure 8.1 : Quarterly growth of IIP - %



8.5 A comparison of the major components of expenditure (based on data from abridged financial results) for a sample of manufacturing companies suggests that even by the second half of 2007-08, the cost structure had worsened despite robust growth in sales. This got accentuated in the first two quarters of 2008-09, suggesting that high commodity prices, during the first half of 2008-09 had strongly affected the input costs of manufacturing companies. Cost on account of consumption of raw materials rose by as much as 38 and 44 per cent during Q1 and Q2 of 2008-09 as compared to 16 and 12 per cent during the corresponding quarters of 2007-08. Similarly, power and fuel costs showed a significant increase during the first two quarters of 2008-09. The build-up in the cost structure during the first half of 2008-09 as compared to the corresponding period of 2007-08 in turn led to a shrinkage of margins (Table 8.2).

Interest expenditure

8.6 Another key component on the cost side, namely interest costs, also increased due to higher interest rates. From the third quarter of 2007-08, there was a sharp rise in interest costs.

Flow of finance

8.7 In recent years, especially from 2004-05, the Indian private corporate sector started to raise external capital (i.e. other than internal resources) mainly to fund its investment and this included foreign institutional sources. Data on sources and uses of funds for a sample of non-financial public limited companies available till 2006-07 (in a study by the RBI) shows that the share of external finance was as much as 64.1 per cent of the total source of funds. In an earlier study (by RBI), the share was estimated to be 44.5 per cent in 2004-05.

Table 8.2 : Growth in sales and expenditure of public limited manufacturing companies in the private sector

Items	Growth rates in per cent							
	2007-08				2008-09			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4*
*No. of companies***	*1811*	*1716*	*1780*	*1803*	*1926*	*1837*	*1849*	*676*
Growth rates								
Sales	17.0	12.7	15.4	18.7	30.1	32.1	6.3	-3.5
Change in stock-in-trade	-18.2	-13.2	-0.8	151.6	131.9	230.1	-377.2	-135.6
Expenditure	16.0	12.0	15.9	21.0	34.3	38.8	9.3	-6.3
Raw material	17.9	10.1	15.3	20.3	38.1	44.0	4.0	-18.3
Staff cost	19.0	16.8	18.3	16.6	19.3	17.0	12.4	6.2
Power & fuel	9.6	6.6	13.7	25.8	28.8	37.8	21.7	9.2
Interest costs	7.8	15.1	35.6	30.8	52.0	69.9	60.5	44.7

Source : Reserve Bank of India
*** Figures are provisional and subject to change.**
**** The data is based on a sample of public limited listed companies.**

8.8 Table 8.3 presents an overview of the major components of flow of finance from different sources mainly to the non-financial companies (in the public and private sector) during 2008-09. It is evident that the mobilization of resources through the equity route saw a precipitous decline during 2008-09. On the external front, resource mobilization from American/ Global Depository Receipts almost collapsed during the year and the flow of external commercial borrowings also suffered a sharp decline. However, the inflow of foreign direct investment (FDI) recorded an impressive growth during H1 2008-09. While FDI flow remained subdued during Q3 2008-09, it recorded a modest recovery in Q4 2008-09.

8.9 The sudden freezing of trade credit especially by foreign banks that took place in mid-September 2008 was accompanied by a sharp depreciation in the nominal exchange rates within a short span of time. These developments made it difficult for manufactures to hedge their positions and to finance their ongoing operations.

8.10 Among the domestic sources, while private placement by non-financial institutions grew on the strength of the resource mobilization by public sector non-financial institutions, the private sector resource mobilization on this count declined sharply. Of all the sources of industrial financing, bank credit remained the biggest which recorded an impressive growth during 2008-09 and in some ways had to fill the gap due to the sudden shrinkage of other sources. The sharp slowdown in financing. especially the foreign capital, from mid-September 2008 accentuated the industrial slowdown that had already set in from the previous year.

Trade channel

8.11 With the opening up of the economy, the trade orientation of Indian manufacturing increased over the years. The exports to sales ratio of the private corporate sector increased over time (Table 8.4). While these changes were more pronounced in certain specific export-oriented industries, the overall increase in terms of trade orientation implied that assured availability of trade credit had become important for day to day business operations.

Table 8.4 : Exports to sales ratio of the private sector

Year	Public Ltd. companies	Pvt. Ltd. companies
1994-95	9.7	8.8
2004-05	17.6	18.5
2006-07	18.9	16.4

Source : Reserve Bank of India

8.12 The shrinkage in demand for exports that followed in the ensuing months (September 2008 to March 2009) sharply dented the performance of industries with high export intensity. The growth in exports from India declined from 28.9 per cent (in US dollar terms) in 2007-08 to 3.6 per cent in 2008-09. The impact of the export slowdown has been particularly pronounced in sectors like textiles, leather and fur products and transport equipment.

Table 8.3 : Financial flows through domestic and foreign sources

Instrument	2006-07	2007-08	2008-09^{P}	change (per cent) 2007-08	change (per cent) 2008-09
Domestic sources (in Rs. crore)					
Pvt. Placement- Pvt. Sector NFIs	33426	30223	20422	19.7	-32.4
Pvt. Placement-Pub sector NFIs	11908	17196	30832	87.1	73.3
Total Private placement NFIs	45334	47419	51254	37.7	8.1
Public & rights issues	33508	87029	14720	159.7	-83.1
Industrial credit	146890	167819*	213621*	25.9	25.8
External sources ($ million)					
FDI	22826	34362	33613	50.5	-2.2
ADRs/GDRs	3776	8769	1162	132.2	-86.7
ECB (Gross)	20883	30376	17549	45.5	-42.2

Sources : SEBI for Public & rights issues and the rest from RBI.
^{P} Provisional; NFIs: Non financial Institutions * Annual variation in February.
Figures for private placement relate to April-December.

Price reversal and demand slowdown

8.13 The sharp reversal in commodity prices from the third quarter of 2008 has adversely affected such units that were left holding inventories, though it can be argued that the decline in inflation would also reduce costs for many industries. The manufacturing sector also suffered because of a decline in the construction and real estate affecting non-metallic minerals, wood and wood products and basic metals. These developments fed into the domestic economy, setting off what may be termed as second round effects that seem to have continued to the end of fiscal year 2008-09. The manufacturing demand, therefore, witnessed double squeeze, a decline in the demand originating from exports and a decline in domestic demand.

Profits and profitability

8.14 The foregoing developments thus impacted the input costs, flow of finance and its cost, demand and revenue growth and finally the growth of profits of the manufacturing sector. From the abridged results of a sample of manufacturing companies, it is seen that while profitability (PAT / sales) was under strain since the third quarter of 2007-08, it came down sharply in the third quarter of 2008-09 accompanied by a sharp dip in the growth in sales. (Figure 8.2)

Micro, small and medium enterprises

8.15 While the picture presented above is for the manufacturing corporate sector, the general course of developments for rest of the industrial sector may not be very different. (Given the better availability of data with shorter lags on the financial performance for the corporate sector, the impact on this segment can be readily gauged in terms of some of the key financial parameters). However, it needs to be recognized that the industrial sector comprises different segments, namely, the non-financial public sector companies, the non-financial manufacturing companies in the private corporate sector, and unincorporated household enterprises. Even within the corporate sector, there is a wide variation in size as also access to capital markets and international funds. While large public limited companies that are listed on the capital markets are able to access domestic and in some cases international capital markets, the dependence of smaller companies and micro, small and medium enterprises (MSMEs) on institutional credit is known to be higher.

8.16 The MSME sector has been contributing significantly to the manufacturing output, employment and exports. Between 2003-04 and 2007-08, the MSME sector registered average annual growth in the number of units and employment of around 4.1 per cent and 4.0 per cent respectively.

8.17 Since the transmission of global shocks came predominantly through the financing channel, it is not surprising that the private corporate sector was the first to be directly affected. However, it is understood that MSMEs that undertook manufacturing as subcontracts or as suppliers / ancillaries to larger units and those predominantly in export-oriented sectors stand affected due to the slowdown. While it is desirable to assess performance of the MSMEs against the backdrop of the recent developments, limitations of data may not permit doing so. The Fourth All India Census of MSMEs, being conducted, will perhaps create a database for the sector and provide a frame for tracking the future growth and development of the sector.

Figure 8.2 : PAT / sales ratio & growth of sales manufacturing companies