

Slow Down in Demand Affects Corporate Growth – An Empirical Study

Prof. Dr. S.K. Baral

Director, Kushagra Institute of Information & Management Science (KIIMS), Pira Bazar, Cuttack,
Odisha, India, drskbaral@yahoo.in

Abstract- *Growth of Indian market continued to slow down in 2012-13, but could witness a slow-paced recovery later this year, contingent on improved governance and concerted action to resolve structural bottlenecks. Unresponsive business and consumer confidence, reflected in various surveys, is expected to drag growth down. Rising prices and slowing growth are making Indians check their household shopping list from soaps, shampoos and skincare to packaged groceries, food items, electronics products, medicines etc. This financial year, India Inc would face several stress factors, the most significant being a slowdown in demand. One in four companies would see a demand slowdown, while two out of every three sectors of the economy would record lower revenue growth, according to CRISIL's 'State of the Nation' report, released on 17th December 2013. This paper highlights some important aspects in context to the issues and challenges faced by the Indian Corporate during slowdown in demand.*

Keywords - *Slowdown, Demand, Corporate, Economy.*

1. INTRODUCTION

Industry and services, which together account for 86 per cent of gross domestic product (GDP), would grow at a slower pace than last year. The biggest stress for companies is slowing demand, and this would hit revenue growth of companies. Despite a significant depreciation in the rupee, foreign exchange vulnerability is the least of the stress factors impacting the credit profiles of 2,481 firms rated 'investment' grade by CRISIL. The rating agency said the rupee would remain weak compared to last financial year. However, only six per cent of companies are highly vulnerable to foreign currency volatility. Besides, foreign exchange debt is concentrated among a few companies — one per cent of firms account for 85 per cent of the total foreign exchange exposure. (CRISIL estimates) Indian market experienced with 30% of agricultural produce does not reach the market, and of the remaining 70%, more than 50% is lost due to poor transportation and storage technology. This is a gross waste in any country; especially in a developing country where there are still hundreds of millions bellow the poverty line. This lack of organization has led to much inefficiency, which is the root of many of India's problems, especially inflation. Over the past two years, basic foods have been suffering an inflation of 15-20% and they have been directly linked to the inefficient supply chain. Increasing the cap on FDI in the retail

sector will allow foreign firms to enter the country and make major investments that will significantly modernize the sector and will set the country on a path towards further modernization, and help it to increase consumer spending and address the food inflation. Monetary policy eased during 2012-13, in response to some softening of inflation and significant moderation in growth. However, monetary policy response to addressing growth concerns was constrained by inflation persistence and the twin deficit risks that prevailed for the most part of the year. The Indian economy remained sluggish in Q3 of 2012-13, with slowdown turning visibly pervasive across most sectors. The deceleration in the services sector growth, which has been the mainstay of high growth in the recent period, had dragged down overall economic activity and employment creation. The agriculture output was dented by deficient rainfall that impacted kharif crop. Domestic policy uncertainties, governance concerns, the impact of earlier monetary tightening and the slacking of external demand continue to adversely impact growth. The Reserve Bank of India, under Raghuram Rajan, is seemingly continuing the legacy of Subbarao's aggressive monetary stance. Like his predecessor, Ranjan too has placed top priority on reining in inflation and has kept the policy rates unchanged in his last monetary policy review much against the wishes of a desperately growth seeking finance minister and Corporate India. Rupee depreciation has increased India's currency competitiveness, said the

report, "the rupee could rebound to 60/\$ by March 2014 as the current account deficit declines to 3.9 per cent, but the currency will remain significantly depreciated compared with last fiscal," Roopa Kudva, Managing Director & CEO, Crisil, said. Hence, export-linked sectors such as IT-ITES, pharmaceuticals, textiles, readymade garments and cotton-yarn spinning will do well. Agriculture is set to surprise on the upside because of a bountiful and well-distributed monsoon. Farm GDP growth could more than double from last year's 1.9 per cent to 4.5 per cent. This will help check food prices and support rural consumption. The farm fillip and pricing power will help the tractor and telecom sectors, respectively, to do well. Services, which have been the bulwark of the economy for several years, will grow at just 6.5 per cent this fiscal compared with nearly 10 per cent through the last decade. India's GDP climbed 4.8% year-over-year in the January-March quarter. This was the slowest pace of growth in a decade. For the fiscal year ending March 31, growth was 5%, down from 6.2% the previous year. Economic growth has been slowing for nearly three years. On the cyclical front we have problems like declining consumer confidence, declining industrial output, poor monsoons, and weakness in the rupee, 'supply and policy obstacles have seen growth decelerate and investment and industrial output slump, with the stasis compounded by weak global demand," said ADB Chief Economist Changyong Rhee in an April 2012 report. Policymakers need to remove structural hurdles to faster growth, and while there have been some encouraging recent reforms, more is needed. It observed that the collapse of the investment cycle will severely dent infrastructure, capital goods, automobiles and real estate sectors. Forex volatility is the least of the sources of stress for the 2,481 companies Crisil rates as investment-grade. It affects only 6 per cent of them. The report is based on a data on 2,481 companies that Crisil rates as investment grade; these account for 32 per cent of banks' corporate lending.

2. LITERATURE REVIEW

According to a recent study by Arvind Subramanian and Martin Kessler, of the Peterson Institute, a think-tank, from 1960 to the late 1990s just 30% of countries in the developing world for which figures are available managed to increase their output per person faster than America did, thus achieving what is called "catch-up growth". That catching up was somewhat lackadaisical: the gap closed at just 1.5% a year. From the late 1990s, however, the tables were turned. The researchers found 73% of developing

countries managing to outpace America, and doing so on average by 3.3% a year. CRISIL Research estimates domestic steel demand growth at 6-7 per cent CAGR between 2013-14 and 2017-18 compared with around 9 per cent CAGR over the last decade. This rate of increase will see steel demand in India touching 93-94 million tonnes by 2017-18. Since incremental demand for finished steel is expected to be considerably lower the demand-supply gap will widen, when majority of the planned capacities are scheduled to be commissioned (16 million tonnes in 2013-14 and 8 million tonnes in 2015-16). The widening gap will encourage, even compel, steel manufacturers to increase exports to arrest the expected fall in operating rates. However, the demand-supply equation globally too is not favouring domestic steel manufacturers. A shift in China's focus from investment to consumption, accentuated by weak economic conditions in mature developed countries will force a deep structural slowdown in global steel demand over the next 5 years. There exists a vast bulk of literature estimating income/price elasticities for the export of goods, but very few studies exist, especially for developing economies, that estimate the income elasticity for the export of services. Even fewer studies exist that estimate the income elasticity for Indian services exports. The small number of empirical time-series studies that exist on the determinants of the United States (US) export of services largely model export volumes in terms of foreign income and the real exchange rate. These studies all show that conventional models of merchandise trade can be applied successfully to the trade in services, as argued by Van Welsun (2003a). Recent examples of these studies include Huang and Viana (1995), Wren-Lewis and Driver (1998), Deardorff et al. (2000), Ansari and Ojemakinde (2003), and Mann (2004). Most of these studies have found that the income elasticity of demand is above unity, while relative price effects are comparatively small to those typically found for merchandise trade. For example, Wren-Lewis and Driver (1998) used a number of different estimation techniques and found that the income elasticity of demand for the aggregate volume of exports of services in the US lies in the range 1.50–1.95%, while the relative price elasticity lies in the range –0.21% to –0.40%. The findings of Huang and Viana (1995), Deardorff et al. (2000), and Mann (2004) raise the possibility of heterogeneous income and price elasticity for different categories of exports of services, although none of these studies seek to test this explicitly. Huang and Viana (1995) and Deardorff et al. (2000) both find much higher income and price elasticities of demand for

passenger fares and other travel-related exports, than for other categories of service exports. In a panel-data analysis of sub-categories of business and technical services, Mann (2004) reports that relative price elasticity are typically insignificant and, in some cases, are not negative as expected.

3. SLOW DOWN IN DEMAND AND GROWTH OF CORPORATE

Though this defies conventional wisdom, the rating agency says its study doesn't include firms such as Essar, GMR, GVK, JSW and Videocon, which are significant foreign exchange borrowers but which CRISIL doesn't rate. Stretched working capital cycles are aggravating liquidity pressures for one in six companies. The slowing economy had led to accumulation of inventory and receivables, resulting in liquidity stress, the report said, adding this had engendered refinancing pressures for firms whose net cash accruals were likely to be insufficient to service debt repayments for a fifth of the large-sized firms. Large firms with operating incomes exceeding Rs 1,000 crore are particularly vulnerable. These large firms also have higher debt levels, increasing stress on financing costs. On the macro front, a well-distributed monsoon and an increase in kharif sowing area would result in agriculture surprising on the upside. It is expected that farm GDP to more-than-double from last year's 1.9 per cent to 4.5 per cent. This would help check food prices and support consumption in rural areas. If agricultural growth exceeds six per cent, which can be seen in the past, GDP growth could be much better, at 5.2 per cent, compared to our expectation of 4.8 per cent. Sales of tractors and two-wheelers are likely to improve, owing to a rising rural economy. The telecom segment, in which pricing intensity is on the decline, is expected to gain on higher revenues per user. Export-linked sectors such as information technology, pharma, textiles, ready-made garments and cotton-yarn spinning would fare well due to the rupee's depreciation. There is a boost for export-linked sectors from the weak rupee. Growth in America is getting firmer. The government's current account deficit is expected to decline to 3.9 per cent, but the currency is expected to remain weak compared to last financial year. It is expected this would put pressure on inflation, fiscal deficit and companies' input costs. Current account deficit (when the value of imports exceeds that of exports) fears have been central to India's economic slump. The current account deficit reached a record high of 6.7% of GDP in the last quarter and has been blamed for weakening the Indian rupee.

Remember, India isn't a heavily export dependent nation — exports account for about 25% of GDP in India, compared with about 31% in China. There is an urgent need for rate cuts to boost the industrial sector that would help the economy to regain the growth momentum, most of the business chambers claim. The high interest rate is acting against the industrial growth potential in two ways, they argue. First, it raised the saving propensity of the households and makes consumers balk at spending, leading to a fall in demand. And second, the high cost of funds increases the overall production cost that in turn, eats into the margins as demand shortages do not allow industries to pass on to the consumers the rise in production cost. Whether a rate cut would give the industrial sector an immediate boost is a debatable issue but surely, a reduction in interest cost will help to improve partly the bottom-line of corporate India which has witnessed sharp deceleration in profit growth in the first half of 2013-14. As more and more companies are coming out with their half yearly results, it is becoming clear that the slowdown in sales growth in the face of rising production costs has hurt India Inc's profits. The plight of India Inc in fact, was reflected in the sharp deceleration of industrial growth in 2011-12 also. According to the latest estimates of the Central Statistical Organisation (CSO), the index of industrial production has growth by a paltry 0.4% during the first six months of the current year compared to the same period last year. The manufacturing output has grown at an even lower rate of just 0.1% during the same period. And unlike in the past, the deceleration in the manufacturing sector has been far more widespread and broad-based this time. As many as 11 out of the 22 industry groups (as per 2-digit NIC-2004 classification) in the manufacturing sector have witnessed a fall in their production during the first half of the current year compared to the same period of the previous year. The production of electronic goods including radio, television, communication equipment and apparatus has suffered the most during this period – down by 22.2% - followed by a decline of over 14% each in the production of computing machinery and furniture manufacturing. The production of machinery and equipment has declined by 10.9% while that of motor vehicles, trailers and semi trailers has gone down by 6%. The production of capital goods sector which forms the base of industrial growth has declined by 0.7% during April-September 2013 and although the production of basic goods has increased by 1.2% during this period, it was too small to make any significant impact on the sector. This is reflected in the performance across various

industry sectors and companies working within them. Consider the performance of the steel industry: India's finished steel production rose by 5.8% during April-September 2013 (Source: Joint Plant Committee). Cumulative production was estimated at 40.2 million tonnes against 38 million tonnes in the same period a year ago. However, subdued demand conditions, especially in the automobile and construction sectors, affected adversely the consumption of finished steel during the period. Aggregate consumption during the first half of the current fiscal as a result has only grown by 0.8% to 36.3 million tons compared to a 2.9% growth in the corresponding period of last year. The fall in the growth rate of consumption has affected steel prices and in turn,

the profitability of the industry. And if the public sector steel major SAIL and the biggest private sector steel maker Tata Steel have increased their net margins during this period, most others have witnessed a decline in their margins. The net profit of three, Jindal Steel and Power, Bhushan Steel and Uttam Galva, of the five big steel makers in the list, have witnessed a decline during the first half of the current year. Bhushan Steel and Uttam Galva have recorded a fall in their sales turnover as well during this period. The industry has blamed the rise in input costs for its poor margins. The sharp rise in the price of imported coking coal as well as indigenous coal has sharply increased the production cost of steel.

Table – 1: Steel Majors Suffer in Margins due to Rise in Production Cost

Company	Net sales (Rs Crore) Half year ended		% Change	Net sales (Rs. Crore) Half year ended		% Change
	Sep – 13	Sep – 12		Sep-13	Sep-12	
SAIL	21515.99	21303.93	1.0	1631.30	1239.52	31.6
Tata Steel	19188.95	17854.39	7.5	2914.78	2707.37	7.7
Jindal S& P	7019.08	6853.79	2.4	495.54	594.63	-16.7
Bhushan Steel	4550.74	5193.53	-12.4	136.32	407.48	-66.5
Uttam Galva	2330.95	3496.78	-33.3	12.01	21.40	-43.9
Total	54605.71	54702.42	0.2	5189.95	4970.40	4.4

Source: moneycontrol.com

And if despite rising production costs and the decelerating consumption of steel, the steel companies could still manage to remain in the black, the automobile industry has witnessed sharp decline in both turnover and margins. As per the data published by Society of Indian Automobile Manufacturers (SIAM) the overall domestic sales of passenger vehicles declined by 5.2% during April-December 2013 compared to the same period last year. Total sales of commercial vehicles have declined by 15.3% during the same period. The two wheelers segment, however, has managed to increase its sales by 3.5% backed by a huge 16.6% rise in scooters and motor cycles sales. To beat the declining trend a number of automobile companies are planning to launch new

products to attract the buyers' fancy. That will be in the future; right now the industry seems to be in the firm grip of recession. Tata Motors has witnessed a fall in its sales turnover by 22.3% during April-September 2013. Worse, it has gone red during this period. That is, unit price realization has failed to meet the rising cost. And this was the general story of the sector. Thus, while the five large automobile companies have witnessed 5.9% decline in the aggregate sales turnover during the first half of the current year, their net margins have declined by an even higher rate of 18.2% during the same period. And now as the interest rate is unlikely to come down soon, sales volume is feared to fall further.

Table – 2: Demand Shortages, High Interest on Car Loans affect Auto Companies' Performance

Company	Net Sales (Rs Crore) Half year ended		% Change	Net Sales (Rs. Crore) Half year ended		% Change
	Sep – 13	Sep – 12		Sep-13	Sep-12	
Maruti Suzuki India	20206.95	18599.35	8.6	1301.84	651.22	99.9
Tata Motors	17796.71	22907.10	-22.3	-100.27	1072.45	--
Hero Motocorp	11823.30	11358.96	4.1	1029.99	1056.04	-2.5
Bajaj Auto	9870.22	9530.71	3.6	1574.84	1459.06	7.9

Ashok Layland	4811.50	6163.42	-21.9	-166.81	209.53	-179.6
Total	64508.68	68559.54	-5.9	3639.59	4448.30	-18.2

Source: *monycontrol.com*

High interest rate on home loans on the one hand and failure of the government to push through various infrastructure projects on the other seem to have undone most of the good work of the cement industry witnessed till the last year. Sluggish demand from the housing and infrastructure sectors impacted the cement volumes and realizations leading to a weak financial performance of the cement companies during the first half of the current year. Sluggish demand and a rise in unit price realization have lead to a sharp fall in margins of the cement manufacturers. Look at what cement major Ultratech Cement has to say. The company has witnessed a paltry

3.4% rise in sales turnover during this period but its net profit has declined at more than double the rate, 10.6%, largely because of the higher production cost. The company talks of its expansion plan and its ability to raise production but at the same time enters into a plea of caution on account of the rise in input cost and supply vagaries of inputs such as coal, slag, power and rail transport. The five large cement companies, included in the study, together have witnessed a 6.3% decline in their net profits during April-September 2013 against the same period last year. Their aggregate sales have increased 1.2% during the period.

Table – 3: Cement Companies Suffered as most Infrastructure Projects Failed to Take-off

Company	Net Sales (Rs Crore) Half year ended		% Change	Net Sales (Rs. Crore) Half year ended		% Change
	Sep – 13	Sep – 12		Sep-13	Sep-12	
Ultra Tech Cement	10246.61	9908.46	3.4	1327.01	1484.18	-10.6
ACC	5706.34	5638.05	1.2	696.79	573.30	21.5
Ambuja Cement	4890.56	5199.26	-5.9	812.10	781.12	4.0
India Cement	2324.28	2324.04	0.0	-5.71	111.15	-105.1
Birla Corporation	1482.67	1285.46	15.3	87.57	164.98	-46.9
Total	24650.46	24355.27	1.2	2917.76	3114.73	-6.3

Source: *moneycontrol.com*

As in case of cost other sectors, the fall in India's private final consumption – down from 61.6% of GDP in the first quarter of 2012-13 to 60.6% in the first quarter of the current year – has affected the performance of the FMCG sector too. But unlike other sectors FMCG seems nevertheless to have done better. Now Delhi's rural focus seems to have finally yielded dividends for FMCG companies. The rural sector reportedly accounts for about two-fifths of the sales of major FMCG categories and thus the government's rural focus leading to employment generation and rural infrastructure spending that increased household income was expected to raise the demand for consumption goods. Apparently, this has happened. Despite high inflation and pressure on the demand for consumer goods, the FMCG sector has posted a reasonably good performance during the first half of the current year. The big brothers in the FMCG stable have all increased their sales. They have likewise increased their margins too during the period, expect for Hindustan Uni Lever. Godrej Consumer Products has increased its net sales by 16.3% followed by Dabur's 10.7%. Net profit of Emami has risen 29.4% during this period. The

combined net sales of the sampled corporations, excluding HUL, have increased by 11.7% during April-September 2013. Their net margins have grown 10.7% during the same period. If the performance of India's manufacturing sector was affected by rising input costs and high interest rates during the first half of the current year, the software companies have enjoyed a return to high growth trajectory during the same period. TCS, the country's largest software company, has increased its turnover by 33.2% and net profit by a huge 39.1% during April-September 2013. This is significant, for the software industry is the biggest employment generator in the country and thus is performance has much bigger implications on the economy. Look at the figures of TCS, the leader: It had a total workforce of 2, 85,250 as on 30th September 2013 – an addition of 17,362 from the same time a year ago. Software giant Infosys Technologies' has increased its workforce by nearly three times in five years from 52,715 in 2005-06 to 1, 56,688 in 2012-13.

Table – 4: FMCG Companies Improved their Margins during April-September 2013

Company	Net Sales (Rs Crore) Half year ended		% Change	Net Sales (Rs. Crore) Half year ended		% Change
	Sep – 13	Sep – 12		Sep-13	Sep-12	
HUL	13434.69	12405.56	8.3	1933.05	2138.11	-9.6
Nestle	4461.29	4034.03	10.6	550.47	521.70	5.5
Dabur	2270.53	2051.21	10.7	301.63	273.89	10.1
Godrej Con Div	1947.37	1673.93	16.3	249.78	218.60	14.3
Emami	744.89	674.63	10.4	141.95	109.74	29.4
Total	22858.77	20839.36	9.7	3176.88	3262.04	-2.6

Source: moneycontrol.com

4. CONCLUSION

“India Shining” has been the unofficial slogan for India since the turn of the 21st century. India averaged 8% annual GDP growth in the three years before the recent global financial crisis. Armed with population strength of more than a billion people, India is now the 11th largest economy in the world. According to data, from India’s Planning Commission, rapid economic growth has contributed to a decline in the poverty rate with 37.2% in 2005 to 29.8% in 2010, a drop of 40 million people in the absolute number of the country’s poor. Per capita income doubled during those five years. Internationally, India has also become an important actor. India plays a very important role in the leadership of the emerging markets and developing nations. India is in urgent need of reform on Foreign Direct investment (FDI) rules, particularly in its retail sector. Outdated technology, and lack of organization and inefficiency, has seen the Indian retail industry slowly and steadily pull down India’s economy. The Indian retail industry’s has annual revenue of \$500 billion as of 2011 and employs the second-most number of people after agriculture, a sector that is intrinsically linked to the retail sector. Yet, the Indian retail industry is also one of the most unorganized sectors in the country. 90% of the retail industry is controlled by small-scale, family-run operations with big chains making up just 10% of the market. According to the consulting firm McKinsey, India is suffering a shortfall of \$190 billion in the infrastructure sector and is in urgent need of capital to enhance the product distribution smoothly and to help in demand creation easy, is an important factor. Bankers have also begun gearing up for the stress in corporate balance sheets. Some of the biggest bankers are closely monitoring credit costs and keeping a close eye on the non-performing assets (NPAs). The biggest task before us is to ensure that credit costs are in check and do not go up, given the turbulent environment. Bankers feel given the

environment, the retail side is steadier and segments like home loans and vehicle loans are doing well. The small and medium enterprises (SME) side is stressed also because typically this segment has limited ability to withstand shocks. On the corporate side, more than sectors, it’s the specific companies or groups we are keeping a close watch on for stress.

5. REFERENCES

- [1] Exchange Rate of the Rupee, Global Business Review, Vol. 2, No.2, 195-212
- [2] Gaffen, David (11 November 2008). “Recession Puts Halfway Rule to the Test”. The Wall Street Journal. Retrieved 29 January 2011.
- [3] IMF (2010), Staff Report for the 2010 Article IV Consultation.
- [4] IMF (2011), *India Sustainability Report*, G20.
- [5] IMF (2012), Staff Report for the 2012 Article IV Consultation.
- [6] JP Morgan (2012), Global Data Watch, “What’s Happening to India’s Growth Drivers”, Economic Research Note, 11 May.
- [7] Krugman, Paul (2009). The Return of Depression Economics and the Crisis of 2008. W.W. Norton Company Limited. ISBN 978-0-393-07101-6.
- [8] Meliciani, Valentina, 2002. The Globalizing Learning Economy: D. Archibugi, B. Lundvall (Eds.), Oxford University Press, Oxford, 2001, pp.307.
- [9] Ministry of Finance (2011), *Economic Survey of India, FY 2011-12*.
- [10] Nigel, P. and Desirée V. W. 2004. International Production Relocation and Exports of Services, OECD, Economic Studies No. 38, January.
- [11] Patnaik, Ila and Peter Pauly 2001. The Indian Foreign Exchange Market and the Equilibrium Real

[12] Reserve Bank of India (2012), *Macroeconomic and Monetary Developments, First Quarter Review*, 2012-13.

[13] Siegel, Jeremy J. (2002). *Stocks for the Long Run: The Definitive Guide to Financial Market Returns and Long-Term Investment Strategies*, 3rd, New York: McGraw-Hill, 388. ISBN 978-0-07-137048-6

Author's Biography



Prof. Dr. S.K. Baral is M.Com, LL.B,PGDBA, MBA, Ph.D. He is currently serving as Director, Kushagra Institute of Information & Management Science (KIIMS) in Cuttack, Odisha, India.