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Research Paper

Indian financial sector reforms and the Indian corporate sector: A historical analysis

Dr. Madhu Lika
Associate Professor, Department of Commerce, Pt. CLS Government College,
Sector-14, Karnal, Haryana

Abstract: *Until the early nineties, corporate financial management in India was a relatively drab and placid activity. There were not many important financial decisions to be made for the simple reason that firms were given very little freedom in the choice of key financial policies. The government regulated the price at which firms could issue equity, the rate of interest which they could offer on their bonds, and the debt equity ratio that was permissible in different industries. Moreover, most of the debt and a significant part of the equity were provided by public sector institutions. Working capital management was even more constrained with detailed regulations on how much inventory the firms could carry or how much credit they could give to their customers. What is more, the mandatory consortium arrangements regulating bank credit ensured that it was not easy for large firms to change their banks or vice versa. In that era, financial genius consisted largely of finding one's way through the regulatory maze, exploiting loopholes wherever they existed and above all cultivating relationships with those officials in the banks and institutions who had some discretionary powers. The financial reforms have changed all this beyond recognition. Corporate finance managers today have to choose from an array of complex financial instruments; they can now price them more or less freely; and they have access (albeit limited) to global capital markets. On the other hand, they now have to deal with a whole new breed of aggressive financial intermediaries and institutional investors; they are exposed to the volatility of interest rates and exchange rates; they have to agonize over capital structure decisions and worry about their credit ratings. If they make mistakes, they face retribution from an increasingly competitive financial marketplace, and the retribution is often swift and brutal. This paper begins with a quick summary of the financial sector reforms that have taken place since 1991. It then discusses the impact of these reforms on the corporate sector under five main heads: corporate governance, risk management, capital structure, group structure and working capital management.*
Keywords: *Indian Financial Sector Reforms, corporate governance, finance.*

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I. Introduction:

Financial sector reforms are at the centre stage of the economic liberalization that was initiated in India in mid 1991. They are the steps taken to change the banking system, capital market, government debt market, foreign exchange market, etc. as an efficient financial sector enables the mobilization of household savings and ensures their proper utilization in productive sectors.

What is the Financial Sector?

- The financial sector constitutes the commercial banks, non-banking financial companies, investment funds, money market, insurance and pension companies, real estate etc.
- It forms the core of an economy which facilitates the mobilization and distribution of financial resources.
- It is engaged in providing financial services to the customers of the commercial and retail segments.

Need for Financial Sector Reforms:

- After independence India inherited a colonial legacy that was full of various social and economic deprivations.

- The planned economic development strategy adopted based on the Mahalanobis model had its limitations that started showing in the 1980s.
- In order to achieve various economic goals, the government resorted to increased borrowings at concessional rates which lead to weak and underdeveloped financial markets in India.
- The nationalization of banks increased government control and decreased the role of market forces in the financial sector.
- Increased bureaucratic control, issues of red-tapism increased the non-performing assets.
- Turbulent international events such as the war in the Middle East and the fall of the USSR increased the pressure on the Foreign Exchange Reserves of India.

Narasimham Committee report (1991):
It was established to give reforms pertaining to the financial sector of India including the capital market and banking sector. Some of its major recommendations have been mentioned below:

- It recommended reducing the cash reserve ratio (CRR) to 10% and the statutory liquidity ratio (SLR) to 25% over the period of time.
- It suggested fixing at least 10% of the credit for priority sector lending to marginal farmers, small businesses, cottage industries, etc.
- In order to provide required independence to the banks for setting the interest rates themselves for the customers, it recommended de-regulating the interest rates.

Major Financial Sector Reforms in India:
Banking Sector:

- Reduction in CRR and SLR has given banks more financial resources for lending to the agriculture, industry and other sectors of the economy.
- The system of administered interest rate structure has been done away with and RBI no longer decides interest rates on deposits paid by the banks.
- Allowing domestic and international private sector banks to open branches in India, for example, HDFC Bank, ICICI Bank, Bank of America, Citibank, American Express, etc.
- Issues pertaining to non-performing assets were resolved through Lok adalats, civil courts, Tribunals, The Securitisation And Reconstruction of Financial Assets and the Enforcement of Security Interest (SARFAESI) Act.
- The system of selective credit control that had increased the dominance of RBI was removed so that banks can provide greater freedom in giving credit to their customers.

Debt Market:

- The 1997 policy of the government that included automatic monetization of the fiscal deficit was removed resulting in the government borrowing money from the market through the auction of government securities.
- Borrowing by the government occurs at market-determined interest rates which have made the government cautious about its fiscal deficits.
- Introduction of treasury bills by the government for 91 days for ensuring liquidity and meeting short-term financial needs and for benchmarking.
- To ensure transparency the government introduced a system of delivery versus payment settlement.

Foreign Exchange Market:

- Market-based exchange rates and the current account convertibility was adopted in 1993.
- The government permitted the commercial banks to undertake operations in foreign exchange.
- Participation of newer players allowed in rupee foreign currency swap market to undertake currency swap transactions subject to certain limitations.
- Replacement of foreign exchange regulation act (FERA), 1973 was replaced by the foreign exchange management act (FEMA), 1999 for providing greater freedom to the exchange markets.
- Trading in exchange-traded derivatives contracts was permitted for foreign institutional investors and non-resident Indians subject to certain regulations and limitations.

What led to these reforms?
There were many great reasons that led to these reforms. Some of the major reasons are as follows:
• The balance of payments crisis that threatened the international credibility of the country and pushed it to the brink of default;

• The grave threat of insolvency confronting the banking system which had for years concealed its problems with the help of defective accounting policies. Moreover, many of the deeper rooted problems of the Indian economy in the early nineties were also strongly related to the financial sector:
• The problem of financial repression in the sense of McKinnon-Shaw induced by administered interest rates pegged at unrealistically low levels;
• Large scale pre-emption of resources from the banking system by the government to finance its fiscal deficit;
• Excessive structural and micro regulation that inhibited financial innovation and increased transaction costs;
• Relatively inadequate level of prudential regulation in the financial sector;
• Poorly developed debt and money markets; and
• Outdated (often primitive) technological and institutional structures that made the capital markets and the rest of the financial system highly inefficient.

Key areas of the reforms:
Exchange Control and Convertibility: One of the early successes of the reforms was the speed with which exceptional financing was mobilized from multilateral and bilateral sources to avert what at one stage looked like a imminent default on the country's external obligations. Subsequently, devaluation, trade reforms and the opening up of the economy to capital inflows helped to strengthen the balance of payments position. The significant reforms in this area were:
• Exchange controls on current account transactions were progressively relaxed culminating in current account convertibility.
• Foreign Institutional Investors were allowed to invest in Indian equities subject to restrictions on maximum holdings in individual companies. Restrictions remain on investment in debt, but these too have been progressively relaxed.
• Indian companies were allowed to raise equity in international markets subject to various restrictions.
• Indian companies were allowed to borrow in international markets subject to a minimum maturity, a ceiling on the maximum interest rate, and annual caps on aggregate external commercial borrowings by all entities put together.
• Indian mutual funds were allowed to invest a small portion of their assets abroad.
• Indian companies were given access to long dated forward contracts and to cross currency options.

Banking and credit policy: At the beginning of the reform process, the banking system probably had a negative net worth when all financial assets and liabilities were restated at fair market values. This unhappy state of affairs had been brought about partly by imprudent lending and partly by adverse interest rate movements. At the peak of this crisis, the balance sheets of the banks, however, painted a very different rosy picture. Accounting policies not only allowed the banks to avoid making provisions for bad loans, but also permitted them to recognize as income the overdue interest on these loans. The severity of the problem was thus hidden from the general public. The threat of insolvency that loomed large in the early 1990s was, by and large, corrected by the government extending financial support of over Rs 100 billion to the public sector banks. The banks have also used a large part of their operating profits in recent years to make provisions for non performing assets (NPAs). Capital adequacy has been further shored up by revaluation of real estate and by raising money from the capital markets in the form of equity and subordinated debt. With the possible exception of two or three weak banks, the public sector banks have now put the threat of insolvency behind them.
The major reforms relating to the banking system were:
• Capital base of the banks were strengthened by recapitalization, public equity issues and subordinated debt.
• Prudential norms were introduced and progressively tightened for income recognition, classification of assets, provisioning of bad debts, marking to market of investments.
• Pre-emption of bank resources by the government was reduced sharply.
• New private sector banks were licensed and branch licensing restrictions were relaxed.
At the same time, several operational reforms were introduced in the realm of credit policy:
• Detailed regulations relating to Maximum Permissible Bank Finance were abolished
• Consortium regulations were relaxed substantially
• Credit delivery was shifted away from cash credit to loan method

Interest rate deregulation and financial repression: Perhaps the single most important element of the financial sector reforms has been the deregulation of interest rates:
• Interest rates were freed on corporate bonds, most bank lending, and bank deposits above one year maturity;
• Introduction of auctions coupled with reduced pre-emption led to more market determined interest rates for government securities;

• Administered interest rates are now confined mainly to short term bank deposits, priority sector lending, and deposits of non banking financial companies. For all practical purposes, financial repression is a thing of the past. Even on short term retail bank deposits which are still regulated, the ceiling rate is well above the historic average rate of inflation. Moreover, quite often the ceiling has not been a binding constraint in the sense that actual interest rates have often been below the regulatory ceiling. Similarly, the prices of most other financial assets are also now determined by the more or less free play of market forces. Consequently, financial markets are increasingly able to perform the important function of allocating resources efficiently to the most productive sectors of the economy. This must count as one of the most enduring and decisive successes of the financial reforms.

Capital Markets: The major reform in the capital market was the abolition of capital issues control and the introduction of free pricing of equity issues in 1992. Simultaneously the Securities and Exchange Board of India (SEBI) was set up as the apex regulator of the Indian capital markets. In the last five years, SEBI has framed regulations on a number of matters relating to capital markets. Some of the measures taken in the primary market include:

• Entry norms for capital issues were tightened;
• Disclosure requirements were improved;
• Regulations were framed and code of conduct laid down for merchant bankers, underwriters, mutual funds, bankers to the issue and other intermediaries;

In relation to the secondary market too, several changes were introduced;

• Capital adequacy and prudential regulations were introduced for brokers, sub-brokers and other intermediaries;
• On-line trading was introduced at all stock exchanges. Margining system was rigorously enforced;
• Settlement period was reduced to one week; carry forward trading was banned and then reintroduced in restricted form; and tentative moves were made towards a rolling settlement system.

Similarly, in the area of corporate governance:

• Regulations were framed for insider trading;
• Regulatory framework for take-overs was revamped.

SEBI has been going through a protracted learning phase since its inception. The apparent urgency of immediate short term problems in the capital market has often seemed to distract SEBI from the more critical task of formulating and implementing a strategic vision for the development and regulation of the capital markets. In quantitative terms, the growth of the Indian capital markets since the advent of reforms has been very impressive. The market capitalization of the Bombay Stock Exchange (which represents about 90% of the total market capitalization of the country) has quadrupled from Rs 1.1 trillion at the end of 1990-91 to Rs 4.3 trillion at the end of 1996-97. As a percentage of GDP, market capitalization has been more erratic, but on the whole this ratio has also been rising. Total trading volume at the Bombay Stock Exchange and the National Stock Exchange (which together account for well over half of the total stock market trading in the country) has risen more than ten-fold from Rs 0.4 trillion in 1990-91 to Rs 4.1 trillion in 1996-97 . The stock market index has shown a significant increase during the period despite several ups and downs, but the increase is much less impressive in dollar terms because of the substantial depreciation of the Indian rupee.

For the primary equity market too, 1994-95 was the best year with total equity issues (public, rights and private placement) of Rs 355 billion. Thereafter, the primary market collapsed rapidly. Equity issues in 1996-97 fell to one-third of 1994-95 levels and the decline appears to be continuing in 1997-98 as well. More importantly, most of the equity issues in recent months have been by the public sector and by banks. Equity issues by private manufacturing companies are very few.

Structural deregulation:

In its mid-term review of the reform process, the government stated: “Our overall strategy for broader financial sector reform is to make a wide choice of instruments accessible to the public and to producers. ... This requires a regulatory framework which gives reasonable protection to investors without smothering the market with regulations. ... It requires the breaking up of monopolies and promotion of competition in the provision of services to the public. ... It requires the development of new markets such as security markets for public debt instruments and options, futures and forward markets for financial instruments and commodities.” Unfortunately, this is one area where actual progress has lagged far behind stated intent. It is true that some steps have been taken to increase competition between financial intermediaries both within and across categories. Banks and financial institutions have been allowed to enter each other's territories. Fields like mutual funds, leasing and merchant banking have been thrown open to the banks and their subsidiaries. The private sector has been allowed into fields like banking and mutual funds. Nevertheless, major structural barriers remain:

• All major banks and financial institutions continue to be government owned and government managed.

• The entire mechanism of directed credit and selective credit controls built up over the years is still in place, and is being strengthened in certain areas

• Financial intermediaries have often been compelled to set up separate arms' length subsidiaries while entering various segments of the financial services industry. This has prevented them from benefiting from economies of scope.

• Competition has also been hindered by the undiminished power of cartels like the Indian Banks Association (IBA). In fact, these cartels have been accorded the tacit support of the regulators. Similarly, the Securities and Exchange Board of India (SEBI) has been reluctant to permit aggressive competition among the different stock exchanges. These half hearted attempts at promoting competition raise fears about the extent to which our regulators have succumbed to regulatory capture by the organizations that they are supposed to regulate.

• Insurance continues to be a public sector monopoly. As a result, financial products which combine the features of life insurance with those of equity related instruments have not developed. The range of insurance products (life and non-life) available in the country is also limited.

• The regulators have not yet moved to create a full fledged options and futures market.

• On the technological front, progress has been slow in important areas. The payment system continues to be primitive despite the central bank's attempts to create an Electronic Fund Transfer System (EFTS). Archaic elements of the telecom regulations have prevented the financial services industry from benefiting from the confluence of communications and computing technologies.

Monetary policy and debt markets:

In the early nineties, the Indian debt market was best described as a dead market. Financial repression and over-regulation were responsible for this situation. Reforms have eliminated financial repression and created the pre-conditions for the development of an active debt market:

• The government reduced its pre-emption of bank funds and moved to market determined interest rates on its borrowings. Simultaneously, substantial deregulation of interest rates took place as described earlier;

• Automatic monetization of the government's deficit by the central bank was limited and then eliminated by abolishing the system of ad hoc treasury bills. Several operational measures were also taken to develop the debt market, especially the market for government securities;

• Withdrawal of tax deduction at source on interest from government securities and provision of tax benefits to individuals investing in them;

• Introduction of indexed bonds where the principal repayment would be indexed to the inflation rate;

• Setting up of a system of primary dealers and satellite dealers for trading in government securities;

• Permission to banks to retail government securities;

• Opening up of the Indian debt market including government securities to Foreign Institutional Investors.

Meanwhile a spate of well subscribed retail debt issues in 1996 and 1997 shattered the myth that the Indian retail investor has no appetite for debt. While only Rs 6 billion was raised through public debt issues in 1994 and Rs 11 billion in 1995, the amounts raised in 1996 was Rs 56 billion. Debt accounted for more than half of the total amount raised through public issues in 1996 compared to less than 10% two years earlier. In 1997, public issues of debt fell to Rs 29 billion, but with the collapse of the primary market for equity, the share of debt in all public issues increased to 57%. Meanwhile, private placement of debt (which is a much bigger market than public issues) has grown very rapidly. Private placement of debt jumped from Rs 100 billion in 1995-96 to Rs 181 billion in 1996-97; in the first half of 1997-98, it grew again by over 50% with Rs 136 billion mobilized in these six months alone.

Impact upon the Corporate Sector:

Corporate governance

In the mid-nineties, corporate governance became an important area of concern for regulators, industrialists and investors alike. Indian industry considered the matter important enough for them to propose a model corporate governance code. However, the major pressure for better corporate governance came from the capital markets. Capital markets have always had the potential to exercise discipline over promoters and management alike, but it was the structural changes created by economic reform that effectively unleashed this power. Minority investors can bring the discipline of capital markets to bear on companies by voting with their wallets. They can vote with their wallets in the primary market by refusing to subscribe to any fresh issues by the company. They can also sell their shares in the secondary market thereby depressing the share price. Financial sector reforms set in motion several key forces that made these forces far more potent than in the past:

• **Deregulation:** Economic reforms have not only increased growth prospects, but they have also made markets more competitive. This means that in order to survive companies will need to invest continuously on a large scale. The most powerful impact of voting with the wallet is on companies with large growth opportunities that have a constant need to approach the capital market for additional funds.

• **Disintermediation:** Meanwhile, financial sector reforms have made it imperative for firms to rely on capital markets to a greater degree for their needs of additional capital. As long as firms relied on directed credit, what mattered was the ability to manipulate bureaucratic and political processes; the capital markets, however, demand performance.
• **Globalization:** Globalization of our financial markets has exposed issuers, investors and intermediaries to the higher standards of disclosure and corporate governance that prevail in more developed capital markets.
• **Institutionalization:** Simultaneously, the increasing institutionalization of the capital markets has tremendously enhanced the disciplining power of the market. Large institutions (both domestic and foreign), in a sense, act as the gatekeepers to the capital market. When they vote with their wallets and their pens, they have an even more profound effect on the ability of the companies to tap the capital markets. Indian companies that opened their doors to foreign investors have seen this power of the minority shareholder in very stark terms. International investors can perhaps be fooled for the first time about as easily as any other intelligent investor, but the next time around, the company finds that its ability to tap the international markets with an offering of Global Depository Receipts (GDRs) or other instrument has practically vanished. In the mid-90s, company after company in India has woken up in this manner to the power that minority shareholders enjoy when they also double up as gatekeepers to the capital market.
• **Tax reforms:** Tax reforms coupled with deregulation and competition have tilted the balance away from black money transactions. It is not often realized that when a company makes profits in black money, it is cheating not only the government, but also the minority shareholders. Black money profits do not enter the books of account of the company at all, but usually go into the pockets of the promoters. The past few years have witnessed a silent revolution in Indian corporate governance where managements have woken up to the disciplining power of capital markets. In response to this power, the more progressive companies are voluntarily accepting tougher accounting standards and more stringent disclosure norms than are mandated by law. They are also adopting more healthy governance practices. Nevertheless, it is still true that the state of corporate governance in India remains pathetic. It is this more than anything else that lies behind the prolonged slump in the primary market today.

Risk management:

In the days when interest rate were fixed by the government and remained stable for long periods of time, interest rate risk was a relatively minor problem. The deregulation of interest rates as a part of financial sector reform has changed all that and made interest rates highly volatile. For example, the rate of interest on short term commercial paper was about 12-13% at the end of 1994, rose to about 17% by the end of 1995, peaked at about 20% in April 1996, dropped back to about 13% by the end of 1996, continued to fall through 1997 reaching about 8% in November 1997 before climbing back to double digits by the end of the year. Companies which borrow short term to fund their new projects may face difficulties if interest rates go up sharply. It may turn out that at the higher cost of finance, the project is not viable at all. Worse, companies may find it difficult to refinance their borrowings at any price in times when money is tight. Many companies which borrowed in the Inter Corporate Deposit (ICD) market in 1994 to finance acquisitions and expansions faced this difficulty in 1995 and 1996 when the ICD market dried up. Large scale defaults (euphemistically described as rollovers) took place during this time. On the other hand, companies which issue long term bonds may start regretting the decision when they find interest rates coming down. In the last few years, companies have tried to protect themselves from this risk by introducing a call provision in their bonds by which they can redeem the bonds prematurely under certain conditions. Of course, such call options make the bonds more expensive (in terms of a higher coupon rate) or more difficult to sell. Companies have also tried to make the bonds more attractive to investors by giving them a put option to seek premature redemption of the bonds. This may make the bond easier to sell, but it exposes the issuing company to interest rate risk. If interest rates rise, many investors will exercise the put option, and the company will have to borrow from elsewhere at high cost to meet the redemption requirements. Put and call options do make a big difference to the pricing of some of these bonds (Varma 1996a) making the design of these instruments quite complex. In the next few years, many of these companies would also be faced with the decision of the optimal exercise of the call options on the callable bonds that they have issued in recent years. In the post reform era, corporates have also been faced with high volatility in foreign exchange rates. The rupee-dollar rate has on several occasions moved up or down by several percentage points in a single day as compared to the gradual, predictable changes of the eighties. Indian companies have found to their dismay that foreign currency borrowings which looked very cheap because of a low coupon rate of interest can suddenly become very expensive if the rupee depreciates against the currency in which the bond is denominated. Foreign currency convertible bonds issued by many Indian companies in 1993 and 1994 illustrate the devastating effects of volatility in interest rates, foreign exchange rates and stock prices. At the time of issue, the bonds carried a low coupon rate (often only 2 or 3% in US dollars), and were convertible into stock at prices which were at a modest premium (5 to 10%) over the then prevailing stock price.

Issuers thought of them as deferred equity and found the instruments very attractive because they allowed equity to be priced at a premium to the market prices and offered the benefit of a low coupon till the conversion date. As it turned out, stock prices fell during 1995 and 1996, and investors chose not to convert the bonds. Issuers then realized that they would have to redeem the bonds in dollars, and that the depreciation of the rupee has increased their effective borrowing cost substantially. To make worse, investors exercised put options wherever they had them, and companies had to raise money in the domestic markets to pay off the foreign bondholders. In some cases, this happened at a time when Indian monetary policy was extremely tight and interest rates were very high. In this case, volatility in three different markets combined to make things difficult for the companies concerned.

Capital structure:
At the beginning of the reform process, the Indian corporate sector found itself significantly over-levered. This was because of several reasons:
• Subsidized institutional finance was so attractive that it made sense for companies to avail of as much of it as they could get away with. This usually meant the maximum debt-equity ratios laid down by the government for various industries;
• In a protected economy, operating (business) risks were lower and companies could therefore afford to take more risks on the financing side;
• Most of the debt was institutional and could usually be rescheduled at little cost.
The reforms changed all of this. The corporate sector was exposed to international competition and subsidized finance gave way to a regime of high real interest rates. One of the first tasks for the Indian companies was substantial deleveraging. Fortunately, a booming equity market and the appetite of foreign institutional investors for Indian paper helped companies to accomplish this to a great extent in 1993 and 1994. The downturn in the stock market that has followed since then has stopped this process from going any further and has probably left many companies still excessively levered. According to the figures compiled by the Centre for Monitoring the Indian Economy, the average debt-equity ratio of private sector manufacturing companies in India fell from 1.72 in 1990-91 to 1.05 in 1996-97, and more than half of this reduction took place in one single year - 1994-95. Over the longer term, economic reforms have also been reshaping the control dimension of the leverage decision. Corporate control is an important consideration in the choice of debt or equity in the capital structure. An equity issue clearly involves loss of control, and as discussed under the section on corporate governance, reforms have increased the power of the minority shareholders. Equally, a debt issue also can have control implications in the form of debt covenants, rating discipline and cash flow discipline. Reforms have impacted these too, but more slowly:
• **Bond covenants:** Internationally bond covenants are quite restrictive especially for companies whose credit worthiness is less than top class. These covenants may restrict the investment and dividend policies of the company, may mandate sinking funds, may include cross-default clauses and may contain me-too clauses which restrict the future borrowing ability of the company. Bond covenants have typically been quite lax in India. Moreover bond (and debenture) trustees have been generally very lax in the performance of their duties.
• **Rating discipline:** The most dramatic example of the power of rating discipline was demonstrated in 1996 when in the face of a constitutional deadlock between the US president and the Congress over the approval of the budget, the rating agencies threatened to downgrade US government securities to default grade. It was shown that even the most powerful borrower in the world can be subjected to rating discipline; it is believed that the raters' threat played a role in the speedy resolution of the constitutional deadlock. Rating discipline is gradually asserting itself in India. The last couple of years have seen a series of rating downgrades as corporate balance sheets deteriorated in an environment of tight money. Rating agencies are becoming more stringent in their rating standards and are paying greater attention to key financial parameters like the interest coverage ratio. Already some companies are beginning to informally sound out their rating agencies before taking major financial decisions to ensure that their rating is not adversely affected. This is standard practice in many other countries of the world where credit rating is well developed.
• **Cash flow discipline:** Equity has no fixed service costs and year to year fluctuations in income are not very serious so long as overall enough is earned to provide a decent return to the shareholders. Debt on the other hand has a fixed repayment schedule and interest obligation. A company that is unable to generate enough cash flow to meet this debt service requirement faces insolvency or painful restructuring of liabilities. Again, Indian companies have not experienced much of this discipline in the past because much of their debt was owed to banks and institutions who have historically been willing to reschedule loans quite generously. Institutions may be less willing to do so in future. More importantly, rescheduling is not an easy option when the debt is raised in the market from the public. Bonds are typically rescheduled only as part of a bankruptcy proceeding or a BIFR restructuring. As the next phase of economic reforms targets bankruptcy related laws, cash flow discipline can be expected to become far more stringent.

Group structure and business portfolio:
Indian business groups have been doing serious introspection about their business portfolios and about their group structure. Under the influence of academics like C. K. Prahalad, Indian business groups which have traditionally been involved in a wide range of businesses have been contemplating a shift to a more focused strategy. At the same time, they have been trying to create a group organizational structure that would enable the formulation and implementation of a group wide corporate strategy. Group financial structures are also beginning to change as the existing complex web of inter locking shareholdings slowly gives way to more transparent ownership patterns. But all these changes in group structure and strategy have been quite slow. In many cases, they have not gone beyond a statement of intent.
By contrast, in a country like South Africa where the group structures were even more labyrinthine to begin with, restructuring of holdings and refocusing of business portfolios (unbundling as it is referred to in that country) have taken place at a rapid pace.
Working capital management: Working capital management has been impacted by a number of the developments discussed above - operational reforms in the area of credit assessment and delivery, interest rate deregulation, changes in the competitive structure of the banking and credit systems, and the emergence of money and debt markets. Some of the important implications of these changes for short term financial management in the Indian corporate sector are:
• **Creditworthiness:** The abolition of the notion of maximum permissible bank finance has given banks greater freedom and responsibility for assessing credit needs and creditworthiness. Similarly commercial paper and other disinter mediated forms of short term finance are very sensitive to the company's credit rating and perceived creditworthiness. Companies are suddenly finding that their creditworthiness is under greater scrutiny than ever before. Over a period of time, companies will have to strengthen their balance sheets significantly to ensure a smooth flow of credit. In the meantime, many borrowers' especially small and medium businesses have seen their source of credit dry up.
• **Choice:** Top notch corporate borrowers are seeing a plethora of choices. The disintegration of the consortium system, the entry of term lending institutions into working capital finance, and the emergence of money market borrowing options gives them the opportunity to shop around for the best possible deal. Some borrowers indeed appear to have moved to a highly transaction oriented approach to their bankers. Over time, however, we would probably see the re emergence of relationship banking in a very different form.
• **Maturity Profile:** The greater concern for interest rate risk makes choice of debt maturity more important than before. Short term borrowings expose borrowers to roll-over risk and interest rate risk.
• **Cash Management:** Cash management has become an important task with the phasing out of the cash credit system. Companies now have to decide on the optimal amount of cash or near-cash that they need to hold, and also on how to deploy the cash. Deployment in turn involves decisions about maturity, credit risk and liquidity. In the mid-nineties, many corporates found that they had got these decisions wrong. During the tight money policy of this period, some companies were left with too little liquid cash, while others found that their "cash" was locked up in unrealizable or illiquid assets of uncertain value.

II. Conclusion:

As one looks back at the reforms, it is evident that India has undertaken financial sector reforms at a leisurely pace and that there is a large unfinished agenda of reforms in this sector . At the same time, it is true that India has avoided the financial sector problems that plagued Latin America in the eighties and are confronting East Asia today. It is tempting (and perhaps fashionable) to adopt a posture of smug satisfaction and point to East Asia as a vindication of the slow pace of liberalization in India. It would however be a mistake if Indian corporates allowed themselves to be lulled into complacency. East Asia has awakened us to the dangers that arise from a combination of high leverage in the corporate sector, poor corporate governance, an implicit currency peg and the resulting overvaluation of the currency, high dependence on external borrowings, a weak banking system and widespread implicit guarantees by the government. Though many of these factors are present in India too, they have been far more muted than in East Asia, and India has therefore come to be seen as less vulnerable. More importantly, extensive capital controls have meant that India is less exposed to global financial markets. Some analysts now appear to think that this a good thing. However, we must not forget that financial markets are only the messengers of bad news and that by cutting ourselves off from these messengers, we do not get rid of the bad news itself. East Asia should be seen as a warning for the Indian corporate sector to pursue more prudent and sustainable financial policies. Slow liberalization has so far given Indian corporates the luxury of learning slowly and adapting gradually. It would be a mistake to believe that this luxury will last long. Rather, Indian companies should use this breathing space to prepare themselves for the further changes that lie ahead. If in the end, Indian corporates find themselves ill equipped to operate in a highly competitive and demanding financial marketplace they will have only themselves to blame.

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