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SURVIVAL AND NOT PROFITEERING : THE RATIONALE BEHIND RETENTION OF BUDGETARY BENEFITS

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A B S T R A C T

The retention, by Indian industry, of the benefits granted to it, in the 1993 Union Budget, has, once again, attracted attention. The Union Civil Supplies Minister has recently asserted that the Government would be forced to withdraw the budgetary concessions if the industry failed to live up to its expectations. (The Economic Times, 8.6.93, p 1)

Assocham, the apex body representing industry interests, on the other hand, asserts that the Indian industry has passed on the benefits to the consumer.

This phenomenon of disagreement over whether the industry is, in fact, passing on the duty benefits or not (including the degree thereof) is not new. It has been the story for years now. One could dismiss this issue, as one did in the past, as mere rhetoric. However, this time, it is necessary to go beyond. This is due to the fundamental changes that have taken place in the Indian economy during the past 24 months. Especially the dismantling of protection from international competition that was hitherto being provided to Indian industry.

The key factor that would influence the strategic response of top managements of enterprise in today's environment is their outlook for the future. This can be dichotomised into

(a) their assessment of the future for their line(s) of business, including their assessment of their ability to acquire competitive capability,(Competitiveness Assessment) and

(b) their assessment of their ability to continue to exercise control over the enterprise. (Threat to Ownership/Control)

The latter has particularly assumed great significance in the new environment. The behaviour of both Indian businesses and the transnational corporations since the adoption of a new economic strategy leads one to believe that perhaps Indian businesses are none too confident about surviving the future - independently.

This paper constructs multiple scenarios confronting Indian businesses and argues that in all the conceivable scenarios that Indian businesses confront, rational behaviour dictates retention of duty concessions granted in the 1993 Union budget.

Survival And Not Profiteering: The Rationale Behind Retention of Budgetary Benefits

The retention, by Indian industry, of the benefits granted to it, in the 1993 Union Budget, has, once again, attracted attention. The Union Finance and Civil Supplies ministers had expressed, earlier on, their 'concern' and had declared their intention to take 'action' in the event the Industry did not pass on the duty reliefs to the consumer. The Civil Supplies Minister has recently reiterated that the Government would be forced to withdraw the budgetary concessions if the industry failed to live up to its expectations. (The Economic Times, 8.6.93, p 1) Interestingly, the Finance Secretary to the Government of India had stated, in the budget debate telecast in the national television network, that the Government expects the Industry to retain some portion of the benefits! (Business World, May 1993)

Assocham, the apex body representing industry interests, asserts that the Indian industry has passed on the benefits to the consumer. According to a survey carried out by it the pre budget hike in administered prices, increase in freight and other costs like upward revision in minimum wages etc. has made it difficult for the industry to pass on the concessions in full. It contends that in some cases the companies had not raised prices even where rationalisation and rounding off had, in fact, increased the duty impact on the products.(Economic Times, 21.5.93, p 18). According to press reports the Government has given Indian industry a new two week deadline to furnish proof that the budgetary benefits have been passed to the consumer.

This phenomenon of disagreement over whether the industry is, in fact, passing on the duty benefits or not (including the degree thereof) is not new. It has been the story for years now. One needs to only peruse /recall the statements of the various finance ministers after the grant of concessions in every budget and the counter claims of industry associations to find a similarity, perhaps comforting, in the statements/ announcements being made.

One could dismiss this issue, as one did in the past, as mere rhetoric. However, this time, it is necessary to go beyond. This is due to the fundamental changes that have taken place in the Indian economy during the past 24 months. Especially the dismantling of protection from international competition that was hitherto being provided to Indian industry.

Enterprise behaviours reflect the ground realities. As is well known, success in the past was largely dictated by the ability of Indian business in gaining government largesse either in the form of licenses or restriction of entry of others or formulation of a

favourable policy in the form of concessions. The profitability of Indian industry was not necessarily determined by efficiency in operations either in terms of cost or in terms of quality or both. The Government was the key force that influenced their profitability.

Consequently, on an issue like the one on hand viz., passing on of duty reliefs, the Government could demand the industry to pass on the benefits granted to the consumer. Industry would have had to comply since the Government was the key factor influencing its profitability. The balance of power was loaded heavily in favour of the government. Ironically though, like in the present, in the past too, the Government did not achieve any significant success in its efforts to force Indian industry to pass on the duty concessions granted to it.

Since in the past there was no meaningful competition (including the threat of potential competition) prevailing in the Indian economy, the retention of benefits granted was interpreted (perhaps rightly) as an act of profiteering by Indian industry. The current assertions on industry behaviour are largely a reflection of this mind set. Viewed with this mind set, one could easily conclude that the current behaviour of Indian industry is just a continuation of its past pattern of behaviour. This, however, would be a rather simplistic and convenient explanation. Given the ground realities of today, there is more to the behaviour of Indian business than what such an explanation offers.

New Ground Realities.

The new economic strategy has unleashed the forces of competition in the Indian economy. Success today , and in the forthcoming years, is going to be determined by Indian industry's ability to compete. What is more the competition is global. The number of shut downs or reductions in the quantity manufactured (the Petrochemical and Fertilizer industries for example.) is on the increase since the announcement in the changes in the economic strategy. This is largely due to the availability of imports at much lower prices. The low prices are due to both weakening of international prices, because of the recession in the developed countries, and the reductions in custom tariffs announced in the budget.

The current reality is that Indian businesses lack global competitiveness. They are technology poor, quality poor, and are not cost competitive. These characteristics being the legacies of the past regulated era. Most Indian businesses are, today, not in position to cope successfully with the forces of competition, especially global competition, unleashed by the changed economic strategy. For example, the existing capacities of Indian businesses in a number of industries is miniscule when compared to the capacities of their global competitors. Perhaps nowhere

else in the world would one find a auto company manufacturing 4,000 - 5000 vehicles per annum. A number of Indian LCV manufacturers do. At such volumes they would necessarily lack cost competitiveness. The scale economies available to global players in this industry far outweigh the benefits of low labour cost enjoyed by Indian manufacturers, especially after one adjusts for the low productivity of Indian businesses.

Nor would one find such narrow scopes of businesses globally. Taking the same LCV industry, nowhere in the world one would find enterprises exclusively manufacturing LCVs. Most of the global players offer a broad range of products and operate in the entire spectrum comprising the automobile market. LCVs would be only one of the products they would manufacture. They would be manufacturing Passenger Cars, Trucks, Jeeps etc.

Thus, apart from scale disadvantages, most Indian businesses also suffer from scope disadvantages. The scope disadvantages are not restricted to manufacturing. They extend to marketing as well. The power of an umbrella brand like Toyota - which manufactures all types of automobiles - is far superior to that of a DCM Toyota or an Eicher Mitsubishi. The unit cost of building brands, due to the limited ability of Indian businesses to amortize the brand building costs due to smaller volumes, would simply render most of them non competitive. They would either under invest or become high cost manufacturers. In either case they cannot emerge as meaningful players in a competitive environment.

Thus, both in terms of Scope and Scale most Indian businesses are at a massive disadvantage. The basic structure of most Indian industries renders Indian enterprises unsuitable to be globally competitive players. Unless Indian businesses initiate corrective action to gain competitiveness, they would not survive in the current competitive environment.

In order to survive in the future, most Indian enterprises need to shore up their competitive capabilities. Primarily they need to upgrade their technology and their capacities to achieve competitiveness. This requires substantial investments. The current resource position of most Indian enterprises, bulk of which are owner managed, is none too sound. Most have financed their past growth by depending essentially on institutional funding from the 'development' financial institutions like the ICICI,IFCI,IDBI etc. Given the impact of the new economic policies on the financial institutions, whose source of cheap funds has dried up, and who are also being subject to competitive pressures (including that of survival), these institutions are unlikely to be forthcoming easily with funds for investment. Institutional funds, even if available, cost more now, which would further worsen the cost structure of Indian businesses.

The alternative available to Indian enterprises is to mobilise more equity from the public, which, once again, being more expensive, would affect their competitiveness. The current depressed state of the Capital Markets does not make this a very

attractive or promising option.

Consequently, most Indian businesses would have to substantially depend on their earnings. The Indian economy has witnessed, during the last 18 months, recessionary conditions. This has affected the profitability of most Indian enterprises. Thus, the principal way in which Indian businesses can improve their resource(funds) position in the immediate future would be by retaining the budgetary concessions granted instead of parting with them. Therefore, instead of profiteering, it could inferred that the need to cope with the current competitive environment that has dictated the retention of budgetary benefits.

Prima facie, the above argument would seem valid only if the Indian businesses seek to invest in the future. This is not true. Apart from their need to survive as a business, in the emerging competitive scenario, the likely threat to their control over the enterprise would also dictate such a behaviour by the top managements of Indian businesses. It would, therefore, be worthwhile to examine the alternate scenarios Indian businesses confront to explain their behaviour vis a vis duty concessions.

Future Outlook

The key factor that would influence the strategic response of top managements of enterprise in today's environment is their outlook for the future. This can be dichotomised into

(a) their assessment of the future for their line(s) of business, including their assessment of their ability to acquire competitive capability,(Competitiveness Assessment) and

(b) their assessment of their ability to continue to exercise control over the enterprise. (Threat to Ownership/Control)

As stated earlier, Indian businesses are basically technologically backward. In order to achieve competitiveness they need to upgrade their technology . The principal source for state of the art technology are the transnationals(TNCs). Since foreign direct investment is being actively sought in the new economic framework, the TNCs may not readily part, as they did in the past, with technology for mere payment of a technology transfer fee. Depending on their perceptions of the future of Indian economy, they have a choice of entering on their own or entering through the route of joint ventures.

In the first case, if the TNCs enter on their own, given their superior technological capabilities and/or superior resources the owner managed Indian enterprises face a bleak future. The decks are stacked against them. They would find it difficult to compete

against the technological superior - resource superior TNCs.

The TNCs would opt for a joint venture in case they have reservations about the India's ability to sustain the policy changes. They would seek to reduce their risk by sharing it with the joint venture partner in India. Additionally, their lack of exposure to the Indian market conditions could also result in their opting for a joint venture. Given the current policy framework, even if they exercise the joint venture option, the TNCs are unlikely to forsake control, both equity and management control, over the enterprise.

Since the liberalisation of policy vis a vis foreign equity acquisition most TNCs already operating in India have acquired a controlling 51 % stake in their Indian subsidiaries. In a number of cases like Proctor and Gamble, Phillips etc. they have nominated expatriates to the position of the Chief Executive Officer of the subsidiary. Thus, they have not only acquired a controlling equity stake, but have also acquired direct control over the management of the enterprise.

This TNC behaviour is not restricted to their subsidiaries. This has been case even with respect to their joint ventures with Indian entrepreneurs. Take for example, Kinetic Honda, the two wheeler manufacturer. Honda Japan has increased its equity stake to a controlling 51 % and have relegated the Firodias, their joint venture partner, to the back seat. Honda is not unique in this regard. There are any number of other cases. Suzuki Japan has displaced the Government of India as the principal owner and manager of Maruti Udyog. Similarly Asea Brown Boveri reportedly has taken over the management of Taylor Instruments, formerly a Birla managed company.

The acquisition of a controlling equity stake in the enterprise need not necessarily be demanded by the TNCs. They could be offered such an option by their joint venture partners who consider such a move necessary to remain competitive. For example, The TATA group, after the announcement of the liberalisation of norms for foreign equity investment under the current reform program, reportedly offered a controlling 51 % stake (as against the prevailing 50 - 50 equity ownership) to IBM, their partner, in the information technology company Tata Information Services Limited. This would have stemmed from the realisation that in this business the key factor that would determine success is technology and the technological capability of IBM, notwithstanding its current troubles, is, indeed, far superior to that of the Tatas in this business.

The threat regarding loss of control is not applicable only to the case of joint ventures - existing and potential. The loss of control, in the emerging environment, could very well be due to the targeting of the company for acquisition by others - both by TNCs and other Indian companies. In the past, acquisitions were not very easy due to restrictive regulations. However, in the new policy environment, this would not be the case. A Swaraj Paul

would find it easier to acquire control over an enterprise today than when he made the bid to take over the control of Escorts in the late Seventies/early Eighties.

The threat of acquisition is a very real one to the managements of a number of Indian enterprises. They are likely to be targeted for takeover by others due to the fact that most existing top managements have relatively low equity stake in their enterprises. They could manage in the past with low equity control due to the economic philosophy of the Government.

The Government, through the financial institutions, was (and is) a majority shareholder in a number of Indian enterprises. In the past, the financial institutions were either neutral (sic!) or supportive of the existing managements. Given the adoption of a market driven economic philosophy, it is unlikely that the financial institutions would remain ' neutral' in such situations in the forthcoming future. Apart from the change in the philosophical stance, the competitive pressure on the financial institutions to perform (in terms of bottom line) would come into play and the existing top managements of such Indian enterprises cannot afford to assume a supportive or neutral majority institutional shareholder.

Thus, the existing top managements face a very real threat of losing control over their enterprise. They are likely to be marginalised in the emerging scenario. The potential loss of control over the enterprise would exercise a great degree of influence on enterprise behaviour. The top managements would take cognisance of this issue, along with their assessment of the future for their existing lines of business (including the need/ ability to acquire competitive capability), while formulating their strategic response to the changes brought about by the new business environment.

Emerging Scenarios:

The future outlook of the top managements can be dichotomised into the top managements' assessment of the competitiveness of the business, and the perceived threat to ownership/control. Competitiveness assessment can in turn be dichotomised into optimistic and pessimistic assessments. Similarly the threat to retention of control over the enterprise can be classified as low and high. In Fig.1(below) the optimistic and pessimistic assessments are paired with the low and high threats to control over the enterprise to suggest typical enterprise responses.

FUTURE OUTLOOK
(Figure 1)

Threat to Ownership/ Control	Competitiveness Assessment	
	OPTIMISTIC	PESSIMISTIC
Low	Invest 1	Harvest 3
High	? 2	Divest 4

Discussion:

The top managements of the enterprises , if they are optimistic about the future and perceive that the threat to their control of the enterprise is low (quadrant 1), would typically seek to **invest** in the future. They would need funds to invest. The impact of high cost of funds (both due to present state of the capital markets and due to their reduced availability from the financial institutions), discussed earlier, on enterprise behaviour vis a vis passing on of duty reliefs holds good for the scenario depicted by the first quadrant. In order to conserve resources for investing in the future, such Indian businesses would retain the concessions granted in the budget.

A significant portion of Indian businesses are likely to find themselves in the second quadrant. The existing top managements (bulk of them, as stated earlier, are owner managers) of these enterprises while being optimistic about the future for their lines of business are likely to perceive a significant threat to their control over the enterprises due to existing low equity holdings. Additionally, ironically, the need to acquire competitive capability (like upgrading the technology or enhancing their capacities) may further worsen their ability to exercise control over the enterprise since it may involve dilution of their existing holding.

In such a scenario, apart from their optimism about the future for their businesses in the emerging environment, their bargaining power vis a vis the source of threat to their control (including potential takeovers) would influence their behaviour.

In the event the top managements are confident of coping with the

needs of the future either independently or with the aid of other non threatening (from the point of view of control) partner(s) they would invest in the future. As in the case of the companies in the first quadrant, they would need to mobilise/conserve resources. The implication to the exchequer is the same. They would retain the budgetary benefits.

The need for resources need not necessarily be for an immediate investment in upgrading the competitiveness of the business. It could also be required to buy out (or shore up the defenses against) the present source of threat to their control. The decision of the Mafatlals to buy out Shell in their joint venture NOCIL being a case in point.

Alternately, the top managements of the companies in the second quadrant would choose to either harvest or divest their existing business. Divesting/Harvesting strategies are essentially variants of a broadly similar response. The employment of either would be determined by the bargaining power (vis a vis the source of threat to their control) of the top managements of the enterprise.

In case the top managements anticipate loss of control over the enterprise in the immediate future they would divest. They would **retain the budgetary concessions so that they could improve the value of their holdings and realise a better price for their stake.** In the event they anticipate a time lag before loss of control, they would harvest. **They would hold on to the budgetary benefits.**

From the above discussion it is obvious, that the strategic response of enterprises in this quadrant is unlikely to be clear cut. For example, Godrej Soaps, a market leader in toiletries, has entered into a strategic alliance with the world wide consumer products giant Proctor and Gamble (P & G). Under this arrangement Godrej would manufacture and P & G would market. Such a strategy implies a greater focus and correspondingly greater investment in its future (in its manufacturing capability) by Godrej. The fact that Godrej, after years of being a closely held company, recently approached the public for equity participation suggests that Godrej perceives the need to have access to greater resources for meeting with its needs to invest in the future.

Alternatively, the Godrej strategy could be interpreted as one of divestment. One could infer that, since the top management is none too confident about surviving the future independently, it has chosen to reduce its commitment to this business. The dilution of their equity would be consistent with such an inference.

Thus, with respect to the second quadrant the enterprise response options vary from **investing to divesting to harvesting** their existing businesses. While the enterprise's strategic response could vary, the behaviour vis a vis the duty concessions would essentially be the same viz., retain the concessions.

In the other scenarios, where the top managements are pessimistic about the future, they would either divest or harvest their business.

In the case of the quadrant 3 the most likely response would be to harvest.In the event of their finding a divestment opportunity they may opt to do so. This strategy would essentially be determined by a trade off between the price they would realise by divesting and the returns they would mobilise by harvesting the business. The TATA group, for example, divested TOMCO. It was acquired by Hindustan Lever. This apparently must have stemmed from their perception that the divestment option was superior to the option of harvesting the business.

In the event of a divestment, from the point of view of the exchequer, the new buyer would move into the first quadrant and their post acquisition behaviour would be to retain the duty concessions so as to conserve resources for investment. They are also likely to retain the duty concessions with a view to improve their returns on their acquisition.

As regards quadrant 4, the predominant choice would be to divest the business. However, until such time as they are able to find a buyer for the enterprise (if at all) they would harvest. The behaviour vis a vis the budgetary benefits, once again, would be to hold on to them.

Thus, in all the conceivable scenarios that Indian businesses confront, rational behaviour dictates retention of duty concessions granted in the 1993 Union budget. The duty concessions will be passed on by only the top managements of those companies who, today, have a dominant control over their lines of business(both in terms of equity and competitive position) and who are confident of their ability to sustain their dominance in the future. These are very few. Hence only the Hindustan Levers of India have announced reductions in prices due to receipt of budgetary reliefs.

The behaviour of both Indian businesses and the transnational corporations since the adoption of a new economic strategy leads one to believe that perhaps Indian businesses are none too confident about surviving the future - independently. It is most likely that it is this basic perception amongst the top managements of Indian enterprises that is resulting in the present retention of concessions granted in the budget. Unlike in the past, where, perhaps, profiteering was the motive behind retention of duty concessions.

Therefore, prior to initiating any action with regard to retention of duty benefits by Indian businesses, especially one involving withdrawal of concessions, the Government needs to assess the impact of such an action on the efforts of Indian businesses to shore up their competitive capability. It needs to take cognisance of the issues raised above. Ideally, it should,

in keeping with its current economic philosophy, leave it to the market/ competitive forces to arbitrate on the issue of duty reliefs rather than intervene in the matter and withdraw it. Given the current low inflation rate and the prospect of a good monsoon, it could afford to do so. An intervention in the form of withdrawal of concessions would only worsen the problem of lack of global competitiveness amongst Indian businesses instead of alleviating it. It would only have a negative impact on our efforts to integrate our economy with the global one.