The effect of Liberalisation on First Generation Entrepreneurs In India

"The number of 'First generation Companies' (i.e. companies that were not more than 25 years old at the time of analysis) that got listed in Group A of the BSE [from] 1995 to 2011 increased by 588%. That proves the effect of India's liberalization post 1991"

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For the detailed analysis, read on:

Abstract

The study examines the hypothesis, "Liberalization & reforms have bred successful entrepreneurs in India". The analysis shows that this hypothesis is true & the First Generation Companies have made quite an impact in the Indian Economy. We analysed the composition of the elite Specified category(often referred to as Group A) of the Bombay Stock Exchange for the presence of First Generation Startups during the period 1995-2011. We chose the said period because the liberalization process in India began in 1991 & we believe that for policy decisions to reflect on performance a t the ground level takes about 3 to 4 years. We chose to focus on the elite 'Specified Group' of the BSE because the 'Specified Group' of companies on the BSE, represents the elite, high-performing & sought-after ones. We have considered that the listing of a company in the 'Specified Group', is an indicator of the success of the company. The number of First Generation Startups listed in the Specified category of the BSE, rose by a whopping 588% from 1995 to 2011

Our findings show that, though First Generation Startups have made a mark in almost every sector in the Indian economy, First Generation Startups from IT, Pharmaceuticals, Infrastructure, Real Estate, Power transmission & Agribusiness have been more impactfull than those in other sectors.

The study also analyses the reasons for the increasing impact of First Generation Startups in the post-liberalisation era. Broadly the reasons are:

1. Technology has substantially reduced the costs associated with Niche marketing.

2. Stock markets have become more efficient & transparent.
3. Cost of starting up has come down, so have Transactional & Interaction costs
4. Indians have opened up to 'Entrepreneurship'.

Introduction

Since 1991, India has taken concrete steps towards liberalization, the effects of which have been evident in the past 10 years or so. Poverty levels have gone down, education penetration in the country has gone up, the numbers in the middle-class band have gone up, disposable incomes have gone up. Taxation got rationalized. The primary reason for this is the generation of new jobs. Have liberalization & reforms helped maverick entrepreneurs build companies that are on their way to become large? First Generation Companies are important in the economy as they bring fresh pool of talent, new ideas are generated, and new techniques in management functions such as Human Resources, Finance and Marketing are implemented compared to old establishment companies.

Hypothesis:

H0- Liberalization & reforms have not bred entrepreneurs in India.

H1- Liberalization & reforms have bred successful entrepreneurs in India. If yes, how big a splash have these entrepreneurs been able to make?

The methodology:

We analysed the composition of companies in the 'Specified Group' from 1995 to 2011 to see trends, based on which we could prove/disprove our hypothesis listed above. We started with the analysis from the year 1995 because we believe that it takes at least three to four years for any policy decisions such as liberalization reforms to begin reflecting in the results on the ground(India began opening up its economy in 1991)

Reasoning about *'Why we considered only those companies that are traded in the Specified category(popularly known as Group A) on the BSE?'*:

The ‘Specified Group’ of companies on the BSE, represents the elite, high-performing & sought-after ones. We have considered that the listing of a company in the ‘Specified Group’, is an indicator of the success of the company.

Terminology:

First Generation Companies (FGCs)- A company that is less than 25 years old at the time of being analysed, i.e. if a company was incorporated in 1980, then, if the date of analyses is prior to 2005, it would be considered as a FGC. If the date of analysis of the same company is later than 2005, then, it would be considered to be an **Old Establishment Company(OEC)**

Government Owned Companies(GOCs) – A company which is managed by representatives of the government, either through a controlling stake or one whose CEO is a government representative or through a majority in the board of directors.

Specified Category- The list of scrips on the **Bombay Stock Exchange(BSE)** that fall under **Group A** and are considered to be elite, high-performing & sought-after ones.

The trend among First Generation Companies(FGCs) listed on the BSE in Group A.

The number of FGCs listed on the BSE in Group A increased by 233 % from 9 to 30 in the period 1995-2011

The details are as per following tables:

Table 1 below denotes the actual number of Companies in the corresponding years listed on the BSE in Group A(displayed in Annexure 1)

	Bse 1995	Bse 2000	Bse 2005	Bse 2011
first generation	9	17	29	30
old establishment	74	97	122	128
govt owned	6	17	47	41
Data not available	3	12	2	0
Total	92	143	200	199

Table 2 below denotes the percentage of the relevant category of companies as compared to the number of all companies listed on the BSE in Group A(displayed in Annexure 1)

	Bse 1995	Bse 2000	Bse 2005	Bse 2011
first generation	9.78%	11.89%	14.5%	15.08%
old establishment	80.43%	67.83%	61%	64.32%
govt owned	6.52%	11.89%	23.5%	20.60%
Data not available	3.27%	8.39%	1%	0

A simple regression analysis on the above data throws up the following relationship between listed FGCs & listed OECs *between 1995 & 2011.*

FGCs= 21.4 + 0.4052 OECs

Put simply, for every 100 OECs in the Group A of BSE, in the not-so-distant future, there will be 62 FGCs in Group A of the BSE. The gap in numbers between the FGCs & OECs will gradually reduce, though not get bridged. There are a lot of ifs & buts, though. ***The big 'if' is how fast does the Indian government accelerate the 'Reforms' process.***

As is evident from the above tables, the number of FGCs listed on the BSE in Group A increased by **233 %** from 9 to 30(actual numbers) in the period 1995-2011. The percentage share of Old Establishment Companies(OECs) in the same category has fallen by 16% in the same period. An increase of FGCs from 9 to 30 does not look very impressive till we delve deeper.

An important point to be noted here: The number 30, that is the number of FGCs in 2011, does not include all the new companies that got listed on the BSE in Group A from 1995 to 2011. It only reflects the FGCs that were listed in Group A on the BSE in 2011. A lot of FGCs got listed in Group A & for some reasons they did not continue to be in Group A till 2011. If we were to consider this number, i.e. total number of FGCs getting listed as well as going out of Group A on the BSE, then 32 more companies would be added to the list taking the tally to 62 instead of 30. In simple terms, 62 different FGCs got listed in Group A of the BSE during 1995 to 2011. Thus the increase of FGCs from 1995 to 2011would be a good **588%** on a base of 9 companies(listed in 1995). (62-9)/9* 100. Supporting data can be found in Annexure 2(right at the bottom). We have called this phenomenon as **'Churn**'

Here's a small note to understand 'Churn' better- We have tracked the companies listed in 1995, 2000, 2005 & 2011. In each of these years we have noted the following numbers:

1. The number of FGCs listed in Group A

2. The number of FGCs that were listed in the previous year of consideration but not in the current year of consideration. The difference between these two figures gives us the number of FGCs that did not remain in Group A of the BSE. Our research shows that the reasons for these companies not remaining in contention could be any of the following:

- They became more than 25 years old & hence became Old Establishment Companies(OECs) or
- Their financial performance & hence stock market weightage slipped forcing their exit from Group A or.
- They were delisted.
- They got dissolved.
- They have been taken over by another company(maybe an OEC) & seized to exist as an FGC.

E.g. if you refer to annexure 2, then under the column of 2011, you will notice different figures in front of words s.a. ‘New’, ‘Maintained in’ & ‘Out’. What this means is that:

- In 2011, 19 **new** FGCs got listed in Group A of the BSE
- 11 FGCs from 2005 **continued to remain** in Group A of the BSE, i.e. were **maintained** from 2005
- 21 FGCs which were listed in the Group A of the BSE in 2005 did not remain listed in Group A of the BSE in 2011, i.e. they went **out.**

So if we add up all the **New** FGCs from 1995, 2000, 2005, 2011, it gives us a number of **62 instead of 30**.

Over the next few paragraphs, we have tried to analyze the reasons for this change.

The reasons for this change are as follows:

1. Technology has substantially reduced the costs associated with Niche marketing.

2. Stock markets have become more efficient & transparent.

3. Cost of starting up has come down, so have Transactional & Interaction costs

4. Indians have opened up to ‘Entrepreneurship’

Explanation of the abovementioned pointers

1. Technology has substantially reduced the costs associated with Niche marketing.

Unlike the Western countries, India is a heterogenous country. Put simply, there are many mini-Indias within India. Every 100 kms that one travels, one can notice that the customs change, cuisine changes, the clothing styles change, the language changes etc… An entrepreneur close to the pulse of the end-user can target these niches more effectively & economically than what he would have been able to two decades back due to reduced costs of promotion due to the telecom revolution in India. His reach has increased substantially and the cost is a fraction of what it would have been otherwise. Migration of people into metros has throw up a host of opportunities that smaller players have capitalized upon. Media penetration has led to the exposure of tier3 & 4 towns to urban & international trends leading to a number of opportunities for entrepreneurs.

Commercialisation is no longer restricted to the three commercially developed cities of yesteryears viz. Mumbai, Delhi & Chennai. Cities like Bangalore, Hyderabad, Chandigarh have taken away a lot of business from the big three. This has created a large shift in the migration patterns throwing up a host of opportunities for entrepreneurs to cash in on. Smart, young minds have capitalized on these opportunities.

Open source platforms, not only of the IT variety, have enabled easier adaption of technologies.

2. Stock markets have become more efficient & transparent.

The stock market regulator, SEBI(Securities & Exchange Board of India) has become more active. Proactive regulations have given more teeth to SEBI. Reforms in trading mechanisms such as dematerialization have substantially reduced the chances of 'rigging' of the market , which used to happen in the 80s & early 90s. As result of this, the stock markets have become more transparent & a better reflector of the financial health of a company than what the situation was a couple of decades back. Investors can therefore make informed & hence better choices depending on the performance of the listed companies. They are more likely to invest in companies that are run soundly rather than go by big names of yesteryears. This has made it easier for entrepreneurs, running their business well, to access public money.

3. Cost of starting up has come down, so have Transactional & Interaction costs

Cost of starting up: The cost of capital has declined since the late 80s & early 90s. The financial markets have opened up a variety of instruments that an entrepreneur short of cash but big on ideas can tap. Hence the access to funds has become easier for entrepreneurs. A host of Private Equity funds, Venture Capital funds have burgeoned in the country.

Reduction in Transactional Costs: Technological advancements have reduced the cost of transactions to a fraction of what the same would cost in the late 80s or even the early 90s. In say, 1991, if an exporter of leather goods had to send a quotation to his German client, he would have to send an envelope through a DHL/Skypak etc. for a cost of approx. Rs. 1000 to Rs. 1200. Now, he just has to send an email at virtually no cost.

Reduction in Interaction Costs: Here too, technology has shrunk the world. Till a couple of years back, one had to fly to another city for a face-to-face meeting, today we are moving towards video conferencing. A chat on SKYPE is as good as an in-person meeting coupled with a day saved.

4. Indians have opened up to 'Entrepreneurship'

A sizeable portion of the Indian middle-class has moved beyond the sense of security of having a 9 to 5 job. Many a parent no longer discourage their child to experiment with a venture because they, themselves, have made the future a bit more financially secure for their children than their own parents could manage to in the 70s & 80s. Young Indians today are confident of competing with the best.

Now let us see the sectors where the FGCs have made a mark.

(Annexure 3 lists out all the sectors that FGCs have been represented in, in Group A on the BSE from 1995-2011)

(Annexure 4 lists out all the companies from the various sectors listed in Annexure 3)

A Snapshot: As can be seen, the top performing FGCs have been from IT, Pharmaceuticals, Infrastructure, Real Estate, Power transmission & Agribusiness. Despite the telecom boom in India, the sector shows only two FGCs in the Group A of BSE from 1995 to 2011. In the following paragraphs, we have analysed the possible reasons.

The IT sector leads the way:

As expected the IT industry leads the way with 12 different FGCs getting listed *on the BSE in Group A* from 1990 to 2011. However, on closer examination, we see that, the maximum influx of first generation IT companies is in the period between 1995-2000 & in the period between 2000-2005(5 companies in the period 1995-2000 & 9 companies in the period 2000-2005). Both, in 1995 & 2011, there is no first generation IT company listed on the BSE. This could be attributed to the fact that from 1995 to 2005, a lot of companies in the IT domain got established due to a tremendous demand for cost-effective IT solutions worldwide. This period also coincided with the dotcom bust(early 2000s) in the west which meant that the extensive undersea data cables laid by western companies became available to their Indian counterparts & this facilitated the adoption of the off-shore delivery model by smaller Indian companies since the costs of transmitting data through these cables dropped drastically. In addition, due to the Y2K crisis, a lot of Indian companies gained a foothold in the western market on the cusp of the 21st century. Indian companies, by mid-2000s, had perfected their offshore delivery model & were raking in the moolah. Another reason for the number of IT sector FGCs going down in 2011 is that companies like Infosys, HCL etc. became a part of the Old Establishment by virtue of their age.

Indian Pharmaceutical companies up their R & D budgets post-liberalisation

Liberalization opened up the pharmaceutical sector to competition. Many Indian companies entered the prescription drugs market, which provides higher margins than the bulk drug segment. Unlike bulk drugs, that focus on efficiency & cost control, prescription drugs need a focus on quality & innovation. In 1995, India signed the TRIPS (Trade Related Aspects of Intellectual Property Rights) agreement. Pre-liberalisation, innovation in the Indian Pharmaceutical sector was limited to process innovation & reverse engineering. Signing the TRIPS agreement, changed the scenario by tightening the patent regulations in India. These factors led to high investment in R & D as compared to the abysmally low standards in the pre-liberalization era. Quite a few techno-savvy entrepreneurs have made a mark since then in the Indian pharmaceutical sector since then with their focus on R & D. Dr. Reddy's Labs, Piramals, Sun Pharma etc., to name a few, have made substantial impact in this domain.

The charge of the Infrastructure, Real Estate & Power transmission FGCs.

This is very much in line with the thrust areas of the Indian government over the last two decades. The government has pushed forth projects in infrastructure, be it roads, rail connectivity, setting up of SEzs, rural electrification, power transmission, rural industrialisation etc. Migration into urban areas has enticed a slew of entrepreneurs into real estate. Increasing disposable incomes of the middle class have contributed to investments in real estate to a great extent. Entrepreneurs have been quick to seize these opportunities.

Companies into fertilizers, biotechnology, tissue culture etc. have benefited due to increased exposure of the Indian farmer to western methods of farming due to the proliferation of media as well as telecom.

The Adani group has been the prominent player to capitalize in these related sectors. It has a presence in agribusiness, infrastructure as well as power transmission.

The absence of FGCs in the telecom sector can probably be explained by the fact that setting up a telecom company needs very heavy investments, which start-ups shy away from. Only Bharti Airtel & Spice have made their presence felt in Group A of the BSE. Out of the two, Spice has not been able to maintain itself in Group A of the BSE due to technological issues, once again underlining the fact that huge investments is the name of the game in telecom.

Conclusion and Suggestions:

The research shows that the hypothesis, "Liberalization & reforms have bred successful entrepreneurs in India" is true & the First Generation Companies have made quite an impact in the Indian Economy. The FGCs have made an impression in almost all the sectors of the economy but have been most impactful in the Information Technology, Infrastructure, Real Estate, Power Transmission & Agribusiness.

The gap in numbers between the FGCs & OECs will gradually reduce, though not get bridged. If reforms are pushed by the government in an orderly manner, the Indian entrepreneurs would continue to create big ticket successes.

The current government under the leadership of Mr. Narendra Modi, seems to be taking the right steps in rekindling the entrepreneurial fire innate in India. A few suggestions for the same:

1. Enable hi-speed broadband services all over India. This brings down the cost of doing business drastically by eliminating the cost of unnecessary travel and time lost doing the same

2. Encourage corporate-academia dialogs and partnerships. We, in India, are far behind in this aspect as compared to the developed world. Encourage experimentation with entrepreneurship at all education institutions by allowing alumni to come back to campus for placements in case their ventures fail.
3. Encourage the R&D efforts of companies by giving handsome incentives.
4. Eliminate the laborious and complicated procedures required for starting a venture. India ranks second last in the world for obtaining construction permits as of march ’14, which is a pity for a country raising the slogan, ‘Come, Make in India’
5. Glamorize entrepreneurship by various means across the country. This will ensure that parents of wannabe entrepreneurs do not discourage their children from opting to start up.