

# Financing Firms in India: Comments

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# Main Findings

- High de jure legal protection for investors
- Low de facto legal protection
- Consequence:
  - Closely held companies
  - Reliance on outside finance for large enterprises
  - Reliance on informal and higher cost finance (trade credits) for SMEs
  - Reliance on non-informal legal enforcement mechanism for SMEs
- Despite disadvantages, SMEs have grown faster during 2001-2004
- Claims:
  - Institutions (formal) not really important for growth
  - Financing (formal) not really important for growth

# Comments

- Findings
- Claims

# Findings

- On the various measures (Table 2), how does India fare relative to its level of income
  - De jure versus de facto
  - Broad versus specific (example of KKZ versus Costs of Doing Business)
- Two concerns/questions about findings:
  - Is it size or something else, for example, sector?
  - Timing 2001-2004 (downturn in Indian economy)
- Sources of financing (Table 6A)
  - “Natural” external dependence on finance varies by sector (Rajan and Zingales (1998))
  - What happens if large and small further disaggregated further by sectors (manufacturing and services too coarse; show composition of large and small)?
  - Credit growth 30 percent since 2004 and stock market boom—would financing numbers look very different?
- Growth between 2001 and 2004
  - So is it SMEs/large or sectors?
  - Timing—downturn affected manufacturing more and large firms more
  - Also, policy reforms must have had a differentially positive impact on formal (versus informal/SMEs): registered manufacturing has grown faster than unregistered manufacturing since 1980s?
- What about time series evidence on growth? What has happened before 2001 in terms of differential between SMEs and large firms?

## Findings (contd.)

- SMEs exhibit “much stronger signs of poor investor protection” compared with larger firms: e.g. more closely held
  - But in Table 5, very similar. Both largely family held (80 versus 77 percent)
- External financing (Equity plus debt) of Indian firms not that dissimilar from other countries (Table 6-C)

# Bigger Questions

- Is it really unusual that SMEs rely on informal financing and legal systems?
  - What is the policy prescription? No need to focus on legal system?
- Growth is possible without institutions (paper's findings—short run)
  - Short run yes, but over longer run? (Bangladesh, Indonesia)
- Institutions and growth in India
  - If institutions weak, then puzzle deepens
    - Not much improvement over time either (Mishra, Subramanian and Topalova, 2007)
  - Alternative is that actually institutions are relatively good and that there is institutional slack (Rodrik and Subramanian, 2005)
- Growth and Finance?

# Institutional Slack?

