

# Size and Structure of India's Private Corporate Sector Implications for the New GDP Series

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In the new National Accounts Statistics, the absolute size of the gross domestic product for 2011–12 is smaller by 2.3% compared to the old series; but the private corporate sector's size is larger by 43%; and, its GDP share higher by 11 percentage points. This is true for the next two years as well. The new estimates are more realistic, claims the Central Statistics Office, as they better represent the contribution of nearly a million "active companies." Critics are unconvinced, however. Seeking to narrow the differences between the competing views, this paper compares the official figures with an alternative estimate for the private corporate sector to gauge the magnitude of (the claimed) improvement, or (the putative) overestimation.

## The Problem

The new series of National Accounts Statistics (NAS) released early this year, with 2011–12 as the base-year, has got bad press. Why? Growth rate of real gross domestic product (GDP) (and its ninefold distribution) in 2013–14 was distinctly higher (6.6%) than that in the old series (4.7%) with a base year of 2004–05. The corresponding figures for manufacturing sector are 5.3% and (-) 0.7% respectively. Moreover, the new estimates are out of line with other aggregate indicators; for example, while growth in bank credit is now running at a decade low, the advanced estimates of GDP growth rate for 2014–15 stand at a high level of 7.4%. Many such anomalies, as brought to light by various commentators, have dented the credibility of the new NAS. The *Financial Times* commented in September, "India's overly inflated statistics are breeding a false sense of security" (Pilling 2015).

Regardless, the Central Statistics Office (CSO) has maintained that the methodological changes and the use of new databases in the revised series represent major improvements in recording economic activity that was missed out earlier. In particular, the CSO takes credit for the wider coverage of value added in the private corporate sector (PCS). To quote the official report:

The more complete corporate sector database helps us describe corporate value addition in all the segments of the economy. The new series also describes growth in value added better, through its greater use of value linked indicators (CSO 2015a: 7).

Faced with unremitting criticism, the Chief Statistician of India has defended the new series by claiming that the use of the new database for the PCS captures production left out in the earlier series. To quote him,

There is a large invisible corporate segment, which we were not adequately describing in the earlier series. We were partially describing it in manufacturing through the ASI. So, there is recognition that there is a need to get better information on this segment as a large part of government policies are aimed at this segment. The 5,000 listed companies are typically not the principal focus of promotional policies (Sidhartha and Gupta 2015).

This paper seeks to shed some fresh light on the statistical dispute by (i) describing the size and structure of PCS using official sources, and (ii) comparing them with an alternative estimate obtained from a widely used corporate database, Prowess, compiled by Centre for Monitoring Indian Economy (CMIE) that claims to include all "working companies."

The paper has four sections: Section 1 reports the size and structure of PCS using the official sources, including a

I sincerely thank Vikash Vaibhav for extracting data from Prowess database.

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comparison of the *levels* and *growth rates* in the macro-economic aggregates, as obtained in the new and the old series of NAS. Section 2 presents an alternative estimate of PCS using CMIE's Prowess database. It is then compared with the new series of NAS to gauge the magnitude of the discrepancy between the official and private estimates of the size of the PCS. To understand the reasons for the discrepancy, Section 3 offers an explanation in terms of the boom in company registration in recent decades, and discusses some widespread corporate practices having a serious bearing on estimating PCS's contribution to domestic output. We believe our effort could help, at a minimum, reduce the domain of dispute surrounding the new PCS estimates. Section 4 concludes the study.

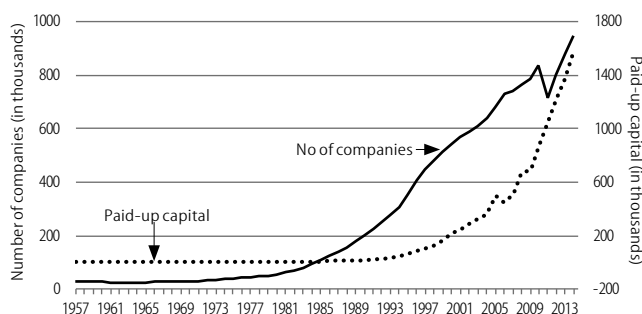
Following the System of National Accounts (SNA) 2008, the new series has introduced two new concepts, namely (i) gross value added (GVA) at basic prices and (ii) GDP, replacing two older concepts of (a) GDP at factor cost and (b) GDP at market prices, respectively. This change has perplexed data users as to the comparability of the old and the new concepts of domestic output. To clarify the matter: the difference between GVA at basic prices (in the new series) and GDP at factor cost (in the old series) is just at 0.1%, hence negligible. So, to minimise the confusion, this paper uses the term "GDP" uniformly to connote "GVA at basic prices" in the new series, and "GDP at factor cost" in the old series (unless otherwise stated). Likewise, all computations reported here are at current prices, but have not been mentioned in the text.

## 1 The Official Account

### PCS as Seen in Company Registry

In March 2014, 8,50,000 non-government (joint-stock) companies with (a cumulative) paid-up capital (PUC) of Rs 158 billion were registered with the Ministry of Corporate Affairs (MCA), the regulatory authority (MCA Annual Report, 2013–14). Figure 1 reports the number of companies and their PUC since

**Figure 1: Number of Registered Companies and Their Paid-Up Capital, 1957–2014**



(year-ending) 1957. Evidently, the pace of company formation has speeded up since around the mid-1980s and their PUC rose sharply since the late 1990s. To quantify the trends, between 1991 and 2014, while the number of companies multiplied 3.2 times, their paid-up capital ballooned 7.7 times.<sup>1</sup> The boom in company registration has, expectedly, coincided with the liberal economic reforms.

In 2014, there were 58,000 public limited companies with a PUC of Rs 76 billion (52% of the total).<sup>2</sup> However, their share in the PCS got halved, from 14% in 1997 to 7% in 2014, implying a faster growth in the number of private limited companies (Table 1). In 1991, a majority of the companies in the PCS were in the manufacturing sector; but by 2013 the financial sector had overtaken it. Together, they now dominate the PCS with 58% of the number of companies and their PUC (Table 2).

**Table 1: Industry-wise Distribution of Companies in PCS, Disaggregated by Public and Private Limited Companies in 2014**

	Number of Companies and Their Paid-up Capital of Non-government Companies in 2013–14					
	Public Limited Companies (%)		Private Limited Companies (%)		Total (%)	
	No of Companies	Paid-up Capital	No of Companies	Paid-up Capital	No of Companies	Paid-up Capital
Agriculture	4.4	1.6	2.4	1.2	2.5	1.4
Mining and quarrying	1.1	2.1	1.2	0.9	1.2	1.5
Manufacturing	29.2	27.5	21.6	29.9	22.1	28.7
Electricity, gas and water	2.5	14.6	1.2	6.3	1.3	10.6
Construction	8.4	8.9	11.0	10.8	10.8	9.8
Trade, hotel and restaurants	9.8	5.3	16.1	10.4	15.7	7.7
Transport, storage and communication	2.2	4.7	3.3	3.7	3.2	4.2
Finance, insurance, real estate, business services	34.5	28.0	35.8	30.5	35.7	29.2
Comm, personal and social services	4.8	4.1	6.0	4.4	5.9	4.3
Unclassified	3.1	3.3	1.5	2.0	1.6	2.7
Total (%)	100	100	100	100	100	100

Total (in absolute numbers) 58,439 8,16,700 7,91,535 76,87,415 8,49,974 15,85,445  
The last row reports the total number of companies, and their paid-up capital (in Rs Crore).  
Source: Ministry of Corporate Affairs, *Annual Report*, 2013–14.

**Table 2: Industry-wise Distribution of Companies in PCS, and Their Paid-Up Capital, 1991–2014**

Industry	Distribution of Companies (%)			Distribution of Paid-up Capital		
	1991	2010	2014	1991	2010	2014
Agriculture	2.6	2.6	2.5	1.5	1.3	1.4
Mining and quarrying	1.3	1.2	1.2	0.6	1.5	1.5
Manufacturing	50.5	27	22.1	73.6	36.3	28.7
Electricity, gas and water	0.3	0.8	1.3	1.2	5.6	10.6
Construction	5.2	9.1	10.8	1.8	9.8	9.8
Trade, hotel and restaurants	10.8	15.1	15.7	6.4	9.2	7.7
Transport, storage and communication	3.1	3.4	3.2	2.5	5.2	4.2
Finance, insurance, real estate, business services	22.1	27.8	35.7	10.4	26.1	29.2
Comm, personal and social services	4.2	4.7	5.9	2.1	5.1	4.3
Unclassified		8.4	1.6			2.7
Total (%)	100	100	100	100	100	100
Absolute total	2,23,285	6,39,478	8,49,974	18,686	7,74,563.0	15,85,445

The last row reports total number of companies in PCS, and their paid-up capital (in Rs crore).  
Source: Department of Company Affairs, *Annual Report*, various issues.

Regionally, at least since 1980, over one-half of the companies in PCS are registered in Mumbai, Delhi and Kolkata. Though Kolkata has dropped out of the national industrial and commercial map, the registration of companies has nevertheless remained high (more about this later).

### Comparing PCS in the New and Old NAS

For the first time, the new NAS has estimated GVA originating in PCS (as part of the institutional classification of domestic output), in addition to the usual ninefold sectoral (or industrial) distribution by industry of origin. In the new series, for 2011–12, the PCS's share in GDP is higher by 11 percentage points—that is, 34.7%, compared to 23.7% in the old series (Table 3). Domestic saving and gross capital formation ratios for the PCS have also got enlarged in the new series, though not to the same extent as in GDP.

**Table 3: Private Corporate Sector's Share in the Economic Aggregates, 2011–12**

	Old Series (%)	New Series (%)
GDP	23.7	34.7
Savings (as % gross national disposable income)	6.4	9.4
Gross capital formation (% GDP)	10.1	13.3

Source: CSO (2015) and EPW Research Foundation (2015).

Figure 2 reports GDP by institutions in the new and the old series of NAS series for 2011–12.<sup>3</sup> A caveat: these categories are not strictly comparable as some activities have got shuffled across the sectors in the new series—keeping in line with the SNA 2008. It shows that public sector's share has remained the same, around 20% of GDP. But PCS's share has gone up by 11 percentage points of GDP, with a corresponding decline in household (or unorganised) sector's share. A broad comparison of the absolute levels of the estimates and their share in GDP for 2011–12 and 2012–13 is reported in Table 4 to discern the changes effected in the new series (compared to the old):

- (1) GDP in the new series is smaller by 2.3% and 1.5% respectively in both years—2011–12 and 2012–13.
- (2) Public sector GDP has also contracted by 1.6% and 4.5%, respectively, in both the years.
- (3) Unorganised sector GDP (now called the household sector) in the new series has shrunk in absolute size by about 20% in both the years.
- (4) However, the PCS size has expanded vastly, by over 40% in both the years; its share in GDP has risen by over 11 percentage points.

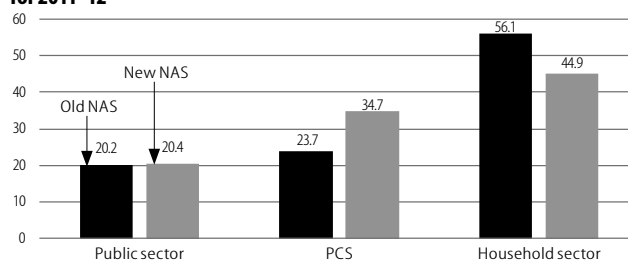
**Table 4: GDP by Institutional Categories** (in Rs crore)

	2011–12		2012–13		2013–14	
	Old Series	New Series	Old Series	New Series	Old Series	New Series
Public sector	16,98,977 (20.3)	16,72,236 (20.4) [-1.6]	19,19,806 (20.5)	18,34,463 (19.8) [-4.5]	20,60,276 (19.7)	
PCS	19,87,055 (23.7)	28,44,259 (34.7) [43.1]	22,77,322 (24.3)	32,52,925 (35.2) [42.8]	37,02,271 (35.3)	
HH/unorganised sector	47,05,659 (56.1)	36,79,050 (44.9) [-21.8]	51,91,749 (55.3)	41,64,663 (45.0) [-19.8]	47,14,592 (45.0)	
GDP	83,91,691 (100.0)	81,95,545 (100.0) [-2.3]	93,88,876 (100.0)	92,52,051 (100.0) [-1.5]	1,04,72,807 (100.0)	1,04,77,139 (100.0)

Figures in brackets refer to percentage of GDP; figures in square brackets refer to percentage change in the new series over the old series.  
Source: CSO (2015), and EPW Research Foundation (2015).

So, without doubt, PCS is the real gainer in the new series, at the expense of the household sector. To investigate further, the PCS is disaggregated into its analytically distinctive

**Figure 2: Institutional Composition of GDP in Old and New NAS Series, for 2011–12**



components, namely (i) financial PCS and (ii) non-financial PCS. Table 5 reports the disaggregated GDP in PCS for 2011–12, which shows the following (row numbers of Table 5 mentioned in brackets):

- (1) GDP in financial services (summed up over all the institutional sectors) in the new series has practically the same size as in the old NAS series (row 2).
- (2) The absolute size of the GDP of the non-financial PCS (NFPCS) in the new series is higher than that in the old series by 9.8% (as officially reported) (row 3.1).
- (3) The ratio of GDP of NFPCS to total GDP has increased to 23.8% in the new series, from 21.1% in the old series (row 4.1).
- (4) But most strikingly, GDP in financial PCS has ballooned by a whopping 319.2% compared to that in the old series (row 3.2).
- (5) The ratio of GDP of financial PCS to total GDP has shot up to 10.9% in the new series, from 2.6% in the old series (row 4.2).
- (6) In other words, most of the enlargement in the size of PCS in the new series is on account of financial PCS (Figure 2). Since the absolute size of GDP in financial services (summed up over all the institutional sectors) has almost remained the same in both the series as noted above. These findings imply that the public sector's and household sector's shares in the financial sector have contracted in absolute terms.

**Table 5: GDP by Financial and Non-financial PCS for 2011-12** (Rs crore)

	Old Series	New Series
1 GDP	83,91,691	81,95,546 (-2.3)
2 GDP in financial services	4,81,495	4,80,232 (-0.3)
3 GDP in PCS	19,87,055	28,44,259 (43.1)
3.1 GDP in non-financial PCS (NFPCS)	17,73,031	19,46,989 (9.8)
3.2 GDP in financial PCS (3–3.1)	2,14,024	8,97,270 (319.2)
4 GDP in PCS/GDP (3/1) (%)	23.7%	34.7
4.1 GDP in NFPCS/GDP (3.1/1) (%)	21.1%	23.8
4.2 GDP in financial PCS/GDP (3.2/1) (%)	2.6%	10.9

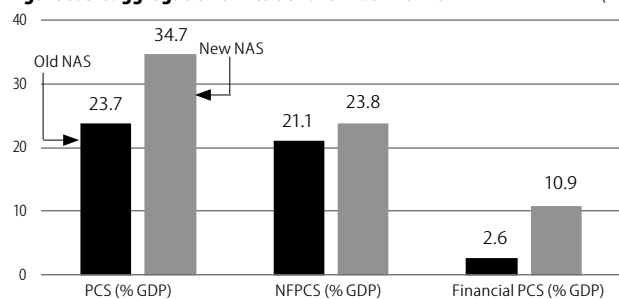
Figures in brackets refer to percentage change in the new series compared to the old series. NFPCS refers to non-financial private corporate sector.

Source: CSO (2015).

### Reasons for the Scepticism of the New PCS Estimates

The recent dispute about the veracity of the new series of NAS is mostly centred on the PCS, as its underlying methodology, and the new data source used to estimate it, have been widely questioned. Why? After all, registered companies are mandated to submit audited annual accounts to the Registrar of Companies under the MCA. But the reality seems far from the legal requirement (as perhaps is the case with many other laws).

Of the close to a million “active companies” (9,45,276 companies to be precise) used for estimating GDP of the PCS, only a

**Figure 3: Disaggregation of PCS's Share in GDP for 2011–12** (in %)

small fraction of them regularly submit their audited accounts to the MCA.<sup>4</sup> In fact, there are no realistic estimates of the number of companies that regularly produce goods and services, and of their contribution to domestic output.<sup>5</sup> So, we do not know what the majority of the companies in the PCS really do.<sup>6</sup>

For a long time the PCS's size was modest—about 12% of GDP in 1990–91—as estimated from the Reserve Bank of India's (RBI) sample of companies (Shanta 1999). The RBI has maintained a database of a purposive sample of large and high PUC companies, whose combined balance sheet has been regularly published in the *RBI Bulletin* for decades now. As the sample—currently of about 4,000 companies—accounted for the majority of the PCS's PUC, its estimates were “blown-up” or “scaled-up” for the “universe” of registered companies to estimate saving and capital formation in the PCS. However, as shown earlier, since the PCS has expanded phenomenally in recent times (albeit without really knowing the number of companies actually working), the blowing up methodology has become untenable—resulting in an overestimation of the PCS's size (Nagaraj 2009).

Recently, however, under the e-governance initiative, the MCA has mandated companies to file their financial returns in electronic form (with a threat of deregistration for non-compliance). About 5,00,000 companies fell in line for two years (2011–12 and 2012–13), but the pace tapered off in the following year to about 3,00,000 companies.<sup>7</sup> In revising the NAS, as the RBI's small sample has been replaced by MCA's much bigger database, the CSO believes that the new series has captured the PCS's contribution more accurately than the old series (as noted in Tables 3 and 4).

Critics, however, have doubted the quality of the MCA database for two reasons: one, the MCA 21 database is shown to be incomplete and inconsistent for drawing definitive estimates for the PCS. Two, the CSO has perpetuated the faulty methodology of blowing up (scaling up) the sample estimates for the “unknown universe” of working companies, resulting in an overestimation of the size of the PCS (Nagaraj 2015a and 2015b). The enlargement of the PCS's GVA in the new series by over 40% in 2011–12 and 2012–13 seems to vindicate the critics' contention.

The crux of the dispute between the CSO and its detractors, therefore, boils down to this: does the enlarged size of the PCS in the new series represent a more realistic estimation of the sector's contribution (as the CSO has claimed), or is it an overestimation on account of the above-mentioned methodological infirmities (as critics have contended)? We contend that it is the latter, as demonstrated in the rest of the study.

To recapitulate: In the new series of the NAS, compared to the old series, the absolute size of the PCS for 2011–12 is larger by over 40%, and its share in GDP is higher by 11 percentage points. When disaggregated, GDP in the financial PCS in the new series is bigger by 319% than that in the old series—as a ratio of GDP, it is 10.9% in the new series compared to 2.6% in the old series.<sup>8</sup> Since the size of GDP in financial services (combined for all institutional sectors) has almost remained the same in both the series, the enlargement of the size of the financial PCS implies a corresponding reduction in the size of the other sectors in financial services.

Similarly, the GDP of non-financial PCS has got enlarged by 9.8% in the new series as compared to the old. As a ratio of GDP, it is 23.8% in the new series compared to 21.1% in the old series. To probe the matter further, Section 2 provides an alternative estimate for the NFPCS.

## 2 An Alternative Estimate

CMIE's Prowess database consists of about 27,000 companies for the last six years (from year ending 2009 to 2014), claiming to collect data of all corporate firms prepared to spare their balance sheet. As the database is incomplete, the GVA for all the companies could not be computed. A snapshot of 2009, for which most complete accounts are available, shows the following:

- (1) The number of companies for which data on sales or total assets are available is about 19,000 (Table 6, column 2).
- (2) The number of NFPCS companies is about 13,000.
- (3) Of these, public limited companies were about 8,500, and about 4,500 of them were listed in stock markets.
- (4) The number of companies for which GVA could be computed is about 8,500 companies.

**Table 6: Number of Private Non-financial Companies in Prowess Database**

Financial Year Ending	No of Companies with Data on Sale or Total Assets	Total Firms (Excluding Public Sector and Financial Firms)	Total Firms for Which GVA Could Be Obtained (Excluding Public Sector and Financial Firms)	Public Limited Companies for Which GVA Could Be Obtained (Excluding PSUs and Financial Sector)	Listed Companies (Excluding Public Sector and Financial Firms)
(1)	(2)	(3)	(4)	(5)	(6)
2009	19,159	13,677	10,013	8,512	4,197
2010	18,809	13,473	9,979	8,508	4,172
2011	16,544	11,879	9,152	7,987	3,975
2012	14,806	10,671	8,439	7,447	3,871
2013	11,571	8,702	7,097	6,221	3,799
2014	9,673	7,249	5,941	5,255	3,502

Source: Prowess Database.

The reason for the foregoing description of the database (or to highlight the gaps in it, to be more precise) is to demonstrate how incomplete the corporate financial data usually tend to be for even the larger companies, and in well-maintained and widely used database.

Table 7 (p 45) reports GVA for 2011–12 by non-financial and non-government companies in Prowess (Prowess companies, for short), the latest year for which complete data are available. The distribution of value added is evidently skewed in favour of larger enterprises: that is, the top 100 companies, measured by sales or assets, contribute nearly half of the GVA of Prowess

companies; and, the top 500 companies for nearly three-fourths of the GVA.

**Table 7: Size and Structure of Prowess Database**

Financial Year Ending	No of Non-financial Companies with Complete Data	Share of Top		Share of all		GVA of Prowess Non-financial Companies as % of New GDP	Share of PCs in New GDP
		100 Companies	500 Companies	Listed Companies	Public Limited Companies		
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
2009	10,013	46	72	72	94		
2010	9,979	46	73	72	94		
2011	9,152	47	74	74	96		
2012	8,439	49	76	75	96	17.0	34.7
2013	7,097	49	77	75	96	16.5	35.2
2014	5,941	53	80	78	97	15.1	35.3

Source: Prowess database.

If one accepts that the Prowess database is a reasonably complete “universe” of working companies, then the difference between (i) the new NAS estimates for the non-financial PCs and (ii) the Prowess estimate represents the overestimation by the new series. If, however, one believes—as the CSO does—that the contribution of private limited companies which is left out of the Prowess database is reportedly captured in the MCA 21 database, the new GDP series is a significant advancement over the older NAS.

For 2011–12, the value added of Prowess companies stood at 77% of GDP of non-financial PCs in the new series; it amounted to 18.3% of GDP, whereas the non-financial PCs constitutes 23.8% of GDP (as per the new national accounts). So, the critical question is this: could the non-financial companies left out of the Prowess database (that is, the difference between the above two numbers) account for 5½% of GDP in 2011–12? In other words, could the half a million or so non-financial private limited companies—whose audited balance sheets are submitted sporadically (if at all), and if they really do produce goods and services—have contributed Rs 4,46,840 crore of GVA in 2011–12? To get a perspective, this is fairly close to the share of the sector “Public Administration and Defence” in GDP (at Rs 4,92,405 crore).

The puzzle is unlikely to get resolved by using parameters obtained from the RBI sample or Prowess database for private limited companies, since these samples are obviously drawn from a few hundred large (relatively speaking) private limited companies, which regularly produce audited balance sheets. They are most likely to be outliers among the half a million private limited companies; about the latter practically nothing being known. The only definitive way to resolve the dispute is for the CSO to make the MCA-21 database public for independent verification of its estimates. In the absence of such public release, one needs to assess the potential contribution of such companies based on our prior understanding of the functioning of the PCs, and the boom in their numbers recently.

### 3 Understanding the Private Corporate Sector

What is the productive contribution of over 9,00,000 private limited (including financial) companies used in obtaining the estimates for the PCs in the new series? Can one take a naive view that since they exist in the official rolls, they must be contributing positively to domestic output? Such a view belies a realistic

understanding of how regulatory and promotional agencies really work in India. As is widely known, deleting a company, a factory or a small enterprise from the official records is often a complex administrative and legal process. Official statistical agencies are surely aware of how such non-functioning legal entities pose difficulties to drawing samples and data collection in many fields.

Therefore, one could reasonably suspect that the majority of private limited companies (whose numbers, as noted earlier, have grown phenomenally in the last two decades) add very little to domestic output. The telling evidence of it is the fact that even with its best efforts (including a threat of deregistration) MCA could barely make 50% of the registered companies comply with the law of the land to submit their audited accounts, and that too for just two years. So, it would not be far-fetched to infer that the remaining companies produce practically nothing on a regular basis.

Then why do such companies get formed, and remain in the official registry? After all it costs (however little) to register and maintain a company, even on paper? A trivial (or cynical) answer to it is that once registered, it costs practically nothing to keep it going, since the onus of deregistration lies with the regulator.

However, the real motive as to why so many dormant companies exist even nominally, one could speculate, is that they serve some purpose for their promoters. What could this be, if it is not for organising production of goods and services? After all, a company is an organisational unit of production—be it a farm, factory or an office. In their absence, a company can exist in relation to other companies, as a subsidiary, or as a holding company. While such firms may serve little social purpose, they are probably crucial for the business group to maximise its return on investment, and for exercising its managerial control.

As is widely known, most business enterprises in India (not necessarily the large ones) consist of a wide array of firms of varying sizes, functions and organisational forms—much like a navy fleet, with one or two flagship (often listed) companies with recognisable products and brand names—supported by a string of unquoted, unlisted, private limited and even unincorporated enterprises. These firms are invariably linked together via inter-corporate investment and interlocked directorships—an insight of R K Hazari’s (1966) classic work. By doing away with the restrictions on PCs in the liberal era, one suspects, the patterns of corporate investment and control that Hazari discovered, have got deepened, with external linkages to tax havens and international investments—perhaps, as reflected in the diversification of the corporate sector.

In such a structure of corporate organisation, private limited companies can often be “shell companies”—defined as, “A non-trading company used as a vehicle for various financial manoeuvres or kept dormant for future use in some other capacity” (Oxford Dictionary)—to hide or divert profits, inflate costs, circumvent rules to maximise return on investment for the entire group. Often, such companies are handmaidens of business groups to navigate the complex regulatory, and tax network, so as also to corner licences and incentives. As Chalapati Rao (1997) remarked:

... multiple registrations clearly suggest the make-believe nature of the growth in number of companies and the distinct possibility of their

being used for manipulative purposes. The main purpose can only be to circumvent one or the other regulatory provision or take undue advantage of official incentives. Each one can have his own motive. It could be indulging in transactions with listed companies, for personal benefit, insider trading, to capture or initiate a industry/service association, takeover of companies, claim tax advantages, defeat provisions of the Companies Act, improve the chances of allotment of public issues offer quotations in case of tenders to satisfy the requirements of minimum numbers, as tools of money laundering, as a back-up mechanism as some of the group companies get into tax troubles, to increase chances of land allotment in industrial estates, circumventing urban land ceiling, etc. The possibilities are quite varied (Rao 1997: 11).

More recently, after financial liberalisation and promotion of private and foreign investment in infrastructure, a new need has reportedly arisen which is apparently fulfilled by the booming business of registering, and trading of shell companies to siphon off money without getting caught in the tax net. The sustained growth of company registration in Kolkata apparently is in response of the need to make such dubious transactions.

In the context of the recent financial scams of unprecedented scale and scope, an investigative report in the *Economic Times* has revealed the modus operandi of such shell companies, as described in the flow chart in Box 1 (Celestine 2013, and 2014a, and b). While it is impossible to be sure of such operations, the nexus exposed by the investigative report could form a working proposition for more serious inquiry. Also discovered in the recent financial scams is how such fake companies are used by corrupt businesses to pay off

politicians in an entirely legal fashion. As the financial journalist Sucheta Dalal (2012) observed:

There was a time when politicians did politics and used businessmen to raise money as they approached the elections. Then politicians started being sleeping partners in business ventures and then, they themselves became businessmen in their own right—owning real estate, education and other service businesses. But the most sophisticated of their moves has been to create shell companies whose shares are sold to businessmen at a stupendous premium (per share), ensuring neatly laundered, possibly tax paid wealth for our *netas*. There is no need for *benami* holding. It is all white and perfectly legal. Those, who bought shares in these shell companies usually, got concessions, mines, and large tracts of land in return (*emphasis as in the original*).

If the foregoing arguments are reasonable and evidence credible, then there is adequate basis to suspect that a substantial chunk of private limited companies—especially in the financial sector whose numbers have expanded by leaps and bounds after the reforms—could be fictitious firms, adding very little domestic output, and they may simply function as instruments to hide profits—by definition, a constituent of GVA—generated elsewhere in the economy. To be sure, there are exceptions, and not all private limited companies can be tarred with the same brush; but we have no basis to know the proportion of such genuine companies.

As the CSO's GDP estimates for 2011–12 for financial companies has got bloated by over 319% compared to the old series, we have reasons to suspect that there is something amiss in the new numbers. If the foregoing discussion is valid, it suggests that the possible fault lies with the CSO's overly simplistic (or mechanical) procedure of blowing up (or scaling up) the estimates for the entire "population" of "live companies" without adequately probing their composition and character.<sup>9</sup>

#### Box 1: White to Black and Back Again

Step 1: A large infrastructure company, in need of cash for various transactions, writes a cheque to shell company A, and accounts for it as payment of commission. A returns the money as cash (after taking a small cut). This way, the infrastructure company has obtained cash for various illicit payoffs, but has managed to account for it in its books (making it tax deductible). In this process, white money is converted into black.

Step 2: A shows the "income" from the infra company as contractual income instead of commission to avoid service tax.

Step 3: To avoid income tax on these earnings, A shows payments are made to another shell company towards fulfilment of contracts.

Step 4: The money is routed to a further clutch of companies—C, D, E, and F, who account for it as share capital. All these money flows are notional—no actual money flows to these firms.

Step 5: These four companies can now be "sold" off to others who want to convert black money into white. Anyone who wants to do this, buys the shares of the company at a huge discount to book value (that is paying say, Re 1 for a share worth Rs 50). Depending on your requirements and how much money you want to launder, there are shell companies of different sizes available.

Step 6: By doing this, the buyer has gained control of a company, whose assets are "clean" by paying only a fraction of the cost in white. It is similar to buying land by paying part of the value in black and part in white.

Step 7: The buyer can bring in the black money into the company—and convert it into white—organising small cash payments through various banks, and into the account of the company.

Step 8: The shell company operator acts as an intermediary or a broker between two different players. One wants to convert white to black, and the other wants to do the opposite (*emphasis as in the original*).

[http://articles.economictimes.indiatimes.com/2013-07-07/news/40408005\\_1\\_kolkata-firm-black-money-india-inc](http://articles.economictimes.indiatimes.com/2013-07-07/news/40408005_1_kolkata-firm-black-money-india-inc)

Source: Celestine (2013).

#### 4 Conclusions

The veracity of the new series of NAS with the base year 2011–12 continues to draw criticisms on many a methodological issue. Moreover, the new estimates are inconsistent with other macroeconomic aggregates. Regardless, the CSO has firmly held that the new series is an improvement over the earlier one, since it is founded on better methodology and larger data sets. As the estimates for the PCS are the real bone of contention, this paper describes the size and structure of the sector as officially reported, and compares it with an alternative estimate, to shed light on the nature and extent of the statistical dispute, with a hope to bridge the differences.

For 2011–12, the absolute size of GDP in the new series is smaller by 2.3%, compared to the old series. But the absolute size of PCS GDP is larger than that in the old series by 43%; and, as a ratio of GDP, it is larger by 11 percentage points (compared to 23.7% of GDP in the old series). A further disaggregation revealed the following:

- (1) The absolute size of PCS in financial sector is larger by 319%, compared to that in the previous series; as a proportion of GDP, it stands at 10.9%, compared to 2.3% in the old series.
- (2) The absolute size of non-financial PCS in the new series is larger by 9.8%, compared to that in the old series; as a proportion of GDP, it is 23.8% compared to 21.1% in the old series.

The differences between the new and the old estimates for PCs are almost entirely on account of the changed methodology and the use of the new and substantially larger official database of PCs. For the first time, the new series has directly estimated PCs's GDP using the statutory filing of financial returns to the MCA (MCA 21 database). CSO has claimed that the enlarged size of PCs in the new series is a realistic representation of the contribution of over 9,00,000 active companies whose contribution to domestic output was inadequately captured previously. Critics, however, contend that the enlarged PCs size is possibly an overestimation caused by the faulty database and flawed methodology.

Comparing the official estimates with CMIE's Prowess database for the non-financial PCs, we have sought to narrow the range of difference between the "improved estimation" (as CSO claims), or "overestimation" (as critics contend), compared to the old series.

Though the number of companies in PCs has grown exponentially in recent times, the distribution of their output is highly skewed with the top 100 companies and the top 500

companies accounting for nearly 50% and 75% of the gross value added of Prowess companies respectively. What does then the rest of the PCs, consisting of the majority of firms, really contribute? What are the true numbers of regularly working companies? There are no reasonable guesses—let alone definitive estimates—to such questions, as the true "universe" of working companies remains unknown.

Discussing the size, structure and behaviour of PCs, we have suggested (by referring to investigative reports on corporate functioning) that large swathes of private limited companies may in fact consist of "bogus," "paper" or "shell" companies, that add little social value, but probably aid and abet widespread corporate subterfuge. If this view is correct, then there is a need for a more nuanced, differentiated and granular classification of private limited companies and a disaggregated methodology to capture the reality, rather than an uncritical and mechanical use of the MCA database of doubtful quality. Though, however, the best way to resolve the dispute would yet be to make the official MCA 21 database public to permit independent verification of the official PCs estimates.

## NOTES

- 1 A public limited company is a limited liability company with at least seven shareholders. For a legal definition in India, see [http://www.archive.india.gov.in/business/starting\\_business/org\\_public\\_ltd.php](http://www.archive.india.gov.in/business/starting_business/org_public_ltd.php). The PCS includes foreign-owned enterprises, companies with unlimited liabilities, not-for-profit companies, limited liability partnerships (LLPs), etc.
- 2 As on 31 March 2014, there were 9,45,276 non-government companies. However, in Table 1, in parentheses, the number of companies for which information on paid-up capital available is only 8,49,974. It means 11.2% of the registered companies did not furnish information on paid-up capital, critical information used in scaling up the estimates for the entire sector. ([http://www.mca.gov.in/Ministry/pdf/58AR\\_English.pdf](http://www.mca.gov.in/Ministry/pdf/58AR_English.pdf)), page 75, as on 12 September 2015.
- 3 We have estimated the GVA for the old series, as it was not officially reported.
- 4 Non-compliance of regulations is widespread. For instance, in December 2013, BSE and NSE suspended trading or imposed fines on 600 listed companies (Press Trust of India 2014).
- 5 It is for this reason that many official reports, most prominently the National Statistical Commission Report (Chairman: C Rangarajan), recommended conducting a one-time census of working companies. Such an effort would also help weed out defunct and bogus companies.
- 6 This is a well-known fact, as acknowledged by National Statistical Commission (2001). To quote its report, "There are more than five lakh [5,00,000] companies registered in the ROCs but the actual number of companies, which are operating, is not known. This situation seriously affects the reliability of various estimates. An exercise conducted in March 1999 indicated that about 47% of the registered companies filed their balance sheet for the year 1997-98 with the ROCs" ([http://mospi.nic.in/Mospi\\_New/upload/css\\_12.html](http://mospi.nic.in/Mospi_New/upload/css_12.html)).
- 7 CSO said, "In the new series, comprehensive coverage of Corporate Sector has been ensured in mining, manufacturing and services by incorporation of annual accounts of companies as filed with the Ministry of Corporate Affairs (MCA) under their e-governance initiative, MCA 21. Accounts of about 5 lakh [5,00,000] companies have been analysed and incorporated for the

years 2011-12 and 2012-13, while the number of common companies (companies for which accounts are available for the year 2012-13) is around 3 lakh [3,00,000] for the year 2013-14" (emphasis added) (CSO 2015b: 4).

- 8 CSO said, "The estimates of GVA for financial services have changed due to two reasons, namely, methodological changes made in computation of the value of output of financial services, specifically, Financial Intermediation Indirectly Measured (FISIM), output of Central Bank (RBI), GVA of Money lenders and incorporation of additional data from MCA 21 and regulatory agencies, like the SEBI, IRDA and PFRDA" (emphasis added), (CSO 2015b: 35-36).
- 9 Use of administrative information for preparing economic statistics, though often unavoidable, can at times be problematic. It is in the procedural logic of administration to project an oversized image of itself, to garner greater resources in intra-departmental competition, and thus to acquire bureaucratic heft. So, often administrative departments are reluctant to critically examine the information they compile about their own operations. Therefore, the onus would rest on the official statistical agency to critically examine the administrative data. In fact, there are many instances of such caution. CSO, for instance, has rarely used the data furnished on small enterprises by the Ministry of small and medium Enterprises (MSME), earlier what was known as DCSSE, in its official industrial statistics as the information are widely known to have an overestimation bias.

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