

# FINANCIAL POLICY AND GROWTH: A STUDY OF THE CORPORATE PRIVATE SECTOR OF INDIAN INDUSTRY\*

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## 1. *Introduction*

The growth of individual firms in traditional economic theory was merely an indirect result of their profit maximisation and resource allocation function. Firms would grow only to achieve the 'optimum' level at which they would maximise profits. Therefore, in equilibrium, there would be no relation between various determinants, for example, profitability, financial policy and growth. But since last two decades, developments in the corporate theory have recast the treatment of individual firms by laying emphasis on the nature and determinants of the forces governing growth of firms. The firm is no longer a profit maximisation abstraction but 'a unique administrative and social organisation possessing the capacity for initiating its own biological growth.'<sup>1</sup> The main issue of discussion centres around the growth rate of firms and a close relation between the policy variables and growth is postulated. The relation between them is generally estimated at micro levels.

Growth, which takes place at micro levels, that is, at plant or firm levels, may be mostly influenced by the internal policies of firms. There are very few studies which examine the effects of financial policy variables on growth of firms. Liquidity retention ratio, internal finance ratio, gearing and debt equity ratio are the important variables which have been taken in some of the studies.<sup>2</sup> It was found that

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<sup>1</sup> Penrose, Edith T., *The Theory of Growth of The Firm*, Oxford, 1959.

<sup>2</sup> See: (i) Singh, A. and Whittington, G., "Growth, Profitability and Valuation", Cambridge, 1968.

(ii) Tew, B. and Henderson, R. F., "Studies in Company Finance", Cambridge, 1959.

(iii) Barna, T., "Investment and Growth Policies in British Industrial Firms", Cambridge, 1962.