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Economic Crises and their Impact on Corporate Performance: Firm-level Evidence from Indian Manufacturing

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Abstract

This study has examined the firm-level impacts of two economic crises on Indian manufacturing viz., the economic crisis generated following the Global Financial Crisis of 2007-08 and the economic crisis generated due to demonetization in November 2016 followed by the emergence of Covid-19 in March 2020. The impacts on the two alternative measures of firm performance viz., Tobin's q and ROA are observed to be different. We observe that capital intensity, competition, leverage, and firm size have to be highly significant determinants of firm survival and recovery. Firms with high pre-crisis capital intensity experienced smaller drops in firm performance. More competition among firms helps to recover early. Thus, both Crisis 1 and Crisis 2 resulted in "creative destruction" in India as argued by Schumpeter (1942). Highly leveraged firms experience more contraction during a crisis, for Tobin's q, in both Crisis 1 and Crisis 2 and for ROA in Crisis 1. Moreover, we observe that smaller firms are more adaptable in times of Crisis 1 for Tobin's q. A similar result was observed for ROA for both the periods of Crisis 1 and Crisis 2. This finding highlights that Crisis 1 and Crisis 2 did not reallocate activity to large firms that have greater market power or political connections which could be harmful to long-run economic growth (Di Mauro and Syverson, 2020). Thus, the impacts are quite different in the two crisis periods, for both Tobin's q and ROA. Our findings suggest that, a unique targeted public policy will not help for firm survival during an economic crisis.

Keywords: capital intensity; competition; leverage; firm size; firm survival