Impact of Lockdown on Indian Corporates

Why in News

Recently an investment information and credit rating agency **analysis looked into** the effect of **prolonged nationwide lockdown on Indian corporate sector.**

Key Points

- **Study:** Around 500 companies which were surveyed have shown aggregate revenues contracting by **31.1%** year-on-year basis in the first quarter of Financial Year 2021.
- **Exceptions**: Stress is visible across major sectors, with the exception of select sectors like IT, telecom, sugar and pharmaceuticals.

- **Impact:**
  - The contraction in revenues was visible across most major sectors, but it was **sharpest in consumer-oriented sectors** where revenues contracted to nearly half of the previous year's levels.
  - Sectors like **airlines, hotels, retail, automotive and consumer durables,** which primarily comprise **discretionary purchases,** are significantly impacted.

    Discretionary spending: It refers to **non-essential items,** such as recreation and entertainment, that consumers purchase when they have enough income left over after paying the necessary expenses such as the mortgage and utilities.
  - **FMCG and consumer foods** were relatively less impacted given the essential nature of these purchases.
  - **Commodity-linked sectors** contracted by **34%** on a y-o-y basis with almost all the major commodity sectors, including oil and gas, metals and mining, iron and steel and cement, reporting revenue contraction on the back of tepid realizations due to **benign commodity prices and subdued volumes.**

    Commodity-linked sectors: Sectors which are dependent upon the **commodity market** (involves buying, selling, or trading a raw product, such as oil, gold, or coffee).
  - **Industrial and infrastructure-oriented sectors** also contributed to the slowdown with **29% and 38%** y-o-y de-growth **respectively** during the quarter, given the restrictions on activity.
  - **Non-pharma exporters, real estate and construction** companies also face one of their worst years.
  - **Banking Sector:** Poor credit growth, including retail loans, along with rising **Non-Performing Assets (NPAs)** and credit costs will be harmful for banks and **Non-Banking Financial Companies (NBFCs).**

- **Reasons:**
  - **Restrictions on manufacturing, industrial, construction and consumption activities** for the major part of **Q1 FY2021** due to imposition of nationwide lockdown primarily hurt the financial performance of the Indian corporate sector.
  - **Demand-side:** Mainly due to customer wariness because of the uncertain economic environment and erosion of purchasing power.
  - **Consumer Confidence Survey:** One of India's most lucrative assets is its large consumer base. But people appeared to be less optimistic about their current situation and future expectations.
    - Data from the **Reserve Bank of India** showed **consumer confidence** has collapsed.
    - The **current situation index and the future expectations index** were both below 100, indicating that consumers were pessimistic. A reading above 100 represents optimism.
- **Consequences:**

  Despite the benefit of subdued raw material prices and favourable rupee movement in select sectors like IT, the negligible revenues for the major part of the quarter has:
    - Made companies struggle to cover even operating costs.
    - Lower realization of profit in commodity sectors (especially metals and oil and gas), with Profit Before Tax margins contracting to multi-year lows.
- **Expectations:**
  - The **revival will be marginal** from these historic lows. However, a sustained recovery to pre-pandemic levels would be gradual.
  - **Banking:** NPAs are expected to swell for non-banking finance companies, too, with microfinance, MSME loans and wholesale/developer funding witnessing the sharpest spike.
  - **Normal monsoons** with sufficient and well distributed rainfall are expected to revive investment sentiments and job creation which are very crucial to sustain the growth in earnings.
  - **Electricity generation** will also see a 6% to 8% growth, however, capital goods sector revenue is likely to decline by 5% indicating that the recovery is not yet broad-based.
  - In **pharmaceuticals,** new launches from a strong product pipeline will propel 15% growth.
  - **Movement** of goods on National Highways, as indicated by the **Fastag** and **E-way** bill volumes, shows recovery to 85% of pre-pandemic levels in July 2020, which was also visible in the railway freight and port tonnage data.

Way Forward

- Healthy rural demand on the back of normal monsoons, healthy Kharif sowing and government support in the form of increased the **Mahatma Gandhi National Rural Employment Guarantee Act (MNREGA)** allocations, MSME guarantee loans, etc. has been the **silver lining** in an otherwise bleak environment, offering some impetus to overall demand and economic recovery.
- Accordingly, select sectors have witnessed faster recovery vis-à-vis earlier expectations. However, the rapid proliferation of the pandemic and intermittent regional lockdowns has the potential to further disrupt supply chains and consumer sentiments so they can better be used with caution.

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