Investment Deficiency in India and Its Implications

This article is based on the opinion piece published in Livemint by the name “Two engines of the economy need to fire”

In a developing country like India, private investments are one of the key drivers of the economy. The economy is witnessing a major slowdown in private investments in the past four years, even though it is growing at 7%. Although, some have been seeing as a precursor to more sustained growth, some have been raising fingers at the claims of the government to have shaped the environment for increased investment in India by initiatives like “Make in India” and “Ease of Doing Business”.

Investment in India in recent times

- **Investment Rate:** This is also known as ‘share of gross fixed capital formation in GDP’. This refers to fresh investments in the form of plant and machinery and other fixed capital. It declined to 31% in fiscals 2015-2018, compared with 33.6% in fiscals 2010-2014. However, it has shown a small increase in the fourth quarter of 2018.

- **Decline in new project announcements:** According to the Centre for Monitoring Indian Economy (CMIE), in the last quarter of 2017, fresh investments in India plunged to a 13-year low. However, it has shown modest recovery in the recent months.

- **Drop in FDI inflow:** According to the World Investment Report 2018 by the UN Conference on Trade and Development (UNCTAD), FDI to India declined in 2017.

- **Decrease in capital expenditure:** As per data from RBI, capital expenditure by the private sector has steadily declined for the last six years. However, RBI only covers institutional financing and does not include projects below rupees 10 crores.

- **Decline in share of the household sector:** The household sector was the biggest contributor to investments in fiscal 2012 (share of about 45%), but its share has declined consistently since then (31% in fiscal 2017). The purchase and construction of houses have slowed down.
- **Improvement in the productivity of investments:** Productivity in investment refers to the output that any investment begets and it is measured by the Incremental Capital Output Ratio (ICOR). Lower the ICOR more is the productivity of capital. ICOR averaged 4.3 as compared to 5.5 before 2014, which is a significant improvement.

Reasons for slow growth in investments

- **Inadequate Capacity Utilization:** Capacity utilization is the extent to which an enterprise or a nation uses its installed productive capacity to produce output. The capacity utilization in some large industrial sector has been much below its peak, as the data from RBI and CRISIL suggests.
- **Focus of corporates on improving their capital structure:** Capital Structure refers to how a firm finances its overall operations and growth by using different sources of funds. The corporate sector has been suffering from debt and low funding. Therefore, the companies have shifted their focus to improving their debt/equity and interest coverage ratio.
- **Demonetization and GST:** The twin shocks from demonetization and GST gave a setback to the corporate sector as it struggled with uncertainty in investment decisions.
- **Pre-election uncertainty:** Election season is marked by uncertainties over regime-change and

policy turnovers. This has also discouraged private investments this year.

- **Over-investment in sectors** like power, steel and telecom led to a high capital/output ratio and a low rate of return on capital.
- **Low Consumer price inflation:** As governments emphasize on keeping the consumer prices low for political motives, companies fear low return on their investments due to the same. Similarly, the government is cautious in rolling out land and labour reforms as it may face a backlash. This also deters multinational companies from setting up their factories in a country laden with labour laws and land regulations.

- **Cautious lending by banks:** Following the bad loans exigency, the banks have been over-cautious in lending. This has led to a shortage of funds for the medium and small companies.

Way forward

Although, it will be unreal to expect the investment trajectory to move upwards in this fiscal as there has been little improvement in the above-mentioned factors. However, the government has initiated a number of steps to ease the business environment including

- Make in India campaign
- Insolvency and Bankruptcy Code (IBC)
- Single window clearance system
- Automatic route for various foreign investments

There have been a few instances which show that foreign investment is getting attracted towards India, like **Walmart acquiring a controlling stake in Flipkart.** Thus, we should be optimistic regarding the pick up in investments in the coming years.

Initiatives like “**Make in India” will show colours only gradually** as MNCs prepare themselves to harness the potential of this programme by setting up their plants and facilities. This should not be expected to take place in a day.

Similarly, the **data showing a decline in investments are not the most accurate ones** as MNCs tend not to borrow from the Indian banking system and, hence, do not reflect in credit growth numbers. Also, most of them are **not listed on our domestic exchanges** and their profitability details are not available in the public domain.

As the government is constantly endeavouring to solve the problem of NPAs by adopting the new **five-pronged strategy recommended by Sunil Mehta Panel**, it is hoped that credit flow will soon resume to normal.

However, **capital investment is not the only key** to unlock the way to growth. As we have seen, misallocated and undisciplined capital investment had led to the global crisis of 2008. Thus, it is important that **productive and steady investments** occur in a directional manner which can be sustained in the long run.

The government should also consider revising the policies and carrying out structural reforms to **remove bottlenecks in investments.** Also, retail investors should be given the opportunity to invest by removing barriers like the minimum 20% promoter holding requirement for investors.

Given the positive foreboding regarding the reversal of investment slowdown, the government needs to keep up the process of liberalizing the economy and simultaneously promoting domestic firms.

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