Capital Expenditure of Corporates: FY09-FY14

RBI recently releaseda study on corporate investments which provides a picture on the envisaged capital expenditure (investment in fixed assets) of companies from the private and joint business sector for the last five years. Based on information provided by companies when raising funds from banks, financial institutions, External Commercial Borrowings (ECBs) and the equities market, the capital layouts over the years have been presented in this report.

The main takeaways are:

- There has been a slowdown in capital expenditure in FY14 relative to FY13
- There is a reduction in the financial assistance acquired from Banks/FIs, ECBs and Equity issues for the same.
    - Share of ECBs in total capital expenditure is on the rise
- More than Rs 1.27 lakh crore new investments are required in FY15, to cross the investment levels of FY14.

The underlying aim of this report is to put into perspective the position of capital expenditure of companies. Thereby, the report includes,

- Analysis of the trend in total capex.
- Change in preferences of companies for financial assistance for envisaged capex
- Proportion of lending by Banks/FIs and ECBs for capex of the total lending at the macro level.
- Proportion of resource mobilization by non-financial institutions as proportion of total resource mobilization in the private placement corporate debt market.

The report is concluded with an outlook on capital expenditure by corporates.

Capital Expenditure *Trend and growth rate*

Capital Expenditure of the companies as per their time phasing plansto be incurred in FY14 has declined to Rs 2.51 lakh crore from the previous year's total of Rs 3.1 lakh crore thereby recording a contraction in growth by 17.8%. This comes on a decline of 16.9% in FY13.

The exhibit below captures the trend in capital expenditure and gross capital formation and also exhibits their growth rates between FY09-FY14.

Capital Expenditure after fluctuating between FY09 and FY12 has been on a downward trajectory in the last two fiscal years. It was at a high of Rs 3.7 lakh crore in FY11 when it grew by 9.6% over the previous year. However, growth in capital expenditure has been negative in the years to follow (-0.7% in FY12, -16.9% in FY13 and -17.8% in FY14). This clearly gives an indication of the rather weak business sentiment in the previous years.

Exhibit 1: Total Capital Expenditure Rs crore)

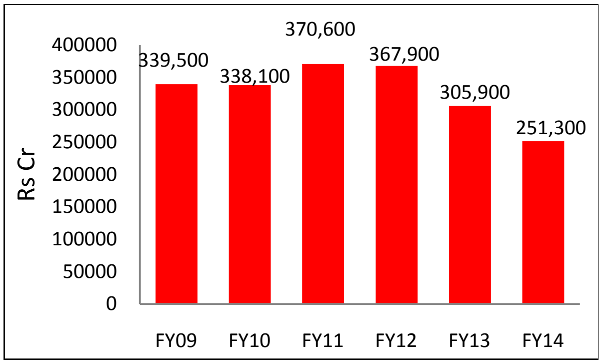
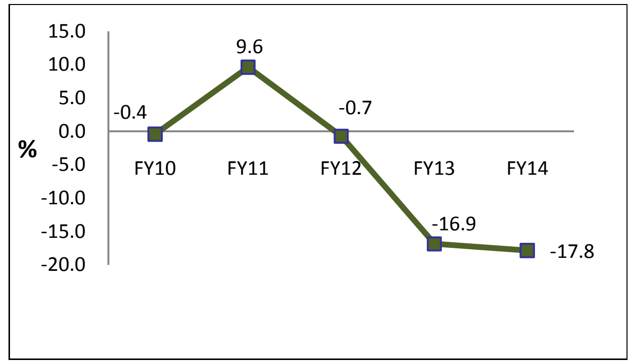


Exhibit 2: Growth in Capex (%)



Source:RBI

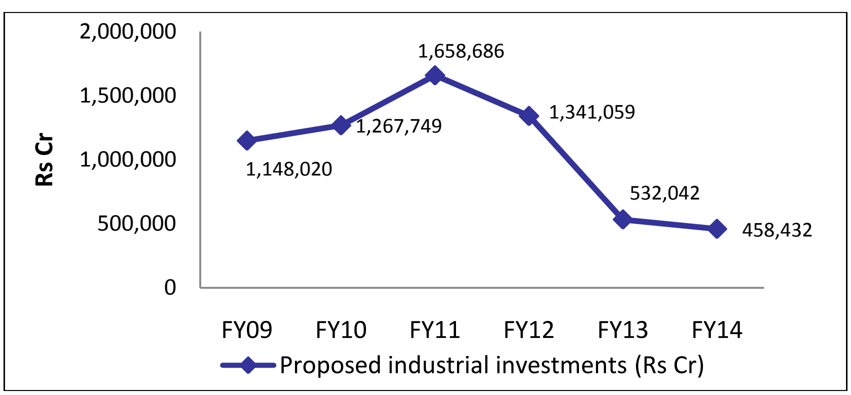
Growth in capital expenditure also appears to be in conformity with the gross fixed capital formation numbers (current prices) at the macro level (which also includes expenditure of households and government on cape which is not covered here). Gross fixed capital formation decreased from 31.7% in FY10 to 30.9% in FY11 and then rose to 31.8% in FY12 (which is an aberration here). In FY13 and FY14 the GFCF rate continued to decline to 30.4% and 28.3% respectively.

The above discussed slowdown in capital expenditure also finds some support in the reducing proposed industrial investments*(DIPP, Ministry of Commerce).* The amount proposed for industrial investments increased from Rs 11.5 lkh crore in FY09 to Rs 16.6 lkh crore in FY11 before declining to Rs 13.4 lkh crore in FY12. However, in the subsequent two years, the decline was sharper to Rs 5.3 lkh crore and Rs 4.6 lkh crore respectively in FY13 and FY14.

The number of proposals involved showed significant variation: 3,910 in FY09 to 4,289 in FY11 and a decline to 3,557 in FY12 and further to 2,761 and 2,283 in FY13 and FY14. This only reinforces the deceleration in capital expenditure by companies as industrial investments remain on the downward trajectory.

The exhibit below displays the proposed industrial investments in India between FY09 and FY14.

Exhibit 3: Proposed Industrial Investments (Rs Cr)



Source: Department of Industrial Policy and Promotion

Regional and sectoral distribution of Capital Expenditure

- *Regional*- Odisha, Maharashtra, Gujarat and Chhattisgarh received 55.7% of the total capital expenditure envisaged in FY14.
  - Odisha received the maximum share in the metal industry while Maharashtra received investments in power, agricultural and food products, sugar and construction. Gujarat received investments for the textiles, ceramics and chemical industries. This is also reiterated in the investment intentions for various states in India wherein the same mentioned states stand to acquire large investments during the on-going 12th Five Year plan[1].

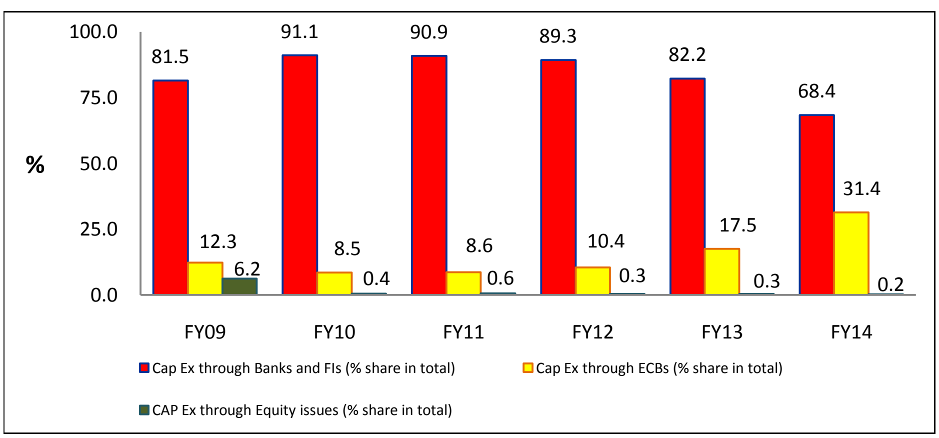
- *Sectoral* -There was prominent investment in the 'power' sector (33.4% of the total) in FY14. Industries of 'metal and metal products', 'textiles', 'cement and construction' were the other major industries that investment flowed to.
  - Striking a chord with IIP- The heavy capital expenditure in the power sector could have supported the 'electricity' segment which recorded the highest y-o-y growth (%) in industrial production in FY14 at 6.1% relative to the 'manufacturing' and 'mining & quarrying' sectors.
  - The other industries with high capex such as 'textiles'recorded a growth of 4.4% compared with the previous year's growth of 5.9%. 'Basic metals' grew by 0.34% (1.9% in FY13). Going ahead, the capital expenditure incurred in the above sectors in FY14 is likely to foster production in these sectors in FY15.

Capital investments: *What is the preferred source for assistance?*

Over the cumulative period (FY09-FY14), capital formation by way of assistance from Banks and FIs accounted for 84.8% of finance for the capital formation while that through ECBs stood at 13.8%. In the last three years, the share of ECBs for capital formation has been increasing.

The exhibit below captures the share of all three sources in the total capital formation.

Exhibit 4: Share of Capital Expenditure through Banks/FIs, ECBs and Equity Issues in total Capex



Source: RBI

[1] *Source: Department of Industrial Policy and Promotion*

The changing preference as brought out in the exhibit above captures the fall in the share of assistance by Banks and FIs to 68.4% in FY14 from its peak of 91.1% in FY10. On the other hand, share of ECBs increased from 12.3% in FY09 to 41.4% in FY14. The share of equity issues is almost negligible.

Following are the main factors contributing towards the above phenomenon.

- Interest rates were slashed to historically low level in the USA post the financial crisis in orderto foster growth in the country. This situation when juxtaposed with the high interest rate regime in India prevalent since FY12, clearly suggests that in order to make the most of the interest differentials, companies preferred borrowing through the ECB route.
- Additionally, in FY14 in particular, there was serious concern over the rising non-performing assets in the Indian banking system. This would have lead to some reluctance on the Banks to lend to companies.
- RBI increased the limits for external commercial borrowings in FY14, thereby enabling companies to borrow more for capital formation.
- Lastly, companies in general prefer raising capital through debt instruments as opposed to equity issues. Therefore, even though the secondary market was buoyant, companies preferred the debt route. Overall IPOs issuances had peaked at Rs 33,097 cr in FY11, and then declined to Rs 5,886 cr, Rs 6289 cr and Rs 919 cr in FY12, FY13 and FY14 respectively.

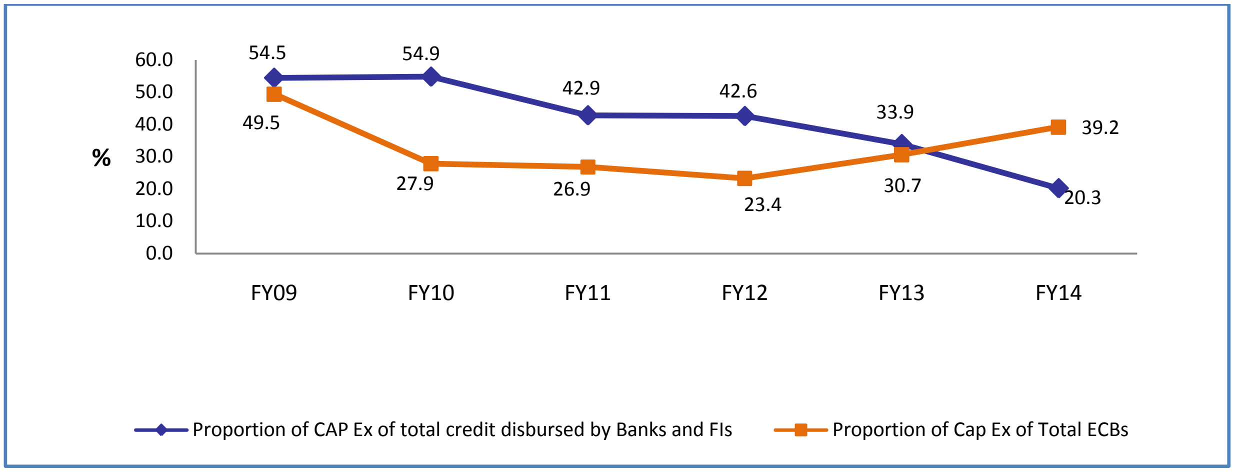
Macro issue: ***How much of Bank and FIs finance and ECBs go for Capital formation?***

The proportion of total credit disbursements by banks, FIs and ECBs used for Capital Expenditure by companies is analysed to gauge better how much of the credit disbursed by banks and FIs is going for capital formation. Capex financed by incremental bank credit and disbursements of FIs and capex financed by ECBs as a proportion of total ECBs are calculated for this time period.

The exhibit below captures this ratio which has been declining over all for Banks and FIs and ECBs alike.

- *Banks and FIs*-The proportion of capex financed by banks and FIs as proportion of total incremental credit of banks and disbursements of FIs was 20.3% in FY14 against a ratio of 54.5% in FY09.The trend has been downward since FY10. In FY14 alone, this ratio contracted by 40% vis-à-vis a contraction of 20.4% in FY13 (-0.6% in FY12).
- *External Commercial Borrowings*-ECBs under the automatic route amounted to Rs 74,691crin FY14 and that under the approved route were Rs 1.27 lkh crore, thereby taking the total ECBs in FY14 to Rs 2.02 lakh crore. Theproportion of ECBs for capital formation of the total ECBs has been more volatile when compared with the same for Banks and FIs. After falling from 49.5% in FY09 to 27.9% in FY10, it declined further in the subsequent two years and reached its lowest in FY12 at 23.4%. However, it has been rising for two consecutive years in FY13 (30.7%) and currently stands at 39% in FY14. Hence, not only is ECBs share in total capital expenditure increasing, but so is the proportion of ECBs utilized towards capital expenditure of the total ECBs, this can be viewed positively.

Exhibit 5: Proportion of capitalexpenditure of the total credit disbursed by Banks and FIs and ECBs (%)



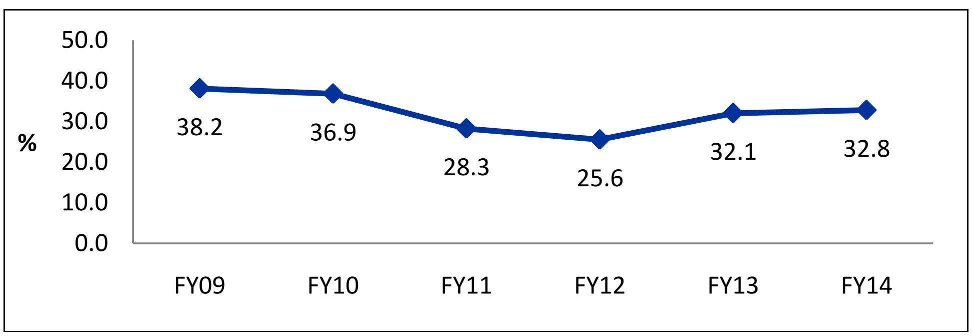
Source: RBI

Macro Issue: Private placements in corporate debt market

Resource mobilization by non-financial institutions- *Proportion of total*

In the debt market, private placements are the preferred route over public issues. The exhibit below shows the share of resource mobilization by non-financial institutions of the total resource mobilization in this market.

Exhibit 6: Share of non-financial institutions in total private placements



Source: RBI

Banks and FIs play a significant role here as they mobilize a sizeable share of resources in the private placement market which in turn they lend to companies. The share of non-financial institutions in the private placement market has been more or less steady for the period under consideration. It fell slightly in FY11 and FY12 to 28.3% and 25.6% respectively and then moved upwards in the subsequent two years in FY13 and FY14.

Outlook for Capital Expenditure by Corporates: *Where can it stand?*

As per the plans upto FY14, the capital expenditure envisaged in FY15 stands at Rs 1.24 lkh Cr, which is less than 50% of the amount in FY14 (Rs 2.51 lkh crore). Hence, in order to improve the capital expenditure in FY15 from its counterpart in FY14 would warrant more than Rs 1.27 lkh crore by way of new investment plans in FY15. It remains to be seen if this is achieved.

As of now, the downward bound capital expenditure by companies has been brought out clearly in the analysis above. However, there is reason to believe that this trend stands likely to be reversed in the short to medium term contingent on the following.

- The government has taken some affirmative steps to improve the environment for business and it is expected that some stalled projects will gain traction.
- As the RBI remains focused on reining in inflation, it is expected that interest rates will ease down once inflation is within RBI's comfort range. Hence, as interest rates come down, borrowings from Banks and FIs will see a pickup which increases the exposure of credit for capital expenditure purposes.
- Given the positive growth outlook for the ongoing and next fiscal year, there is a higher need for capital expenditure which the private and joint business sector will satisfy along with the Government. Hence, not only will a cut in interest rates provide some cushion from the supply side, but there will also be a higher demand for the same.
- Global interest rates are still at historical low levels. However, this scenario is soon to change particularly in the USA as the Federal Reserve will look to squeeze in liquidity in due course following the end of its tapering programme even as the European Central Bank starts its version of a stimulus programme. Hence, while higher interest rates in USA might discourage ECBs from the region, the opposite in the Euro region might keep ECBs buoyant to some extent.

However, the pace of turnaround will be gradual interest rate environment, demand conditions and overall growth environment is still not overtly supportive of rapid investment. Q1 FY15 has shown stability in capital formation; and fresh spending by government as per the budgetary estimates and traction in the stalled projects space will be the supporting factors.

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