Behavior of private corporate investment in post reform India and the role of leverage

Abstract

From 1980s onwards and especially after economic reforms of 1991-92 private corporate sector played an important role in driving investment in the Indian economy. In the 1st decade of 21st century when gross investment became the driver of aggregate demand, private corporate investment became the most important component of overall investment activity. Further, in the downturn that followed the global financial crisis of 2008-09, private corporate investment saw its share in overall investment fall. In this context we analyze four separate but interrelated aspects associated with private corporate investment in the post-reform Indian economy using demand-side frameworks.

A quick glance at the balance sheets of modern non-financial Indian corporates reveals that they hold a large amount of financial assets along with physical capital stock. For non-financial corporates whose major business is manufacturing, mining, providing technological and other kind of services etc. there is no intuitive reason for holding large amounts of financial assets. These financial assets include investments in equity shares, preference shares, debentures, bonds, mutual funds, and bank balances. In this context, we explore the possibility that for Indian manufacturing firms accumulation of financial assets and physical assets are negatively related, as is suggested by the theory of financialization. Theory of financialization provides a framework to critically view the increasing importance of financial assets in corporate balance sheets. Using data from Indian manufacturing sector firms we establish that, for the small non-group firms, financial income as well as financial accumulation have a positive impact on physical capital accumulation. For largest firms, both group and non-group, however the relationship between financial income and

proportion of financially stressed firms who cannot invest in downturns; and second a set of healthy firms who choose to minimise debt during the downturn and therefore are not investing. We suggest that it is the combination of these effects that has prolonged the recent investment slowdown