ILLUSTRATION: AJAYA MOHANTY

Financial investments by non-financial firms

Is this the future, or will market volatility reverse the trend?

The aggregate corporate data, as reflected in the income tax returns, captures a systematic shift in the composition of income of this segment of the economy — away from business income and in favour of passive incomes, i.e., capital gains and other incomes.

To understand this trend a little more, this column uses data from the BSE 500 companies to explore any observable trends. While these companies do not represent the average enterprise in the country, they account for a large share of the value added in corporate India and, therefore, are likely to drive these trends.

There are two ways of looking at this problem — first, has the composition of reported income changed? And second, has the composition of assets changed? In this piece, one looks at the composition of assets to understand the underlying trends by using data from the PROWESS database of the Centre for Monitoring Indian Economy.

Since the nature of business activity differs between financial and non-financial firms, these are presented as two separate categories of companies. The table provides information on the share of physical investments to total investments. Physical investments are defined as net fixed assets, plus capital work in progress and intangibles, while financial investments are defined as long-term investments and long-term loans and advances.

Of the 500 companies, 408 are non-financial companies, while the rest belong to the financial sector. Given the question of interest here, the focus is on non-financial companies. These account for 94-95 per cent of the net fixed assets for BSE 500 companies.

R KAVITA RAO

For non-financial firms, the share of fixed assets has declined from 66 per cent to 59 per cent in the same period. The systematic decline in fixed assets implies a corresponding increase in the share of financial assets for these firms. Another way to view this information is to look at the ratio of net fixed assets to financial assets. This ratio has declined from 1.95 to 1.45 during the same period.

Further, the share of capital works in progress and intangibles as a percentage of net fixed assets has declined from 24 per cent to 14 per cent. This is another reflection of the reduced focus on capital formation in these companies.

In terms of the number of companies, comparing information of 2014 and 2023, of the 500 BSE companies, 82 are financial companies, while 408 are non-financial companies. Of the latter, considering 384 companies for which data is available for the entire period, 248 companies have reported an increase in the share of financial assets in total assets. These companies account for 62 per cent of the net fixed assets as of March 2024.

It may be noted that this is also the period during which there has been a clear increase in the share of passive incomes in income tax data. The increase in passive incomes could be the result of a number of different factors. A change in the structure of the economy and corporate sector in favour of sectors that rely less on fixed assets could be one reason. In terms of broad categories of financial and non-financial companies, there has not been much change in composition — as mentioned above, the share of financial companies in total net fixed assets for the BSE 500 companies remains between 4 and 5 per cent. Further, sectoral decomposition could throw some light. A second factor could be a restructuring of businesses — deleveraging of companies following the introduction of the Insolvency and Bankruptcy Code (IBC) could support a reduction in assets, accompanied by a reduction in liabilities as well. Such an adjustment could explain the observed trend of an increase in capital gains reported in income tax. However, given the consistent increase in the share of financial assets in total assets of non-financial companies, deleveraging does not seem to present a complete picture.

A third factor could be an emerging preference for investment in financial instruments. For non-financial companies, the share of long-term investments has increased from 61 per cent to 78 per cent, reflecting a reduced interest in long-term loans and advances. Apart from possible incentives provided by sharp increases in stock prices in the capital markets —an average growth of over 14 per cent in the index over the last 10 years and in more recent times, a growth of over 25 per cent — the above trends raise questions about the opportunities for gainful investment within the economy.

A moderation in private investment in 2019, preceding Covid, suggests a medium-term moderation in demand in the economy — a simultaneous surge in stock markets would provide an attractive venue for investment of surpluses generated by profitable companies. Recovery in demand could provide the opportunity for a return to investment in the real sector.

An increase in capacity utilisation in companies is evident in the Reserve Bank of India OBICUS survey on an aggregate basis. What remains to be seen is whether uneven recovery in demand across sectors, along with perceived uncertainties from domestic and international demand, can pose hurdles to the recovery in fixed investments.

The recent spurt in volatility in capital markets, if sustained, could reduce the attractiveness of financial investments when juxtaposed against investments in fixed assets. Would this be a blessing in disguise — albeit with high opportunity costs for individual investors?

The writer is director, National Institute of Public Finance and Policy, New Delhi

SHARE OF FIXED ASSETS IN TOTAL ASSETS (%)

	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
Non-financial	66	66	65	65	63	61	60	62	60	61	59
Ratio of fixed assets to financial assets	1.92	1.93	1.90	1.88	1.67	1.55	1.52	1.65	1.51	1.57	1.45

Note: End of financial year estimates