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Corporate Investment in India: Why Demand, Profitability and Credit Access Matter More Than Interest Rates Alone

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Recent Developments and Current Context:

- A recent analysis published in August 2026 examines the prolonged weakness of **corporate investment as a share of GDP in India** and argues that investment decisions depend on **expected profitability, future demand, business confidence and access to finance**, rather than interest rates alone.
- The analysis is particularly relevant for understanding the **asymmetric constraints faced by firms of different sizes**, with smaller firms generally facing stronger financing constraints and larger firms facing stronger demand constraints.
- However, the recent macroeconomic picture indicates that the investment cycle is showing signs of revival. The **Economic Survey 2025-26** estimates **Gross Fixed Capital Formation (GFCF) at 30.0% of GDP in FY26**, while GFCF growth reached **7.6% in H1 FY26**, above the pre-pandemic average of 7.1%.
- Private corporate investment announcements also strengthened considerably, reaching **?14.6 lakh crore in H1 FY26**, compared with ?7.9 lakh crore in H1 FY25 and ?11.4 lakh crore in H1 FY24.
- Therefore, the present issue should be understood as a **structural investment weakness followed by emerging signs of recovery**, rather than as an uninterrupted decline continuing into 2026.

Meaning and Importance of Corporate Investment:

What is Corporate Investment?

- **Corporate investment** refers to expenditure by businesses on productive assets such as factories, machinery, equipment, technology, research and development and other forms of fixed capital.
- Such investment expands the economy's **productive capacity**, supports employment generation, raises productivity and can strengthen long-term economic growth.
- Corporate investment is also important for India's structural transformation because sustained private capital formation can increase manufacturing capacity, technological adoption, export competitiveness and formal employment.
- At the macroeconomic level, corporate investment forms an important component of **Gross Fixed Capital Formation**, although GFCF also includes investment by households, government and financial corporations.

Why Corporate Investment Matters for Growth?

- Higher investment increases the economy's productive capacity and can generate a **multiplier effect** through demand for machinery, construction, intermediate goods and labour.
- Investment in technology and modern capital can increase **labour productivity**, reduce production costs and improve international competitiveness.
- A sustained investment cycle can create a virtuous interaction in which higher investment generates employment and income, stronger demand encourages further investment and rising productivity supports

higher growth.

Evolution of Corporate Investment in India:

High-Investment Phase of the 2000s:

- India's corporate investment experienced a major acceleration during the early 2000s, with private corporate investment rising from around **6.5% to 10.3% of GDP** in the 2003-04 period. Historical evidence also shows a strong increase in corporate investment during the broader high-growth phase of the 2000s.
- The investment boom was supported by strong domestic demand, expanding credit, favourable business expectations and rising capacity requirements.
- **Gross Fixed Capital Formation** subsequently reached very high levels during the mid-2000s, coinciding with India's rapid economic expansion.

Post-Global Financial Crisis Slowdown:

- The **Global Financial Crisis (GFC) of 2008** weakened external demand and financial conditions, contributing to a decline in investment activity.
- India's subsequent investment slowdown was also associated with accumulated corporate leverage, stressed bank balance sheets and the emergence of the **Twin Balance Sheet Problem**, in which overleveraged companies and banks with stressed assets constrained new lending and investment.
- The decline in private investment therefore reflected both **demand-side weakness and financial-sector constraints**, rather than a single monetary factor.

Post-2016 Investment Weakness:

- The analysis highlights **demonetisation in 2016** as an important domestic shock associated with a prolonged weakening of corporate investment and business confidence.
- Unlike the GFC, which originated as a global financial shock, demonetisation represented a significant **domestic policy shock** that disrupted cash-intensive economic activity and affected business expectations.
- The subsequent introduction of **GST**, banking-sector stress and uncertainty surrounding demand further complicated the investment environment.
- The RBI had also noted that stressed bank balance sheets could constrain the recovery of private investment despite improved liquidity and lower lending rates following demonetisation.
- Importantly, the investment slowdown predates the **COVID-19 pandemic**, indicating that the pandemic intensified an existing weakness rather than creating the entire problem.

Determinants of Corporate Investment:

Expected Profitability:

- A firm invests when the expected return from additional productive capacity is sufficiently high relative to the associated costs and risks.
- Investment therefore depends on whether firms expect a new factory, machine or technology to generate adequate **future profits**, rather than merely on whether the investment can technically be financed.
- If existing capacity is already sufficient to meet expected sales, firms have less incentive to undertake additional capital expenditure even when financing costs are low.

Expected Future Demand:

- **Future demand** is crucial because productive assets generally have long economic lives and cannot be adjusted easily after installation.

- A firm expecting weak sales may postpone investment because additional capacity could remain underutilised.
- Conversely, sustained growth in order books, consumption and export demand can encourage firms to expand capacity before existing facilities become a binding constraint.

Business Confidence and Keynesian Animal Spirits:

- **John Maynard Keynes's concept of "animal spirits"** describes the confidence and expectations that influence investment under conditions of uncertainty.
- Firms do not make investment decisions solely by calculating current interest rates because future demand, profitability, regulation, taxation and macroeconomic conditions are uncertain.
- Strong business confidence can therefore increase investment even when financing conditions are not exceptionally favourable, while uncertainty can suppress investment even when credit is relatively inexpensive.

Cost and Availability of Credit:

- Interest rates influence investment because firms compare expected returns from productive assets with the return available from financial assets and the cost of borrowed funds.
- However, the **headline policy rate** is different from the actual borrowing conditions faced by individual firms.
- Firms may face higher effective borrowing costs because of risk premiums, collateral requirements, weak balance sheets, limited access to formal finance and lender risk perceptions.
- Consequently, reducing the policy rate does not automatically ensure that every firm receives cheaper or more abundant credit.

Why Firm Size Creates Different Investment Constraints:

Smaller Firms and Financing Constraints:

- Smaller firms generally possess lower internal cash reserves and weaker balance sheets, increasing their dependence on external finance.
- Lenders may perceive smaller firms as riskier because they often have fewer tangible assets, shorter credit histories and greater vulnerability to demand shocks.
- Higher perceived risk can increase borrowing costs and restrict access to finance even when aggregate monetary conditions are accommodative.
- This mechanism is consistent with **Michal Kalecki's principle of increasing risk**, under which greater reliance on external finance can increase the perceived risk borne by both the entrepreneur and the lender.
- Empirical research on Indian firms also finds that investment slowdowns can be **asymmetric across firm size and leverage**, with highly leveraged and smaller firms experiencing stronger investment constraints.

Larger Firms and Demand Constraints:

- Larger firms generally possess stronger internal financing capacity and better access to banks and capital markets.
- Their principal constraint may therefore shift from **finance to demand**, particularly when existing productive capacity is already adequate.
- Lower interest rates may have limited additional impact on such firms if they do not expect sufficient demand to justify new capacity.
- This creates an important policy asymmetry: **smaller firms may need better access to finance, while larger firms may need stronger demand expectations**.

Why Lower Interest Rates and Corporate Tax Cuts May Not Be Sufficient:

Limits of Monetary Policy:

- Lower interest rates can reduce the cost of borrowing, but their investment impact depends on whether firms actually face a financing constraint.
- Smaller firms may remain constrained by collateral requirements, credit risk and inadequate internal funds even when the policy rate declines.
- Larger firms may have adequate access to finance but postpone investment because they lack confidence in future sales.
- Therefore, monetary easing can support investment, but it cannot independently resolve **weak demand expectations or structural credit-market imperfections**.

Corporate Tax Cuts and Investment:

- India reduced the csorporate income-tax rate for existing domestic companies opting for the concessional regime to **22% in September 2019**, while eligible new domestic manufacturing companies received a concessional rate of **15%**, subject to specified conditions.
- The timing is important because the major corporate tax reduction occurred in **2019, not 2018**, and should therefore be stated accurately in UPSC answers.
- A lower corporate tax rate increases post-tax profitability and can improve the expected return on investment.
- However, firms may retain additional profits or strengthen balance sheets instead of undertaking fresh capacity expansion when expected demand remains weak.
- Tax incentives are therefore more effective when combined with **strong demand conditions, stable policy expectations and adequate financing access**.

Role of Government Expenditure in Reviving Private Investment:

Demand-Creation Channel:

- The analysis argues that **autonomous government expenditure** can influence corporate investment by creating additional demand for goods and services.
- Higher government demand can increase firms' expected sales, improve capacity utilisation and raise expected profitability.
- Improved profitability expectations can encourage both financially constrained and demand-constrained firms to undertake additional investment.
- This mechanism represents a **demand-side channel of investment revival**, rather than merely a reduction in the cost of capital.

Public Capex and Crowding-In:

- India's recent strategy of increasing **public capital expenditure** can support private investment by creating infrastructure, improving logistics and generating demand for construction, steel, cement, machinery and related industries.
- The Economic Survey 2025-26 reports that central government capital expenditure has increased substantially as a share of GDP compared with the pre-pandemic period, while effective capex has also risen.
- The desired outcome is **crowding-in of private investment**, where public investment improves demand and infrastructure conditions sufficiently to induce additional private capital formation.
- However, excessive or poorly targeted fiscal expansion can create inflationary, debt-sustainability or resource-allocation concerns, making the quality and composition of government expenditure important.

Complementary Reforms for Investment Revival:

Strengthening Credit Access:

- **Credit guarantees, collateral-light lending, fintech-based credit assessment and deeper corporate bond markets** can improve financing access for smaller firms.
- Strengthening the financial position of banks and improving credit-risk assessment can reduce the transmission gap between monetary easing and actual borrowing conditions.

Improving Business Conditions:

- Stable taxation, predictable regulation, faster approvals and reduced compliance costs can lower policy uncertainty and improve investment confidence.
- Faster resolution of stressed assets can also release capital that remains locked in unproductive projects.

Insolvency and Bankruptcy Code:

- The **Insolvency and Bankruptcy Code (IBC)** can improve investment by strengthening creditor rights and reducing financing frictions.
- Recent empirical evidence using Indian firm-level data finds that IBC implementation increased investment among financially constrained firms and improved their responsiveness to growth opportunities.
- This demonstrates that investment revival requires not only cheaper credit but also **better financial institutions and stronger creditor protection**.

Capacity Utilisation and Demand:

- Manufacturing **capacity utilisation** is an important indicator of future investment prospects because sustained high utilisation signals that existing productive capacity is approaching its limits.
- RBI data showed seasonally adjusted manufacturing capacity utilisation at **75.3% in Q3 FY25**, well above its long-term average, alongside healthy indicators of investment demand.
- Higher capacity utilisation can therefore become a bridge between current demand growth and future private capital expenditure.

Key Challenges for India:

Structural Challenges:

- India's investment environment continues to face challenges from **unequal access to finance, stressed assets, demand uncertainty, regulatory complexity and uneven infrastructure quality**.
- Smaller firms remain particularly vulnerable to financing constraints, while large firms can postpone investment when market demand is insufficient.
- Global excess capacity in sectors such as steel can also weaken investment incentives by increasing competitive pressure and reducing expected returns.

Policy Trade-Offs:

- Excessive dependence on interest-rate reductions can weaken macroeconomic stability if inflationary pressures emerge.
- Broad corporate tax reductions can reduce government revenue without generating proportional additional investment when demand expectations remain weak.
- Large fiscal stimulus can support demand but must remain consistent with **debt sustainability, fiscal credibility and productive expenditure priorities**.
- The optimal strategy is therefore a combination of **demand creation, targeted financial support, structural reforms and macroeconomic stability**.

Way Forward for India:

A Balanced Investment Strategy:

- India should pursue a **three-pronged investment strategy** consisting of stronger demand, better access to finance and improved investment conditions.
- Public capital expenditure should continue to focus on infrastructure with high economic multipliers, while avoiding inefficient expenditure that merely increases fiscal costs.
- Credit policies should address the specific financing constraints of smaller firms instead of relying exclusively on broad reductions in interest rates.
- Stable taxation and predictable regulation should strengthen long-term business confidence and reduce the uncertainty premium attached to investment.
- Manufacturing competitiveness should be improved through better logistics, reliable power, skilled labour, technology adoption and integration into **Global Value Chains**.
- The objective should be to create conditions in which rising demand translates into higher capacity utilisation, stronger profitability expectations and ultimately sustained private investment.

Conclusion:

- India's corporate investment slowdown reflects a **multi-dimensional interaction between profitability, demand expectations, business confidence, financing conditions and firm-specific constraints**.
- The central analytical insight is that firms are not homogeneous: **smaller firms tend to be more finance-constrained, whereas larger firms tend to be more demand-constrained**.
- Consequently, a single policy instrument such as lower interest rates or corporate tax reductions cannot be expected to generate a broad-based investment revival.
- The recent rise in GFCF, manufacturing capacity utilisation and private investment announcements suggests that India's investment cycle is strengthening, but sustaining this revival requires stronger domestic demand, efficient financial intermediation and a predictable business environment.
- A successful investment cycle can create a **virtuous circle of demand, profitability, investment, employment and productivity**, thereby strengthening India's long-term growth potential.

Value Addition for UPSC:

Key Concepts to Use in Answers:

- **Keynes:** Investment depends partly on expectations and **animal spirits** under uncertainty.
- **Kalecki:** External finance can increase perceived risk through the **principle of increasing risk**.
- **Twin Balance Sheet Problem:** Overleveraged corporates and stressed banks can jointly suppress private investment.
- **Crowding-in:** Productive public investment can stimulate private investment by improving infrastructure and generating demand.
- **Crowding-out:** Excessive government borrowing can potentially raise financing costs and compete with private borrowers for available funds.
- **Capacity Utilisation:** Higher utilisation of existing capacity can signal the need for fresh capital formation.
- **Tobin's Q:** A higher market valuation of firms relative to replacement cost can strengthen incentives for investment; empirical research finds Tobin's Q relevant for manufacturing and non-financial services firms in India.

Mains-Ready Analytical Framework:

- **Problem:** Weak private corporate investment despite relatively favourable financing conditions.
- **Causes:** Weak demand expectations, low expected profitability, business uncertainty, financing constraints and firm-level heterogeneity.
- **Small-Firm Constraint:** Limited internal funds, higher perceived risk and restricted credit access.
- **Large-Firm Constraint:** Adequate finance but insufficient expected demand for additional capacity.
- **Policy Response:** Public capex, demand creation, targeted credit support, IBC effectiveness, regulatory stability and improved infrastructure.

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- **Caution:** Demand stimulus should remain compatible with inflation control, fiscal sustainability and efficient allocation of public resources.
- **Overall Objective:** Convert India's emerging investment revival into a **sustained private-capex cycle** that raises productivity, employment, manufacturing capacity and long-term potential growth.

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