

Study of Investment Models in India

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Abstract:

Investment Models – Traditional Models – Non-Investment Models – Private Sector Investments – Leveraged Investments – Foreign Direct Investment – Sector Specific Investments – Cluster Investments – The Right Model for India.

Introduction:

Indian economy goes through several phases, which requires the various investments models from time to times since the last for several decades in India. Therefore, it becomes very necessary to go through a proper study for the same.

Objectives of the Study:

Following are the major objectives of the study.

1. To know the various investment models in India.
2. To suggest the right investment model for India.

Traditional Models:

Macro-economic framework revolved around growth models and growth a function of both savings as well as investments but largely determined by the overall levels of savings, in the earlier concept of 'closed' economy. India in its initial years, post-independence, suffered from low savings and it resulted in low investments leading to low growth. India was believed to be caught in the low growth cycle and unable to break through this cycle, known as 'Hindu rate of growth'. Investment was determined by the overall levels of savings and secondly the investment was largely by the government. Excess spending over and above savings, resulted in deficit in such economies.

It may be appropriate to define savings of an economy as the difference between income and consumption. It could be financial saving (money put in banks, government securities shares, bonds, debentures, insurance, pension funds, etc.) but other than the cash held. The

other is physical savings which could be assets such as real estate, gold and commodities.

Savings can be across household sector, corporate sector and even through the departmental undertaking of the government like Department of Posts, etc. However, more than 70 per cent of the savings is accounted for by the household sector. It can well be known that India is a 'household sector savings driven economy. The recent increase in saving, post reforms, is known as a 'macro-economic fundamental strength of India'.

Investment in the macro-economic framework implies increase in capital (machinery) stock, known as gross capital formation and after accounting for depreciation (usage of machine), as net capital formation. Growth can only be increased with capital formation. and thus, the importance of investments in an economy. For example, if Maruti decides to set up a new plant leading into production of more cars, and increase in GDP, it will also lead to greater employment and increased income for the people.

What investment model has been followed by India in the past?

Traditionally, there were two models of investment 'top down investment' and the other as 'bottom up investment'. The first model is to invest in basic, capital and core industries such as crude oil, steel, cement, power generation, etc. This would lead to investment in other industries and finally investment in consumer goods which would then drive more investment in the core industries. The other focuses more on small and

village industries and then allowing for their scalability to higher and more capital intensive investment over a certain period of time.

India opted for the first investment model post-independence as a part of the second five-year plan through the new concept of investment through public sector.

Pre-reforms investment was through public sector being set up in the core areas, through budgetary allocation. The objectives were of increasing significant capacities in critical areas, achieve self-reliance and become a driver of industrialization and increase overall growth of the economy. Such investment can be known to be basic capital expenditure or as 'core investment'.

What were the limitations of the earlier public sector-led investment?

First, India in the past was characterized by low savings resulting in low-levels of investment and thus low growth. Secondly, the government always had a binding resource constraint arising out of increased social sector spending, increased subsidy on food grains, fertilizers, etc. The government was not able to raise tax revenue in the economy resulting in an ever increasing fiscal deficit.

Thirdly, government is an inefficient spender in the economy especially in capital formation as there is time overrun in completion of projects which results in cost overruns and higher cost of projects. This results in 'capital deepening', increasing capital intensity but not allowing for 'capital efficiency'.

Fourthly, the focus of earlier investment was on 'creation of capacities' in different areas through 'available technologies' in India or technologies from other economies following a similar investment model like erstwhile USSR.

Fifthly, this model allowed for capital formation but in a limited manner and not 'technology and knowledge intensive' driven investment.

Sixthly, with the lack of focus on profits and with other social responsibilities, public sector did not have sufficient resources to augment investment in the economy.

Finally, as a closed and regulated economy there were no alternatives to savings and public sector investment.

Neo-Investment Models:

The concept of other investment models is a post-reforms phenomenon, post liberalization and with the beginning of transformation of India from a closed to an open economy. The economy at present requires digging deeper into investment shifting from 'quantitative to qualitative', from 'traditional to technology and knowledge intensive' and from 'capacity building to efficient capital investment'.

Private Sector Investment:

Opening of the economy allowed for newer avenues of investment especially as private investment. This helped in raising the investment levels in the economy but with a difference, of investment earlier being in the public sector domain now to private sector investment. Post-reforms with larger role of private sector, a liberalized environment, allowed private sector to operate in a competitive environment and at same time with new windows of untapped opportunities, resulting in plough back of profits translating into increased investment. This led to 'supplementary core investment' and also a 'diversified capital investment' into newer areas. This model also differed from public sector investment which was more 'capacity building investment' to an 'efficient capital investment'. This contributes to leveraging of the core investment and diversification of the industrial base, capable of lifting the plain of growth, as happened in the case of India.

Leveraged Investment:

Another investment model being experimented in India, is the concept of public private sector partnership (PPP) which is being used for infrastructure projects. Such investment can be known as 'leveraged investment'. Briefly, this model seeks to take advantage of the strengths of both the government as well as the private sector for execution of various infrastructure projects and operations by the private sector for a limited period.

In recent times, there were a few question marks on this model, due to lack of transparency and

ambiguities in the model concessionaire agreement (MCA) executed between the government and private players. There has to be a resolution mechanism for *inter-se* disputes arising from private parties and the government. The discontinuance Delhi metro airport express line is an example. Such instances can derail the model being used in India. There is nothing wrong with the model if the areas of work, responsibility and accountability of both the private party and the government are clearly delineated and made integral part of the MCA.

Similarly, wherever 'tolls' are being levied there should be a complete display of the details of the project, toll levied, period of levy. Most tolls levied are not 'rounded off' resulting in the problem of 'change'. For example, instead of toll being say Rs 22 it could be rounded up to Rs 20. Similarly, toll of Rs 18 can be altered to Rs 20. There would be no loss of revenue to the concessionaire and this result in a lot of operational convenience also for the commuters and lesser waiting time at toll gates. The other alternative to this could be to retain the existing tolls and to introduce 'smart cards' which would allow for electronic auto debit through sensors installed at the toll gate.

The other issue around levy of toll is that each toll gate is independent of the other resulting in the payment at multiple gates during the course of one journey. Understandably, this could be because of different concessionaire for different stretches of the same journey. What is being suggested is, for example, travelling from Delhi to Chandigarh, is it possible to pay the entire toll at the first gate itself rather than at five different gates of the journey. The concessionaires could have a technology-enabled toll sharing mechanism. This would reduce waiting time at toll gates and effective use of the created infrastructure.

Yet another variant to the existing PPP model be bringing and additional 'P' standing for 'People'. In this variant, a representative -body of people gets involved in the project right from the conception stage to the project building, monitoring progress thereof and also maintenance once the project is completed. This

PPPP model can be used for people centric investment especially in social sector programs. It could be the Accredited Social Health Activist (ASHA) under primary health care, rural electrification, rural roads, minor irrigation projects, etc.

Foreign Direct Investment

As a result of opening up of the economy, this has allowed for inflow of foreign capital both as foreign direct investment (FDI) and also foreign portfolio investment (FPI). The government only recently as clubbed all categories of FII investment as FPI. The investment model now being talked about is FDI which is 'direct interest of a foreign investor in production or rendering of services' (having control of over 51 per cent shares). It can also be indirect if the foreign investor has a control of minimum 26 per cent shares which would give it 'management control' (ability to 'influence' production, rendering of services but not able to 'directly run' the business).

This model goes beyond the domestic savings and is envisioned as a supplement to domestic investment. This allows for scalability of investment even beyond the savings of an economy and the model used by China for increasing the overall investment and becoming the fastest growing economy of the world. It has redefined the boundaries of investment.

Various forms of FDI in India could be the following:

1. Wholly owned subsidiary (WOS).
2. Wholly owned company incorporated in India (WOC).
3. Joint venture (JV) company incorporated in India (JV with an Indian partner with management control or controlling share of 51 per cent to directly manage the business).
4. JV into an existing line of business with management control.

All options are open in India. The government from time-to-time notifies FDI caps for different

sectors of 26 per cent, 49 per cent, 51 per cent and 74 per cent and 100 per cent. The government is considering increasing sectoral caps in many areas to attract more FDI into India. Changes in the sectoral caps are notified by the Department of Industrial Policy and Promotion (DIPP) under Ministry of Industry and Commerce.

FDI has two distinct advantages—one of augmenting domestic investment and the other helps in meeting current account deficit (CAD). For detailed elaboration, refer to sections on foreign investment and balance of payments.

Sector Specific Investment:

Another investment model being used in India is setting up of special economic zones (SEZs) to attract investment for increasing exports from India. This investment adopted by China in seventies has been responsible for China emerging as the largest exporter of manufactured goods, a position enjoyed by US in the past. Such investment can be known as 'sector specific investment models'.

Another example of sector specific investment model is setting up of National Manufacturing Investment Zones (NMIZs) which will be integrated in industrial townships. It will co-locate productions units, logistics, public utilities and residential and green environment. The prime objective is to increase the share of manufacturing sector output to around 25 per cent as a percent of GDP over the next decade. This model also aims to double employment in the manufacturing sector in the same period. Tax and other fiscal benefits as applicable to SEZs would also be applicable to NMIZ. They are now referred as Integrated Manufacturing Clusters (IMC).

Cluster Investment:

While sector specific investment can be multi-dimensional, cover different industry groups, cluster investment can be there to promote specific set of industries, such as handlooms, leather, garments, brassware, electronic goods, etc. These clusters comprises of small-scale industries which enjoy certain benefits of location, of proximity to raw material, markets,

availability of skills and infrastructure. These clusters are promoted by the government.

The Right Model for India:

The above are various investment models which have emerged in recent times especially in post-reforms and also from experiences of emerging market economies (EMEs). These models are not alternates to each other but are only variants of investment models. At a broad level, investment in India has to be driven by private sector and FDI. However, this will require a large role of the government in providing 'policy support' with 'a partnership approach' and an 'enabling environment' to facilitate natural flow of investment to bring back India on the high growth trajectory.

The policy support will require well-drafted 'futuristic policies' in different areas especially in the areas of 'pricing and tax matters'. These are the areas of grave concerns affecting investment in the economy. Pricing should be such to induce investment and also at the same time protect the interest of the ultimate consumers. At the same time, it should also be ensured that the pricing is competitive. Similarly, there should be 'certainty' of taxes, unambiguous and provide comfort that they would not be applicable retrospectively, unless warranted in exceptional circumstances and that too it should be on a case-to-case basis. Policies should be like goal posts, which are firmly entrenched and visible to all.

Partnership approach is not to 'prevent but to allow' or finding a way of getting things performed but within the policy framework. It is not short circuiting of laid down procedures but looking at them positively. It is about giving speedy clearances through a single window approach both at the central as well as state government level.

Enabling environment lies in creating the infrastructure around which such investment can be induced. 'Reviewing' various acts which influence such investments like mining and minerals (development and regulations) act, land acquisition and various labour laws all of which date back to 1950s. There is a requirement to comprehensively review them in totality to make

them more relevant to the changed present context.

Conclusion:

India is one among the few countries today which is 'investment starved' and requiring huge

levels of both resource as well as technology intensive investment and requires concerted efforts on the part of the government to play its role to facilitate both private and foreign investment in the country, to reverse the present down turn in India's growth story.

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