23 August 2022

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Industry and Capacity Utilization

India's economy has grown by 8.7% in FY22 after contracting by 6.6% in FY21. This does reflect a significant improvement on a negative base. However, the economy had only grown by 6.5% in FY19 and 3.7% in FY20 in pre-pandemic times; implying that while the revival story does remain intact the pace of growth may not be robust. To understand how industries have fared during these years, this study focusses on identifying possible alternatives to the concept of capacity utilization which is an indicator of optimal level of functioning of any company or industry. It is hence more indicative of progress than growth in production or net sales which are subject to base effects.

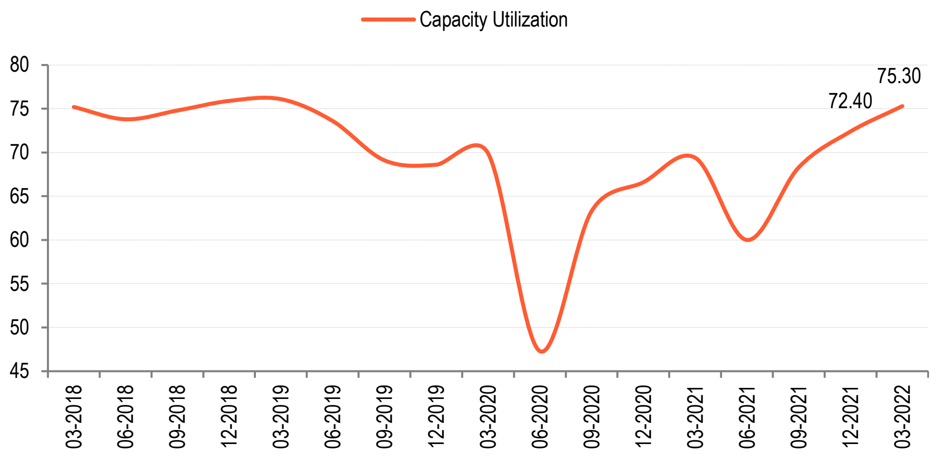
What is Capacity Utilization and its alternative?

One of the important determinants of economic growth is Capacity Utilization, which is defined as ratio of actual output to capacity installed. It is also indicative of potential investment that can be invoked by a company as an optimal level when reached requires expansion in capital for future growth in output. Information of capacity utilization is however not easy to get as companies no longer need to reveal the same in their Annual Reports.

The only source of information is the OBICUS (order books, Inventories and Capacity Utilization) Survey conducted by RBI on a quarterly basis that sheds light on aggregate CU level. RBI indicates that higher CU levels along with higher order book highlights strong demand in the economy. Fig1 reflects the latest round of the OBICUS survey by RBI, wherein the Capacity Utilization in the manufacturing sector has risen to 75.3 in Q4FY22 from 72.4 in Q3FY22. It also need to be noted the CU levels have improved consecutively for 3-quarters in a row. In Q1FY21, the Capacity utilization in the manufacturing sector had fallen sharply to 47.3 led by lockdown restrictions imposed the government. However, with easing off restrictions and reopening of the economy, the capacity utilization began to improve steadily.

Alternatively an indicator that signals strength in the economy or can be used to determine CU levels can be the –fixed assets turnover ratio. This ratio measures the net sales (turnover) to fixed assets and estimates the ability of a company to generate sales from the fixed assets. While there can be no ideal level, an increase in the ratio of sales/GFA will indicate that companies or industries are operating at higher levels with a given level of capital stock. This study attempts to analyze the same comparing the ratio levels from 2019 onwards to 2022. The sample size of over 1365 firms have been taken and includes over 40 sectors. To maintain parity in terms of sectors relevant for capacity utilization, banks, insurance firms and rating firms have been excluded from the exercise.

Fig1: RBI's Capacity Utilization



Source: CEIC, Bank of Baroda Research

After the pandemic induced slowdown, India has been on a path of recovery with some of the high frequency indicators also signaling the same. Focusing on the manufacturing sector, indicators such as Industrial production and core sector growth have also reflected robust demand. But are all the industries really out of the woods, or do some sectors need special attention? On comparing the fixed asset turnover ratio for FY22 with FY21; it was noticed that barring two industries i.e photographic product and Education & Training, all the other sectors have registered a much healthier ratio in FY22 compared with FY21 (Table1). However, this picture needs to be viewed with caution and on further analyzing and comparing this ratio in FY22 to pre-pandemic time that is in FY19, there is a different story emerging (Table2 and 3).

Table 1: Sectors showcasing moderation in Turnover to GFA ratio : FY22 vs FY21

Sectors	FY21	FY22
Photographic Product	1.68	0.37
Education & Training	2.41	1.38

Source: Ace Equity, Bank of Baroda Research

Table 2 shows that over 13 sectors have shown strength with much higher asset turnover ratio in FY22 compared with the ratio in FY19. These includes different sectors with sharp improvement seen in the following: Mining, gas transmission, non-ferrous metals, ship building, plastic products, textile and Iron & steel amongst others.

Table 2: Sectors showcasing improvement with respect to sales-asset turnover ratio

Sectors	FY19	FY22
Telecom	0.20	0.21
Non - Ferrous Metals	0.64	0.82
Ship Building	0.69	1.01

Construction Materials	0.84	0.86
Iron & Steel	1.07	1.19
Ferro Manganese	1.18	1.59
Gas Transmission	1.20	1.55
Textile	1.29	1.48
Plastic Products	1.67	1.88
Chemicals	2.35	2.39
Mining	2.99	3.98
Electricals	3.17	3.22
Trading	18.25	22.96

Source: Ace Equity, Bank of Baroda Research

On the other hand, Table 3, highlights the sectors that have registered a moderation in their asset turnover ratio compared with the pre pandemic times. The industries where the turnover to GFA ratio has decelerated the most include Diamonds & jewelry, Education, photographic products, Consumer durables, Aviation, FMCG along with infrastructure among others. On comparing the ratios to pre-pandemic levels it is noted the many such sectors are still under pressure.

Table 3: Sectors showcasing moderation with respect to sales-asset turnover ratio

Sectors	FY19	FY22
Power	0.39	0.35
Logistics	0.87	0.75
Hospitality	0.99	0.65
Paper	1.04	0.88
Media & Entertainment	1.29	0.64
Diversified	1.39	1.20
Healthcare	1.52	1.37
Inds. Gases & Fuels	2.03	1.79
Crude Oil	2.05	1.84
Agriculture	2.09	1.95
Photographic Products	2.19	0.37
Miscellaneous	2.36	2.23
Alcohol	2.44	2.00
Automobile & Ancillaries	2.51	2.01

Aviation	2.58	1.07
Abrasives	2.75	2.59
Education & Training	3.15	1.38
Realty	3.26	2.92
FMCG	3.27	1.99
Capital Goods	3.31	2.70
IT	3.80	3.34
Retailing	3.90	1.74
Infrastructure	6.29	5.43
Consumer Durables	6.63	5.04
Diamonds & Jewellery	13.54	9.16

Source: Ace Equity, Bank of Baroda Research

Concluding remarks

The turnover to GFA ratio, which is a proxy for capacity utilization in industry shows a mixed bag for FY22 when compared with FY19. This ratio provides further clues on the level of activity in the corporate sector as it is free of base effects. FY20 was also a year which showed a depressed corporate performance due to the lockdown which was imposed in the last week of March. FY21 was the first year of the pandemic which was typified by lockdowns of various varieties which affected production. FY22 had the advantage of both a low base statistical effect as well as recovery in the corporate sector as restrictions were removed largely for most sectors. Therefore, in this exercise the turnover to GFA ratio was compared with FY19 which is the pre-pandemic year when conditions were normal.

An improvement in this ratio for 13 sectors indicates that the recovery has been real. The metals group along with some intermediates like chemicals as well as textiles have registered higher ratios. For 25 sectors the picture however is still a concern as the ratio of turnover to GFA is still lower than pre-pandemic times. These sectors are more in the services segment besides consumer goods and capital goods.

Appendix

Sectors	FY19	FY20	FY21	FY22
Trading	18.25	16.35	17.28	22.96
Diamond & Jewellery	13.54	8.01	7.60	9.16
Consumer Durables	6.63	5.39	4.95	5.04
Infrastructure	6.29	6.02	5.21	5.43
Retailing	3.90	2.17	1.59	1.74
IT	3.80	3.00	2.99	3.34
Capital Goods	3.31	2.50	2.26	2.70
FMCG	3.27	2.77	1.72	1.99
Realty	3.26	2.95	2.32	2.92
Electricals	3.17	2.85	2.51	3.22
Education & Training	3.15	2.48	2.41	1.38
Mining	2.99	2.48	2.89	3.98
Abrasives	2.75	2.28	2.20	2.59
Aviation	2.58	1.65	0.92	1.07
Automobile & Ancillaries	2.51	1.77	1.53	2.01
Alcohol	2.44	2.23	1.65	2.00
Miscellaneous	2.36	2.14	1.92	2.23
Chemicals	2.35	2.00	1.92	2.39
Photographic Product	2.19	2.02	1.68	0.37
Agriculture	2.09	1.70	1.86	1.95
Crude Oil	2.05	1.56	1.14	1.84
Inds. Gases & Fuels	2.03	1.74	1.23	1.79
Plastic Products	1.67	1.48	1.60	1.88
Healthcare	1.52	1.41	1.34	1.37
Diversified	1.39	1.16	0.97	1.20
Media & Entertainment	1.29	0.98	0.56	0.64
Textile	1.29	1.12	0.93	1.48
Gas Transmission	1.20	1.31	1.07	1.55
Ferro Manganese	1.18	1.05	1.17	1.59
Iron & Steel	1.07	0.86	0.85	1.19
Paper	1.04	0.94	0.67	0.88

Hospitality	0.99	0.87	0.35	0.65
Logistics	0.87	0.74	0.65	0.75
Construction Materials	0.84	0.79	0.78	0.86
Ship Building	0.69	1.24	0.98	1.01
Non - Ferrous Metals	0.64	0.53	0.55	0.82
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Source: ACE Equity, Bank of Baroda Research

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