



Tailwinds (and Headwinds) in India

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India, the world's second-largest country by population, is home to 1.3 billion people, about half of whom are below age 25, meaning that a huge number of Indians will be entering their prime in terms of productivity and consumption over the coming decade.¹

The appealing size of India's total addressable market (TAM) is undeniable, but the question has been—and continues to be—which companies have the ability to monetize the TAM.

Efforts to do so have been slowed by the challenges related to operating in an economy that lacks the organization, connectivity, and basic infrastructure that are characteristics of developed economies. But major advances in India's digital infrastructure over the last several years, coupled with a series of governmental reforms, suggest that India has entered a new phase of its economic development.

Digital Infrastructure and Connectivity

One of the greatest hindrances to economic progress in India has been the lack of digital infrastructure. But that has changed dramatically over the last three years, thanks primarily to the efforts of Reliance Jio to build a wireless and fiber-optic network throughout the country.

Cities and villages that previously had voice-only capabilities or no wireless connectivity at all now have access to a low-cost, reliable digital network that provides data service at speeds that, in many cases, far exceed what is available in developed countries.

How Reliance Jio Is Reshaping India’s Digital Connectivity

Reliance Jio’s investment in building digital infrastructure across India in the past several years has brought high-speed wireless connectivity to consumers and businesses across India.

	Before Reliance Jio	After Reliance Jio
Data		
• Speed	• 256 Kbps (Download Speed)	▶ • 21 Mbps (Download Speed)
• Pricing	• INR 250 - 20,000 (Per GB of Data)	▶ • < INR 130 (Per GB of Data)
Customer Revolution		
• Increasing Usage	• 240 MB (Average Data Usage Per Subscriber Per Month)	▶ • 11.7 GB (Average Data Usage Per Subscriber Per Month)
• Expanding and Shifting User Cases	• Voice, SMS, Radio	▶ • Audio and Video Streaming (Primarily Through Bundled Offerings by Telecom Players), Online Gaming, Social Media, News

Source: Reliance Jio Investor Presentation and William Blair, as of October 26, 2019. INR refers to Indian rupee.

This herculean investment by Reliance Jio is truly a game-changer for India’s economic development. Indian consumers now use more gigabits of data per month than in many developed countries, at a fraction of the cost. And developers are creating applications that enable the services that have powered the digital revolution seen in the developed world during the past two decades.

For consumers, these advances include access to banking and credit services, digital payments and e-commerce, video streaming, advertising, and various aspects of the shared economy. These services are fueling increased consumer spending and enabling business models that are built on network effects.

Small and midsize Indian businesses now have access to real-time information and point-of-sale systems that power better decision-making for pricing, forecasting, and inventory management.

This digital connectivity is helping to condense inefficient, multilayered supply chains, while the ability to accept digital payments is reducing the friction and security concerns of dealing in what had been a largely cash-based society.

In the agricultural sector, which still represents a huge portion of India’s economy, digital connectivity in rural regions is enabling productivity gains through access to weather forecasts and current market information.

Governmental Policy

India has also experienced meaningful economic reforms in the past few years. Prime Minister Narendra Modi and his government have aggressively implemented changes designed to formalize India’s economy, improve financial inclusion, and limit the influence of graft and crony capitalism.

Demonetization: To reduce the country’s reliance on cash transactions and fight corruption and tax avoidance,

the Modi government announced in November 2016 that it would replace existing 500- and 1,000-rupee banknotes, which together accounted for about 90% of all rupee bills in circulation.² This, along with direct deposit of government subsidies, has begun to reduce the influence of the “black economy” and its drag on economic efficiency.

Goods and services tax: In 2017, India implemented a new goods and services tax (GST). The tax is designed to streamline India’s complicated system of state and federal levies and improve tax collection from companies that operate within India’s informal economy.

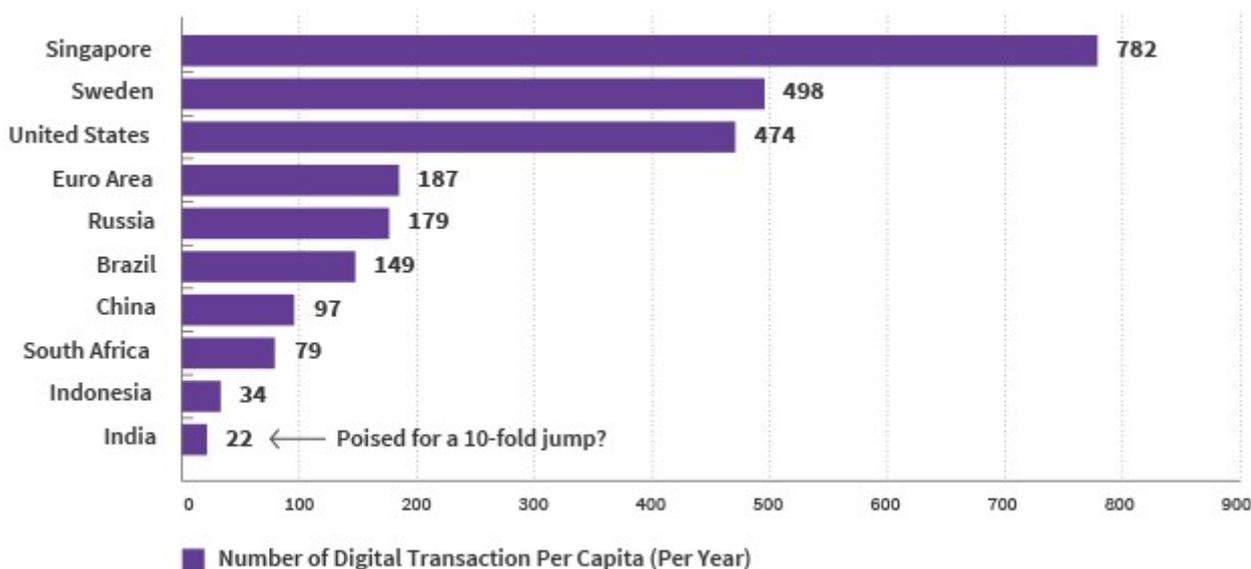
Corporate tax rate cut: In September 2019, India cut its headline corporate tax rate from 30% to 22%. Prime Minister Modi announced on Twitter that the tax cut would “give a great stimulus to #MakeInIndia, attract private investment from across the globe, improve competitiveness of our private sector, create more jobs and result in a win-win for 1.3 billion Indians.”³

Bankruptcy precedent: A November 2019 ruling by India’s Supreme Court involving Essar Steel confirmed the rights of secured creditors in bankruptcy proceedings. The ruling provides “relief to lenders and sets a precedent that could speed-up the resolution of other insolvency cases,” according to Reuters.⁴ Historically, businesses in India could continue to borrow even when they were failing. Bribes to officials in the Ministry of Finance often would result in new loans, leaving the state-owned banks with bad loans

Unified Payments Interface: The National Payments Corporation of India launched its Unified Payments Interface (UPI) in 2016. This fast ACH system, part of the government’s efforts to support digital payments and extend banking services to underbanked citizens, enables users to send money without providing bank details. UPI has attracted major investments from Google, Amazon, Ant Financial (Alipay’s parent), and other tech giants looking to promote adoption of their digital wallets.

India's Reliance on Cash

Several years after demonetization, India still significantly lags other large countries in terms of adoption of digital payments. India's Unified Payments Interface (UPI), however, is enabling rapid advances in the adoption of banking accounts and mobile-based payments.



Source: Report of India's High Level Committee on Deepening of Digital Payments; The Washington Post, "India Going Cashless Could be a Model for the World." June 6, 2019. India's data is from March 2019. For other countries, data is from 2017.

In addition to these recent initiatives, the Modi government has prioritized improving financial inclusion for India's large unbanked population. Launched in 2014, the PradhanMantri Jan Dhan Yojana initiative has given millions of Indians access to no-frills bank accounts and other basic financial services. As a result, the percentage of Indians with access to bank accounts increased from about 40% in 2011 to nearly 80% in 2017, according to the World Bank.⁵

India's Aadhaar program, launched in 2009, now provides unique identification numbers based on biometric data for more than 90% of India's population and has been essential in helping to address "know your customer" requirements of the financial services industry, according to the World Economic Forum.⁶

Financial inclusion and the shift toward digital payments are helping to address the widespread corruption and "leakage" that have been a drag on India's economic growth. For example, the leakage of funds for pension payments dropped 47% when payments were made through biometric smart cards rather than being distributed as cash, according to the World Bank.⁷

Realities That Will Constrain India's Growth

Despite optimism resulting from India's new digital infrastructure and transition to a cashless, rules-based economy, there are many factors that will constrain the country's economic growth and progress. We discuss these more in our paper, but briefly, they include:

Physical infrastructure: While India's digital infrastructure has made a quantum leap forward, decaying roads and

gridlock traffic impede the movement of goods across the country, and an outdated power grid is a major challenge to India's efforts to enhance local manufacturing. The Indian government estimates that it will need \$1.5 trillion in infrastructure investment for the 10-year period ending in 2026, and there are major questions about how these projects will be funded.⁸

Legacy of crony capitalism: The Modi government's concerted effort to formalize India's economy must overcome decades of business practices and consumer behavior that had adapted to a largely underground economy plagued by crony capitalism. These practices won't be eradicated overnight.

Unintended consequences of reforms: As with all governmental policies, there are unintended consequences that need to be managed. For example, demonetization caused liquidity in India's banking system to surge, and the resulting "irrational exuberance" on the part of lenders led to a rapid deterioration in the quality of their loan portfolios.

Air quality and environmental concerns: Twenty-two of the world's 30 most polluted cities are in India.⁹ This affects more than just the health of India's residents; it chokes off economic growth. For example, more than 30 flights were diverted from Delhi on a single day in November 2019 because of poor visibility due to air pollution.¹⁰

Investment Implications

The messiness of India's ongoing transition to a more formalized economy presents a tremendous opportunity for fundamental, bottom-up investors.

As the playing field becomes more level for businesses, and as new digital infrastructure unlocks latent economic energy, strong companies are likely to become even stronger and the gap between leaders and laggards may widen.

In our next post, we discuss how these tailwinds and headwinds are affecting the investment landscape in distinct ways across sectors.

1 Source: World Economic Forum. "Financial Inclusion in India is Soaring Here's What Must Happen Next." January 14, 2019.

2 Source: *The Wall Street Journal*. "India to Replace Largest Bank Notes." November 9, 2016.

3 Source: Reuters. "India Cuts Corporate Taxes to Boost Manufacturing and Revive Growth." September 20, 2019.

4 Source: Reuters. "India's Top Court Clears Path for ArcelorMittal to Acquire Essar Steel." November 14, 2019.

5 Source: World Bank Group. "Global Findex Database 2017."

6 Source: World Economic Forum. "Financial Inclusion in India is Soaring. Here's What Must Happen Next." January 14, 2019.

7 Source: World Bank Group. "Global Findex Database 2017."

8 Source: S&P Global. "The Missing Piece in India's Economic Growth Story: Robust Infrastructure." August 2, 2016.

9 Source: AirVisual. World's Most Polluted Cities 2018 (PM2.5).

10 Source: BBC News. "India Air Pollution At 'Unbearable Levels,' Delhi Minister Says." November 4, 2019.

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