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VIEWPOINT

India's digital revolution offers more opportunities for investors

- India has entered a structural growth cycle, with a focus on reforms, infrastructure investment and manufacturing.
- Favourable demographics are underpinning both a credit and property cycle, and digitalisation is unlocking huge potential.
- All this is making India an easier country in which to do business and we are excited about finding opportunities within these themes.

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In November 2016, on the same day Donald Trump won the US presidential elections, the Indian government announced a massive demonetisation effort, removing the country's largest bills from circulation, representing 80% of total currency.[1] On any normal day this would have been on the front pages of all the major financial publications, however, election of the 45th President of the United States understandably took precedence.

Demonitisation, which initially created tremendous economic upheaval, was part of the government's ambitious efforts to combat corruption, curb tax evasion and bring more people into the formal economy. It was part of a comprehensive strategy by the government of Prime Minister Narendra Modi to structurally transform the Indian economy. Since he was elected in 2014, Modi has pushed forward economic reforms aimed at fostering a more business-friendly environment, including instituting a national goods and services tax (GST). This streamlined the complicated web of state taxes and helped bring the manufacturing and industrial sectors into the formal economy. He also revised the Insolvency and Bankruptcy code which facilitated improving capital allocation and the cost of credit.

Many market participants did not connect the dots at the time, but the digitalisation of the Indian economy, known as IndiaStack, was a core part of the government's strategic thinking. This digital public infrastructure is best understood as a public utility and it could have enormous implications for the people of India and its economy. It could also present new and compelling investment opportunities.

Understanding India's digital evolution and revolution

The potential significance of IndiaStack is best understood through an example: Prema is a 23-year-old born in a rural Indian village who recently migrated to Mumbai in pursuit of better opportunities. But without a permanent address Prema would fall at the first hurdle when trying to open a bank account. Here's how IndiaStack works for her:

1 **Identify:** The first layer of IndiaStack is AADHAR, a biometric identity database, which links Prema's national ID to her biometric data so she can open a bank account and financial service providers can conduct "know your customer" checks.

2 **Payments:** Next, the Unified Payments Interface (UPI) enables cashless payments by linking Prema's ID number, phone number and bank account to a payment address. This allows her to receive her salary electronically. It also enables her to send money back to her parents or shop at the local market, all on her smartphone and without a costly middleman.

3 **Data:** The final layer, DigiLocker and e-consent, allows Prema to store copies of documents like academic records, birth certificate and driver's licence. She can share these with potential employers or financial service companies to apply for loans.

[1] American Economic Association, 2020

Together with India's demographic and income trends, these reforms could support continued economic development and growth. India is the world's most populous country, with a median age of 29,[2] recently breaking the $2,000 GDP-per-capita level,[3] and a rapidly expanding middle class – the number of households earning in excess of $35,000 a year[4] is expected to rise fivefold in the coming decade (Figure 1). It is estimated that more than 40%[5] of the Indian economy is informal. Digitisation has the potential to bring many people into the formal economy, for example by facilitating access to credit. The reforms have also revolutionised credit underwriting and streamlined lending, which should result in a significant pick up in loan growth, boosting the financial sector and the economy. We've also witnessed an explosion in retail investing with a potential quintupling of stock market participants from 62 million to around 300 million.[6]

Figure 1: India's income pyramid is forecast to invert within the next decade

	2021	2031
>US$35,000	5.6mn (2%)	25.2mn (7%)
>US$10,000-35,000	70.2mn (24%)	165.4mn (46%)
>US$5,000-10,000	106.4mn (36%)	122.7mn (34%)
<US$5,000	112.3mn (38%)	47.2mn (13%)

Source: PropEquity, Jefferies, 2023

[2] Worldometer. 2023
[3] Citi Research. 2023
[4] Jefferies. 2023
[5] World Economics. 2023
[6] Morgan Stanley. 2023

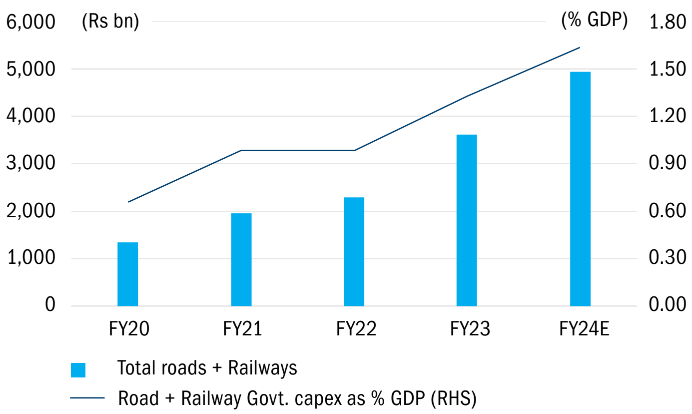
Digitisation has the potential to bring many people into the formal economy, for example by facilitating access to credit

Infrastructure and manufacturing are still key

India’s structural growth story is not just limited to digitalisation, population and wealth creation. The government is investing in massive infrastructure projects and supporting the development of its manufacturing sector in a bid to increase foreign direct investment and kick-start substantial network effects in supply chains, as the economy seizes the opportunity of China+1 diversification efforts by multinational corporates.

Historically, India’s lack of fiscal stimulus and limited infrastructure spending has been a significant impediment to unlocking its growth potential. In 2021, the government announced a $1.4 trillion infrastructure spending plan[7] to improve its competitiveness with more than 9,000 projects from railways, highways, ports and dams to airports (Figure 2). Within manufacturing, the goal is to increase capacity, scale and productivity to serve its domestic market and eventually gain the competitiveness to export internationally. The Modi government has been steadfast about removing bureaucratic and regulatory barriers to support growth, such as streamlining the process for land acquisitions. In addition, it is courting international companies, from Japan’s Daikin to Apple in the US. Local players such as Dixon Technologies and Amber Enterprises are also getting in on the act, investing heavily to gain a share of the growing pie.

Figure 2: infrastructure investment on road and railways is increasing significantly

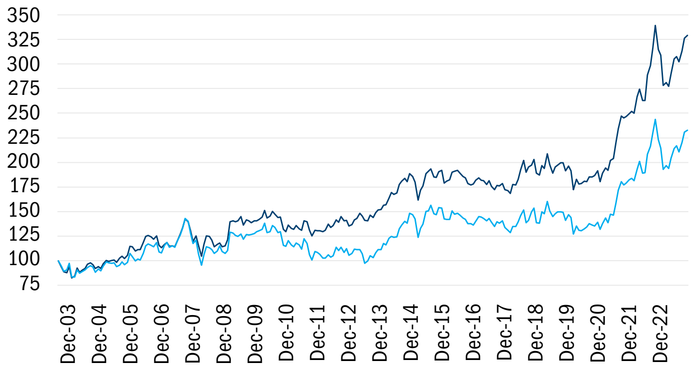


Source: Ministry of Finance, Jefferies, 2023

Where are the investment opportunities?

Many market participants expect India will grow at least 6% annually for the next decade.[8] Over the past decade MSCI India has compounded at 12% versus MSCI Emerging Markets index at 5%,[9] which has been a fantastic source of alpha with many stocks rising 10x over the period. The stock market has helped connect the growth story with investment returns (Figure 3).

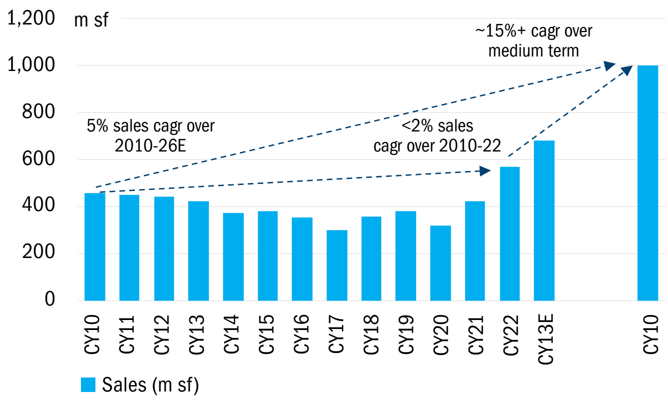
Figure 3: MSCI India relative to MSCI Emerging Markets over the past 20 years



Source: MSCI, Citi Research, September 2023

We believe another key beneficiary of the reforms will be the property market, which is predicted to double to 15% of India’s GDP by 2030[10] after more than a decade in the doldrums. Unlike what we see in developed economies, real estate in India has cheapened significantly relative to incomes. A robust labor market, aided by the wealth effect, will demand housing in a sector that has been chronically undersupplied (Figure 4). This could create investment opportunities across the value chain, from developers and building materials to air conditioning companies. The government also waved its reform wand here with the Real Estate (Regulation and Development) Act, which protects home buyers, helps them access credit, boosts investment and is wrapping up a period of cleaning out inadequately capitalised players.

Figure 4: housing volumes are set to grow +15% over the next few years



Source: PropEquity, Jefferies, 2023

7 India Brand Equity Foundation. 2022
8 OECD. 2023
9 Bloomberg. 2023
10 Morgan Stanley. 2023

But is India's stock market expensive? That might be the case within specific sectors or for specific companies. Take Colgate Palmolive India, for example. Being a dominant producer of toothpaste in the most populous country in the world could sound like a fantastic business, but you would be paying 40x earnings[11] in a saturated market. Conversely, private banks continue to gain share from the public system with robust loan and deposit growth, benefiting from the tailwinds of a healthy credit cycle, all at an attractively priced book value. India could be a source of long-term quality opportunities, and the runway for growth is long and wide for many corporates. That is why we argue for an active approach that involves quality companies with stakeholder alignment, a committed focus on return-on-invested-capital and exposure to structural tailwinds of economic growth.

We are cognisant that labour, capital and productivity are far from hitting their peak. We believe the themes discussed in this piece will present great opportunities over the next decade and beyond: the private banks will benefit from a vibrant economy with loan growth in both retail and corporate segments picking up, as well as taking market share from the weaker state-owned-banks; building materials and industrial companies will benefit from the focus on infrastructure, real estate and manufacturing investment; and consumer companies or healthcare providers will benefit from the wealth and demographic trends.

We believe India is in a structural growth cycle and that the government's policies and reforms are making it easier to do business. Underpinned by a young and large population, the focus on digitalising the economy as well as investing into infrastructure and manufacturing could unlock its economic potential. Alongside the new credit and property cycle, we are excited to uncover investment opportunities geared to these themes over the coming decade.

We believe the themes discussed will present great opportunities over the next decade and beyond

[11] Bloomberg. 2023

Get to know the authors

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Dara White is Global Head of Emerging Market equities at Columbia Threadneedle Investments and has acted as lead portfolio manager of emerging market equity strategies since 2008. He joined the company in 2006 as co-manager of the Strategic Investor team and is based in Portland.

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Dara received a B.S. in finance and marketing from Boston College. He is a member of the CFA institute and the Security Analysts of San Francisco. In addition, he holds the Chartered Financial Analyst designation.

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Cory Unal is an analyst on the Global Emerging Markets Equities team with responsibility for researching the industrials sector. He joined the company in 2015 as a graduate on the Investment 2020 programme before joining his current team in July 2016. Cory has an MSc in Finance & Investment (with Distinction) from Durham University Business School and a BSc in Physics from Durham University. He also holds the Chartered Financial Analyst®designation and is a member of the CFA Society of the UK.

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