India’s Digital Transformation

Charles Roth: Hi. I’m Charles Roth, uh, global markets editor at Thornburg Investment Management. Welcome to another episode of Thornburg's away from the noise where we're taping from our home offices. I'm joined by associate portfolio manager Josh Rubin who helps pilot our emerging market strategies. Uh, today we're chatting about India, the seventh biggest economy in the world and the third biggest in Asia. It of course is grappling with, um, the COVID pandemic and extending lockdowns and is now trying to figure out how to save lives without sacrificing more livelihoods, um, and Lockdown 4-O as Prime Minister Narendra Modi called it in a, in an address to the nation a few days ago. Um, in that address he announced a stimulus package that, uh, including previous stimulus measures amounts to about 10 percent of GDP and perhaps more interesting, uh, he repeatedly spoke of self-reliance and exhorted Indians to buy local. He clearly aims to grow local manufacturing capability and really wants to position India as an alternative to China as, uh, a, a link in the global supply chain. We'll get back to that, but first we'd kinda like to talk about, um, some of the quantum leaps that India has taken in developing some of its digital infrastructure in recent years and Josh if you can walk us through those. We've got four more or less that I'd like to mention. Could you start with, um, AADHAAR.

Josh Rubin: Sure, sure, uh, th, thanks also for having me and I'm, I'm glad that we can make this happen in a, a complex environment and ac, actually it's funny but really the, for the same reason that we are able to have this conversation and then ultimately to share this conversation with our clients, uh, th, these are the same types of things that are driving a new set of opportunities for India as well. So something called Adar. It was launched in 2009 so we’re a little bit more than 10 years into it, but really it was the beginning of formalization in the Indian economy from a methodologies and standardization standpoint for the adult population and the beginning of, and, it, it was under a prior government but it, it’s what has gotten this the point today where over 90 percent of the adult population now has biometric identity cards. So you can think of this as transformative in many of the same ways that the U.S. Social Security program was transformative in the 1930s where suddenly every adult in the United States, it wasn't just about retirement income, but it was all of the other things that we use our Social Security numbers for today and for India to be able to identify and differentiate a 1.3 or 1.4 billion dollar, billion person population, Adar has been really important for that and then all of the elements of economic formalization to come with it.

Charles Roth: So, among the key if not really the key element of economic formalization came in August 2014 with the financial inclusion initiative. What was that about?

Josh Rubin: Well really once people had identity cards that were standardized, it changed people's ability to participate in the banking system. You know a tough thing even in the United States today is, uh, a small or medium business might go to their bank for a loan and the bank can say hey we know you've been a deposit, a depositor, had a relationship with us for a very long time, but if you can't give us all of the records that we need, uh, you know, the bank can't make that, that loan even in the U.S. and so imagine in India where a person could not even prove who they truly were, the bank was not interested in giving them a loan. Within 5 years of AADHAAR and, you know, really around 2014 and beyond, um, suddenly we got to the point where we went from 50 percent of Indians having a bank account to over 80 percent of Indians having a bank account. Uh, we went from, you know, a few hundred million debit cards to over 800 million debit cards and, you know, if you think of a banking system that is 100 years old, but literally hundreds of millions of people only entered the banking system, uh, in the last 5 to 7 years, that's an absolutely transformative adjustment to people's ability to participate in the modern economy.
Charles Roth:  Just to go into a little more detail, I, I would imagine that with financial inclusion and the identity card then credit profiles could, could be established and direct salary deposits made and loans generated as you pointed out and financial products like life insurance contacted, pension investments, but there's, there, there was more to it as well.  I, I suppose was, was there distribution of government benefits directly to individuals? Was that made possible as well?

Josh Rubin:  There are a lot of opportunities like that. Most of them are in the early stages, um, there, there are various government plans or, or benefits that they have been implemented for a long but, but certainly their execution has become a lot better. Probably something that was a lot more important was what the government tried to do to change what is often called the gray economy. So the, the gray economy are all of the transactions that happen in, in an economy that are not necessarily taxed or not necessarily recorded and in an environment where most everyone is operating in a very informal way, what, what is missed out on is government tax revenue that can be allowed to provide more benefits or services or per, you know, pay for new infrastructure along with businesses' interest in, uh, improving their business adopting account software that can help them manage inventory better or sell to customers better, things like that. So what was actually the really big change was in late 2016 and then early 2017 there were two different types of financial reforms. One called demonetization which was a move by the government to try to create more recorded transactions in the economy. So not just gray market cash transactions, but ways that people would actually pay taxes on a purchase they made or businesses again would have different types of incentives to modernize their business and then there was a tax reform in 2017 that changed how and where, uh, taxes were paid and the, the impact of both of those again really changed the way money flows through the economy and the way that people interact with money. If you go back to 2016 over 90 percent of transactions were in cash and over 85 percent of Indians were paid in cash. Uh, today, you know, those numbers have begun coming down particularly the salary payments in cash and, and this is what led to the big change of, uh, over 80 percent of Indians having bank accounts today. So, you know, today we're around a billion adults in India and there are over 850 million debits cards. So that really shows just how much the cash economy has been shifting to a more digital transaction economy which has wider implications as well.

Charles Roth:  So a digital economy would imply that, uh, a telecommunications network expansion had also to take place. Can you describe what's been happening in that, in that sector?

Josh Rubin:  Sure and, and this is, this is probably the most transformative element in the last, uh, 100 years within India. So, um, sometimes statistics can be boring, but sometimes they can be fun and, and hopefully the following will be a little bit of fun. Telephones were first rolled out in India in the last 1800s and by 2009 there were 38 million land lines in India. So call it 120 years and we got 38 million land lines. Cell phones –

Charles Roth:  In a country of more than a billion people.

John Rubin:  In a country of more than a billion people. That’s right. Um, fewer than 20 percent of households had, had land lines and cell phones began being rolled out in India in the late 1990s. We entered the global financial crisis where India had 400 million cell phones and 40 million land lines. So just think of that pace of adoption before the financial crisis.
Charles Roth: Um hum.

Josh Rubin: Today, there are over 1 billion mobile subscribers in India and there are only about 20 million land lines still in use. So while the rest of the world’s communication abilities will improve during the 1900s, India’s did not accelerate that much, but in the last decade the entire adult population of India has gotten access to telecommunications which absolutely has enormous impacts on, on the economy, on the way business is done, on the way social communication is done and, and it’s, it’s really unbelievable. When you think of that 1 billion people, a different way to frame it could be Facebook, the world’s largest social network from 2016 to 2020 has added about 700 million users and India over that time just one country has added almost the same number of, uh, high-grade mobile subscribers, 3G and 4G mobile subscribers.

Charles Roth: So that 4G rollout along with, um, iPhone or, or rather mobile telecommunications penetration really has facilitated the advent of ecommerce, remote learning, digital payments. The growth rates must be phenomenal. Can you go into some of those segment?

John Rubin: The, the, they are pretty phenomenal and not necessarily in the ways you would think. I, if we actually step back first and we just think about what I talked about earlier the, the debit card penetration or the interest of the government in making more transactions easier to record. In 2016 before demonetization there were a little over 1 million card processing machines in India. So the, you know, when you go to the convenience store, you go to the restaurant you put your credit card in and there are about 1 million of those and today a little over 4 years later there are over 5 million of those card processing machines. So, you know, fi, five times the number of digital transactions or card transactions are possible today because of, of telecommunications, because we have so few land lines in India you needed a mobile phone network to have wireless card readers because you simply couldn’t connect it to a land line the way you’re used to seeing in the United States.

Charles Roth: Um hum. Um, so you mentioned Facebook. Um, Facebook just made an investment in one of India’s leading wireless companies, Geo. Um, 5.7 billion at the same time, uh, Silicon Valley the investor Silver Lake made another 750 million in, in Geo and, and then Beast Equity Partners another 1 1/2 billion. Uh, Amazon has moved in to India. Uh, Wal-Mart has as well buying Flip Cart. Um, can you talk about the, the development in ecommerce in India?

John Rubin: Well the, the interesting thing and this is not only the case for India because we see it across a number of emerging markets is each country has a, a differentiated set of consumers and income levels, but even when you think about a small percentage of consumers in a big population country that can actually be an enormous absolute number of consumers. So again India with 1.4 billion people even if only 5 or 10 percent of those people have attractively high income levels that, uh, you know, might be comparable to what a middle class American would be at, that can still be 100 or 200 million total consumers and that, that is driving a big change in ecommerce in India. Uh, a couple things that are important for ecommerce in general are usually both the ability to make payments in a standard and transparent way and then the ability for logistics services to work in a low cost way or kind of in, in an attractive economies of scale way and what you get in India with the telecom, with the banking or the financial inclusion changes is, is certainly the ability to make digital transactions easy and the other thing you have are, you know, the big metropolises with 5 to 10 million people and in the U.S. for instance we
only have a few of those and then we have these big suburban economies, but in India there are, you know, well over 10 cities that have multi-million person populations living very densely together where delivery on motorcycles or in trucks is very easy. So like you mentioned, no one knows exactly what Amazon has invested in India, but the rumors are that it’s somewhere between 5 and 7 billion so far of just year-after-year organic investment trying to build a presence. Uh, a few years ago Wal-Mart bought a domestic Indian start-up company called Flip Cart which, uh, at the time was competing to be an Amazon of India. Alibaba has ben trying to get its foot in India as well and then there are a number of other domestic unicorns who have also been growing quickly and they've really been growing in the range of products. So it’s not just general merchandise or books or getting TVs delivered. It is online grocery, um, you know, digital entertainment. So certainly we know that Netflix is trying to get in, but uh, there are domestic versions of Netflix as well. So really the Indians are building a very large domestic ecosystem of ecommerce and other, uh, digital services some of which look like what we see in the U.S. and some of which are definitely adapted for the Indian market.

Charles Roth:  So in his address the other night, Modi exhorted Indians to buy local, use the term self-reliance numerous times. Uh, it was clear that, um, he wants India to grow it’s local manufacturing capabilities, local supply chains. At the same time he was invited foreign investors to come and set up shop in India and in, in fact Apple’s reported to be, uh, moving a fifth of its supply chain from China to India. I’m just wondering if, if you think that India’s efforts are going to, uh, bear fruit?

Josh Rubin:  Ab, absolutely. I, I do think they’ll bear fruit, but I think it is very important to, to maintain the right perspective about how and over what timeframe. You know, if we think of China. China had, you know, several years before joining the WTO it had a number of years after joining the WTO where it was just a, a slow process of building the momentum and building the critical mass to become the manufacturing, uh, powerhouse that it is today and so I, I think we need to be careful of just putting numbers into an Excel spreadsheet and saying because X was, um, asked for or offered that it will turn into Y in a certain timeframe and, and actually one of the, the things it relates to is what we just talked about for telecom which is physical infrastructure in India remains a weak link for economic development and one of the reasons mobile phones are so powerful is you didn’t have to worry about rolling out the same types of physical infrastructure, you know, the land line infrastructure. You, you could skip a lot of that and once you want to move toward manufacturing you do need a lot more physical infrastructure. You need the roads and the train lines and sewage services and the water, uh, and the electricity. You need all of those things to be working. You need the trained labor force. So it’s just a, a slower moving rollout to become a real manufacturing or export, you know, uh, powerhouse the way China or some of the other Asian exports have been. However, a real source of friction for a number of years have been either regulatory environments or just politics, sometimes local sometimes national and so the more that we see some of those softer elements of friction improving, those can help get the critical mass, uh, going.

Charles Roth:  So, uh, you mentioned, uh, a couple of the, um, bottlenecks. Land acquisition is clearly troublesome if you can’t get that, uh, or rather blocking the physical infrastructure development. I guess the government is moving to compress timeframes to, to days or weeks, not months or perhaps years. Um, labor laws are, are another ketch, but a handful of states including the biggest Uttar Pradesh is, uh, those run by the BJP ruling party have declared a moratorium on the labor laws for 3 to 4 years. Do you think that’s gonna provide a framework for the federal government to institute reforms that might facilitate more FDI?
Josh Rubin: It could, but I would say that, you know, sort of my, my history in emerging markets or, or the history of a lot of India watchers would say, uh, you know, go, going back to the old Ronald Regan axiom trust but verify and we, we've seen a lot of two steps forward and two steps back in India over the years, I think right now we're more likely to be in a two steps forward and half a step back type of world, but, you know, there are other elements because, uh, s, state politics can be very device and very different, but, but one of the things that is really interesting and, and really valuable about the large population emergency markets is if, if half of the country is in, going one direction and half of a country is going another direction, but, but half of India going in an attractive direction for foreign companies to invest, that's still 700 million people. That's still more people than the European Union and the United States combined and so if we see some ups and downs for the, the federal government, uh, within India or just for different states, that doesn't mean that the attractiveness for the overall, overall opportunity really changes and I think that's what we'll see whether it is the online players in India or the brick-and-mortar players in India or manufacturing, they can always find a big enough audience or a big enough consumer base in the places that are working well to remain attractive investments and they just may chose to postpone, you know, where, where they want to build the next store or the next factory if they see, uh, some uncertainty in another state, but if, if you think of the United States people generally are happy building, if, if they can get the land they would be happy to build a new warehouse or a new store in Southern California or in Texas or in, uh, the southeastern United States. That may not be the case in India, but again in, in the big state you mentioned that's a, a multi-hundred million person population state, um, that is certainly as attractive as addressing much of the United States or much of Europe. So, so the investments will certainly keep going.

Charles Roth: And I would imagine you have not just a, a gigantic population, but you have quite a few engineers graduating every year in India and I think it's safe to presume all of them are English speaking.

Josh Rubin: They are, and you know that is one thing that is, is different for India compared to many other emerging markets and is part of what has given it a unique place in the global intellectual supply chain if you will. So China it didn't matter if you spoke English or not. If you could help assemble the widget on the assembly line as fast as possible, China could become part of the global manufacturing supply chain, but India has grown and it will continue to grow in, in the global intellectual supply chain. That's partially the British colonial history giving people English. It actually is part of the global technology industry today. So if you are a software engineer graduating in South America or in an African country, or elsewhere in Asia, you're an English speaker, but, but that is an advantage just sort of a natural inherent advantage for a lot of Indian workers, uh, actually I would say it's not just for that software developer, but if I'm graduating with an MBA in China, I may or may not speak English, but if I'm graduating with and MBA in India, I am going to be an English speaker which makes me more attractive to be hired by that foreign company who does want to invest in India or by that domestic champion in India who wants to keep growing across India.

Charles Roth: Well Josh thank you so much. We appreciate your time.

Josh Rubin: Absolutely. I hope that everybody can, uh, stay safe while still managing to have a little bit of fun and, uh, just, just remember to be, be nice to your significant others and, and don't forget the kids either.
Charles Roth: Or the dog.

Josh Rubin: Or the dog.

Charles Roth: Thanks for listening you can find us on Thornburg.com/podcasts as well as on Apple Podcasts where you can rate subscribe and review us. Thanks, again.

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