The Colony Group

INTERNATIONAL SERIES:

INDIA 2.0: THE NEXT PHASE OF GROWTH

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Have you traveled to India recently? If so, you must have noticed how fast the country is changing. Everywhere you look, it seems that India has embarked on a new social and economic transformation, driven by the rapid digitalization of businesses, the financialization of the economy, the regulation and formalization of many industry sectors, and the rise of local manufacturing and exports.

These are new growth drivers. They are strengthening and accelerating the country's multi-decade transition from a rural, agricultural-led economy to an urban, consumer-led economy. They are also making it possible for India to benefit from a demographic dividend that will see its working age population expand for the next two decades.

India is transforming itself… again.

India is embracing the digital age

From food delivery to online insurance, from e-commerce to online trading, India has embraced the digital age. Technology investments are rising. Cost-efficient, tech-driven business models are rapidly spreading, disrupting large markets.

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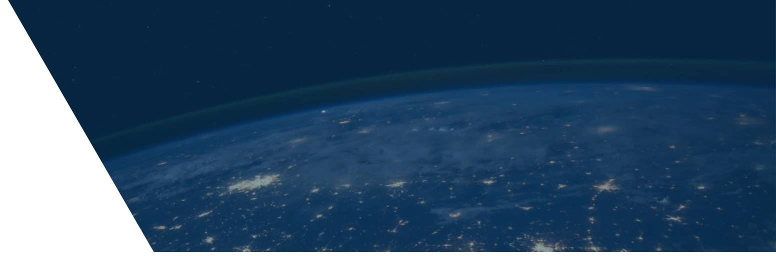


This is not surprising in a country that graduates more engineers every year than China, and more than Europe and the United States combined; or that recently managed a successful moon landing at a reported cost of only $70 million, less than what it would have taken Hollywood to turn it into a movie.

One could argue that the original impetus for India's digital transformation was provided by the previous government in 2009, when it launched Aadhaar, a biometric digital identity program to provide all citizens with a digitally-verifiable means to prove who they are. Within a decade, Aadhaar has enrolled more than 1.3 billion Indians, and become the largest single digital ID program in the world.

Aadhaar is now a powerful catalyst for the broad adoption of digital services in India. For example, a suite of applications is linked to it, such as the Unified Payments Interface platform, which enables quick and inexpensive payments among individuals, businesses, and government agencies. The government also used Aadhaar to launch a mass financial-inclusion initiative, with several hundred million people opening Aadhaar-authenticated bank accounts linked to their mobile phones. In turn, Aadhaar has enabled the direct transfer of subsidies to bank accounts, thereby reducing loss, fraud, and theft.

These programs are now providing the foundation for the private sector to drive India's transformation. Entrepreneurs are adapting low-cost technologies to mobilize the masses, using simple and affordable tools to improve productivity at the government, corporate and consumer levels. One example is Jio, an affordable wireless service launched by Reliance Industries that provides voice communications, some free content and several apps for less than $5 per month. India is expected to reach a billion smartphone users by the end of 2023, with one of the highest per-subscriber data consumption levels in the world. There are already more than a billion internet users, up from fewer than 50 million fifteen years ago.

India's young and growing population is embracing and driving all this change. Nearly two-thirds of Indians are less than 35 years old, an ideal demographic profile for a society adopting new technologies.

India is mobilizing local capital to finance its growth

Modernizing a country requires investments. The good news is that Indians are starting to mobilize the capital needed to achieve their country's transition.

While India is a high-savings economy, with a gross savings ratio of 25-30%, most people have traditionally saved through real estate, gold, jewelry, and bank deposits. This is changing rapidly. The younger generation is increasingly embracing financial products, and India is witnessing a broad acceleration of financial penetration. For example, the number of mutual fund accounts has grown five times in the past decade. It is now increasing even more rapidly, with the adoption of automatic investment plans.

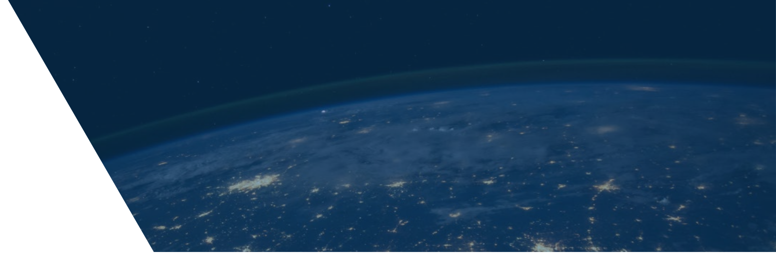
This new trend is important. Mobilizing local capital will increase the availability of financial services and credit for individuals and companies. It will complement growing Foreign Direct Investments, and help India finance its own growth. It will ultimately make the country more economically resilient.

New regulations are driving the formalization of the economy

Government-led reforms and new regulations are also accelerating the formalization of the economy.

While Westerners tend to think of India as a single country, it was until recently a patchwork of states for trade and tax purposes. Remember Europe before the European Union? The Goods and Services Tax ("GST") has simplified business across Indian states and transformed India into a unified economic entity. This is facilitating trade, improving logistics, and increasing tax compliance and government revenue. Most importantly, it is forcing the formalization of many businesses that need to register with the government and comply with GST tax rules to integrate themselves into their industry's supply chains.

In a similar vein, the government's Insolvency and Bankruptcy Code eliminated the interminable judicial procedures that used



to accompany bankruptcies and hampered credit allocation. The new regime favors banks and secured lenders over borrowers, and speeds up bankruptcy resolution. It is freeing up capital and improving business efficiency.

India is also witnessing a significant upturn in its residential property and construction markets. This is in part due to the new Real Estate Regulatory Authority set up to protect the interests of home buyers and help boost investments in the real estate sector. Building new homes is driving demand for a wide variety of materials and goods ranging from cement to kitchen appliances.

Manufacturing is rising

The biggest surprise for most investors is how manufacturing is increasingly becoming a new engine of growth, something that would have been unthinkable ten years ago.

While the Indian economy has been traditionally built around services, the current administration has been successful in encouraging companies to develop, manufacture, and assemble products in India through its "Make In India" and "Production-Linked Incentives" programs. The government has reduced corporate taxes for manufacturers, passed labor reforms to make it easier to hire and fire employees, and streamlined the approval process for new plants.

The development of physical infrastructure played a large role in this success. Since 2014, the length of national highways has risen by 60%, port capacity has gone up 85%, and the number of airports has doubled. This year alone, India's largest airlines have ordered nearly 1,000 jets. In New Delhi, the Indira Gandhi International Airport will be ready for 109 million passengers next year, as it prepares to become the world's second busiest airport. For those of us who have been traveling to India for several decades, the changes are sometimes hard to believe.

Foreign companies have noticed. Negative sentiment towards China is prompting them to reorganize their supply chains and take advantage of India's ample labor resources, attractive costs and large domestic market (the so-called "China +1" model). Most notably, Apple recently announced that it would make India one of its global manufacturing hubs. Apple's rival, Samsung, has set up one of its largest factories in the country. Even the Chinese smartphone maker Xiaomi now assembles handsets in India.

In less than 10 years, the country has transitioned from being a net importer of mobile phones to a net exporter. The iPhone 14 or 15 in your pocket may have been manufactured in India.

Final thoughts

Economic success is not destiny, countries must work at it. Moving people from rural areas to cities does not necessarily create jobs and make them more productive. India's long-term success will ultimately depend on whether it creates the conditions to leverage its huge potential demographic dividend.

In the past decade, India has embraced reforms and initiatives that can make its transition successful: business digitalization, economic financialization, and industrial formalization. In doing so, it has started to mobilize local capital while making itself more attractive to global investors. With the rise in manufacturing and the acceleration of the construction sector, it is now improving its ability to absorb the migration from farms to cities and to employ its young people at the levels needed to match the growth of its working population.

It is said that in the past, India has often disappointed both the optimist and the pessimist. This time, the country is positioning itself to deliver on its economic ambitions.

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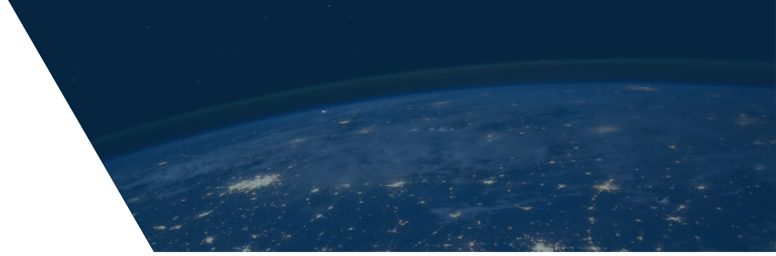

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