

Rising to the occasion: India in the twenty-first century

By Matthew Culley and Janus Henderson Central Research Team

Emerging Market Equities Portfolio Manager Matthew Culley and the Janus Henderson Research Team explain how India is leveraging government reforms and innovation to position itself to deliver strong economic and earnings growth.

Key Takeaways:

- India's reformist government recognizes that an innovative private sector has a pivotal role to play in achieving the country's economic and social goals.
- To help seize the opportunity, India has prioritized building out physical, digital, and social infrastructure.
- Further buoying India's position as a potential investment destination are a restructuring of global supply chains and flagging developed market growth.

In an era where globalization appears to be on the wane, the landscape for investing in emerging markets (EM) is shifting. A dispersion of economic prospects should result in both winners and losers. Consequently, investors seeking to access the powerful secular growth themes embedded in emerging regions will have to be more discerning. We believe a sweet spot going forward will be EM countries that possess both a reformist government and an innovative private sector. India is one such country.

This nexus, along with India's favorable demographics, aligns with the *country*, *company*, and *governance* approach that, in our view, serves as an effective framework for EM investors.

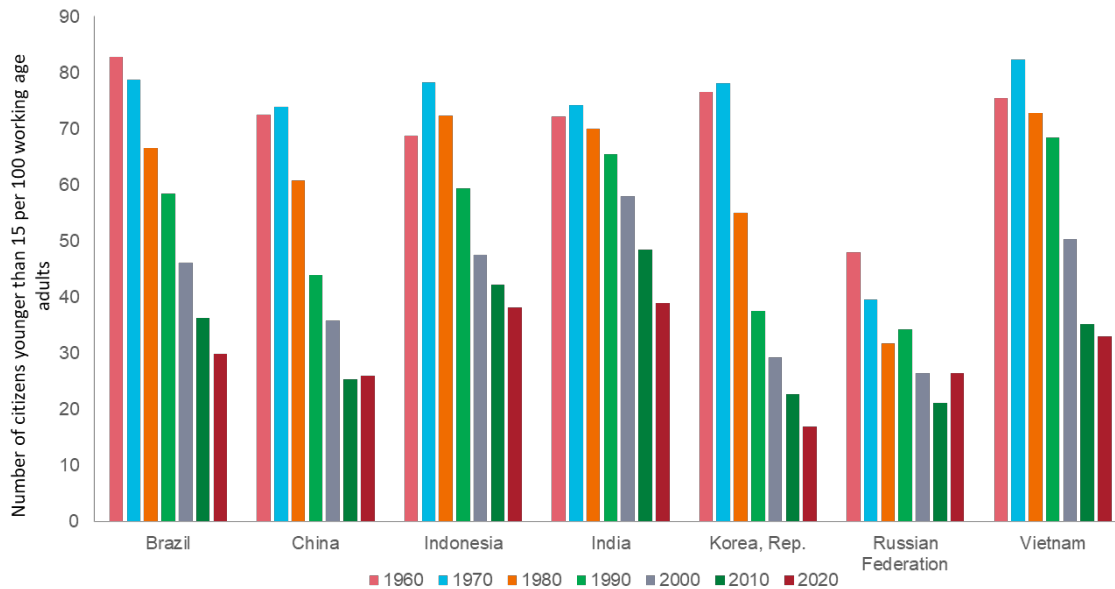
Within the EM asset class – especially during a period of economic and policy transition – investors may understandably place considerable emphasis on the macro. We have written extensively on the *country* aspect with respect to India's reformist government and will provide a sufficient summary in this note, but our focus will be on the *company* level – namely the sectors in which well-positioned and innovative businesses thrive. Over the long term, one of the main determinants of equity returns is earnings growth. A favorable macro backdrop and robust corporate governance matter insofar as these factors set the stage for companies to invest, innovate, and grow.

India's century

In 2023, India eclipsed China as the world's most populated country – and one endowed with a young population relative to other major economies. But for years, a massive market alone was insufficient to unlock the potential of the country's corporate sector. Historically, local companies and foreign investors were tasked with navigating an often-byzantine regulatory regime that stymied growth. That paradigm has shifted during the decade-long tenure of Prime Minister Narendra Modi.

Exhibit 1: India's favorable dependency ratio

India's young population relative to emerging market peers serves as a demographic compounder to the pro-growth themes of reform and innovation.



Source: World Development Indicators.

Mr. Modi's administration recognizes the integral role the private sector must play if the country is to achieve its objectives of increasing productivity and generating national wealth. With this in mind, the government has reduced red tape and implemented policies that incentivize profit growth. The timing is fortuitous, as the trend toward deglobalization is compelling multinationals to seek alternative manufacturing hubs to China and, internally, India must effectively harness the ascending forces of urbanization, industrialization, and consumption.

In addition to corporate-friendly policies, India's economy also requires a significant infrastructure upgrade to advance. This has become a priority of the Modi government. Twenty-first century infrastructure not only creates an environment in which companies can efficiently operate but also serves as a revenue source for the private enterprises tasked with helping the government achieve its objectives. Three areas of emphasis are physical, digital, and social infrastructure. Each of these addresses a distinct set of government priorities and creates opportunities for companies operating within these spheres to compound earnings growth over a multi-year horizon given the scale of the task.

Laying the foundation

In many respects, India has lagged other major EMs in terms of physical infrastructure and has ground to make up. The government recognizes that future economic advances depend upon improved roads, ports, power grid, housing stock, and telecommunications. Physical infrastructure is quite literally the foundation upon which India is building a modern economy.

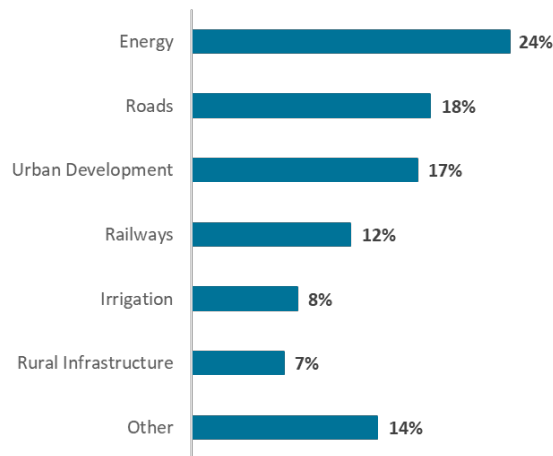
Urbanization goes hand in hand with economic development, and the influx of workers into cities creates considerable demand for housing. This dynamic is amplified given India's still-massive rural population. We view housing construction a secular theme that will play out not

over years but decades. In many regions, entirely new urban centers are being developed, typically near existing or anticipated sources of jobs. While local and national authorities are doing their part by streamlining the construction approval process, much of the effort will fall to private-sector developers.

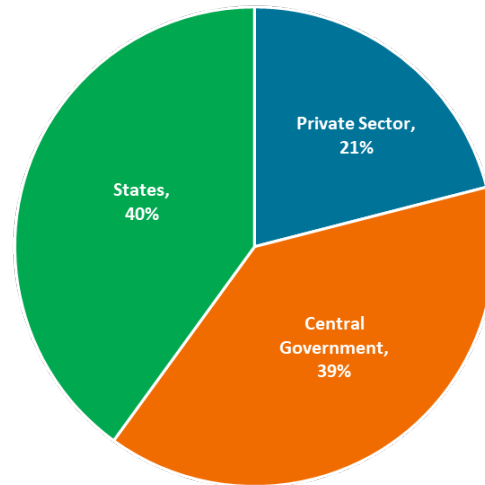
Exhibit 2: India's national infrastructure pipeline

After lagging EM peers, India is investing heavily in physical infrastructure to create a foundation for an innovative 21st century economy.

Infrastructure investment by category



Investment by funding source



Source: Bloomberg Intelligence, India Ministry of Finance.

With multinationals and advanced countries seeking to diversify supply chains, the manufacturing sector will increasingly become a source of jobs for new urban arrivals. This aligns with the Modi government's *Make in India* initiative. A larger manufacturing base not only increases India's potential to become more integrated into global supply chains, but also should enable producers to more efficiently meet demand within the large domestic market.

Much of the domestically manufactured capital equipment will be aimed at expanding and modernizing the country's electricity and communications grids. Both are critical to other facets of economic development, especially building out India's digital economy. As with other countries dependent upon energy imports, renewables present an opportunity to secure domestic sources of electricity production, thereby increasing energy reliability and security. Consequently, the government has underscored renewables as an area of specific policy support, targeting 50% of installed capacity to be comprised of non-fossil fuel energy sources by 2030.

As is the case with housing, we view power grid expansion as a multi-decade story. The parallel forces of industrialization and urbanization will invariably result in a more energy-intensive economy. To ensure sufficient capacity, we estimate that the energy sector will have to grow at rate up to 1.5 times faster than an already rapidly expanding gross domestic product. This secular tailwind will not be limited to energy generators, transmitters, and

distributors; also benefiting will be a multitude of equipment and services suppliers that are integral components of the energy ecosystem.

Another sector that illustrates the government's appreciation of the role an innovative private sector can play in achieving strategic priorities is defense. Historically, state-owned enterprises dominated the industry, with the private sector's contribution limited to supplying subcomponents to larger systems. This has changed as private defense contractors are now increasingly tasked with developing entire systems. Behind the paradigm shift is the higher technological complexity of the platforms needed to modernize India's military – a development in which an innovative and efficient private sector is well-suited to participate.

Bridging physical and digital infrastructure is telecommunications. An *all of the above* approach, including both broadband and wireless, will be required to meet India's communications needs given the size of the market and myriad applications dependent upon the network. With tailwinds of policy support, progress is being made, as seen in the intensification of the country's 5G network.

Evidence of the government's understanding of the role to be played by the private sector can be seen in the communications industry being allowed to rationalize, improving the potential for profitability by limiting the price wars that tend to occur when companies build out competing networks. As this unfolds, we would expect cash-flow generation of leading players to reach an inflection point, giving boards the flexibility to invest in new projects or return capital to shareholders.

A digital future

The digitization of the global economy has been a defining characteristic of the early twenty-first century. Recognizing the possibilities presented by integrating digital solutions into their economies, forward-looking emerging markets are now taking part.

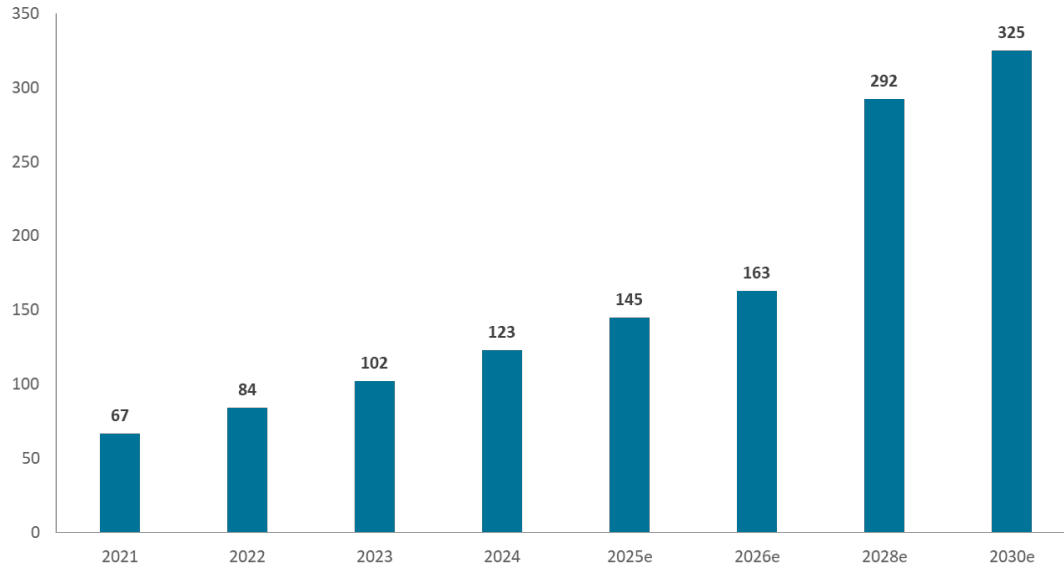
Initially, companies in emerging regions imported digital business models from advanced economies. Many of these businesses proved successful, but this strategy only went so far on unfamiliar ground. To maximize the potential of this technological revolution, EM businesses needed to create digital solutions that addressed EM-specific frictions. India has been at the forefront of this movement.

The e-commerce platforms and financial technology (fintech) solutions imported from advanced economies succeeded in tapping into the top third of EM income cohorts. Left unaddressed were the bottom two-thirds.

To remedy this, innovative entrepreneurs are harnessing technology to expand the digital economy across society. Among these are companies leveraging fintech to facilitate transactions and offer credit to historically underbanked populations. Other sectors embracing digitization are travel, via online platforms and much-needed logistics and mapping services for India's complicated transportation network, and e-commerce with a unique Indian flavor.

Exhibit 3: India's estimated e-commerce market growth

While e-commerce is expected to reach \$325 billion by 2030, that represents only a portion of the \$1 trillion digital economy anticipated for that year, with much of the growth emanating from tier 2 and tier 3 cities.



Source: India Brand Equity Foundation.

As was the case in other EMs, food delivery gained considerable during the COVID-19 pandemic. Since then, another digital phenomenon has taken hold: quick commerce. The concept of small orders with near-instantaneous delivery leans into the traditional habits of Indian shoppers, especially in dense urban environments where speed and price are prioritized over selection. The economics of this quick-delivery model work largely due to India's massive supply of labor – typically young men on mopeds monitoring their smartphones. Several quick-commerce platforms have emerged, providing the opportunity for consumers and vendors (and delivery drivers) to connect.

Digital delivery is also giving rise to other business models, including dark kitchens. With takeout becoming a larger component of dining, some restaurants have opted to skip traditional storefronts and instead operate out of an industrial kitchen, employing only cooks and relying upon quick-commerce apps for distribution. In many instances, dark kitchens can be shared by multiple “digital restaurants,” improving the economics of each.

Improving quality of life

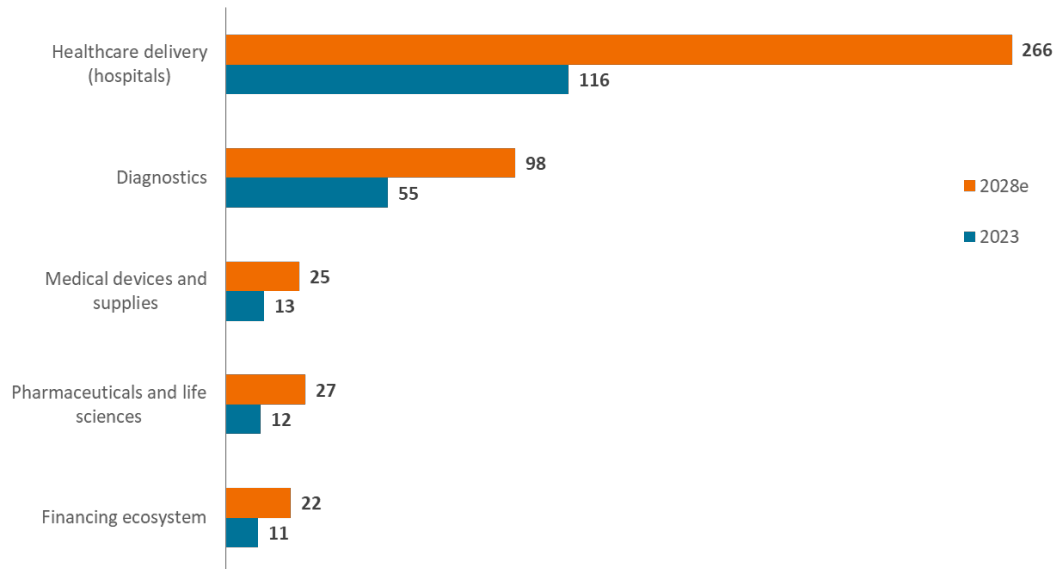
The growth of quality job prospects that accompany urbanization and industrialization is a key component of fortifying India's social infrastructure. So too is consumption as households have better opportunities to provide for themselves.

One sector that merits special mention with respect to social infrastructure is healthcare. Despite having more favorable demographics than most major economies, India's sheer size dictates that it has a considerable number of aging citizens. This market has historically been underpenetrated by modern healthcare options. That too is changing. Recognizing the

growing demand – and the risks posed by a population’s healthcare needs not being met – the Modi government is heavily promoting the participation of private providers in the healthcare system.

Exhibit 4: Forecasted Indian healthcare market growth

The central government is leaning on the private sector to help it improve the country’s healthcare delivery system.



Source: Statistica.

Private hospital operators are aggressively expanding bed capacity. Despite what might be considered an unsustainable pace that risks saturation in other markets, the demand for quality healthcare is so great in India that occupancy remains high given the significant unmet need. This is allowing private operators to maintain attractive margins and returns, facilitating the continued investment for the betterment of society.

This latter point illustrates how the private sector can be deployed to meet government imperatives while also creating sustainable businesses. Importantly, the administration is not standing in the way, allowing larger players to build competitive moats and develop scalable businesses.

Monitoring risks, optimizing exposure

After decades of promise, India’s economy appears well positioned to meet its potential. Behind this are the dual catalysts of a pro-growth reformist government and an innovative private sector. The pace of change is palpable, both in the speed at which essential infrastructure is being erected and the breadth of business models created to address EM-specific frictions.

For investors, India epitomizes a multi-decade growth theme. The economic promise of secular growth stories, however, must be balanced with valuation discipline. The multiples of companies positioned to participate in India’s digital future and infrastructure buildout must not get too far ahead of the underlying fundamentals. In such periods, patience is likely to be

rewarded. However, in an era of rapid innovation, markets tend to underestimate technological advancements and the positive impact they can have on earnings and cash-flow generation over the long term.

Much of India's economic tailwinds emanate from reformist policies. Consequently, potential shifts in the political environment could inject volatility into markets. This was on display in the 2024 general elections that saw Prime Minister Modi's majority narrow – a development that eventually resulted in modest downgrades to economic growth forecasts. Similarly, some of the most rapidly developing sectors may invite regulatory scrutiny at times, much in the manner that occurs in advanced economies.

Policy support and continuous innovation are creating investment opportunities across sectors ranging from real estate, logistics, defense, healthcare, and an ascendent digital consumer experience that includes – but is not limited to – e-commerce. Each of these sectors includes companies with strategic visions and strong management teams.

While *economic convergence* is still playing out and country-level forces have created a conducive investment backdrop, we believe future excess returns in India will be increasingly driven by an investor's ability to identify the companies with the most innovative business models and management teams capable of seizing this generational opportunity.

Emerging market investments have historically been subject to significant gains and/or losses. As such, returns may be subject to volatility.

Foreign securities are subject to currency fluctuations, political and economic uncertainty, increased volatility and lower liquidity, all of which are magnified in emerging markets. Fixed income securities are subject to interest rate, inflation, credit and default risk. As interest rates rise, bond prices usually fall, and vice versa.

Volatility measures risk using the dispersion of returns for a given investment.

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