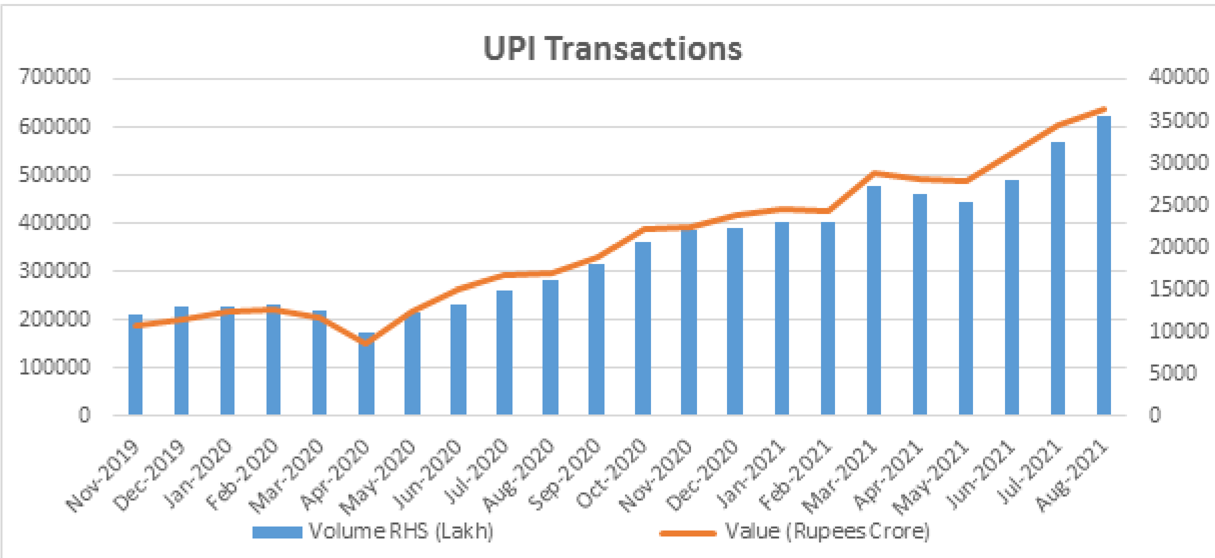
November 23, 2021

HDFC Mutual Fund's Tuesday's Talking Point: Great Formalization of the Economy!

Over the past few years and the years to come, beginning from demonetization, GST implementation and the digital move pushed by the pandemic, a great formalization of our economy is underway.

Demonetization paved the way for India to move towards a cashless economy. While digital payment options were available before, the demonetization move was instrumental in creating awareness about them among the country's masses. In hindsight, we can imagine how difficult it would have been during the pandemic, if not for the culture of digital payments brought in by demonetization. The chart below shows the proliferation of UPI transactions in recent years.



Source: RBI

GST – Another key push toward formalization

The GST ecosystem is structured in a way as to disincentivize registered businesses to deal with unorganized players, thereby bringing in a lot more of the latter lot into the tax net or the formal economy. For instance, business A is engaged in manufacturing and is sourcing raw materials from business B, which is part of the unorganized segment. In order to avail input tax credit, business A will force B to get a GSTIN number or, will itself be forced to look for a different supplier from the organized segment. The GST collections have been healthy in recent months (over Rs.1.30 lakh crore in October 2021@), signalling not just an economic recovery, but also the fact that GST regime has been a major game changer ushering in the era of formalization.

Shift toward Formal Economy during Covid -19 Pandemic

How the recent lockdowns led to a digital shift across most aspects of our life is no secret. While the digital adoption is adding to the country's productivity in a major way, a new trend is catching on significantly boosting our economy's prospects. With the option of working from home, a whole lot of previously non-participating / unorganized labour force are entering the formal economy in the form of gig workforce. They are temporary contract based workers / freelance workers who enter into formal agreements.

Formalization to Benefit Listed Companies

With the shift from unorganized to organized segments, a key set of beneficiaries are the listed companies. This became apparent during the pandemic led lockdowns with their superior digital reach leading to incremental market share gains from the informal sector. Many businesses from sectors including Banks, NBFCs, Cement, Steel, Pharma, etc. have gained market share from the informal segment over the past 3 to 4 years as shown below-

Sector	Parameter	Share	Existing Market Share (FY21)	Incremental Share* (FY21 vs FY17)
Bank Credit	Credit market share	Top 6	49.3%	67.3%
NBFCs - HFCs	AUM share	Top 2	73.0%	89%**
Cement	Sales Volume	Top 5	60.2%	100%
Steel	Sales Volume	Top 6	68.0%	95%
Telecom	Revenue	Top 3	87.0%	NM
Real Estate^	Launches	Top 30	NA	203 vs 166***
Power generation - Share of private	Units	NA	39.5%	58%
General Insurance	Gross Premium	Private sector share	57.2%	75.8%
Domestic Pharma	Revenue Market Share	Top 20	67.5%	75.8%

**Incremental share = change in aggregate company numbers divided by change in industry numbers between FY21 Vs FY17; **HDFC + LIC AUM change between Sep-20 Vs Sep 18; ***Number of units launched per developer; ^New launches share in tier 1 cities. NM – Not Meaningful.*

Source: Spark Research, MCA, CMIE.

A key concern for Mutual Fund investors today is the near-all-time-high market levels and seemingly higher valuations. While the topic of equity valuations is not the main subject of this note, the great formalization of our economy is an important pillar of economic growth over the next decade and is expected to augur well for equity Mutual Fund investors in the long term.

Sources: RBI, @pib.gov.in and other publicly available information.