# Honesty and Integrity Investment (HNI Investment)

## Email for Dec 2021

Dear Friends,

Here are the details of performance of HNI investment based on the share prices as on 31st Dec 2021:

| Annualised Returns (IRR) (1) (2) (3) (4)(5) | HNI Portfolio | Nifty | Sensex |
|---|---|---|---|
| FY13 | -10.6% | -5.3% | -3.7% |
| FY14 | 112.2% | 21.1% | 21.3% |
| FY15 | 21.6% | 25.0% | 23.0% |
| FY16 | 86.0% | -7.0% | -7.7% |
| FY17 | 168.3% | 21.9% | 20.1% |
| FY18 | *66.4%* | *17.0%* | *18.8%* |
| *FY19* | *-19.2%* | *16.9%* | *18.3%* |
| *FY20* | *-45.8%* | *-28.6%* | *-26.9%* |
| *FY21* | *104.7%* | *71.1%* | *68.2%* |
| *Q3FY22 - IRR* | ***-21.5%*** | ***-5.2%*** | ***-5.1%*** |
| *Q3FY22 – Absolute Change* | ***-5.9%*** | ***-1.3%*** | ***-1.3%*** |
| ***From Inception till 30th Sep 2021*** | ***29.6%*** | ***20.5%*** | ***20.4%*** |
| ***From Inception till 31st Dec 2021*** | ***23.9%*** | ***18.4%*** | ***18.3%*** |

(1) For all HNI clients and promoters (2) Inception was in August 2012 (3) Gross IRRs excluding the impact of HNI investment fees (4) Return during the quarter is reported only when it's adverse i.e. negative or lower than Sensex/Nifty. Quarterly IRRs looks overblown due to compounding effects of short periods (5) Absolute change is calculated based on IRR numbers for the quarter

At first I would like to wish you a very happy and prosperous new year. There is not much to speak on the performance during the quarter except the fact that we are in process to exit one of our investment which should be completed by the end of current quarter.

## Made In India

Over the last few decades, India has made significant progress in the services sector both in domestic and exports market. However, the opportunities on manufacturing side has been captured by our neighbour. It's a topic of great interest to understand why that has happened and how can it be changed?

There are few important reasons why India lost in manufacturing opportunities in the first place.

First and the most important of them is the culture of tax evasion in India. It's a well-known fact that tax buoyancy in India in one of the lowest in the world. Evading taxes has now become more or less a habit in large section of the population except salaried class. This culture of tax evasion creates lot of other chain reactions which reduce India's competitiveness in manufacturing sector.

- One, lower tax buoyancy reduces potential investments in infrastructure creation by the government. Lower infrastructure investment reduces logistical efficiency in the system which is very important for manufacturing sector to thrive.

- Second, tax evasion creates fragmentation in many industries in which scale drives competitiveness. A tax compliant company of a large scale will be on equal footing to non-compliant company of small scale simply because of tax leakages. This prevents the creation of large scale manufacturing companies with significant scale benefits. As a result, in most of sectors where scale is the biggest factor to drive cost down, India lose out to competing countries because cost for the whole system is much higher due to high level of fragmentation
- Third, the deployment of black money generated in tax evasion, is mostly in real estate. This creates an artificially high price of land which is the biggest investment for any large scale manufacturing operation. High cost of land make lot of manufacturing projects unviable or cost inefficient.

Second important issue is the high cost of power for industrial consumers in India. The root cause of this is power being a political issue. Due to politics, electricity distribution companies incur heavy losses in the retail/consumer sector (both electricity theft and lower rates) and they have to cross subsidize these losses through higher charge on industrial consumers. Due to this, India’s electricity sector end up making any power intensive manufacturing uncompetitive.

Third is the high cost and low availability of railway transportation. This is again a political issue. Indian Railway continue to cross subsidize losses in passenger traffic by high freight rates. High rail freight rates makes long distance transportation expensive leading to higher cost for manufacturing sector as a whole. Similarly new investments in railways favour passenger rails over freight rails. Railways are the most efficient and cost effective mode of transport globally but in India, over decades share of road transport has increased simply because political issues prohibiting growth of Indian freight rails.

Fourth is a historical reason of corruption and slow project approvals. But that in my view is largely historical. Over last few years there has been significant improvement on this front. But it has contributed a lot historically in increasing cost for manufacturing sector.

Though, admittedly, there have been significant efforts by the government over last 7-8 years to improve on first three issues, but still, there is no material improvement in any of them. Some of the initiatives were not in right direction and some failed miserably in its implementation.

So can India be a manufacturing hub in coming decades. The surprising answer is yes, it can happen. It can happen because

a) Cost Competitiveness is always relative: What if India does not improve on its competitiveness but other competing countries become more inefficient due to domestic issues. This will improve India’s relative competitiveness and hence import substitution or exports can drive manufacturing. The increasing environment issues in China is making environment sensitive sectors cost inefficient in China.
b) Cost Competitiveness is not always relevant: Geo political issues like China-US trade war can create large export opportunities even if it means higher cost of procurement for US companies. China plus one strategy now being adopted by many global companies are an effort to reduce risk even if it comes at cost of higher prices.
c) Exchange rates can correctly price relative competitiveness: If Indian currency depreciates significantly relative to currencies of competing countries like china, automatically, exports and import substitution will drive manufacturing.

But all of above means that the world is sourcing goods which have higher cost of manufacturing than the earlier sourced goods. All of this indicates overall world economic system becoming more inefficient or ignoring efficiencies for other strategic reasons. Who is going to pay for higher cost/increasing inefficiencies? The answer lies in inflation and who bears the brunt of it. But more on that later…

That's it for the quarter from my side. Happy to answer any queries that you might have…