

Aadhaar & its Implication for Corporate India

Thoughts contributed by India Avenue Investment Management Australia Pty Limited

"When you bring a new capability like Aadhaar, it takes time for people to understand what it does and how it can be used. There is certain diffusion time, we are in that phase, I am very confident in the coming year, Aadhaar based companies and application will be numerous. It will become a big platform of innovation." - Nandan Nilekani, Co-founder of Infosys Technologies and Ex-chairman of UIDAI.

What is Aadhaar?



Aadhaar, a significant structural reform initiated by the previous UPA government and fast tracked by the Modi led NDA government, has enabled electronic identification and authentication of any person resident in India and registered with the Aadhaar platform. Aadhaar is a unique identification number issued by the Unique Identification Authority of India (UIDAI) that provides a strong authentication of a resident using biometrics / IRIS scan ('who you are') combined with one-time password sent to the mobile phone ('what you have'). By 31 December 2016, the UIDAI has generated 1.09 billion (~89% of population) Aadhaar numbers and authenticated 4.06 billion transactions using the Aadhaar platform.

The objective of issuing Aadhaar numbers was to eliminate duplicate and fake identities and enable the government to efficiently deliver social welfare services through direct benefit transfer (DBT).

Benefits of introducing Aadhaar:

A recent economic survey highlighted that India's public distribution system (PDS) for wheat, rice and kerosene had leakages of 54%, 15% and 41% respectively. The leakages are mainly

due to lack of easy identification and verification of beneficiaries, the dependence on bureaucratic discretion to identify beneficiaries, and the involvement of too many middlemen in the delivery of the benefits. These has led to the inclusion of ineligible and exclusion of the eligible from welfare schemes. The Government spends about A\$70 bn in various social welfare programmes in India. Direct transfer of these benefits will:

- likely curtail the annual spend by A\$13-15 bn, as leakages in the system will reduce substantially.
- augment the effectiveness of welfare schemes, reaching the intended recipient directly.
- curtail the opportunities for leakage by reducing the number of government departments involved in the distribution process.
- weed out duplicate beneficiaries.

Beyond standard monetary transactions, Aadhaar can be used

- as an identification tool for availing government and private services.
- for doing e-KYC for buying financial products and availing pre-paid mobile sim cards.

The multiple uses of Aadhaar authentication is summarised as Exhibit 1 below

Exhibit 1: The multiple uses of Aadhaar authentication

Social Security Schemes	Public Distribution System , NREGS (National Rural Employment Guarantee Scheme) , Sarva Siksha Abhiyaan (Education for All)
Subsidies	Fertiliser, Kerosene, LPG, Food, Water, Electricity
Government Services	Driving Licence, Passport, Airport Entry, Tax Return filling, Land Titles
E-KYC	Bank account opening, buying financial products, buying SIM cards, ATM Cash dispensation
Voting	Voter ID issuance while voting
ADMIN	Attendance of government officials

Implementation of the scheme and implementational challenges:

The biggest hindrance to DBT was the high number of unbanked households in India. To overcome this challenge, Prime Minister Modi introduced **a financial inclusion scheme**, Pradhan Mantri Jan-Dhan Yojana (PMJDY), aimed at providing a bank account to every household. The scheme has seen strong traction since its launch in August 2014, with **more than 281 million bank accounts opened** (coverage over 90% of households) and A\$12.6 bn in deposits by 22 March 2017. With this major challenge being successfully addressed, DBT into the bank accounts of intended beneficiaries is now a reality.

The Government is currently conducting pilots for DBT of fertiliser and kerosene subsidies (these two along with food subsidy account for over 70% of the Government's welfare payouts) in several parts of the country. It has set a **deadline of 31 March 2018 to roll out Aadhaar enabled DBT in its entirety**. The total number of beneficiaries currently under different schemes is shown in Exhibit 2:

Exhibit 2: Total number of beneficiaries

Scheme	Beneficiary Accounts (Mn)
NREGS	110.2
LPG	169.3
National Social Assistance Programme	29.4
Scholarship Schemes	3.9
Others	3.5

One more area of challenge has been the issue of privacy and security. While the benefits of DBT are huge, privacy related concern need to be addressed. Privacy legislations need to be strengthened before Aadhaar can be made mandatory for all benefit transfers. *Currently in the absence of strong privacy legislations, beneficiaries will still need to be given the option of availing the benefits outside of the Aadhaar system!*

Recent developments relating to DBT

The government has made several announcements expanding the scope of Aadhaar and DBT during the last month, some of these announcements are

- Aadhaar has been linked to 525 mn bank accounts
- Aadhaar has been made mandatory for receiving food subsidy
- Fertiliser subsidy will be delivered through DBT starting Jun'17
- Aadhaar seeding and DBT will be extended to 536 social welfare schemes by Mar'18 from the current 84 schemes
- DBT and geo tagging to be followed for rural housing scheme
- Transfer of drought relief through DBT
- The government has saved ~A\$10 bn due to use of DBT in benefit transfer of A\$32 bn across 2013-17.

There has been steady progress on preparing ground to push this programme aggressively over the next 12- 24 months. As of 28 February 2017, 1.1bn Aadhaar cards have been issued covering ~88% of India's population. Given the increased Aadhaar coverage and bank account linkage, we believe the Government will increasingly look to follow the DBT route for most of the subsidies going ahead.

DBT to drive rural incomes

The key benefit of Aadhaar will be the improved quality of Government spend and the reduction in subsidy and welfare scheme expenses of the Government. It is expected that the government will invest these savings from implementation of DBT to build rural infrastructure, or for other rural development schemes. Further, direct benefit payments will put more money into the hands of targeted households encouraging them to spend. The reduction of leakages and the expected investment of savings into rural welfare on implementation of DBT can generate A\$ 9 bn of incremental annual disposable income for the targeted households. This can help create a sustainable rural demand recovery reducing the impacts of fluctuating monsoons. Given the propensity of these households to spend on consumer products, DBT could become a sustainable driver for rural consumer demand.

Consumer staples, cement and auto likely to be the biggest beneficiary of increase in rural spend

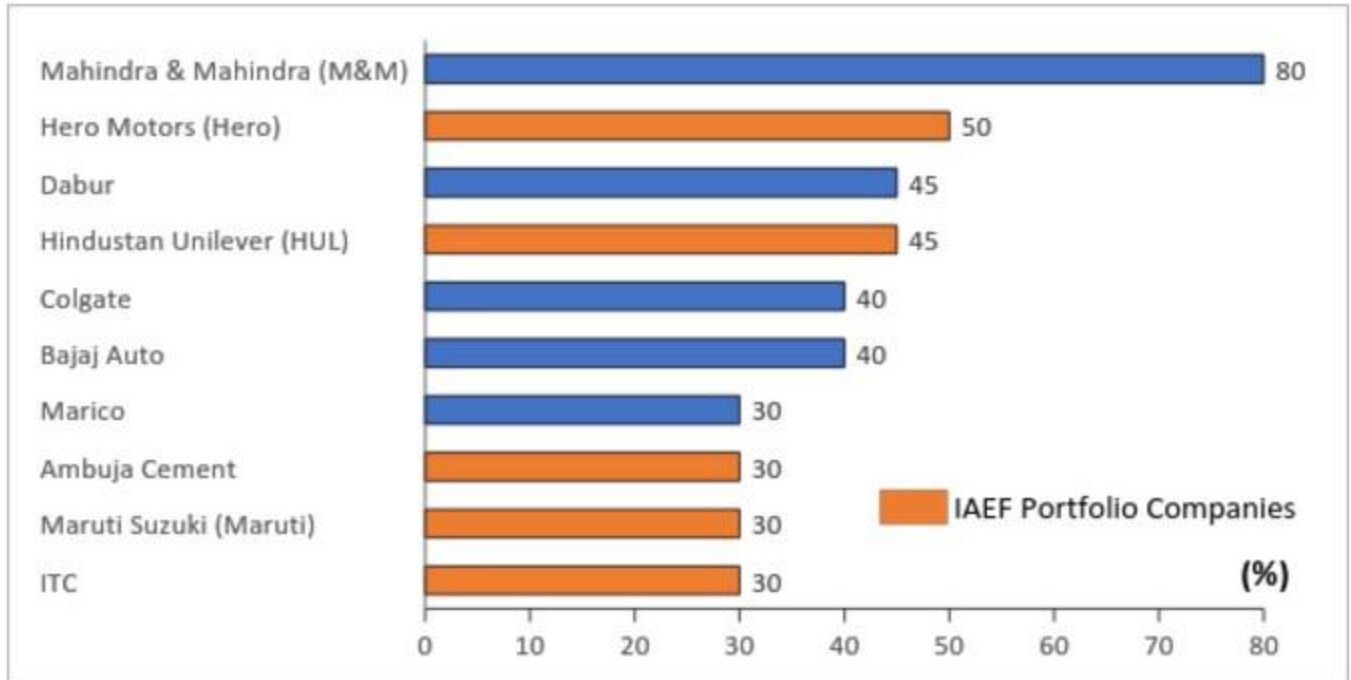
The key attributes for a company to benefit disproportionately from increased consumer spends by rural households are:

- Percentage of total sales derived from rural areas
- Distribution outreach in rural areas
- Mass and mid-mass positioned brands
- Brand equity

Based on these criteria, Hindustan Unilever (HUL – refer to example on page 5 for details) with ~45% of its sales coming from rural, market leadership across multiple categories, and one of the widest rural outreaches to be the biggest beneficiary of increased rural household spends in the consumer staples space. Cement manufacturers will benefit as they derive 30% of their sales from affordable rural housing, a key focus area for the government. Mahindra & Mahindra will be a big beneficiary as it derives nearly 60% of volume sales of utility vehicles, and 100% of volume sales of tractors from rural India.

Some of the companies which have a high contribution from rural India in their sales and will benefit due to DBT are shown as exhibit 1, companies which are part of the India Avenue Equity Fund (IAEF) Portfolio are highlighted in orange.

Exhibit 1: Contribution of rural to company sales volume



Oil PSUs will be beneficiaries of DBT

DBT for subsidies on cooking gas (LPG) and kerosene would be positive for state-owned oil companies such as HPCL (IAEF Portfolio company), BPCL, Indian Oil Corporation (IAEF portfolio company), ONGC and Oil India. The under recoveries, on account of subsidies provided on petroleum products, are shared between the government and the Oil PSUs (upstream and downstream companies). Oil companies in India have to provide a discount of 85 percent of the incremental oil prices beyond US\$60 per barrel, and this discount rises to 90 percent beyond US\$100 a barrel.

The targeted allocation of LPG & kerosene subsidies to intended beneficiaries based on Aadhaar profiling and direct transfer of payment to the account of the beneficiary will reduce the number of beneficiaries significantly. Presently, 169.3 million beneficiaries have registered under PAHAL, the scheme to provide DBT for LPG, and 10.5 million erstwhile beneficiaries have voluntarily opted out. The government has till date disbursed a total cash of A\$10 bn under the scheme. DBT will also remove the scope for corruption that exists in the present system of providing these items at subsidized rates. Reduction in pilferage of these subsidies will be beneficial for these companies, as the overall subsidy bill would reduce, especially when crude oil prices tend to go above US\$ 60 per barrel, the rate above which the subsidy bills starts ballooning.

Lower fiscal deficit good for Indian Banks

Lower slippage because of DBT will contain India's fiscal deficit, and allow room for a structural reduction in banks allocation in low yielding government bonds and deposits that currently represent 24.5% of bank deposits. A fall in the statutory liquidity ratio (SLR) for banks

will enhance the pool of resources available for private sector and expand the net interest margins and ROAs of banks.

Aadhaar enabled e-KYC will enable fast ramp up of businesses

Reliance Industries (IAEF portfolio company) acquired over 100 million customers within 6 months of its launch in September 2016 for its telecom offering Reliance Jio using a simple Aadhaar based e-KYC process. The ease and speed (less than 5 minutes) of activating an account using Aadhaar KYC enabled Jio to onboard an average 600,000 subscriber per day, a feat which was unthinkable of earlier for any company at launch.

Enabled by Aadhaar e-KYC and digital technology, Kotak Mahindra Bank (Kotak – IAEF portfolio company), a private sector bank in India (IAEF portfolio company) has launched India's unique full service digital banking ecosystem on mobile that will drive the bank's organic growth agenda. Under this offering, Kotak provides a zero-balance savings account with zero charges for all digital transactions, where customers can earn up to 6% p.a. on their savings account balances.

This offers a completely digital and paperless account opening experience (account opening anywhere, anytime within 5 minutes using Kotak's mobile banking app) across nearly 700 locations in India. Kotak is the first bank in India to integrate the newly introduced Aadhaar based OTP (one time password) authentication process for account opening on mobile. Only Aadhaar and PAN numbers are required to open and operate the account. Kotak expects that this initiative will enable it to double its customer base to 16 million customers over the next 18 months. It's noteworthy that Kotak had earlier acquired 8 million customers after 14 years of its existence and post a recent sizeable acquisition of another bank, ING Vysya Bank.

Our View

We believe that Aadhaar will

- increase financial inclusion
- enable the reduction of cash payments in the system
- significantly reduce the corruption involved in the transfer of social benefits and subsidies in India
- ensure that social security benefits will be made available to those who require it the most
- disrupt the KYC (know your customer) processes adopted by corporations and governmental agencies, reducing the time required to conduct diligence and offer services.
- help businesses innovate and grow rapidly using digitization and Aadhaar enabled e-KYC.
- lower slippage will reduce fiscal deficits and government borrowings, lowering interest rates in the economy and increasing government's ability to do developmental spend.

Company Example: Hindustan Unilever (HUL)

HUL is best positioned to capitalise on the benefits of the DBT rollout over FY 18-20 due to

- Well diversified Product portfolio of soaps, detergents, shampoos, packaged tea, skin care and oral care products, which will be the biggest beneficiary of DBT

Categories	Beneficiary Companies	DBT induced Drivers of Growth
Soaps	HUL, Godrej Consumer (GCPL)	Increased frequency of consumption and some premiumisation
Toothpaste	Colgate, Dabur, HUL	Increased per capita consumption
Biscuits	Parle, Britannia	Increased penetration and shift from unbranded to branded
Malted Food Drinks	Glaxo Consumer	Increase in penetration and frequency of consumption
Household Insecticides	GCPL	Increase in penetration
Shampoo	HUL, Dabur	Increased frequency of consumption and some premiumisation
Detergents	HUL	Increased frequency of consumption
Hair Oil	Marico, Dabur	Shift from unbranded to branded
Skin Cream	HUL	Increase in penetration
Tea	HUL	Shift from loose to packaged tea powder

- Market leadership in both mass and mid mass market across product categories with
 - Over 60% of revenues derived from product categories which will be the biggest beneficiary of DBT induced incremental spends
 - Over 50% of HUL's revenues from these categories is from rural India, the main benefactor of DBT induced consumption spend

Brand	Position	Category	Market Position	% of HUL sales
Lifebuoy	Mass	Soap	# 1	~ 20% of Sales
Lux	Mid-mass	Soap	# 2	
Wheel	Mass	Detergent	# 1	~20% of sales
Rin	Mid-mass	Detergent	# 2	
Brooke Bond	Mid-mass	Packaged Tea	# 1	~8% of sales
Fair & Lovely	Mass	Skin Care	# 1	~10% of sales
Clinic Plus	Mass	Shampoo	# 1	~5% of sales

- Well Positioned to capitalize on the opportunity with a strong distribution reach of over 3 million outlets across India, the highest as compared to any other consumer staples company, which is supported by best in class technology inventory and sales management solutions
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