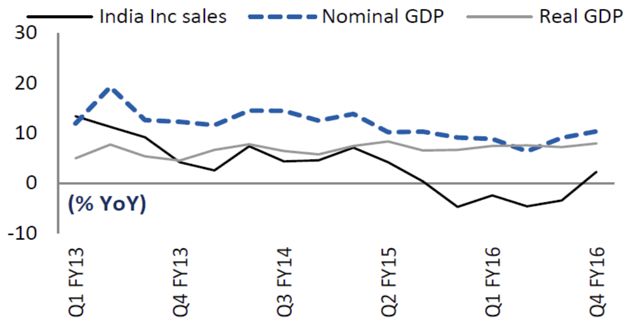
# Demystifying GDP vs Corporate Growth

One of the key contentious issues in the Indian economy, which has been debated significantly over the past 2 years, is the large divergence between India Inc.'s corporate performance and GDP numbers. Amidst declining exports, gloomy auto sales, subdued corporate profitability, depressed loan growth, piling up of bad loans and consecutive deficit monsoons, India has reported GDP growth rate of over 7% (7.6% for FY16 and 7.1% for Q1FY17 to be precise).

Intuitively, higher production in a country should lead to higher economic activity which would be reflected in higher top-line growth for corporates and/or improved profitability. However, the universe of listed companies has failed to report meaningful growth in the top-line over the last couple of years. As per the quarterly data released by the Reserve bank of India (RBI), corporate net sales growth has averaged 3.5% in the past four years and contracted 2% in FY16, leading to a wide gap between GDP growth and sales growth.

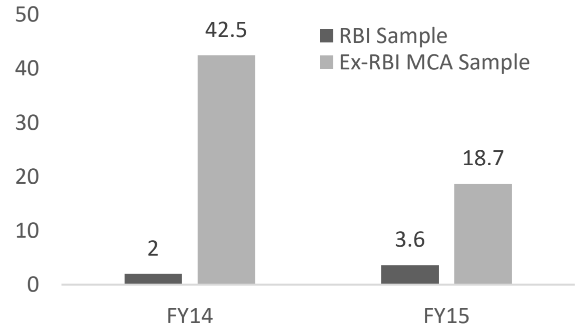
**Figure 1: Divergence between GDP data and corporate sales data**




**Source: Reserve Bank of India (RBI), Central Statistics Office (CSO), MoSL**

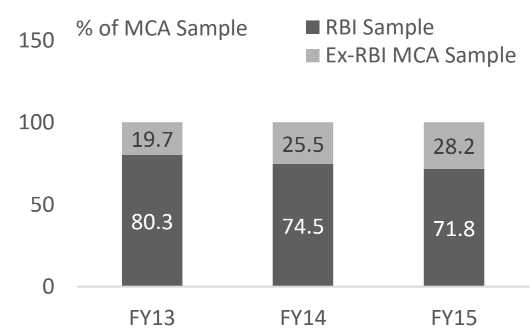
Across industries, listed players usually represent market leadership. Thus a small number of large firms make up the listed space. On the other hand, a large number of small firms – the unlisted universe – usually remains untracked due to lack of availability of regular and consistent data. Thanks to the RBI, aggregate data of ~254,000 companies (listed and unlisted) was released recently, which provides some interesting insights. For the sake of simplicity, we denote the listed space as the RBI sample and the unlisted space as the Ex-RBI MCA sample. A detailed understanding of the various data samples is appended in Annexure 1.

**Figure 2: Sales growth in the unlisted space much higher than in the listed space…**




Source: RBI, CSO

**Figure 3: …due to which their share has increased significantly in the past few years**

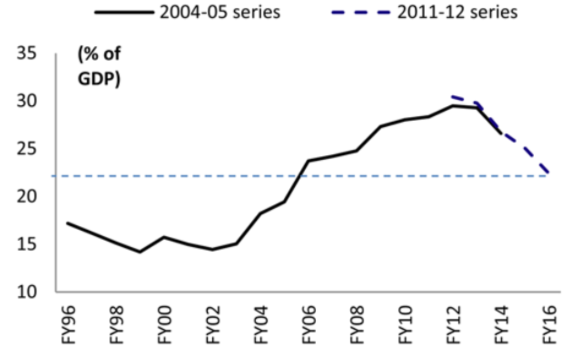



Source: RBI, CSO

The above exhibits show that the unlisted companies have performed much better than listed companies in terms of sales growth. Consequently, the share of the ex-RBI MCA sample, in terms of sales, has increased from ~20% of the total MCA sample in FY13 to ~28% in FY15. Further, the unlisted companies have not only performed better in terms of sales but are in much better shape than the listed companies on other key parameters as well.

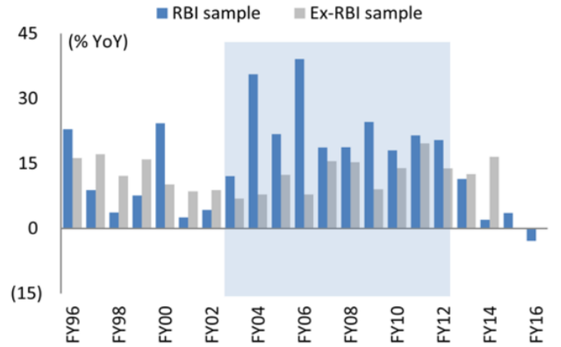
Interestingly, the revenue market share of the listed companies' sample has fallen to the lowest level in 11 years. In FY16, it is less than what it was in FY06 as shown in Figure 4. It is important to note that this is not the first time that the unlisted space (including unorganized sector) has grown faster than the listed space (or RBI sample). Interestingly, similar trends were witnessed during the previous slowdown during early 2000's as shown in the Figure 5.

**Figure 4: Listed companies are losing market share in terms of Sales to GDP as…**




Source: RBI, CSO, MoSL

**Figure 5: …Sales of listed companies growing slower than unlisted companies' universe**




Ex-RBI sample = Nominal GDP – sales of RBI sample
Source: RBI, CSO, MoSL

Top-line of the listed companies' sample grew 9.1% per annum on an average between FY97 and FY03 as against the growth of 11.4% seen in the unlisted sample. The trend was then reversed during the next decade, when the RBI sample posted an average growth of 23% per annum till FY13, as against ~13% by the ex-RBI sample. Since FY14, the trend seems to have reversed once again, as growth of unlisted universe (including unorganized sector) takes over the listed sample. In the past two years, growth in the unlisted universe has also eased to 13%, the lowest since FY10.

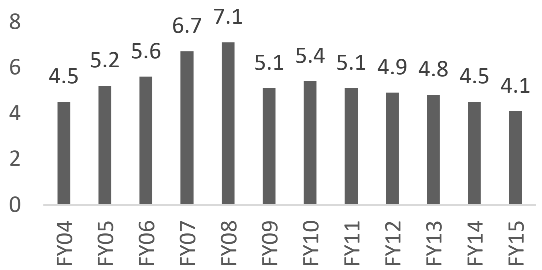
Thus, presumably, a slowdown in economic activity leads to consumers down-trading their purchases. Smaller players gain market share from their larger counterparts who usually command a higher price given their market leadership. We have conferred such a hypothesis with a number of managements across industries, and their conclusions are similar – higher quality / higher priced goods are typically substituted for cheaper goods during slowdowns as consumers tighten their purses. However, financial theory advocates that better economies of scale should render a better pricing power to larger companies than small ones. How, then, would the smaller players be gaining market share from larger ones? We believe that there could be several reasons for this.

We believe a large portion of gains to unlisted space is due to boom in E-Commerce (better reach, high discounting) and gaining momentum of budding entrepreneurs (local brands), both are far from secondary capital markets (listed space) where most of the data is available. Additionally, there could be several factors helping unlisted companies to keep prices low: (a) tax benefits, as smaller size may have helped them to stay out of tax net, and (b) their ability to evade/conceal taxes where payable is also higher than large and listed companies. This also evident in the tax to GDP ratio which has seen a dip from 17.2% in FY13 to 16.6% in FY16 despite growth in the economy.

A reversal of the above trend, at least in part, would be driven by an upswing in consumer sentiment. High inflation coupled with low wage growth had significantly restrained consumerism. With inflation cooling off, and wage growth looking promising, we expect the pendulum to swing to the right soon. Additionally, the impending GST should also help listed players as it levels the playing field with local businesses who were hitherto not subject to a number of cross border taxes unlike their larger peers.

Tellingly, it is hard to precisely forecast the timing and magnitude of economic gyrations. History, usually, serves as a quick reference check for the implications of economic twists and turns. For an economy growing at 12-15% in nominal terms, corporate profits to GDP went up from 4.5% in FY04 to 7.1% in FY08 as we see it in Figure 6. If the previous decade is anything to go by, then a positive change in economic momentum could lead to a disproportionate change in the earnings growth for listed companies. In Figure 7, we show how corporate profitability growth could shape up at different *nominal* GDP growth rates over a five-year period. As investors, there is nothing more that we yearn for…

**Figure 6: Corporate Profit to GDP (%)**




Source: CLSA, Tamohara

**Figure 7: Corporate profitability at different Nominal GDP growth rates (an estimate)**

| | FY15 | FY20e | FY20e | FY20e |
|---|---|---|---|---|
| GDP | 100 | 161 | 176 | 201 |
| *Assumed GDP CAGR* | | *10.0%* | *12.0%* | *15.0%* |
| Corp Profit/GDP | 4.1% | 7.1% | 7.1% | 7.1% |
| Implied Corp Profit | 4.1 | 11.4 | 12.5 | 14.3 |
| ***Implied Corp Profit CAGR*** | | ***22.8%*** | ***25.0%*** | ***28.3%*** |

Source: Tamohara

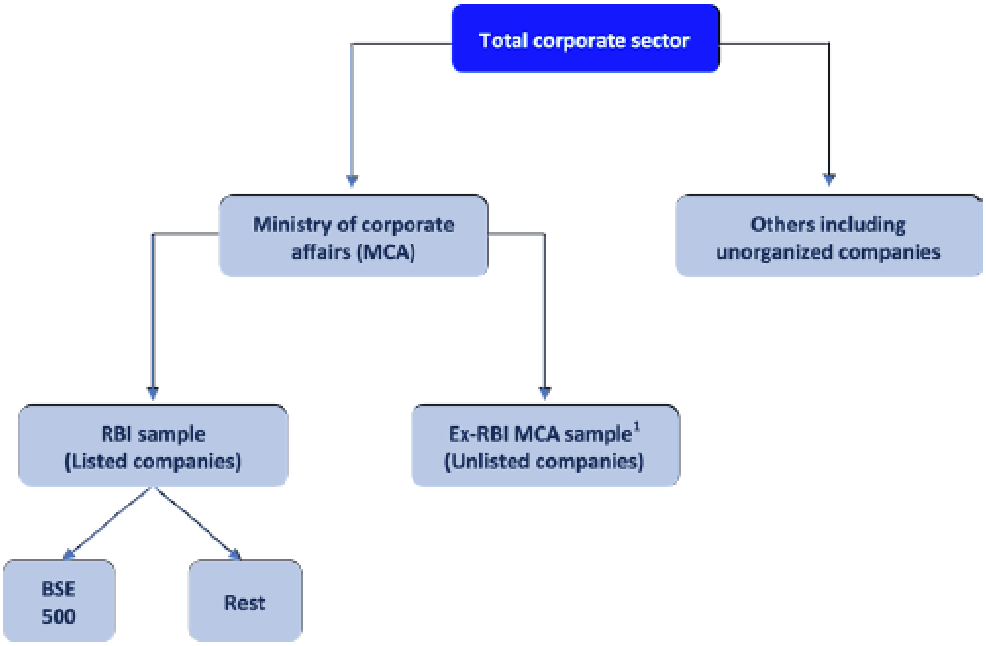
Until next month,

Team Tamohara

Annexure 1

For the first time, the Reserve Bank of India (RBI) released aggregated detailed data on ~254,000 companies for three years (2012-13 to 2014-15). It includes listed and unlisted non-government non-financial (NGNF) companies. The RBI has compiled data based on audited accounts of select 16,923 NGNF public limited companies and 237,398 NGNF private limited companies from Ministry of Corporate Affairs (MCA). Let's call this entire sample "the MCA sample". Separately, the RBI releases quarterly data on some 2,700 listed NGNF companies. Let's call this "the RBI (or listed) sample". Since the MCA sample includes the companies under the RBI sample, we calculate "the ex-RBI MCA (or unlisted) sample" by excluding the RBI sample from the MCA sample (Please note that the RBI sample is not a perfect sub-set of the MCA sample. However, given the lack of data on individual companies and the fact that majority of the RBI sample is included in MCA sample, we exclude the entire RBI sample aggregate data from the aggregate data of the MCA sample to gauge performance of the ex-RBI MCA (or unlisted) sample).

**Understanding the Indian corporate data sources**




On the basis of the above tree we have derived various corporate samples listed below which we will use for our analysis.

MCA Sample = Sample of ~254,000 companies (Non-Government, Non-Financial)
RBI or Listed Sample = 2,700 listed Companies (Non-Government, Non-Financial)
Ex-RBI MCA or Unlisted Sample = MCA Sample – RBI Sample

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