

Dec 29, 2023

Dear Investor,

Quite often, MNCs entering into India find actual demand turning out to be much below their original projections. Also, I have always wondered why are Biharis so insecure, despite being simple folks, as intelligent as people in other states I know of, and hardworking. Could these two phenomena have a similar underlying cause? As of now, this exploration could be more of a conjecture. However, Chanakya PMS is in the business of meaningful conjectures, to be empirically validated or rejected with credible information. In order to explore this, in this Newsletter I have chosen to focus on select 'churns' within the Indian society and in its businesses. In order to go deep in the psyche of the Indian society, I have chosen to rely on a new version of Indian history written recently by a few profound researchers. This historical sense of the Indian society is full of repression, missed opportunities and also resilience. The future of the emerging India is of a society regaining its poise, and **समभाव** – not only in its spirit, but also in its economy and businesses. A lot of discussions relate to my home state of Bihar. I believe that if economic growth picks up in Bihar in a well – calibrated manner, rate of growth of GDP of India would elevate to 7% + level in the long – term.

Re- writing of Indian history and economics

“The tragedy, of course, is that it was Bihar, and its increasingly impoverished poppy farmers, that made it possible for the colonial regime to set up the drug-pushing racket that later became a gravy train for the opium industry of western India. Yet, sadly, in today’s Mumbai, migrants from eastern UP and Bihar are often the targets of all manner of abuse and discrimination. In recent years, Bihari migrant workers in the city have even been physically assaulted by Marathi chauvinists for performing rituals for Chhath Puja, their most important religious observance of the year. 30 Yet, as Farooqui notes: ‘Modern Bombay, in a sense, has its genesis in the poppy fields of Bihar.’” - Amitav Ghosh, Smoke and Ashes, HarperCollins, Pg. 125

I wish my school – level history books had covered the plight of people of Bihar at the hands of the British East India Company. Bihar and Eastern UP are still paying a very heavy price for repression during British Rule. I urge you to read a well– researched and articulated version of modern Indian history in the book, by Amitav Ghosh. I had heard of opium wars in China, but not of the opium catastrophe in my home state of Bihar. I do sincerely believe that future growth of political economy and risk-return equation in the Indian stock market are intertwined very closely with evolution of political economy in the regions of Bihar and Eastern UP.

“That Bihar is now often described as being steeped in tradition and backwardness is a complete reversal of the reality. What the region is actually mired in, as Phoolsunghi so brilliantly shows, is not ‘tradition’ but rather a particular iteration of colonial modernity, one that followed the imposition of an entirely new and thoroughly modern industrial system centred upon the production of opium. What is truly staggering to contemplate, however, is that the upheavals caused by the opium regime, which profoundly altered the lives of millions of people, and shaped my family’s destiny, were not dictated by any local or regional imperatives. They were rather the unintended consequences of the ongoing, centuries-long relationship of conflict and competition between two foreign powers located at the far ends of the Eurasian landmass—Great Britain and China.” - Amitav Ghosh, Smoke and Ashes, Pg. 96

The deep insecurity within Biharis has fostered a caste – centred political hara-kiri, more so since 1980s, captured with precision in a recent article in the Economic Times.

“Understanding the significance of growth and development and how some states are shaping divergent destinies over time is imperative. Therefore, this essay outlines the contrasting growth and development experiences of two states -- Bihar and Odisha. Over the last 40 years, these historically impoverished states have undergone contrasting economic experiences. While Bihar has consistently ranked as the most impoverished among large states in recent decades, it was not historically the case. In 1991, Odisha was even poorer than Bihar. Therefore, it is apt to compare and contrast the experiences of the two poorest states regarding what was achieved and what was lost in the last four decades. For this purpose, the last four decades have been divided into three epochs: 1980 to 1991 (before the economic crisis), 1992 to 2002 (emergence of caste politics, economic reforms and division of states) and post-2002 (growth and development).

1980 to 1991

In 1980, Bihar was the poorest large state, with a per capita GDP (2015 prices) of ₹12,553, while Odisha's was ₹17,256, a gap of almost 37%. However, Bihar's average annual per capita GDP growth rate during this period was robust at 5.1%, while Odisha experienced a slower growth rate of 1.4%. As a result of the high growth rate in Bihar during this decade, by 1991, Bihar's per capita GDP surpassed that of Odisha. It was ₹21,282 in Bihar, while it was ₹20,591 in Odisha.

1992 to 2002

Even though Bihar, compared to Odisha, entered the epoch with a higher per capita GDP, this period witnessed a dramatic change in the fortunes of the two states. Caste politics and lawlessness led to an unprecedented reversal in Bihar's average annual growth rate, dropping from +5.1% (1980-1991) to -0.6% (1992-2002). Conversely, Odisha doubled its growth rate from 1.4% (1980-1991) to 3% (1992-2002). This divergence resulted in Bihar's per capita GDP plummeting by almost 33%, from ₹21,282 (1991) to ₹14,209 (2002). In contrast, Odisha experienced a 31% increase, growing from ₹20,591 (1991) to ₹26,881 (2002). Caste politics, poor governance, and lawlessness pushed Bihar behind Odisha, widening the per capita GDP gap from +3.4% (1992) to -47% (2002).

Post-2002

The state's economic fortunes somewhat reversed following a shift in Bihar's political landscape from caste politics and lawlessness to a focus on agriculture and women's well-being. Post-2002, Bihar's per capita GDP experienced an average annual growth rate of 5.6%, increasing from ₹14,209 (2002) to ₹37,050 (2019), a 161% rise. Odisha saw a 4.7% average annual growth rate in the same period, leading to an increase in per capita GDP from ₹26,881 (2002) to ₹86,287 (2019), a 221% growth. By 2019, Odisha's per capita GDP was 130% higher than Bihar's.

Recent political shifts in Bihar towards caste politics away from economic growth, serve as a reminder of the repercussions. Reflecting on the 1992-2002 period emphasises the enduring costs on the weaker sections, women, and socially backward groups. Caste politics and misgovernance persist as longstanding problems, not solutions to economic and social backwardness.” - Shamika Ravi, The Economic Times, Dec. 16, 2023

Available income and expenditure data seem to indicate that residents of states like Orissa and Purvanchal also have improved their economic lot significantly in the last decade. Madhya Pradesh and Rajasthan are no longer considered among BIMARU states.

In almost every Indian state other than Bihar, in recent decades, consumption of high-value and sophisticated goods and services has been increasing more rapidly compared to in case of lower value items. When we in Chanakya advertise for the position of analysts, rarely we come across one from a

Bihari – among the hundreds of applications every time we receive! Bihar remains frozen to its past Centuries.

It is my conjecture that slow rate of economic progress in Bihar, and similar regions elsewhere in India, have stunted demand for sophisticated goods and services. In my estimate, population of their regions currently could be around one-third of the Indian population. In my opinion, this could partly explain the demand deficits encountered in India by MNCs. No wonder that the likes of the Citibank as well as leading private banks in India chose to focus on the top 10–20% of the Indian consumers, till very recently.

Genesis of the backward caste movement in India

“In such a situation where funds were scarce, both educational institutions and the manufacturing classes became history, leading to grave consequences. Literacy and knowledge among the Indian people were seriously affected. The traditional Indian social balance, in which persons from all sections of society appear to have received a significant degree of schooling, was also destroyed. This destruction, along with the concomitant economic plunder, led to great deterioration in the status, socio-economic conditions and personal dignity of those now known as the scheduled castes. To a lesser degree, the peasants (largely, today's backward castes) were also affected.

Towards the end of the nineteenth century, various factions did begin to attempt a reversal of the results of British policy. This led to what are now termed as backward-caste movements. What is important to note is that the backward status they were struggling against was not an ancient phenomenon, as usually depicted. Their cultural and economic backwardness (this is, of course, distinct from their status in religious rituals on specific occasions) is post-1800, and what all such movements are basically attempting to achieve is the restoration of the position, status and rights of these people prior to 1800.”
- R. Vaidyanathan, Caste as Social Capital, Penguin Books, Pg. 20

Mr. Vaidyanathan attributes the genesis of the backward caste movement to a fight – back by the people crushed by an extremely exploitative British rule in early 1800s. The mind of the State of Bihar remains under that spell till date, why?

My recent discussions at a grocery store at Buddha Colony, Patna, November 15, 2023

Buddha colony is an up-market residential area in Patna, and has emerged as the ‘Kota’ of Bihar for coaching for engineering and medical tests. In early November 2023, at a grocery store near my home there, I tried to dissuade a teenager and a retired Deputy Superintendent of Police from buying of Rajnigandha, a leading brand of Gutkha. In the course of our discussions, I had quite a few revelations from these two persons and the owner of the store, as summarised below.

1. *“This store sells ₹1,00,000 worth of cigarettes and Gutkha in the Buddha colony every week. Total sales of all other items is around rupees 40,000 per week.*
2. *25% of sale of Gutkha is of Rajanigandha, the pricier variety at the rate ₹20/packet. 75% of sales is of lower – end Gutkha, priced at the rate ₹5/packet. Overall, Rajnigandha and lower – end Gutkha account for 50% each of the total sales of this grocery store.*
3. *People here get addicted to these items very young, having watched their father do that. They find it very difficult to give up a such addictions later in their life.*

4. *This store-owner generated initial capital by selling these addictive items and vegetables. Later on, he decided not to sell these items like Gutkha and cigarettes. However, his customers moved over to other nearby shops selling these items, which was at the cost of his revenue. Then his father decided to continue selling Gutkha and cigarettes, but not to exhibit these up – front.*
5. *Most of such customers now own house there. Consequently, their overall monthly expenditure is quite low. They lack any other avenue to keep themselves engaged, and hence end up consuming these addictions.”*

40% of the disposable income spent at the grocery store is being spent on Gutkha in a posh colony in the capital of the state of Bihar! This state doesn't need Fentanyl!

In usual course, this money should have been used for consuming sophisticated products offered by MNCs. Partial empirical validation of my conjuncture, perhaps!

Government cannot solve every problem. I believe that by now residents of Bihar and Eastern U.P. ought to have become aware of growth and underlying processes, post – 1992, in other states of India. In a way, the 2024 general election in Bihar would tell us about level of awareness of *all* this, and also thought process of the Indian society we keep on discussing in our newsletters. We will find it out in four months. If Biharis vote rationally in this Election, we would see a new “Moment” of development of India, outshining all the “Moments” we talked of in our previous newsletters. Else, one may have to remain patient till next rounds of election in Bihar.

Social trust underlies globally competitive business organisations.

“In his work, Fukuyama examines a wide range of national cultures in order to better understand the underlying principles that result in social and economic prosperity. His contention is that we cannot divorce economic life from cultural life and that in an era when social capital is as important as physical capital, only those societies with a high degree of social trust will be able to create the flexible, large-scale business organizations that are needed to compete in the new global economy.”- R. Vaidyanathan, Caste as Social Capital, Penguin Books, Pg. 53&54

While diversity in opinions is a sine qua non for creativity, excessive fissures in societal structures often impede social cohesion and thereby economic growth. Over many decades, I have witnessed gradual decline in quality and level of cultural activities in my home state of Bihar. Media coverage of mass – scale copying in exams, with parents perched on high walls of exam centres, reflects a high-level of economic desperation in the Bihari society. Near – stagnation in industrial activities in Bihar has been a direct outcome of the state of affairs there.

“If AI can explore a full hypothesis space, and even enlarge the space, then it may show that humans have only been exploring small areas of the hypothesis space, perhaps as a result of their own scientific biases,” says Dr King.” - Sep 13th 2023, Science and Technology, Robot scientists, The Economist

Seemingly irrelevant in the context of all we have been discussing here about Bihar? I'm not in the business of psephology, but I choose to be optimistic on this count in light of my various field trips covered in previous newsletters. Hopefully, Bihar will enable India to attain 7% + rate of growth in GDP for a few decades in the future.

Or, is it possible that a better quality and dedicated set of politicians may change the growth hypothesis for the state of Bihar and its residents. Technology, including AI, can facilitate such a growth. Bihar has

progressed well in respect of electricity, roads, mobiles, and inward remittances. It needs imagination and execution to put itself in higher orbits. As of now almost every MFI in India thinks Bihar to be their best areas.

Market forces, seen along with perceptive bank management, seem to have made mass – banking also an attractive business for the financial institutions, FIs, in India. In the future, hopefully a similar transformation would be seen in a case of other services and products, especially in regions like Bihar.

Access to formalized capital to small borrowers in India

“All this has happened because borrowers have become more sensitive to compliance.” – Our recent discussions with a lending officer of HDFC Bank

Increasingly, we see a lot of feet – on – the – street in case of various service – providers in India. Even a conservative bank like HDFC Bank has now become a lot more open to SME and unorganised sectors very interestingly, recently Mr. Thyagarajan, the founder of the Shriram group, observed:

“The Shriram Group will need to shift its focus from its mainstay lending business to insurance amid tighter regulation and rising competition from banks, said R. Thyagarajan, who founded the financial conglomerate as a chit fund nearly half a century ago.

(If) I’m looking at a 10-year scenario, diversification into other financial services (is imperative). In the next 10 years, more bank funding will come into the commercial vehicle (CV) financing segment and NBFCs’ (non-financial banking companies’) CV business will come down. Banks will provide 80% of the credit requirement of the industry, and NBFCs will be down to 20%. In the next 15 years, it will further come down to 5%. We should focus on diversified enterprises as they will become important for us,” Thyagarajan, 86, said in an interview.

“Financial resources of the banking industry are massive and non-banks, minuscule. Therefore, non-banks have been operating in segments where banks were not active. As and when banks move into this space, non-banks have to restrict their operations. As more funds from banks move into CV financing, non-banks will have to play a smaller role,” Thyagarajan said.

Financing small businesses and individuals comes with risks, but regulators view bad loans with disdain, and the current regulatory environment does not encourage entrepreneurship, Thyagarajan said.” – Gopika Gopakumar, Mint, Dec 2023.

In light of demonstrated lending track-record of the small finance banks, now also the larger commercial banks have begun increasingly lending to borrowers lacking formal accounts. NBFCs have to become innovative in distribution and under-writing. Recent alignment of NPA norms between NBFCs and commercial banks has accelerated this process. Also, partial credit – guarantee, by means of CGTMSM scheme of the Government of India launched during the COVID-19 phase, has led to even leading private banks to get a feel and launch robust business models to lend to the unorganised – type borrowers.

“If the current era, a financial institution has to be either too big or nimble – footed.” – CEO of a small private bank in discussions with us

We could not agree more. In fact, even a large FI, has to be meaningful nimble-footed. We also believe that size is going to be a significant competitive lever for any FI in India in the long – term. Lack of size

hamstrings a FI from attracting and retaining quality resources, including a tech – savvy CEO, credit professionals and relationship officers. Your investment portfolio remains quite alert to this.

Portfolio Composition and Risk

In our portfolios, top 10 stocks accounted for 63.32% of the total investment. The overall sectoral break-up of our investment portfolio is given in Table 1.

Table 1: Chanakya PMS - Portfolio Sectoral Allocation as on December 28, 2023

Sector	Allocated Portfolio %
Banks & NBFCs	46%
Holding Companies	13%
Metals & Minerals	8%
Industrials	7%
Auto & Auto components	7%
Consumer Goods	2%
Logistics	2%
Others	15%

Source: HDFC Bank Fund Accounting

Compared to sectoral allocation at the end of August 31, 2023, percentage invested in Metal and industrials increased 1% by each. Percentage invested in holding companies has decreased by 2%, we don't churn our portfolios. The aforesaid shifts in portfolio allocation are largely reflective of price movements of various shares in our portfolios, or re-balancing for maintaining risk limits for specific stocks.

Overall Performance of the Chanakya PMS compared to Benchmark

Over the last financial year, the overall performance of our investments portfolios is given below in Table 2.

Table 2: Chanakya PMS - Investment Performance as on December 28, 2023

Period	Portfolio (In %)	Nifty 50 TRI (In %)
1 Month	7.02	9.50
3 Months	10.15	11.75
6 Months	20.93	15.37
1 Year	34.27	21.45
2 Years	24.75	13.76
3 Years	28.17	17.61
5 Years	18.96	16.30
Since Inception (13.08.2018)	16.84	14.06

Source: HDFC Bank Fund Accounting

Consciously, we have chosen to invest in shares of select holding companies of some of the finest market leaders in India. While prices of underlying shares have improved considerably in recent period, prices of the shares of the holding companies in your portfolio continue to be quoting at discount of 50–75% to the respective underlying values. We believe that over time, discounts may be expected to come down significantly, resulting in considerable boost to NAVs, and return on year investment portfolios.

The above performance figures help to validate our investment process. Our endeavour is to provide to a high absolute return, within reasonable risk limits. Bench– mark is a statutory requirement, and also meant for your convenience of comparison. We focus on a right set of investing companies, hopefully to keep on adding to your prosperity over many decades in the future.

With best regards,

Rajesh Tiwari

Wishing you a fulfilling 2024

Gautami Desai and Team Chanakya

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