Why India Beats China Hollow On Consistent Compounding

By Saurabh Mukherjea, Omkar Sawant & Nandita Rajhansa

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Amongst emerging markets, India and China have produced the greatest number of consistent compounders – companies that have delivered 10% year-on-year revenue growth and 10% return on capital employed consistently over a decade. However, not only does India produce more consistent compounders than China, but Indian consistent compounders have also delivered more than twice as much shareholder return as their Chinese counterparts. In ...

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Quantifying Indian Versus Chinese Consistent Compounding

As is well known, not only have emerging markets grown twice as fast as developed markets over the past decade, China and India have been the fastest-growing emerging markets if measured by growth in real gross domestic product over the past decade.

Unsurprisingly, therefore, when it comes to producing consistent compounders, India and China are head and shoulders ahead of any other emerging market.

What is more intriguing, however, is that although China's economyis 5x larger than India's, India has produced significantly more consistent compounders than China.

Even more intriguingly, the Indian consistent compounders have compounded their share prices more than twice as fast as their Chinese counterparts – 26% versus 10%.

Moreover, if we just apply 10% revenue growth filter and 10% ROCE filter each at a time (rather than simultaneously applying the two criteria – as has been done in the preceding exhibit), we get a similar conclusion, i.e., India and China stand far above other emerging markets and the Indian companies significantly outperform the Chinese companies in terms of shareholder returns.

India produces more consistent compounders than China and the Indian consistent compounders compound almost three times as fast as the Chinese ones.

Not only do the Indian consistent compounders outperform the local stock market far more comprehensively than their Chinese counterparts, at a broad index level basis, but the Nifty50 Total Return Index has also outperformed Shanghai SE Composite TRI on 1, 3, and 5-year CAGR basis.

So why do India's consistent compounders perform so much better than China's? What underpins this consistent superiority both in underlying fundamentals and in share price performance?

Polarisation Of Profits Is Far More Pronounced In India Than China

Whilst we do not know exactly what is happening in China, what we can see from the data available for market-leading Chinese and Indian companies is that the polarisation of profits (share of the country's profit after tax accruing to the top 20 PAT generators) has been far more rapid in India than in China, as the first chart in this column shows.

As shown in the first chart and this most recent table, the share of PAT accounted for by the top 20 PAT generators in India is: (a) twice the level of their Chinese counterparts; and (b) has almost doubled (from 45% to 85%) the past ten years.

These data-points raise two questions:

- Why has corporate profitability in India polarised in such a dramatic manner; and
- Why has corporate profitability not polarised in China?

Focusing on the second question, one possibility that exists is that in China economic growth has been so broad-based that smaller companies have grown faster than the top 20 PAT generators. However, we don't have in-depth knowledge about the Chinese economy to be able to address this issue in a competent manner.

Focusing on a), the rise in corporate profitability of India's top 20 PAT generators has been underpinned by the drivers of polarisation, which are rippling through the Indian economy. For example, over the past ten years, the length of roads in India has increased from 3.3 million kilometres to 5.9 million kilometres (CAGR of 6%). The number of mobile phone subscribers has increased over the same period from 392 million to 1161 million (CAGR of 12%). The number of broadband users has increased from 6 million to 563 million (CAGR of 57%). A decade ago, around 44 million Indians were taking flights each year. Now 3x as many Indians are flying each year (CAGR of 13%). 15 years ago, only 1 in 3 Indian families had a bank account; now nearly all Indian families have a bank account.

As a result of this networking of the Indian economy, efficient companies with strong distribution systems have pulled away from regional and local players. For example, as the economy gets integrated, lending, which was once dominated by regional players is now seeing

the emergence of a few national leviathans like HDFC Bank and HDFC with both lenders entering the list of top 20 PAT generators over the last 10 years.

The global dynamic is the rise of affordable, easy-to-use enterprise technology which if implemented increases profit margins, reduces working capital cycles, and increases asset turnover. India's best compounders are using such technology to create wealth for their shareholders.

Implications For Investors

Our research suggests that whilst China is the only other emerging market to rival India in producing consistent compounders, India's consistent compounders mightily outgun their Chinese counterparts—both on fundamentals and on share prices—due to their ability to use the changes taking place in India to build dominant positions in the Indian market.

Saurabh Mukherjea, Omkar Sawant, and Nandita Rajhansa are part of the Investments team at Marcellus Investment Managers. Saurabh Mukherjea is the author of 'Diamonds in the Dust: Consistent Compounding for Extraordinary Wealth Creation'. HDFC Bank is a part of many Marcellus portfolios.

The views expressed here are those of the authors and do not necessarily represent the views of BloombergQuint or its editorial team.

Data Notes:

For ***Three-Year Moving Average Ratio Of PAT Of 'Top 20 Listed Companies / PAT Of Listed Corporations'***

Listed companies' PAT used for both countries because data for PAT for unlisted companies was not available for China.

For ***Number Of Consistent Compounders By Country***

* (a) the underlying time period for this analysis is 2010 to 2021 (E.g., A 2010 CC is identified by clearing the filters from 2001 to 2010); (b) financial services companies have been excluded from this analysis; and (c) there are some CC companies which appear in multiple years and therefore the total number of unique CCs is lower than the figures given in the first column of this table.

** (a) The year of identification is the first year in which the company passes the CC criteria of 10% revenue growth and 10% ROCE (10 years in a row); and (b) All returns are in dollar terms. ^None of the Brazilian companies passed the CCP filters for the period under consideration.

Source: Marcellus Investment Managers. Reuters data used for all countries except India. For India, data from Ace Equity is used. Consistent Compounders filtered on 10% YoY Revenue Growth & 10% ROCE criteria for the past 10 years. Consolidated data taken wherever available.

For ***Companies Consistently Delivering 10% YoY Revenue Growth***

* (a) The underlying time period for this analysis is 2010 to 2021; and (b) financial services companies have been excluded from this analysis.

** (a) The year of identification is the first year in which the company passes the criteria of 10% revenue growth per annum (10 years in a row); and (b) all returns are in dollar terms.

Source: Marcellus Investment Managers; Reuters used for all countries except India. For India, data used is from Ace Equity. Consolidated data taken wherever available.

For ***Companies Consistently Delivering 10% ROCE***

* (a) the underlying time period for this analysis is 2010 to 2021; and (b) financial services companies have been excluded from this analysis.

** The year of identification is the first year in which the company passes the criteria of 10% or more ROCE (for 10 years in a row); and (b) all returns are in dollar terms.

For ***Nifty 50 Versus Shanghai SE Composite Index***

* TRI was not available for Shanghai SE Composite Index and therefore, the CAGR calculated is on adjusted close prices.

** All share prices are for the trading date ending Oct. 29, 2021, and all share prices are in dollar terms.

For ***Percentage Of Total Profit Generated By Top 20 Companies In FY20***

*All share price returns are in dollar terms.

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