

## RESEARCH NOTE

# The Adani Saga Delivers a Reality Check to India's Economy

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## Executive Summary

**Turmoil in Adani Group came as sentiment over the investment outlook in India was at an all-time high**

**Adani's sheer scale and linkages across the Indian economy raise concerns**

**Indian authorities have yet to get directly involved, but pressure to support the conglomerate's investment targets will grow**

**The crisis raises fundamental questions about India's economic model**

## Background and Context

The years following the start of the Covid-19 pandemic were a bullish time for India. With China seemingly mired in its zero-Covid policy, India seemed like the growth bet for global investors. Perhaps more important than the pandemic, or at least more enduring, was the sense that China was entering a period of geopolitical confrontation with the West. Increasingly, Western capital and technology were much more likely to find a safe harbor in India than in China.

In November, Morgan Stanley made headlines by predicting that India's GDP would more than double from \$3.5 trillion to over \$7.5 trillion by 2031.<sup>1</sup> In private, many investors shared their skepticism with us about these figures. But the public mood was supportive, and there were also those simply hoping to ride the Indian wave until at least the first signs of trouble.

What surprised the skeptics was the lack of interest in the destabilizing effects of rapid growth. Could India be the exception to the boom-and-bust cycles so often repeated in recent decades among fast-growing Asian economies? It is true that over the past few years, India has studiously avoided the problems affecting many of its neighbors, but part of the explanation was that growth had until recently remained moderate. There was safety in caution, but that period had now ended, with almost everyone converting to the narrative of India as "the new China." Shares in the main Adani Group companies gained 706.95 percent on average in the three years before the current crisis, a clear indicator of unsustainable dynamics.

After Hindenburg Research, a New York-based short seller, published an explosive report in January accusing the Adani businesses of engaging in “brazen stock manipulation and accounting fraud,” the conglomerate was forced to call off a share sale. Despite some rebounding, the stock is still down some 45 percent since January 24, while Adani Group companies have lost over \$120 billion in market value. Recent reports suggest the conglomerate may be forced to halve its revenue target for the next fiscal year to 15-20 percent, down from an earlier 40 percent growth target.<sup>2</sup> The group will likely also be forced to pay a \$500 million bridge loan due in March, with global banks intent on reducing their exposure.

## Key Issues

### ADANI AND THE INDIAN ECONOMY

Over the past decade, Adani Group has taken on a central role in almost every sector where India needs large-scale investment or has made strategic bets to move up the global value chain. The conglomerate has a significant presence in airports, ports, power and cement. It has invested in renewables, semiconductors, healthcare, data centers, and even the development of a homegrown defense sector. National champions are now driving policy to a remarkable extent. India's five or six leading billionaires have pledged to spend more than the government on the country's energy transition, but Adani Green Energy is seen by the financial analysts we have consulted as the weakest of the group's companies.

Adani Group has expanded globally in sync with India's foreign policy priorities. Adani Ports, for example, has ventures in Israel and Sri Lanka. Now, thanks to the group's travails, an Indian plan led by Adani Power to provide electricity to Bangladesh may reportedly be delayed.<sup>3</sup>

The conglomerate's scale and deep linkages across the Indian manufacturing and industrial sectors make any retrenchment in investment a warning sign for the entire economy.

## What's Next

For emerging economies, bouts of fast economic growth are not an unalloyed good. An economy needs the right control mechanisms to prevent unsustainable bubbles, misdirected investment, conflicts between incumbents and new investors, currency and stock market crises, and unsustainable levels of debt, among other ills. Simple narratives of the kind seen in recent months arguably make things worse. Above all, the case of India continues to raise two main questions, to which we see no clear answer. First, is a country accustomed to decades of slow growth ready for the very different set of challenges posed by an economic takeoff? Second, what control mechanisms are available? India cannot boast either the competitive dynamics of a free market or the guidance of a strong party-state. Both models have their failings, but the absence of any mechanisms at all is likely to be worse.

As the commentator Mihir Sharma put it, “the development model we have now chosen requires risk-taking ‘national champions’ such as the Adani Group.”<sup>4</sup> The question is whether Gautam Adani will bring down India's economic narrative along with him. The Adani crisis is raising new doubts about the soundness of Indian economic institutions and their ability to keep a necessary distance between business and politics. Indian authorities are finding no good options in dealing with the troubled conglomerate. If they stick to the hands-off approach adopted so far, the decline in Adani's fortunes may spread to the larger economy; if they step in, accusations of cronyism will discourage foreign investment. We regard this as

the variable to watch as the Adani saga continues to unfold.

Adani himself is perceived to be close to the government of Narendra Modi. In a recent speech in the Lok Sabha, opposition leader Rahul Gandhi argued that Adani Group owed its meteoric rise to its connections to the ruling BJP. "Since the group is entrenched in India's strategic businesses, the allegations of fraud against it is a national security matter," he said.

Adani Group ratcheted concerns still higher when it described the short seller report as "not merely an unwarranted attack on any specific company but a calculated attack on India, the independence, integrity and quality of Indian institutions, and the growth story and ambition of India."

<sup>1</sup> <https://www.morganstanley.com/ideas/investment-opportunities-in-india>

<sup>2</sup> [https://www.business-standard.com/article/companies/adani-group-cuts-growth-target-capex-in-post-hindenburg-repair-moves-123021300067\\_1.html](https://www.business-standard.com/article/companies/adani-group-cuts-growth-target-capex-in-post-hindenburg-repair-moves-123021300067_1.html)

<sup>3</sup> <https://www.thehindu.com/news/national/as-adani-group-faces-market-storm-indias-neighbours-watch-closely/article66471466.ece>

<sup>4</sup> <https://www.bloomberg.com/opinion/articles/2023-01-26/adani-short-seller-accusations-won-t-faze-indian-investors>