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India's economy: Why the time for growth is now

The driving forces of the country's growth—including urbanization, a rising middle class, and increasing consumer spending—are ripe for companies to seize upon.

India stands to become one of the largest growth engines in the world, according to research in a new McKinsey Global Institute (MGI) report, *India's ascent: Five opportunities for growth and transformation*. In this episode of the *McKinsey Podcast*, McKinsey senior partners Noshir Kaka and Alok Kshirsagar and MGI partner Anu Madgavkar talk with McKinsey's Cecilia Ma Zecha about the way forward in a growth- and productivity-powered India.

Podcast transcript

Cecilia Ma Zecha: Hello and welcome to this edition of the *McKinsey Podcast*. I'm Cecilia Ma Zecha, an editor with McKinsey Publishing in Singapore. Twenty-five years ago, India embarked on a journey of economic liberalization, opening its doors to globalization and market forces. The IMF [International Monetary Fund] expects GDP to grow more than 7 percent this year, making India the world's fastest-growing large economy. Powered by a rising middle class that's expected to more than triple to 89 million households by 2025, India has an attractive long-term future and compares favorably with other emerging markets.

What’s the road ahead? Our guests today are Noshir Kaka, a senior partner in McKinsey’s Mumbai office, and Anu Madgavkar, a partner of the McKinsey Global Institute. They are the authors of a new MGI report on India’s ascent, which outlines five opportunities for India’s growth and transformation. Also joining us to look at the implications for domestic and multinational companies is Alok Kshirsagar, a senior partner and leader of McKinsey’s Asia Risk Practice. Welcome, everyone. Noshir, let me start with you. What is the road ahead for India’s economy?

Noshir Kaka: Thank you, Cecilia. First, as you outlined, we are in an exciting time for India and companies in India, both multinational as well as domestic. India’s going to be the third-largest incremental GDP growth engine for the planet by 2030. That’s significant if you think about India’s size relative to the other massive geographies out there, like China or the US.

What’s powering that growth is two or three things that are pretty unshakable. First is the trend toward urbanization, which is going to increase consumption power massively, as well as economic leverage. The demographic changes that India’s going to go through are, again, unshakable and undeniable. But I think powering those two or three things, along with changes in the way the government is functioning as well as changes in technology, are ensuring that this growth engine has several more cylinders than the few that we used to originally think about.

That doesn’t mean that this growth is going to be without air pockets. India is very dependent on external factors, such as monsoons for agriculture and external investment. But the underlying trends are undeniably positive to make this one of the largest growth engines for the world. If you think about the state we are sitting in today, Maharashtra, if it were a country, it would be the 17th largest country in the world, in terms of population, just behind Germany.

Cecilia Ma Zecha: Alok, what are the opportunities that you see for domestic and multinational companies, given that India has so much to work with, as Noshir said?

Alok Kshirsagar: This is an extremely exciting time for leaders and entrepreneurs in India. If you look at the most successful companies, they have grown vastly ahead of average GDP growth. The best companies in India grow at 25 to 30 percent a year. Some of the best banks in India have grown north of 20 percent a year for 20 years in a row.

This is the bit that, when you look at traditional companies whether domestic or global, they miss the fact that India grows in jumps and spurts. When you get your business model right, because so much opportunity exists—whether it’s in terms of low penetration levels of financial services or low penetration levels of healthcare and other services—when you start to get your business model right, you grow at 25 or 30 percent, not just 7 percent. There’s a huge underlying tailwind for all the reasons Noshir talked about. But if you’re good, you can do two and three times that.

Cecilia Ma Zecha: And Anu, what’s your perspective on India’s growth and transformation? Is it at a particular inflection point?

Anu Madgavkar: India’s growth is at an inflection point. This is something we will see pan out over the next 10 to 15 years. One of the core structural drivers of that growth that Noshir talked about, which was urbanization, is coming to a tipping point—back to the notion of an inflection point.

If you look at data across India, it’s clear that when urbanization rates in districts or in states cross the threshold of about 35 percent, that’s when we start seeing productivity benefits kick in. You see higher GDP per capita because the dense cities and urban centers suddenly get better connected with the rest of the world and better connected to markets. Citizens have better access to education, health, and so on.

What’s happening for India as a whole is that the urbanization rate will cross this threshold for us as a country over the next 10 to 15 years. For some of the largest states, we will get as much as 50 to 60 percent urbanized by 2030. That’s what’s driving the fact that our states are as large and will be as large as very significant middle-income countries are today. For example, Maharashtra plus Gujarat will look like Brazil.

The Indian policy framework today is to empower the states more and to decentralize decision making for funding, so you will see dynamic and vibrant states almost competing with each other for resources and being much more open to investment. Businesses, therefore, will have to pick and choose in terms of thinking about their footprint in India.

Noshir Kaka: The growth story is evident in the number itself, which is 69 megacities, essentially each with a million-plus population. What most companies struggle with is that India is not a country, it’s a continent. All of these cities in their own right are almost like mini countries. Getting down from the massive India to just 69 cities is a great simplification when people think about India and their strategies to address this market.

If I said, "Well, conquering India is just about getting 69 destinations right," it makes the opportunity much more meaningful. As Anu said earlier, in the MGI work, we've seen that these will cities power a significant portion of GDP growth. If you get these cities right, you can capture a tremendous amount of opportunity in India.

Cecilia Ma Zecha: How can the private sector develop the right business models and strategies to address the opportunity of urbanization, Alok?

Alok Kshirsagar: There's a huge consumer opportunity. Because, to Anu's point, as you get to that 35 percent, the actual per capita GDP on that particular district more than doubles. So, there's a huge consumer opportunity that the private sector needs to recognize.

To amplify Noshir's point, some of the demographics are very different. When you go down south, the demographics are more like southern Europe. You need to know that the consumer growth there is in the relatively older population. It's the 50- to 70-year-olds that have the purchasing power because of various reforms and government payments. Whereas if you go to the northeast of the country, it's all in the young—it's all in the 18- to 30-year-olds.

Going back to this theme that there are regional business models with different consumer preferences and a big inflection point: there's a huge amount of success associated with that. And, frankly, your ambition needs to be, "I need to grow at 30 percent a year." If you're not growing at 30 percent a year, you're missing the opportunity.

The second big opportunity with urbanization is in infrastructure. With the competition among state governments for resources and an increasing focus on governments as a big part of winning elections, people recognize that you have to improve infrastructure. That is everything—from water, sanitation, power, renewable power, and improving road systems.

There's a huge opportunity for both domestic and global companies in the provision of that infrastructure—often, leapfrogging generations of what's happened elsewhere through the use of smart meters, smart technologies, and networked cities. To me, that's a huge, relatively untapped opportunity.

We see that with the Smart Cities competition. Now there are 20-plus of these smart cities where there's enormous innovation. One city we're involved with is Pune, where you can see—whether it's in terms of creating citizen engagement or associated infrastructure services—there is a huge private-sector opportunity.

Cecilia Ma Zecha: Speaking of networks, being connected, having the right infrastructure, and smart cities, can you all comment on the advance of digitization in India and how companies and decision makers can harness the opportunity that digital technologies can offer?

Noshir Kaka: For many years, when you talked about digital and technology in India, one automatically referred to the tech sector that traditionally has been the sector that served companies globally, out of India, on their technology needs.

That industry went from something like $2.5 billion in the late ‘90s to more than $110.0 billion today. It‘s been a huge force multiplier in India‘s GDP growth. It created almost 50 percent of all organized jobs in the past five years in India, that one sector.

What we see now as the opportunity for the digitization of India is almost five times that opportunity. As large as that opportunity is—the opportunity to use digital and technologies to enable India's growth in education, agriculture, and power, and as Alok talked about, smart metering and transmission sectors—that is almost five times. That will be between 20 to 30 percent of India's incremental GDP growth. That's why I think the prime minister's launch of Digital India, Startup India, and the Skill India campaigns around some of these technologies is so important.

Because the reality of this is that it's going to be another one of those major engines that transforms India. Just to give you a simple example, India will never produce as many doctors as it needs—never. It's just physically impossible if you looked at any healthcare statistics to get to the number of doctors in rural India that the population really needs.

Today, with technologies including remote-healthcare technologies and call-in numbers where you can diagnose simple remedies in five to ten questions, you're able to save lives in remote parts of the country. That's the change it's making. It's not just an economic change but a huge sociological and human change as well.

Cecilia Ma Zecha: Anu?

Anu Madgavkar: Globally, there are some concerns about how automation and technologies more broadly are impacting the labor market or the ability of middle-skill or lower-skill workers to increase incomes. Because automation, in a way, is eroding the job market.

India comes at it from a different perspective: with the amount of inefficiency and the barriers to the delivery of some of these services to people, on the one hand, and on the other hand, the fact that a large share of the labor market is in the informal and unorganized sector. You put these two things together, and you find that many of these digital platforms—which again, we are very much at an inflection point—we're going to see them getting near ubiquitous in many ways; for example, the ability of everyone to have a smartphone that has some form of digitally verifiable identity and payments. That is such an empowering tool, that even from a labor-market perspective, we would see innovation in the form of online talent marketplaces for relatively medium- or even low-skill jobs—informal jobs in the security business, driver jobs, independent small operators, and entrepreneurs—just having access to markets because of these online marketplaces.

From where we come from, it's a massive leapfrogging opportunity from almost every perspective. It's also inspiring innovation that could have applications and relevance outside India as well.

Alok Kshirsagar: I'll build on that with two comments. One is, I think there have been some fundamental regulatory or policy transformations over the past two years under the current prime minister. First, and most important, is the passage of the goods-and-services tax, which is going to create an integrated market in India for the first time. It's a value-added tax regime, which is going to dramatically reduce all of the inefficiencies and barriers within the internal market.

Frankly, we see that as a massive fillip as far as global companies are concerned, because now your ability to drive intelligent transportation networks, fast logistics, and the delivery of services is dramatically transformed. The second big part of this is around the financial infrastructure, such as the provision of what they call the *Jan-Dhan Yojana*,[1] which is 100 million-plus bank accounts enabled by mobile phones.

And the provision of benefits transfer directly to people's bank accounts, using their mobile phone and the *Aadhaar*[2] unique identifier. It's a unique platform—there is no other country in the world that has this scale of mobile-driven bank accounts with the ability to transfer money and services directly to the beneficiary without all of the leakages that have plagued the sector for many, many years.

Cecilia Ma Zecha: What about manufacturing? India's manufacturing sector has lagged behind China's, but there are substantial opportunities to invest. What's the appeal to potential investors as a base, certainly beyond low-cost labor? And how can the companies in the manufacturing sector be as competitive as possible?

Noshir Kaka: First, to two of the points Alok made earlier, there has been a fundamental shift in the past few years in India: just to pick up on one, there is the goods-and-services tax that was passed by parliament a few weeks ago. Not only does it create enormous advantages in logistics and taxation, and a whole bunch of other benefits around that, but it dramatically enables manufacturing in the country. Because, historically, manufacturing was splintered and fragmented across the country based on where you got the tax break or where there was advantage. It was not economically or geographically the best place to manufacture something.

There were quite hilarious consequences where, essentially, shipment of goods—let's say 400 kilometers hinterland into India to the port—was more expensive than taking a container from that port to Brazil. That is the kind of complexity that India's logistics networks, enabled by local state taxes, was creating.

With one landmark amendment, you have production sites that can scale—and scale not only for the domestic market but also, as China has done, for the international market. Now, for the first time, you have a single market, unified across the country, which has a billion-plus consumers ratcheting up their spending, along with the fact that you can get efficient logistics to serve international markets. That's never happened before.

The second thing is, and I think this is where India will be different from China and many of the countries that have jumped on the manufacturing opportunity to expand, is that India's manufacturing opportunity will be different. By the nature of where we live and the times we live in, it will be more technologically enabled.

It may create different types of jobs. It may not create that many physical jobs, as China has done. But there's a whole slew of other jobs it will create. For example, when Anu and I were researching the Internet report, we came back with this notion of a technology enabler. What it simply meant was that in villages in India you don't have that many people who are able to use the Internet, or able to use digital technologies, whether it's for healthcare, education, or a whole bunch of purposes.

We found that banks and other companies were having somebody stand next to a kiosk, just showing people how to use it. Yes, those jobs will be transient for a particular period of time. But those transient jobs are massive in India. Because you have a population of more than one billion. You'll see different types of opportunities. With some of the landmark legislation, you'll see a huge opportunity in manufacturing opening up both domestically and globally.

Alok Kshirsagar: I would also say it's a favorite pastime here to compare with China. I think it's irrelevant, because the real opportunity is, as Noshir said, in the domestic market. The second thing is that there are already world-class manufacturing capabilities in India. If you look at auto components, if you look at pharmaceuticals, if you look at aspects of—

Noshir Kaka: Textiles.

Alok Kshirsagar: Textiles, you actually have those. The real question for us is not whether or not we do and become the world's factory in the way that China has, but what are the relevant aspects of goods and services for India? What are the new types of jobs in the way that Noshir described? Where do we have real advantages that we can definitely export? Not only in auto components and pharma but also, when you start to look at all sorts of other services, you now see a lot of financial innovation here in terms of serving bottom-of-the-pyramid customers, that you can scale up, whether it's low-cost digital insurance, people's credit, or SME [small and medium-size enterprise] and supply-chain financing. All of those sorts of services are both enabling the SME sector, which is the big job-growth sector in India, and can be part of future global supply chains as well.

Anu Madgavkar: Just to amplify the differences or the irrelevance of comparison with China, India's model might well be quite different in terms of not being megascale manufacturing facilities located along the seaboard and primarily serving an overseas market.

For a whole variety of reasons, India has had, and perhaps will have even in the future, lower labor mobility and internal migration than China has. We are much more culturally diverse. The willingness and the desire to move very far from your own cultural context is not that high.

That’s a big opportunity as we think about the goods-and-services tax, which removes artificial barriers. Jobs and businesses can move to the right areas, which are fundamentally near local markets. There’s a big segment of midsize cities, the cities that are from half a million to about 4 million in population, which have a huge potential in terms of upside to scale up. A much lower share of urban India lives in these midsize cities.

We would think that many of the jobs could be around knowledge-enabled services now, thanks to IT, as well as to what in MGI we call the supplier-proximate industries: where there are advantages to being near consumers, whether in terms of logistics or of being more responsive to consumer needs—so whether it’s an auto two-wheeler or specialty chemicals. There are a whole lot of manufacturing jobs that can be supplier- and market-friendly locations, given this critical mass that we’re likely to see not just in a concentrated way but also much more spread out over India.

Alok Kshirsagar: Could I just also say that the infrastructure point we talked about earlier is also relevant in the Indian context. Manufacturing for us does not need to be huge, large-scale semiconductor foundries. For us, having road contractors and road developers scale up is thousands and tens of thousands of jobs.

There’s effectively the SME supply chain that Anu talked about. Similarly, when we talk about water treatment, we talk about appropriate city-based services. Effectively, manufacturing with the technology capability relevant to our country is hugely important. The infrastructure sector is where much of the job creation is. There’s an opportunity here that needs to be in India, for India, as opposed to worrying about anyone else.

Cecilia Ma Zecha: Let’s move to the discussion about how this enormous potential can be translated into performance—the challenges that have to do with execution for companies on the ground. What are your thoughts on the best strategies?

Alok Kshirsagar: That’s a big question. I’m not sure there’s any generic answer. But let me share a few thoughts. For the past five years, we’ve convened a group of CEOs, 30 CEOs, of the largest global companies. We’ve met in private sessions several times a year to talk about what it will take to win in India. We all see the opportunity. What does it take to win? What does it take to execute? There are four or five things I’d like to share that might be useful.

First is, and it’ll sound soft, but it’s very real, just commitment through the cycle. As Noshir said earlier, this will be in spurts. There will be air pockets. But the companies that have been successful have said, “Look, I’m going to stay firm through the cycle and not just come in and out of the market.” Because the rest of your domestic partners, networks, and suppliers are there for good. They’re there for the long term. If you don’t take a view that, “I’m going to stay in through the cycle,” you’ll have a hard time being successful.

The second theme is this notion of building an India-centric business model, and that means identifying the three or four segments within the country that you want to participate in. It means that—as many of the Korean electronics companies have done—customizing products to be relevant to how Indian consumers use them. For example, cars often need to be designed so that you have six or seven family members, not four. You need to have electronics in a way that people listen to music and watch TV. So, there’s a very different way in which you need to understand the Indian consumer and customize to that. The other aspect of that, which is specific to the Indian-centric model, is that this is not about selling the product. We have to sell products and services.

A number of the big industrial or engineering companies we’ve worked with, big turbine manufacturers and others, struggled for a long time because they were trying to sell products that were not relevant. You couldn’t actually install the product in India. You need to have the capability to both provide the product and the services together; this means installation, managing the local EPC [engineering, procurement, and construction] contractor, providing aftersales service at a very high-quality level, and understanding the complexities and challenges of Indian infrastructure. Two examples here: one is consumer customization and the second is product plus service, not just product alone.

The third big point is around empowering your talent. Multinationals, in particular in India, have struggled over the past few years. Because what's happened is the best talent doesn't want to work in a remote branch office with no empowerment. You might get people who are fresh graduates who still want a good brand on their resume, but they leave two years later. They'd rather work for an entrepreneurial Indian company that's going to give them huge growth opportunity.

So, this notion of saying, "Look, I'm going to have an empowered CEO for this country, given the size and scope," if you just have a representative coordinating different global products, you will fail. You need an empowered CEO, and, frankly, empowered middle management.

What we're seeing with global companies is they're creating global leadership positions out of India. They are located in India but running Asia, and they are located in India but running the Middle East or Africa. That has created a different talent proposition. The third big point that we've learned through this CEO forum is that you have to empower the local organization—not just the CEO, although the CEO is critical, but also create a path for senior leaders—to feel that they have the empowerment, the entrepreneurship, and the scope. Otherwise, they'll just go do something else.

The last point I'll make is having the right alignment with the government. By the way, this is an important but sensitive point. People say, "Well, how do we deal with the government at different levels?" The truth is the best companies do so with absolute commitment to ethics and values.

What that means in practice is understanding how you get in line with where the government is already focused. Those who are focused on Smart Cities, those who are focused on Skill India, all the points that Noshir was making earlier—you will be much more successful if you're in the flow and are able to take advantage of that and demonstrate that you're doing good for the country in terms of jobs and employment.

As long as you're demonstrating that you're developing the country, whether you're domestic or global, you will find the government is extremely supportive.

Noshir Kaka: To win in India, you need to be relevant in India. We see too many companies coming into India because they see the consumer opportunity or they see some opportunity.

But they’re not relevant. They’re not relevant to what the government is trying to get done. They’re not relevant to what the people really need. Inevitably, if you play in a small sweet spot, which is, let’s say, your global sweet spot or your premium-pricing sweet spot, you will fail for two reasons. Number one, you will create a price umbrella for competition—local competition—to come and essentially disrupt your business model. First in India, and then possibly in emerging markets elsewhere. The second is you won’t be, to Alok’s point, aligned with where the country needs to go.

Therefore, you will find that there is no reason for people to care about the company and where it’s going and what it needs to do. It’s important for companies to know that you have to be relevant to India. And that’s not just a CSR [corporate social responsibility] activity. You have to feel that the contribution you are making to the country, in whatever way or shape or form that the company is passionate about, is relevant to India and its citizens. That’s what will enable you to be successful down the road.

The second is that we’ve seen too many companies sending in what I would call a professional manager, the one who is absolutely adept at managing the matrix. While that’s helpful in headquarters, it doesn’t help on the ground. What you need is serial entrepreneurs, people who are mavericks. Because India is volatile. You will see that volatility.

You need trusted mavericks—someone like that—to go behind and essentially change the business model, where it is appropriate, and be trusted by the corporation that, “Yes, I have X, Y, Z there, and he or she will act with the best values, with the best of intentions, to make sure the company is both relevant to India as well as to its international needs.” Those are the companies that are more successful. We’ve seen them grow enormously quickly, as Alok has said, and be extremely profitable as well, and create enormous market capitalizations and value based on that.

Cecilia Ma Zecha: Finally, any famous last words to the global listener or to those listening in the region that are interested in accelerating their business in India?

Noshir Kaka: The simple thing I would say is that going big in India, we are increasingly becoming convinced, is a question of when and not if. We’ve had a lot of stops and starts. There’s no question about it. There has been 20 years of promise versus actual performance.

But one thing has been clear even in those 20 years, which is that the cost of being successful in India goes up significantly every year. You could choose when you want to make India or another emerging market a real core piece of the global strategy. But every year, that cost goes up.

Cecilia Ma Zecha: Anu, Noshir, and Alok, thank you for sharing your insights today. And thank you for joining us and listening in. If you want to find out more about our work on India, head over to McKinsey.com.

1. *Pradhan Mantri Jan-Dhan Yojana*, or the Prime Minister’s People Money Scheme, is a national mission in India to provide people with affordable access to financial services.
2. *Aadhaar* is a 12-digit identification number that the Indian government issues to every resident of India.

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