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Future of Asia Podcast

India's turning point

Faced with creating 90 million jobs over the next decade, India will need to implement significant reforms across the economy to ensure its trajectory of growth.

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Oliver Tonby: You are listening to the *Future of Asia Podcast* by McKinsey and Company. I am Oliver Tonby, your host and chairman of McKinsey Asia. In this series, we feature leaders from across the region to discuss the forces, the opportunities and the challenges that are shaping the future of Asia.

Welcome. Welcome everyone to the *Future of Asia Podcast* series. Today's topic is called a turning point for India's economy. I am joined by three of my colleagues; I am joined by Gautam Kumra. He is the managing partner of McKinsey in India. I am joined by Anu Madgavkar. She is a partner with McKinsey Global Institute based in India. And also, I am joined by Shirish Sankhe, senior partner out of Mumbai, who advises on urbanization and economic growth in India and more broadly, across Asia. So, ladies and gentlemen, let's just warm up a little bit. Let's talk about your experiences over the last six months. Give one positive outcome or reflection from the COVID-19 era over the last months that we've learnt. Gautam, do you want to start us off?

Gautam Kumra: Yeah. Do you want a positive start? I think I would say, Oliver, I've been struck, and even I was positively surprised by the resilience. I think the resilience of the country, of its people, and of our colleagues, have been impressed by how … it's not been easy, but I've been impressed by how people have found ways to operate and be at least reasonably effective in these few months. That would be my reflection.

Oliver Tonby: Anu?

Anu Madgavkar: I think adaptability, Oliver, not just for people like us who adapted quite easily just given the nature of work we do, but all sorts of small vendors, small service providers—the way they've just embraced remote forms of working or the way they wrap their heads around how to protect themselves in their own communities, even if it's in informal housing, I am very inspired by that.

Oliver Tonby: Thank you. Mr. Sankhe.

Shirish Sankhe: Yeah, I am particularly inspired by how the large Indian cities, for example, the city that I live in, Mumbai, actually rose to the challenge of COVID-19, despite having 60 percent [of their] population in slums. There was a possibility of a runaway COVID-19 [situation], but it was well-managed. And actually, the healthcare system rose to the challenge. It was a big positive surprise for me.

Oliver Tonby: Got it. Thank you. Listen, let's dig into the topic at hand, which is India. India's situation, India's growth, India post-COVID-19. But let's start with, what was the state of play for India's economic development before COVID-19? Who would like to kick us off on that question?

Gautam Kumra: Maybe I can add a comment here, Oliver. I think it depends a bit on the timeframe you take, but I think if you take a longer-term view or say last 30 years, as you're aware, India is one of the 18 outperforming economies globally that has delivered high rate of per capita GDP growth. Real economic growth has been 6.8 to 7 percent over 30 years. But it's fair to say that going into COVID-19, I think the Indian economy was on a difficult wicket. The momentum had been slowing down from 2013 to 2019 on two particular markets, which had been engines of growth for India. One is on private investment. If you look at bank credit, it had been slowing down. Level of investment in the economy had come down by about 5 percentage points. Also, India's participation in the global markets. We should look at India's exports as a share of GDP went down from 25 percent to 19 percent over the 2013 to 2019 period.

So, both the cylinders of India's growth, previous growth—private investment and share of exports actually were falling. We also saw in this period, by the way, a decrease in labor participation rates, which had been falling for more than a decade. And eventually, it led into growth. It's only about 4 percent or 4.2 percent in 2019–2020 going into COVID-19. So, it's fair to say, Oliver, that we had been slowing down as an economy and we have

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structural weakness in the economy quite since the global economic crisis of 2008. That has exposed the economy to the challenges now being imposed by COVID-19.

Shirish Sankhe: Yeah. I would like to add on to the long-term frame of India’s growth. I’d like to point out the inclusiveness of this growth a bit. It’s easy to criticize, obviously, the last few years. And yes, India has been slowing down, but it has been remarkable that during a 10-year period, the last 10 years, almost 270 million people were lifted out of poverty, as well as the household electricity access is now 95 percent, the household sanitation aspect is 100 percent. Almost everybody has a bank account. So, the inclusiveness of this, the bottom of the pyramid aspect, I think, have been quite good, but definitely the economy has been slowing down in terms of job creation. For example, the net job creation in the last six years was close to zero. But at the same time, I think a number of inclusiveness-related advances have been a positive surprise for the economy.

Anu Madgavkar: In addition to that, I think there’s also been a remarkable revolution on the digital front and the pace at which digital access has actually increased in the country in the last four years or so. And the strength of the underlying digital platform, namely the Aadhaar digital ID platform and the ability of the government to reach people directly or for consumers to reach vendors and providers directly. I think that has been another important aspect of state of play, which has actually helped us deal with and tackle COVID-19 and distributing support to households, and so on, in a way, that has been extremely useful actually at this point.

Oliver Tonby: So, what I hear is, and now we’re talking pre-COVID-19—high growth, I hear inclusive growth on a number of dimensions, I hear about the growth of the digital platforms. I haven’t heard you talk much about innovation amongst companies. Would one of you care to comment about that? I think there has been quite a bit of that, too. I don’t know who wants to take a stab at that.

Gautam Kumra: Maybe there are different angles to innovation. In India, I think, in many ways, it’s been innovation around business models and being able to deliver products and services at costs that have never been achieved before. I could just give you two examples of innovation, Oliver, that struck me. If you look at telecom costs, like India, I remember when I started with McKinsey 27 years ago, we didn’t really have mobile phones to a point now that you look at the same movie 30 years later, where virtually a billion people now have access to a mobile phone and a few hundred million of them with smartphones, and so forth. The cost of telecom [in India] is probably the lowest-cost telephony market in the world. So, that's just one example of how we have innovated. Leapfrog technologies, whether it's 3G, 4G, and the data cost in India, again, is one of the lowest in the world, if not the lowest. And you see that pattern repeating consistently in different products.

India also a market for low-cost automotive. We were one of the first ones to produce a $3,000 car. So, I would say frugal innovation. Learning from the West and presenting those products and services at cost that have never been achieved before. By the way, pharmaceuticals is another example. So, a lot of innovation on sourcing, manufacturing, development to deliver product at those kinds of price points.

Anu Madgavkar: I think one kind of consequence of this innovative drive that Indian companies have shown is that economy, as a whole, has sort of been through shocks and cycles over the last three decades. It's not been a smooth or steady ride. As is expected, we've lived through at least two or three domestic crises, and of course, two or three global or regional crises over this period, but through those shocks and wobbles, I think each time there have been new engines of growth and productivity that have actually come on board and helped to buoy and shore up economic growth. So, whether it was the IT revolution of the 90s, or more recently, the telecom revolution that has actually enabled all of the digital, not just access, but also innovation in terms of B2C companies. These engines have actually helped stabilize the economy, and I think should be considered as one of the natural endowments, if you will, of India going forward.

Oliver Tonby: Very good. Anu, you mentioned that India has been through some of these crises. Let's zoom in on COVID-19. Now, what has so far been the impact of COVID-19 on India's economy? I don't know. Who wants to take the first stab? Shirish, do you want to take first stab at that?

Shirish Sankhe: Yeah. The effect of COVID-19 on Indian economy is still unfolding. We are now in the sixth month, globally as well as in India, right? The scenarios that we have projected, and these are scenarios only, show pretty adverse impact of COVID-19 on the Indian economy, somewhere between 3 percent to 9 percent contraction in the Indian GDP during the current fiscal year. Right? That's pretty dramatic. I think that's probably the lowest growth in the last 50 or 60 years. In addition, as a result, consequent, result of this, the NPAs, the nonperforming assets will probably move from double, 7 percent to 14 percent. And unemployment in the first couple of months went to almost 20 percent even though since then it has come down to 10 percent.

But India may not have the substantial fiscal resources that will be available to the developed countries, and therefore, this is going to be a set of tough two years for India. Now, the positive news in this is that we were quite happy to hear that the government announced, in fact, two or three long-pending structural reforms, such as allowing the farmers to sell directly to consumers and companies. Privatizing the electricity distribution companies, which was on the agenda for like 20 years, and as well as really providing the portable benefits to the migrant workers. Today, if you move from one region to another, you may not have got the benefits, but that has been sorted out. So, some reform process have already started. It's positive news, but overall, it will be a tough two years for India, is what our sense is.

Oliver Tonby: Go ahead. Anu, would you like to add?

Anu Madgavkar: The labor market implications of this are also worth noting, Oliver, in which we're basically seeing that levels of either unemployment or what is more characteristic of an informal labor market, which is underemployment, very little income earning potential. So, that has become widespread at the time of COVID-19. Unlike many of the other crises that India has been through, which may have had their roots in global capital flows, may have kind of flown into India through larger institutions; this crisis, because it affects health and safety on the ground, is affecting every Indian worker right down to the smallest informal sector worker. We've seen unemployment rates spiking to 20 percent in the months of the lockdown with the tentative subsequent lockdowns and restarts that are going to be a matter of reality for the next several months.

We will see persistent both unemployment/underemployment, as well as a tremendous pressure on small- and microenterprises. We reckon that on an unmitigated, unprotected basis, there could be a lot of small loans actually turning nonperforming, and obviously resulting in pressure both on the borrower as well as on the financial system. Financial-system NPAs could be anything incrementally between 7 percent and 14 percent. Now, I think the central bank and the government have taken a set of very helpful measures that span moratoriums, credit guarantee schemes in which the government guarantees some of these loans and removes the pressure and allows the banks to actually lend to these small enterprises, but nevertheless, it is a grave shock and I think it really puts into sharp relief, the fact that looking ahead, given the 90 million-odd workers who will incrementally enter India's workforce in the coming decade, it is going to be extremely important to get our job-creation and income-generation engines alive and humming again once the worst of the crisis is over.

Oliver Tonby: Asia's standing in the world has changed and it's clear that where the focus once was on how quickly the region would rise, the reality is now all about how Asia will lead. Keep listening to the *Future of Asia Podcast.*

Thank you. I want to pick up on something Shirish said because, Shirish, I think you said the GDP could contract between 3 percent to 9 percent. That's a big gap. What determines if it's three versus nine? What are some of the factors are driving either way?

Shirish Sankhe: As I said, the crisis is still unfolding. So, the models that we put, we're trying to figure out when would manufacturing start in a full scale, for example. Many of the factories are still running at 50 percent capacity utilization. When will the consumption engine start? I'm still sitting at home and I haven't bought anything other than food. And when will that restart? Will it happen in September, or will it happen in December? When will people start buying cars? And so on, and so on. So, there's

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a lot of uncertainty depending on the level of "lockdown". The Indian government has substantially opened up, but people's behaviors are still very different. So therefore, there is a lot of uncertainty and that's where the –3 percent to –9 percent, which we projected, by the way, in May of 2020 comes in. Anu, do you want to add on? You have done this work, quite in detail.

Anu Madgavkar: Absolutely. I think there are two dimensions of uncertainty here at play. And one is the one that Shirish talked about, which is we just don't understand how the virus itself is going to be contained or how successfully, and what the risk of resurgence and repeated lockdowns over large parts of the country could be potentially. Plus, of course, the behavioral issues and challenges. I mean, people's behaviors have changed, and this is sticky, and it will not come back very quickly. So, that's one dimension. The other dimension is how effective our economic policy intervention is going to be to stabilize the economy or to boost consumption in the face of, sort of, the wage declines and job losses that people have had. And there are genuinely uncertainties on both fronts and therefore, there's sort of relatively wide range of –3 percent to –9 percent.

But whatever that number is, I believe the consensus view right now is about –4 percent to –5 percent, but we don't hazard a guess, whatever that number is. I think it's worth noting that this would be the first contraction in India's GDP in the last 40 years. So, through all the wobbles and dips, we've never actually grown negatively in India's, at least, four-decade economic history.

Oliver Tonby: Yeah. There's a contrast, and I think Gautam said earlier on, that since 1992, India has been growing almost somewhere 6 percent, almost 7 percent on average per year, and now we contrast that to something that's going to be –3 percent to –9 percent. So, that is a huge, huge change. Huge change, very tough times. So, let's go back and now let's change topics. Let's talk about what steps can be taken to return India's economy to a high-growth track. Gautam, why don't you take first pass?

Gautam Kumra: So, Oliver, as you've seen our nation, I think we rise to the occasion best in the face of a crisis and it is our sense that now's the opportunity to substantially scale and accelerate several structural reforms that are needed in the country to deliver jobs and economic growth rates. Given the Indian population and the demographics, we need to produce about 90 million jobs over the next decades to keep unemployment in check. By the way, if women participation in labor workforce increase further, you could have another 55 million people coming into the workforce. So, even conservatively speaking, we need to be able to create about 90 million jobs in the nonfarm sector. Now, if you look at that challenge, and by the way, we hope that 30 million people will migrate from agriculture to nonagriculture in this period of time as it's happened in other economies, they have delivered economic growth rates. Now, to put things in perspective, you know, this requires basically economic growth rate of about 8 percent to 8.5 percent, which will come from a combination of two things.

On one hand, employment growth of about 1.5 percent per year, and on top of that, a productivity growth rate of about 6.5 percent to 7 percent. Now, the good news here is that India has done bits of this in the past. You see, if you go back to the early-2000 decade, in the period of 2000 to 2012, India had generated employment at the rate of about 1.5 percent. Similarly, if you look at a period 2013 to 2018, the last five years, when we didn't create any jobs, but productivity did grow at about 6 percent to 7 percent. So, in other words, if India could match the employment growth of the early 2000s, and the productivity growth rate of the last 6–7 years, we have an opportunity to get the economy to 8 percent to 8.5 percent economic growth rate track and create the 90 million jobs that I talked about. So, that is the real imperative. And what we outline in this report is really a series of measures.

My colleagues can expand on that, but if I can just say at the outset; three big measures. One is a whole set of high-productivity frontier models, and maybe one of my colleagues can expand on that, that's a big imperative. Second, the role of building 1,000 large and 10,000 small/midsize companies. And then finally, the need for structural reform in six areas, and the need to increase risk capital. So, there are probably four themes, or we can explore any one of those as we like, but there are 14 we outline in the report on what needs to happen to deliver this 8.5 percent growth rate and 90 million jobs.

Oliver Tonby: So, let's double click on those three topics. Let's start with the first one. So, I think you've called high-productivity frontier models. What does that mean? And give us some examples if you don't mind—Shirish?

Shirish Sankhe: Yeah. The first set of what we call the growth-booster theme, which has the high-productivity models incorporated in it, is what we call global hubs serving India and the world. The trend has slowly already started, but a lot of it can be manufactured and assembled in India. Just as an example, this is the manufacturing revolution that has escaped India for the last 8 to 10 years but [now] could be a great time to build up. So, that is just one of the themes under the global hubs. The second theme under the second model, under the global hubs is the next escrow on IT.

India has already been known as the Information Technology superpower, but the next generation of digital, artificial intelligence, machine learning is several billion dollars' worth of export opportunities. Similarly, something that is quite obvious to anybody that looks at India, tourism. India has only 10 million foreign tourists a year. Many cities in Asia have more than that. I'm taking that from 10 million to 50 million, and again, building on to connecting to the world is another third subtheme under this overall theme of global hubs. So, there's just one theme explained. Anu, maybe you want to take the next theme to explain on these growth-booster tips.

Anu Madgavkar: I should say that the three growth boosters cumulatively represent a potential of $2.5 trillion of economic value in 2030. This is a very sizeable set of high-productivity opportunities. And the first one that Shirish talked about, the global hubs, together at about $1 trillion of that. The second one is to think about how India can really build competitive and efficient production platforms that, in turn, can enable all sorts of enterprises to flourish and compete. And when you think about the platform that enterprises need, the core elements of that, the first is really around low-cost, highly efficient financial intermediation. So, you can think about a financial system that has the ability to use digital automation, all sorts of technology to deliver credit and capital products to mobilize savings and so forth.

So, the financial institutions are one part of this. I think power and logistics are another key part of that efficient production platform that India can build. And both power and logistics costs can actually come down by 20 percent to 25 percent just by using a much more market-based, much more technology-intensive business models to serve customers in both these domains. And that, in turn, unlocks lots of efficiencies around the country in terms of other firms as well. And then a third example in this bucket is really the notion that you can transform the way government interacts with businesses, particularly small businesses that don't have the wherewithal to manage lots of compliances. For example, today, the average micro or small enterprise in India needs to do something like 20 plus registrations and licenses each year.

But as many as 120 filings of information, 250 compliances a year. If you had business models that actually reinvented all those processes, made use of market forces and market participants to deliver these services better to businesses—it would unlock a huge amount of value. So, cumulatively, this is really the second thing, which is around creating competitive and efficient platforms on which other businesses can grow and flourish.

Shirish Sankhe: Yeah. I just wanted to build on to what Anu said on this second growth-booster theme, which is efficient and productive platforms. I just wanted to give the power sector as an example. I think India is the only country across 20 countries where commercial and industrial tariff is higher than the residential tariff. This situation does not exist anywhere else. And with that, a whole set of competitiveness, manufacturing, and so on, does not come up. So, therefore, the power cost needs to drop by 20 percent to 25 percent. And there's a set of reforms that the government has announced but need to undertake to get that done. Just as one example of the high efficiency, power and logistics model that Anu spoke about.

Oliver Tonby: Got it. And the third growth booster, Anu?

Anu Madgavkar: The third growth booster is really to reinvent the way India and Indians live and work essentially. So, new ways of living and working. And by this we mean both, for example, much more productive and resilient physical, living and working conditions in India's cities. We have far too little, I think, capital investment in creating the right environment in which cities can both house people in decent and affordable housing. There is a huge affordability gap in terms of housing in our cities, and equally in city centers or in areas, which need to attract and create spaces where businesses can flourish and people can work, we find that zoning regulations actually keep building in those areas way below potential. So, there is actually scope to think about cities very differently urban infrastructure housing, commercial space, master plan that, and create very welcoming and resilient environments there. That's one example.

The other example is a much more distributed collaborative sharing-economy type of model, which actually comes very easily in India, which is quite a fragmented labor market to begin with. But the power of all those digital platforms I had talked about earlier, many of them linked to the Aadhaar digital ID. And with telecom access or internet access so widely available, you could have an explosion of everything from education to healthcare, to creative services, and lots and lots of remote work. This could also enable a lot of women to enter the workforce or more semi-urban and rural parts of India to be integrated into the modern economy through these collaborative sharing economy types of models where everyone can participate for example.

And I think the one other thought I would have on all of the three growth boosters is the following; these are important not just because they represent $2.5 trillion of economic value or GDP, but each of them is actually a potential pathway in which workers who have aspirations to raise their income can actually climb that ladder or move toward the productivity frontier. If we have more businesses and enterprises. for example, in retail trade, modern trade and e-commerce operate at 9 to 10 times the productivity of the traditional small, fragmented store, but their employment today is a very small share, probably about 1 percent of total employment in that sector. So, by enabling more businesses to move to that frontier, it's also a way to pull up workers who are operating in low-productivity environments and give them options and ways to actually raise their wages and raise their income by moving closer to that frontier.

Oliver Tonby: So, what you're outlining here, in the third theme, is new ways of living, new ways of working. As you say, this is going to pull up the workers, pull up the citizens. We've also recently launched a report on climate risk and mitigation across Asia, and clearly, India is one of the countries that is going to be affected. So, can you say a little bit about what's the future in India in terms of sustainability? Have you looked at that?

Shirish Sankhe: Yeah. Maybe I would take that up. If you take sustainability in two elements, one is related to the mitigation aspect, I think India is, really, on a good path to get renewables in for the energy production. So, the energy systems of India are actually included in this third growth-booster themes and another 180 gigawatts of renewables can come in. This plan, this is solar and wind mainly, but also some hydro power and so on. India has enormous potential. It said that just the desert of Rajasthan, solarized, can provide electricity to the whole of India. So, therefore, that is the mitigation aspect of climate change. But our current report did bring out one or two very important risks that were actually not as well understood in India, which is the risk of flooding, sea-level breaching, as well as the risk of heatwaves.

I think recently we did publish this report, based on the global report, in India. And in one of the key presentations I did, for example, in an international conference in Mumbai, a number of government authorities said that we did not know of this risk, especially the heatwave risk, as well as the flooding risk. They said that we need to incorporate it in our infrastructure planning and in our risk mitigation measures. So, it's beginning to get slowly understood and addressed. But by the way, the opportunities around this are also quite a large number, and therefore, India should use the climate change and mitigation as an opportunity to really build a new India in this particular growth-booster theme.

Oliver Tonby: Yeah, exactly. Listen. Three themes that you talked about. I heard about global hubs, I heard about the building competitive and efficiency platforms, and we heard about new ways of living and new ways of working, which totals, I think Anu you said was, $2.5 trillion in total value.

Shirish Sankhe: Yes.

Oliver Tonby: Now, in making this happen, what needs to be the role of the states? What needs to be the role of the business sector going forward? Gautam.

Gautam Kumra: Yeah. Maybe I can start with the role of business because it is a firm belief that to achieve these aspirations, Oliver, I think, there is a very strong imperative to build world-class competitive firms. We've seen this in a form of research that the number of large world-class competitive firms is directly correlated to sustained economic growth rates. Now, if you think of the Indian corporate sector as a large ladder, we have a couple of interesting things going on. Firstly, you find that there are very few companies at the top of the ladder. When you think about large companies defined as more than half a billion dollars in size, India has only about 600 of those contributing about 40 percent of GDP. It is our sense that by 2030, this number needs to triple to about 1,800 companies that should collectively deliver about 80 percent of India's GDP.

So, the first observation is that we need more companies at the top of the ladder. The second observation is that part of the reason we don't have enough companies at the top of the ladder is because we have a "missing middle" problem. If you look at the small and medium-sized companies between $50 million and $500 million, India has far fewer firms than what it needs. It is our hope and expectation that about 10,000 companies can rise from being very small companies to becoming these midsize companies and fill the vacuum in the middle. And over time, many of them can rise to become large companies that I talked about earlier. Now, the reason why large companies are important is, as we all know from our own client service, they are much more productive. In large firms in India, they're 11 times more productive. Labor productivity is 11 times more than small or medium firms and twice more productive.

By the way, they already, in India, drive 40 percent of India's exports—they are delivered by large companies, and 20 percent of the formal sector employment is driven by large companies. So, there is no wishing away from the fact that we need to have an ecosystem where more innovation happens at the bottom, more entrepreneurs set up new businesses. But if we put in place the conditions, the enabling

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conditions, for these companies to rise from the bottom to the middle, which is missing today, and from the middle to the large. If we do so, we think that that can actually fuel a lot of things we talked about in terms of job creation, innovation, and so forth. By the way, the situation is very different by sector. If you just take the engineering and construction sector as an example, India has virtually only one or two major firms there. We need at least 10 times that to meet India’s potential of construction real estate. So, you can go sector by sector, and you will find that there are some pretty serious gaps and opportunities for building large competitive firms, and we think this should be actually a real priority.

Oliver Tonby: Very good. Shirish, would you like to add?

Shirish Sankhe: Yeah. So, the role of businesses is something that Gautam mentioned. I would just like to point on the sectoral and the financial-sector reforms that are required and then perhaps Anu can talk about the sectoral reforms that are required. So, I would like to point that we were quite surprised, Oliver, when we started looking at what sectors will create these jobs. So, basically, we talked about the growth-booster theme, but as we started adding up across the eight or nine sectors that typically comprise a whole economy, personally, I was surprised that out of the 90 million jobs, 25 million have to come from construction. And that’s where Gautam mentioned, the need for large companies, real estate, affordable housing, as well as infrastructure.

The need to build India at this stage is extremely important. We will, of course, look at all the growth-booster themes, but there are some sectors that really stand apart, and that’s where I just wanted to bring construction, and therefore, construction-related reforms. The real estate-related reforms are extremely important. I would not go into all the details, but it’s related to land-market reforms—making more land available, making land less costly, making construction far more productive. I just wanted to point that out as perhaps one of the sectors that really needs to take off. It’s one in four jobs that India needs. So, just wanted to point that out. The other point I wanted to make, which Anu can perhaps build on is that a lot of people ask us, Oliver, all this is fine, but where will the money come from? Especially [where] the risk capital of this will come from.

Maybe the debt capital is there, but where will the equity capital come from? And I think India is really short. All the analysis we have done is India is short of the risk capital, equity capital required for this growth. And how to get that done? Our savings need to go from gold and real estate, to financial products, like mutual funds and insurance, and so on. It's a very, very important shift—4 percent of our savings need to shift to what we call risk investments. How to incentivize that and how to reform around that? It's critical, otherwise, we will fall short of money required for this growth rate. Anu, maybe you want to build onto this further.

Anu Madgavkar: On financing the growth, just to put it into perspective, this is obviously a critical component of both just growth as well as making investments that actually lift productivity to 7 percent or so that we need. On a pre-COVID-19 basis, India's investment rate had slowed down and it had come down to about 32 percent or 33 percent. A relatively large portion of this was actually government investment as opposed to private investment. Now, against that 32 percent to 33 percent, we would think that an investment rate of at least 37 percent is what is required, which means as you go up, the numbers mount, and by 2030, it would mean $2.4 trillion of investment in that year, of which the mid and small segment, which are so critical to have, sort of the vibrancy and upward mobility of companies and innovators we talked about. So, that mid and small segment would need $800 billion or so of capital and half of that roughly would be risk capital.

So, the numbers are large. The good news is that there is potential in the economy from a domestic savings perspective to actually generate that. In addition to, of course, FDI increasing and foreign inflows increasing, the domestic savings market can be put to work in financial intermediation much better by creating the right sorts of tax and other incentives addressing barriers—both tax and non-tax barriers—that come in the way of wealth accumulation and people really investing in asset classes like pension funds, insurance, mutual funds, all sorts of alternative investments like REITs or alternative investment funds, and so on. So, unshackling some of that, allowing and attracting more savings into those instrument classes would really help. The second piece is really to reduce the cost of credit.

So, on a like-for-like basis, we think that in nominal terms, a firm in India would face a credit cost, which was about 500 basis points higher than its counterpart in another high-growth emerging economy. And of these 500 basis points, there are two or three levers that, if addressed, can actually reduce this quite comprehensively. So, streamlining the government's borrowing programs so that there's less demand on national funds and therefore, more funds available to the commercial sector. The second is really to address the overhang of nonperforming assets, the credit costs of which are inflating the credit costs for new borrowers. So, addressing that overhang through perhaps a special asset bank or a so-called bad bank, which can take these nonperforming loans even in a post-COVID-19 era, this becomes critical, actually, to think about to address the resolution of those assets separately, but not load on those incremental costs to new borrowers, for example. And finally, you can think about topics and streamlining that as well.

Oliver Tonby: Thank you. Thank you, Anu. So, we've talked quite a bit about the business sector. Can we shift for a minute and talk a little bit about the role of the state in this? Shirish, yeah.

Shirish Sankhe: So, a number of financial-sector reforms, that Anu spoke about do rightfully belong to the central government, through the Ministry of Finance, and through the Reserve Bank of India. That rightfully belongs to the central government.

And there are many other reforms that also rightfully belong to the central government, like the incentives for manufacturing, the tax changes, and so on. But as we started looking at it, personally, we were quite surprised that how many of the reforms that we have mentioned actually come in the realm of the state governments. We found that almost 60 percent of the recommended reforms have to be done by the state government. And anytime we spoke about reforms, it's always directed toward the central government.

So, as a part of this report, we also want to firmly point to that, many of the state governments have not done the market-facilitating reforms that could have been done. So the Indian state governments have to step up. Just as an example, we talked about land-market reforms, bringing cost of real estate down by 15 percent to 20 percent. That belongs to the state government, Indian Constitution, all land-market reforms are about states. We talked about power sector. Most power-sector reforms belong to the state governments. We spoke about agriculture. Agriculture is firmly a state topic. And a number of the reforms that we spoke about, again, will be in the realm of state governments. In addition to the prime minister and the cabinet minister, I think we firmly have to focus on the state chief ministers and their Cabinet to play the role that is required for the 8 percent to 8.5 percent growth rate.

And there are some good examples: Gujarat in manufacturing, Karnataka in services, but they're a little bit few and far between. So, therefore, one of the key pushes of this report is firmly focus on facilitating and enabling reforms at the state-government level.

Oliver Tonby: Thank you, Shirish. Now, I'm going to start rounding this out. And to end thus, what I would like to do is ask you each one question. So, let me start with Shirish and Anu. Shirish, if you put yourself in the shoes of business leaders in India, what is the one ask that you have of them? And Anu, if you put yourself in the shoes of government or state leaders, what is the one ask you would have of them? Shirish, why don't you go first?

Shirish Sankhe: Yeah. If I put myself in the shoes of the business leaders, the ask to the business leaders is really those three growth-booster themes; just embrace them because those [can result in] six, eight, 10 times the productivity. Okay. So, the scale and speed of productivity-enabling business practices will be my one ask. And again, taking back the construction sector, instead of the traditional construction methods, if we use high-productivity, prefabricated construction, it's eight to 10 times more productive and therefore, eight to 10 times less time, just as an example. So, if they fully embrace it—the productivity enhancing 43 business model, three growth-booster themes—will be my one key ask to the business leaders.

Oliver Tonby: Thank you, Shirish. Anu.

Anu Madgavkar: There is no single silver bullet, but there is one key ask that can make all the difference. And for me what I would ask government leaders both at the center and at the state level, it's basically to make economic reforms a number one priority item. We need the resolve and the conviction at this point in time that are very sweeping, important, critical economic reforms need to be undertaken in the next 12 to 18 months. This has to be tackled in an all-out manner. The speed and scale of reform is something that we need, which we have probably seen in different measures through India's last 30 years starting with the early '90s and the liberalization. But every time India has set its mind to do something bold and big, and to do it well, it has actually managed to make great progress in a 12 to 18 month period, as we've seen with several programs in the past, across education, sanitation, the national highway program, and so forth.

This is the time to make economic reforms your number one agenda and put enough leadership capacity, technocratic capacity, and monitoring and execution capacity behind this for the next 18 months.

Oliver Tonby: Thank you, Anu. And I would love to ask Gautam to summarize us and round us out. Gautam, if you look forward, what is your narrative about India between now and 2030?

Gautam Kumra: Oliver, I think, as has been discussed, I think this is a real leadership moment for India. I think much like the 1991 crisis when we had run out of foreign exchange reserves to even sign the month of the course, India rose to the occasion. I think it is a similar leadership moment for India. I think the good news here is that the size of the prize is significant. As we have seen here, we have the opportunity to produce $2.5 trillion in gross value through these new high-frontier business models and create employment opportunities from 90 million of our colleagues and people who have high aspirations. So, the size of the prize is huge. But I think what this would require is decisive leadership on many of the concepts Shirish and Anu talked about. And I think if we act with decisive leadership, I think we have the potential to put India squarely as the third pole in what is a bipolar world today by 2030 right after the United States and China.

If we miss this opportunity, and sort of plod along at the 5 percent to 5.5 percent economic growth rate we have seen recently, I think we would have failed to meet the aspirations of a rising India, and I think we would have been missed a decade. I think the last thought I would say is I think competing in India has never been for the faint-hearted. I think even though we've had 7 percent economic growth rate over over 30 years, let's not forget that has gone through peaks and troughs, and I think the next decade will be no different. But I think if you were to embrace, as Shirish said, I think these three growth engines, and if the country would rise to the occasion, I think that there are few countries in the world that can match the promise of what is still to be realized in a country like India.

Oliver Tonby: Thank you. Thank you, Gautam. Thank you. Anu. Thank you, Shirish, thank you for being such great participants. This has been a very thoughtful, been a very fact-based, and a very heartfelt conversation. Thank you so much, and to everybody else, thank you for listening in. Have a great day.

Gautam Kumra: Thank you.

Oliver Tonby: Take care.

Shirish Sankhe: Thank you.

Anu Madgavkar: Thank you.

Oliver Tonby: You have been listening to the *Future of Asia Podcast* by McKinsey and Company. To learn more about McKinsey, our people, our latest thinking, visit us at mckinsey.com/futureofasia or find us on LinkedIn, Twitter, and Facebook.

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