India matters
Winning in growth markets

Contents

Executive summary

The unprecedented growth of the new middle class outside the Western economy will arguably be the most powerful economic trend in the coming decades. In an attempt to spur UK companies to increase their presence in new markets, UK Trade & Investment (UKTI) has identified 20 countries as growth markets.[a] According to Deloitte analysis, the 20 countries identified by UKTI are forecasted to increase their share of global GDP from approximately 30% in 2011 to more than 35% by 2020. Over the same period, we estimate that their imports will swell from £4.2 trillion to £10.2 trillion.[b]

India is predicted to be among the fastest growing markets, alongside China, Vietnam and Indonesia.[1] There are two aspects to India's growth. First, the rapid expansion of India's middle class. By 2020 India is projected to be the world's third largest middle class consumer market behind China and the USA. By 2030 India is likely to surpass both countries with an aggregated consumer spend of nearly US$13 trillion.[2]
The second aspect is the increase in income levels of the Indian middle classes,[c] which is driving greater aspirations, the need for world class infrastructure, high quality healthcare, brand leading consumer products, and sophisticated public and private services. A significant amount of knowledge and technology intensive (KTI) capabilities will be required in order to service these aspirations in a sustainable manner.

India will therefore present significant opportunities for companies from mature markets in a range of KTI sectors[d] including engineering infrastructure, financial services, healthcare, education and skills as India seeks to service this quantum of demand at an unprecedented scale and speed.

Mature markets such as the UK are well placed to collaborate with local players in the growth markets such as India, to address some of these opportunities. The UK is a leading knowledge economy and its KTI companies have world leading positions in sectors such as business and financial services, healthcare, aerospace and education among others. Indeed, KTI industries make up c.38% of UK GDP, which is far ahead of the world average of c.30%.[3] The OECD ranks the UK fourth in the world for its KTI capabilities (relative to GDP). The UK also has a uniquely high level of cultural engagement and connectivity with India, due to the Indian diaspora who have made Britain their home.

However, UK companies are punching below their weight in their trade with India. Currently, the majority of the UK's foreign direct investment is targeted at mature markets; whilst the UK's share of global exports in 2011 was 3.9%, its share of exports to growth markets was only 1.9%.[4] In fact, the UK was 21st in a ranking of exporters to India, securing less than 2% of the Indian goods import market. Deloitte believes that the reasons for this paradox seem to be centered on a lack of ambition, a gap in ground-level capabilities, and a limited understanding of the idiosyncrasies of the Indian market.

How should UK companies organise themselves for success? Our analysis has shown that the companies which have been successful in growth markets tend to share a common characteristic – a purposeful approach to building and maintaining local ecosystems. Creating local ecosystems potentially allows companies to overcome the difficulties of expanding into the Indian market, mitigating risk whilst bridging cultural differences and managing geographical and political complexities. This also benefits the Indian collaborators as they get better visibility of the UK knowledge champions and greater access to the mature markets. It also allows Indian firms to potentially expand their trade with the UK and leverage the UK as a springboard into Europe.

Deloitte believes that there is significant potential for UK and Indian firms to develop collaborative ecosystems for mutual benefit.

Why India matters

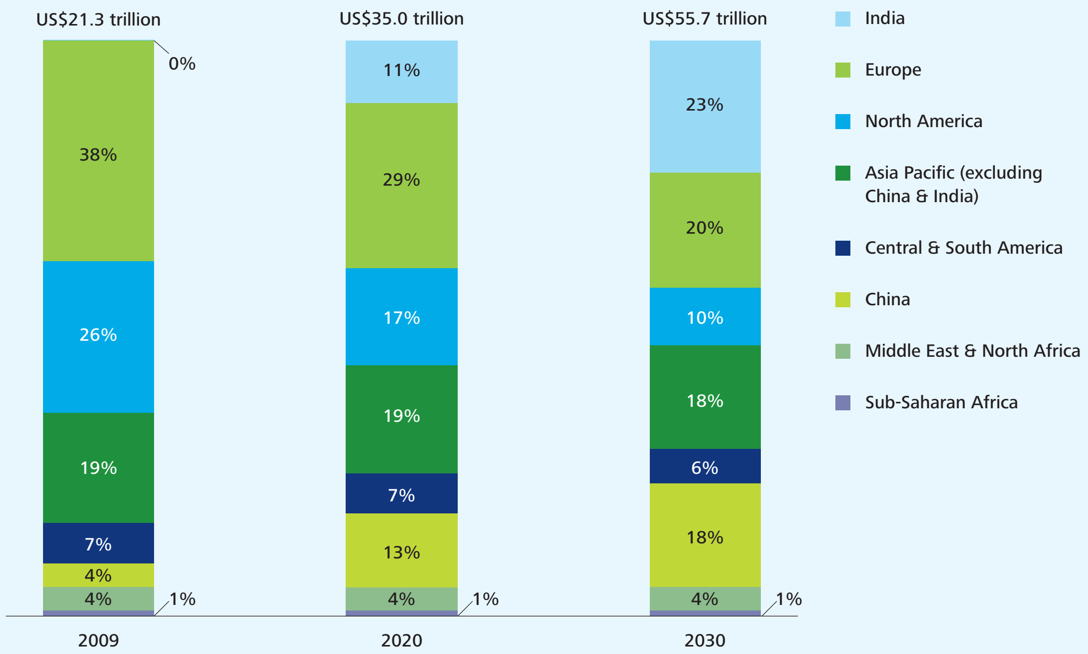
The Indian opportunity

The unprecedented growth of the new middle class outside the western economy will arguably be the most powerful economic trend in the coming decades. We believe this shift will herald a golden period for a number of economies, as the centre of world power shifts from west to east, and markets such as China and India develop their potential as economic powerhouses of the future.

The explosion of middle class consumer power began to take shape in India during the 1990s, following trade liberalisation post-1991, an increase in foreign direct investment and the proliferation of information technology exports. Rising average income levels among the Indian middle class are driving aspirational consumer behaviour, as people seek out higher quality products, better healthcare and more sophisticated services.

By 2030, India is projected to house the world's largest middle class consumer market, surpassing both China and the US.

Figure 1. Spending by the global middle class,[c] 2009-2030



Note: Purchasing Power Parity (PPP) million dollars, 2005

Source: *"The Emerging Middle Class in Developing Countries"*, Homi Kharas, OECD Development Centre

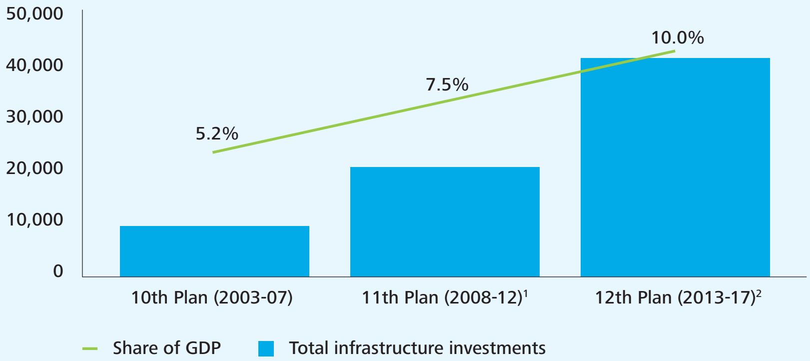
Select opportunities in India

Our research has identified four key sectors which represent significant opportunities for UK knowledge and technology intensive companies wishing to expand into the growing Indian market. They are: infrastructure, financial services, healthcare, and education and skills.

Infrastructure

The Indian Government is planning to double infrastructure investment to almost US$1 trillion between 2012 and 2017, with power (31%), telecoms (25%) and road and bridges (12%) receiving the bulk of the sector's investments. By the end of the five year period, the share of infrastructure investment in GDP is expected to reach more than 10%. Accelerated infrastructure investment will boost the wider growth trajectory of the country by enhancing India's attractiveness to the investor community, thereby generating long-term benefits which should sustain economic growth. This infrastructure investment programme represents a significant opportunity for world class professional services firms, advanced manufacturing, energy and telecommunication firms to accelerate their presence in the Indian market.

Figure 2. Infrastructure investment in India, 10th Plan (2003-07) to 12th Plan (2013-17) (Rs billion)

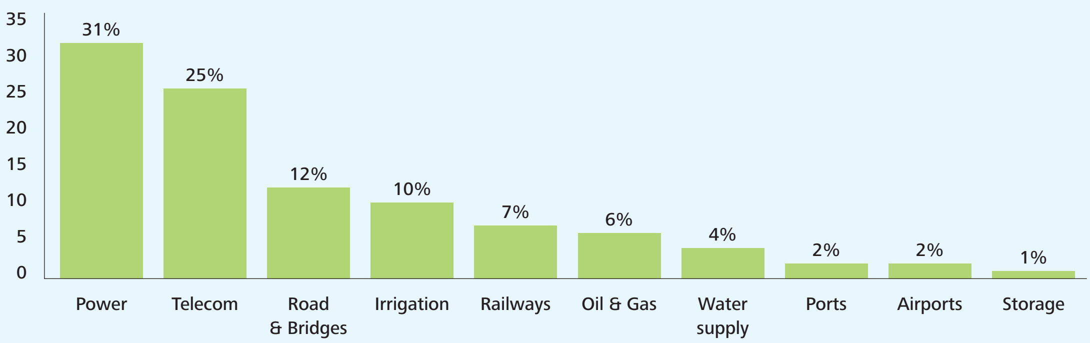


(1) At 2006-07 prices

(2) Projected; equals to US$1 trillion at Rs40/$ coversion

Source: Government of India, Planning Commission

Figure 3. Sectoral investment planned in 12th Plan (2013-17)



Source: Government of India, Planning Commission

India plans to spend US$1 trillion on a variety of new infrastructure projects by 2020, encompassing roads, airports, power and urban regeneration

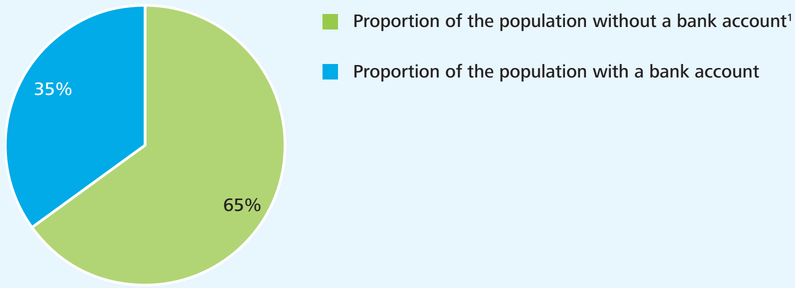
Financial Services

The Indian financial services industry is characterised by increasingly vibrant public and private sector institutions. As the common Indian acronym BFSI, which stands for "banking and financial services industry" indicates, the banking sector has historically dominated the industry. But other sectors, such as insurance and wealth management, have made significant gains as well.

Banking

Whilst the Indian banking industry has grown quickly over the last two decades, there is still a significant proportion of the population which is unbanked. This represents a major opportunity for innovative banks and financial institutions to develop low-cost service delivery models using mobile and other online platforms to address a sizeable proportion of the emergent middle class.

Figure 4. Penetration of banking services in India (%)



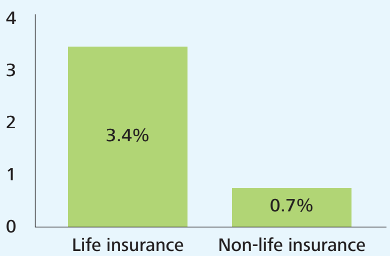
(1) Estimate

Source: Asli Demirguc-Kunt and Leora Klapper, 2012, *"Measuring Financial Inclusion: The Global Findex Database"*, World Bank Policy Research Paper 6025

Insurance

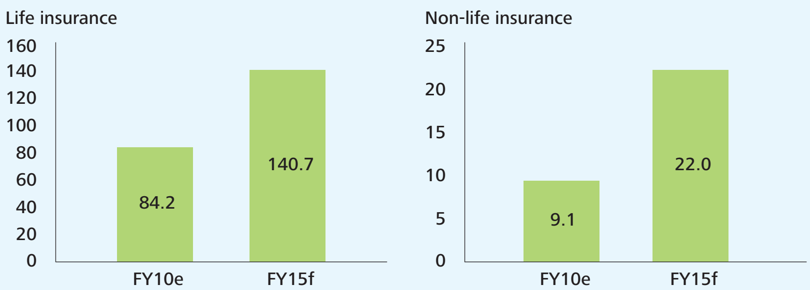
Considering India's low insurance penetration at 3.4% for life insurance and just 0.7% for non-life, there is also potential for world-class insurance players to expand in the Indian market.

Figure 5. Insurance penetration in India, 2011 (%)



Source: World Insurance Report 2011, Swiss Re Sigma

Figure 6 & 7. Life and non-life insurance premium projected growth, FY10e-FY15f (US$ billion)



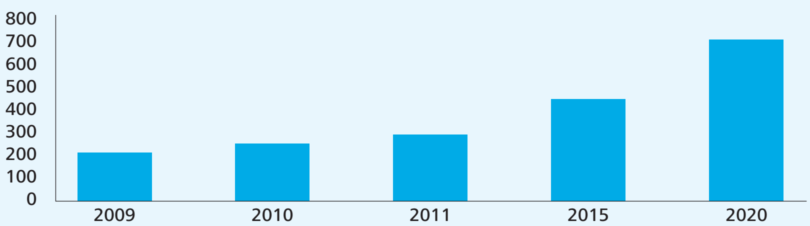
e Estimate f Forecast

Source: BMI estimated/forecasts from ISI Emerging Markets

Wealth management

The number of high net worth individuals in India is expected to grow significantly over the next decade, indicating a large potential market for private banking and wealth management services.

Figure 8. Estimates of high-net-worth individuals in India, 2009-2010[1] ('000)



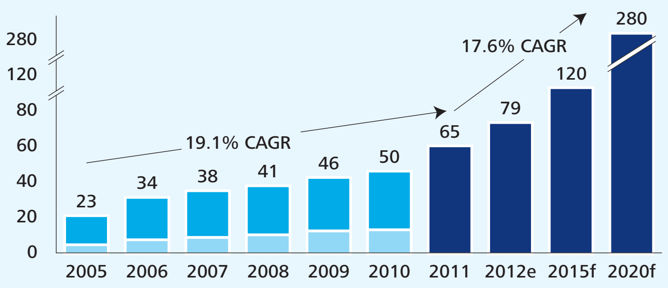
(1) Includes households with net worth of >US$1 million

Source: Deloitte Centre for Financial Services

Healthcare

Investment in India's healthcare market has grown at a 19.1% CAGR over the period 2005-11. Despite this, India's healthcare infrastructure remains under-developed and under increasing pressure due to the ongoing expansion in size and expectations of the middle class. In order to address this issue, the Indian Government plans to increase healthcare spending from 1.4% of GDP to 2.5% of GDP by 2017, with a specific focus on improving access to public healthcare, healthcare monitoring and evaluating systems, and training health professionals.[(5)]

Figure 9. Total healthcare spending in India, 2005-2020f (US$ billion)

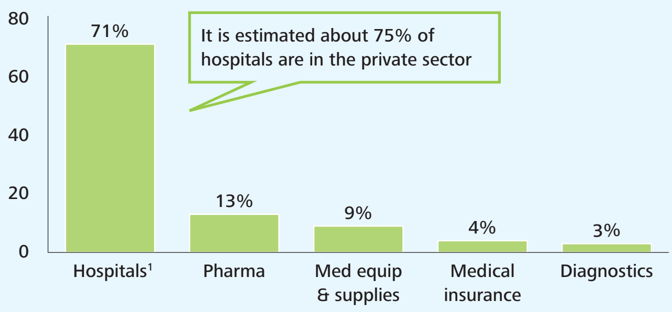


Private expenditure in health General government expenditure in health

Total e Estimate f Forecast

Source: WHO, IBEF Healthcare Report Nov 2011, Northbridge Capital

Figure 10. Healthcare expenditure breakdown, 2012e (%)



(1) Includes primary, secondary and tertiary hospital providers

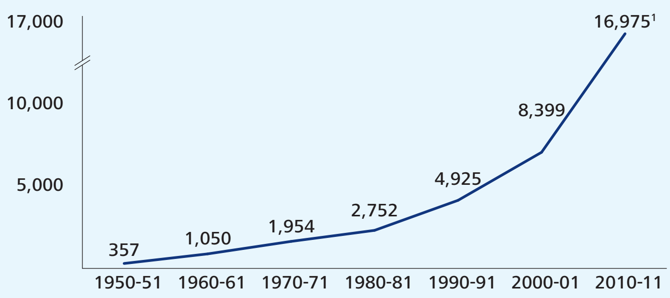
Source: IBEF Healthcare Report Nov 11, Northgate Capital

India's healthcare market has risen at a 19.1% CAGR over the period 2005-11; it is expected to touch $79bn by 2012 and $280bn by 2020

Education and skills

As a result of the 'demographic dividend', India aims to train over 500 million people by 2020,[(6)] to help them improve their chances of finding employment. Student enrolment rates and the number of teachers in higher education have both quadrupled in the last two decades. In 2010/11 there were almost 17 million enrolments and this is expected to continue to grow. Investment, capacity and capability from world class players would benefit the transformation of education in India.

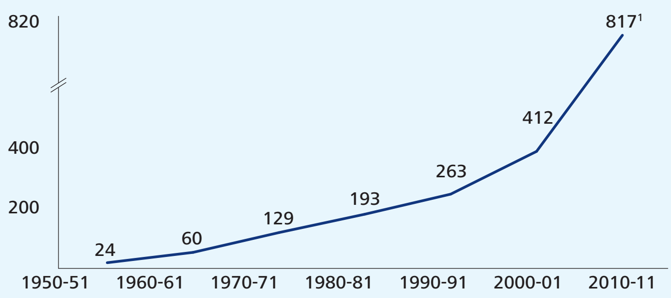
Figure 11. Student enrolment (HE) in ('000)



(1) Provisional

Source: MHRD for 1950-51 & 1960-61 and UGC for 1970-71 onwards
Coverage: Figures of students enrolment & teaching staff (1970-71 onwards) pertain to regular courses in Universities & Colleges (excluding Polytechnics, other Diploma awarding Institutions & Non-formal System of Higher Education)

Figure 12. No. of teachers in University/Colleges (HE) in ('000)



(1) Provisional

Source: MHRD for 1950-51 & 1960-61 and UGC for 1970-71 onwards

India aims to provide vocational qualifications for 500 million people and to create 40 million new university places by 2020

The UK advantage

While growth in India races ahead, mature economies in the west, particularly the US, the UK and the EU, are richly endowed with knowledge and technology intensive capabilities, making them ideally placed to harness the complex opportunities provided by high growth markets.

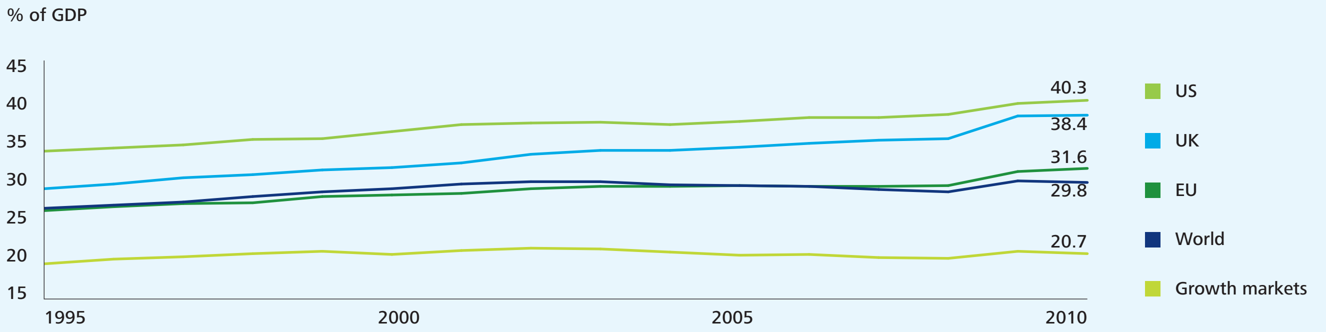
The UK is particularly well placed in this arena. Within the UK, the value added by knowledge and technology intensive industries as a proportion of GDP was c.38% in 2010. This figure is the 4th highest proportion amongst OECD countries and compares generally favourably to a growth markets average of 21%.

The UK's knowledge and technology intensive industries should include both high-end goods and services, such as:

- knowledge intensive services, including financial services, business services (e.g. consulting and architecture), and education services; and

- advanced manufacturing goods, from aerospace and medical equipment to pharmaceuticals.

Figure 13. Value added of knowledge and technology intensive industries,[1] 1995-2010



1 The OECD identifies 10 industries as being knowledge and technology intensive (KTI), see end notes

Source: OECD, National Science Foundation (US), Deloitte UK analysis

The trade paradox

Despite the vast landscape of opportunities opening up in high growth markets such as India, the UK continues to punch below its weight, as companies stick to old trading relationships rather than venturing further afield into high growth markets. The UK's major trading partners remain the US and Europe, while exports to the high growth markets represented approximately c.17% of the total in 2011. Similarly, in 2011, nearly 65% of the UK's outward foreign direct investment stock was directed towards the US and EU.

With respect to India trade, the UK only represents c.2% of India's global imports.[(4)]

While this mismatch between India demand and UK supply is already in evidence, India's continuing superior growth will amplify the discrepancy.

Explaining the trade paradox

Based on our studies of individual cases and extensive UK client interaction, we believe that there are several reasons for the failure of UK KTIs to take advantage of the opportunity offered to them by growth markets. Lack of ambition is partly to blame, as companies seem inclined to harness opportunities closer to home and lack the foresight to eye strategic opportunities in high growth markets such as India. Another explanation is the tendency to project successful formats developed within headquarters into new markets without understanding local nuances. Finally, companies often simply do not have the contacts or ground-level understanding of what it takes to do business in the Indian market.

That said, there are outstanding examples of success. Our analysis has shown that the companies which have been successful in growth markets tend to share a common characteristic – a purposeful approach to building and maintaining local ecosystems. Shaping local ecosystems has helped some of the UK's most successful companies in the knowledge and technology sector to overcome the difficulties of expanding into these markets, mitigating risk while bridging cultural differences, and managing geographical, logistical and political complexities.

Developing collaborative ecosystems for success

What do we mean by ecosystems? An ecosystem is a network of organisations and individuals that co-evolve their capabilities and roles, and align their investments, so as to create additional value and/or to improve efficiency.[7] Ecosystems are by no means a radically new idea. Studies of the woollen textile cluster in 14th Century Prato, Italy, show how specific companies both contributed to and leveraged upon the mutual strength of a network.[8] Today the technology industry gives ample evidence of ecosystems at work. Companies such as ARM Holdings, Google and even Apple (which has traditionally preferred a tightly integrated business model) have gained success by powerfully shaping the formation of business ecosystems around them that have helped to fuel growth and to enhance returns.

A business ecosystem typically consists of a dynamic combination of innovators, allies, partners, influencers and complementors. Critically, successful participants in ecosystems have a collaborative mindset when creating value – they have moved away from a defensive approach, looking for quick payoffs and constantly protecting themselves, to a more collaborative mindset that co-creates value (Figure 14).

Clearly, not every strategic opportunity needs to be addressed by an ecosystem approach. Our analysis of UK knowledge champions shows that ecosystems work best where knowledge is a key resource that tends to be dispersed among different organisations around the globe, and where there is considerable uncertainty – which in turn means companies have to be flexible about how they create value. Such is the complexity of high-end knowledge intensive sectors that individual companies rarely possess the capabilities to construct the end goods and services all by themselves. They need to engage a diverse group of stakeholders, which bring different assets and capabilities to develop the required solution. Furthermore, ecosystems have particular advantages for mature economy companies operating in fast-growing markets, which have inherent intricacies and uncertainties (Figure 15).

On the other hand, for standardised services where economies of scale and operational efficiency are critical, the ecosystem system approach is less useful and can even be detrimental, given the inherent transaction costs involved in co-ordinating ecosystem players. So, for example, while an ecosystem approach might be invaluable for complex business or urban management service providers, it would not be useful for a bottle cap contract manufacturer.

The ecosystem model allows businesses to focus on their core operations, to cope with rising investment demands, and to adjust to changing situations. While typically facilitating a global delivery model, it also allows companies to manage economies of both scale and scope. But in order to make the ecosystem model work, companies need to change their mindsets – promoting a behaviour and culture of collaboration throughout their organisations, and casting off old competitive attitudes.

Generally speaking, successful ecosystems benefit all parties – not only UK companies seeking to expand but also Indian collaborators seeking to partner with external knowledge champions to better integrate their local expertise in order to significantly expand the opportunity pie.

Figure 14. Typical players in an ecosystem[9]

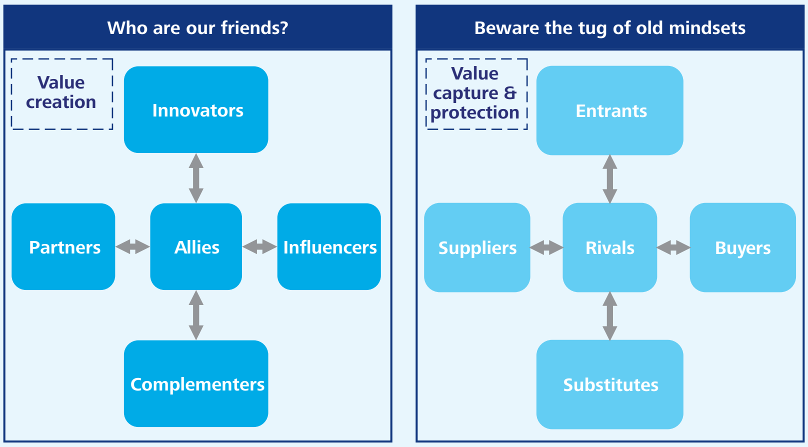
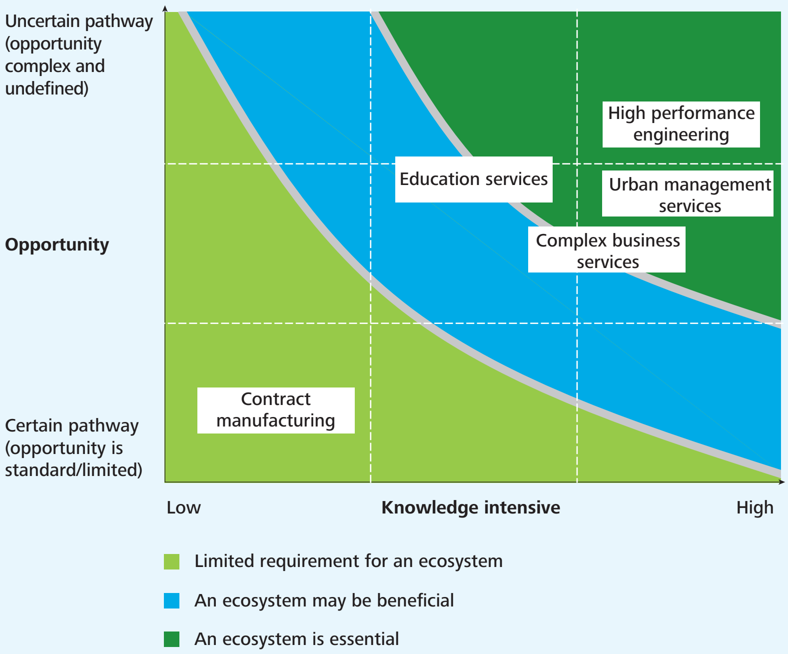


Figure 15. An ecosystem view – select examples



Acknowledgements

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References

End notes

(a) The 20 countries identified by UKTI are Brazil, China, Colombia, Egypt, Hong Kong, India, Indonesia, Malaysia, Mexico, Qatar, Russia, Saudi Arabia, Singapore, South Africa, South Korea, Taiwan, Thailand, Turkey, UAE and Vietnam

(b) The import figures for 2011 and 2020 are nominal

(c) The global middle class is defined as those households with daily expenditures between $10 and $100 per person in purchasing power parity (PPP) terms

(d) The knowledge intensive sectors identified by the OECD are transport, storage and communications; financial services; real estate, renting and business activities; education; health and social work. The high-technology manufacturing sectors are pharmaceuticals; computers and office machinery; semi-conductors and communications equipment; scientific instruments; aircraft and spacecraft

Sources

(1) IMF, Deloitte UK analysis

(2) The New Global Middle Class: A cross-over from West to East, Homi Kharas and Geoffrey Gertz, OCED Development Centre

(3) OECD, National Science Foundation (US), Deloitte UK analysis

(4) UN Comtrade, WTO, Deloitte UK analysis

(5) Government of India, Planning Commission

(6) UK Trade & Investment

(7) J.H. Moore, "Predators and Prey: A New Ecology of Competition," Harvard Business Review, 71/3 (May/June 1993): 75-86

(8) M. Lansiti and R. Levin, The Keystone Advantage: What the New Dynamics of Business Ecosystems Mean for Strategy, Innovation, and Sustainability (Boston, MA: Harvard Business School Press, 2004), p. 124

(9) Prof. Dominic Houlder, London Business School

UK Futures

As part of a strategic initiative to help stimulate growth in the UK economy, Deloitte UK has created 'UK Futures', a multi-year programme to assess and facilitate how business can drive UK growth. The aim of this strategic initiative is to identify the key opportunities and challenges facing British businesses and articulate the key interventions that would enable these businesses to both create and capture value in the changing global landscape. Under this broader charter, Deloitte has identified a few critical topics such as international ecosystems. To this end, Deloitte's 'Ecosystem-in-a-box' programme will leverage our vast international network and advisory experience to help decode the core elements of the ecosystem puzzle and enable our global clients to mitigate risks as they shape and develop international ecosystems, especially in growth markets.

As a key step in this exercise, we recently hosted a breakfast discussion at Davos, alongside the World Economic Forum, with representatives from leading organisations to hear and debate their views. Following the Davos session, we are now embarking on the next stage of our research and, in the later part of the year, we will communicate the key findings, describing what constitutes best practice in shaping and managing ecosystems. We will investigate the relevant efficacy of ecosystems against other collaboration models, and investigate how firms should structure their ecosystem initiatives to simultaneously create and capture value.

For more information please visit our website: **www.deloitte.co.uk/ukfutures**

India Services Group in the UK

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