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Factories to the fore: India must reboot its growth model before the AI-pocalypse hits its IT sector

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Much of India's IT sector's services fall in the category of work which can be executed by Agentic AI. (REUTERS)

SUMMARY

India's IT services boom drive exports, employment and middle-class growth for three decades plus. But with agentic AI out to automate much of what the sector does, that success story may be nearing its limits. It's time to turbo-charge manufacturing—which needs a renaissance.

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As the dust settles on India's recent AI summit—optimistic in tone, ambitious in scope—a harder question demands an honest answer. What does the next wave of artificial intelligence mean for a sector that has served as a key economic engine for three decades?

Information technology (IT) services generate over \$254 billion in annual exports, employ 5.4 million professionals and finance a merchandise trade deficit that has breached \$300 billion.

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Software exports are a success story. They are also a macroeconomic stabilizer, rupee backstop and social contract (given their role in expanding India's middle class).

This engine is under threat as Agentic AI systems deployed at scale by Anthropic, OpenAI, Google and Microsoft can autonomously write code, manage workflows, process claims and run structured business processes. Much of India's IT sector's services fall in this category.

Niti Aayog warns that our tech-sector headcount could fall from 7.5 million to 6 million by 2031. The stock market has voted: India's IT majors have seen their share prices fall while their global counterparts surged.

A sharp slowdown in IT exports can precipitate a collapse of the rupee, forcing up interest rates and pushing the Centre to cut expenditure, which would put further pressure on growth and jobs.

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If there's a silver lining, it is the possibility of a broad manufacturing renaissance. India accounts for just 2.9% of global factory output and 1.8% of goods exports—a share that has barely moved in two decades. Manufacturing contributes just 13% of GDP, against 25–32% in East Asian countries that exhibited miracle growth. The gap between India's potential and performance reflects not so much a market failure as a policy failure waiting to be corrected.

Paradoxically, a weaker rupee could become an asset. It would serve exports well, giving Indian merchandise a price edge just as global supply chains seek to diversify beyond China.

India's production-linked incentive (PLI) scheme has seen electronics production surge 146% since 2020-21, even as mobile exports have grown 8-fold. Our National Manufacturing Mission could convert this proof of concept into a structural shift in favour of the factory sector. Here is how:

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First, a global value chain taskforce should identify the top 20 global firms across priority sectors—electronics, EVs, semiconductors, defence, chemicals and medical devices—and pursue them with a whatever-it-takes mandate: bespoke incentives, coordinated Centre-state action and 90-day decision cycles. Apple's move to India catalysed billions in investment and made us the world's second-largest mobile phone maker. The lesson: a few strategic anchors can transform a field.

Second, ease import bottlenecks. High tariffs on base metals, speciality chemicals, capital goods and components protect upstream producers but also price downstream exporters out of global markets. A surgical audit of input costs across the top export value chains, followed by tariff rationalization and faster customs clearances, would restore competitiveness better than a weaker exchange rate.

Third, 'Gift cities' for manufacturing. Less than 2% of India's land is used for industry. Manufacturers, particularly small businesses, struggle to find suitable sites that are cleared and connected.

States must develop industrial clusters where land is pre-acquired and titled, utility connections are in place, building bye-laws are liberal and approvals are delegated to local authorities offering truly single-window clearances. These clusters should be modelled on the Gift City framework, where meaningfully differential regulation can be applied on par with the world's most liberal.

Fourth, PLI 1.0 has given India a clear set of lessons. It has attracted over ₹2 trillion in investments across 14 sectors and helped transform electronics and pharmaceuticals.

We now need PLI 2.0, which should be more ambitious in its targets. It should anchor the National Manufacturing Mission's goal of this sector accounting for 25% of GDP and be simpler in design: fewer sectors pursued with greater depth, and with streamlined eligibility and faster disbursement cycles. PLI 2.0 must operate with a dedicated secretariat and measurable quarterly milestones with full accountability.

Fifth, India must deregulate quickly. It has made genuine progress on this front through dedicated taskforces recently. But much still needs to be done before we can claim parity

with frictionless investment destinations like China, Vietnam and other Asian countries. The immediate priority is to sharply reduce licence and compliance requirements, consolidate overlapping regulatory jurisdictions, digitize inspections with time-bound outcomes and enforce accountability for delays.

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While these five measures can get our manufacturing engine going, it will require a few more reforms to sustain. We must tackle the issue of electricity cross-subsidization to ensure that Indian companies have access to reliable power at competitive rates. Similarly, GST and labour code simplification should go further, so our labour market and tax administration are on par with the best.

Finally, we need a strong dispute resolution mechanism with dedicated commercial courts, mandatory pre-litigation mediation and specialist arbitration to reduce the risk premium that investors price into every decision.

India has missed the manufacturing bus before. The next one is boarding. We must spare no effort to get a ticket.

The authors are, respectively, founder-CEO, and operating partner, The Convergence Foundation

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