Profitable growth strategies for the Global Emerging Middle

Learning from the 'Next 4 Billion' markets

Strategy and Research

pwc

Foreword

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The Global Emerging Middle is a class of citizens and consumers defining a critical growth horizon for companies over the coming decade. They are found largely in markets we define as the 'Next 4 Billion': countries like India, China, Indonesia, parts of Africa and Latin America where over 4 billion of the 7 billion people on our planet reside. Not only will this horizon define how businesses grow over the coming years, but strategies to foster profitable growth in this segment will determine whether companies can achieve sustained success.

Our report focuses on strategies adopted by leaders who have tried to grow profitably in this market. Their experiences, brought out through case studies and interviews with CEOs, and practitioners give interesting pointers for success in this market. Our detailed research focuses on the large Indian emerging middle, which is often seen at the front line of innovations to address this segment. Selected cases studies then take this learning to other parts of the 'Next 4 Billion' markets to flesh out these strategies.

Each company will have to approach the Global Emerging Middle with its own industry axioms. Different 'Next 4 Billion' countries will also have their own variations to the strategic themes our research has thrown up. This research can only act as a starting point of a deeper investigation for the company or the country. However, the nine keys themes that emerge in this report throw up a very lively picture and have some contrarian suggestions.

For instance, the aspirational nature of this emerging middle challenges 'cost only' strategies. The requirement to complement technologies with brick and mortar presence, to sell and distribute in this market, needs careful consideration. And most importantly the mindset shift needed both in building trust with customers and to change internal organisational dynamics for this market is critical.

We hope strategies brought out by this research offer the first stepping stone in your journey of discovering and engaging with the Global Emerging Middle. Success in this exciting market will challenge you to come up with new value propositions, innovative business models and new ways of thinking. However, for those companies committed to this vast new growth horizon, capabilities that are built through this stretch will allow you to compete globally and win.

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Global Strategy Leader

Executive Summary

Globally, businesses are looking at the 'Next 4 Billion' nations for growth, especially now, given the slowdown in mature economies. These nations are defined as having average per capita gross domestic product (GDP)of between $1,000 and $4,000 per year, and are home to 4 billion people, or more than half of the world's total population of 7 billion. (see figure below) Within this group of nations -- which includes China, India, Indonesia and Latin America countries in Africa -- businesses have traditionally focused segments on the 'Middle' and 'Upper Middle+' income. We believe – the ***'Global Emerging Middle'*** (GEM) -- which lies just below the Middle segment constituting a significant, expanding and largely untapped market. (see India's income distribution, next page)

Our research shows that pioneers that succeed in creating profitable growth use strategies and innovations very different from those employed in more developed economies. Multinationals stand to learn from these pioneers, but only if they leave their preconceived approaches and business models behind them and show greater flexibility in addressing this new market.

Once a company has established itself in the GEM, customers will carry their loyalty with them as they migrate up to the Middle class. By focusing on this large, relatively untapped market, companies will be able to build early loyalty that will hold them in good stead as these customers acquire greater economic power.

Global Population distribution by GDP/capita

7 Bn Population	Upper 1bn	Middle 1bn	Next 4bn (Target population)	Low 1bn	Difference Middle vs. Next
Average GDP/Capita	> $ 12,196	$ 3,946 - $12,195	$ 996 - $ 3,945	< $ 995	
Years of education	14.5	13.8	10.3	7.9	25%
Urban population (%)	78	74	41	27	45%
Mobile phones subscription (per 100 people)	106	92	47	22	50%
Internet users (per 100 people)	68.3	29.9	13.7	2.3	54%
Cars (per 1,000 people)	435.1	125.2	20.3	5.8	84%

Source: World Bank

The Global Emerging Middle (GEM) already accounts for 2.3 billion people globally. And it is only going to get bigger, thanks to high birth rates and above-average economic growth in many countries in the group. The GEM will represent a combined annual market in excess of $6 trillion (USD) by 2021. In India alone, the segment is expected to cross the $1 trillion threshold by 2021 as its ranks swell to 570 million, from 470 million in 2010.

Companies seeking growth can ill afford to ignore the opportunity offered by this GEM market. But while the segment itself is experiencing sharp growth, companies entering the market often find that profitable growth can prove elusive.

Companies can also use the capabilities they have built in the GEM not only to address the Middle class in that country but also to compete in other Next 4 Billion markets that have similar segments.

What's more, innovations developed in the Next 4 Billion countries can be exported to mature economies, to spur growth and increase efficiencies there. This is particularly relevant in recent years as mature economies are going through a recessionary phase. To protect themselves from this new competition on their home turf, and to turn it to their own advantage, multinationals will need to understand the strategies and innovations that are now germinating in the Global Emerging Middle.

In short, companies will either have to enter this increasingly important sector during the coming decade or be prepared to battle those that do. Either way, they need to learn from the leaders in this market and tool up to meet the challenges that are on the way.

In this journey, the strong innovation and R&D capabilities of international companies can be of help. By tapping these strengths, companies can develop the novel value propositions, business models, and mindset needed to succeed in this beckoning but challenging environment.

The value propositions designed for countries at the upper end of the global income spectrum seldom work sustainably to meet the needs of the Global Emerging Middle class. Instead, companies have to develop a nuanced understanding of the aspirations and unique tradeoffs of this segment and develop solutions to meet these needs. Value propositions can't simply focus on low cost if they are also going to connect with the segment's aspirational framework. Nor can companies treat the Emerging Middle class as a homogeneous set of customers. Differences based on location (urban vs. rural), age, religion, and language require customised products and services based around a standard and scalable platform. However, the right value proposition will fuel rapid growth.

Companies also need innovative business models and processes to address this segment profitably, to overcome institutional weaknesses and gaps in everything from credit systems to supply chains. Companies have to collaborate with key players in the unorganised or informal economy to create an ecosystem that supports their business model. While prototyping and pilots are required in the initial stages, scale solutions are essential

Key themes for succeeding in the Global Emerging Middle

New value propositions

- Aspiration trade-offs. Understand the very different aspirations, influencers, and tradeoffs of this segment
- Beyond low cost. Position product and services beyond cost, pricing beyond functional considerations
- Platform Customisation. Design product and services with a few key features, but tailoring it for diversity

Innovative business models

- Ecosystem Collaboration. Extract value by creating an ecosystem, collaborate with the unorganised sector
- Modular scale. Have a modular design, aggregate local demand and think scale from the beginning
- Smart reach. Cluster marketing and distribution, create local financing mechanism, enable through technology and offline

Shift in mindset

- Trusted endorsements. Build the brand with aspiration in mind, but using word of mouth to drive awareness
- Disruptive thinking. Seek Disruptive change in addressing this market often with leapfrog solutions
- Values and metrics. Drive this business with broader values and incubate it with different metrics

India's Income Distribution (millions)			1.19 Bn	1.36 Bn	
Household income/year (INR)		$*/day per capita	2010	2021 (Projection)	(%)
> 850,000	Upper Middle +	>$10	80	190	14%
300,000 – 850,000	Middle	$5-$10	170	300	23%
150,000 – 300,000	Emerging middle	$1.7-$5	470	570	42%
< 150,000	Low	<$1.7	460	290	21%

Source: PwC Analysis, NCAER (National Centre for Applied Economic Research), CMI
**Purchasing Power Parity (PPP)*

While India constitutes 470 million individual in the 'Emerging Middle' and 'Global EmergingMiddle' is estimated to be 2.3 billion people globally in 2010 for success. In addition, successful entrants employ a mix of techniques and channels to meet the segment's varied and often-unique needs. Technology is key, of course, but so are networks of brick-and-mortar service centers and other offline support systems. An appropriate business model will lead to sustained profitability.

The third critical element for achieving profitable growth is a shift in mindset. Companies need to adjust, both in their external approach to the market, and internally to the special requirements of the Global Emerging Middle. Often this requires a strong leadership presence, a bold approach that embraces disruptive solutions, and a willingness to adopt new values and metrics to drive and measure success.

Businesses addressing the market will have different financial strategies at the adoption, acceleration and steady state stages of growth. For instance, the right financial approach emphasises prototyping and experimentation, and can be asset light in the initial stages. However, to achieve such success, investments are needed in the acceleration phase to get to scale. In many cases, profit at low cost is only possible at great scale.

AND thinking

You must focus on quality AND affordability; quality is fulcrum

Ex-CEO,
Medical Services Company

In this report, our research has focused on India because it is home to one of the biggest Emerging Middle segments in the world. The hard-won lessons of companies that have been pioneers there will be of interest to those now ready to do business in this segment, in India or elsewhere. We interviewed CEOs and innovation leaders, conducted primary research, and compiled case studies, some involving companies from other geographies such as Africa, Latin America, and China.

As diverse as the Emerging Middle is within a given country, it follows that the segment's characteristics and dynamics vary as well, to some degree, from country to country. That notwithstanding, the framework and lessons that we have developed in this report are relevant throughout the 'Next 4 Billion' and offer a strong starting point for further investigation.

Our framework recognises that companies will be at different stages of maturity in addressing the 'Next 4 Billion' growth horizons. Those that are looking to enter this market will focus on value propositions, while those already well entrenched will require improving their business models. Both will require a change in mindset. Ultimately, this framework will help companies come up with a holistic strategy for profitable growth.

Global 2021

The emerging middle will represent an annual market of USP 6 trillion

Trusted Endorsements

In India, promotion through word of mouth is very important and it is very difficult to substitute it with technology.

Founder, ITES Company

Introduction: Nine Themes for Success

The GEM Framework

More than half of the world's population – about 4 billion people -- live in countries with per capita income between $1,000 and $4,000. And a significant proportion of these people — represent a huge and largely untapped market: the Global Emerging Middle class. In India, China, Indonesia, Nigeria, and other developing nations that we call the 'Next 4 Billion,' untold millions of consumers are continuing to climb out of the lowest income segment, thanks to economies that are galloping ahead at rates that developed countries can recall only with nostalgia.

But how do you do business with this diverse and sprawling segment, whose members are often dispersed over vast rural areas or live in dense urban clusters that are largely unconnected to the formal economy?

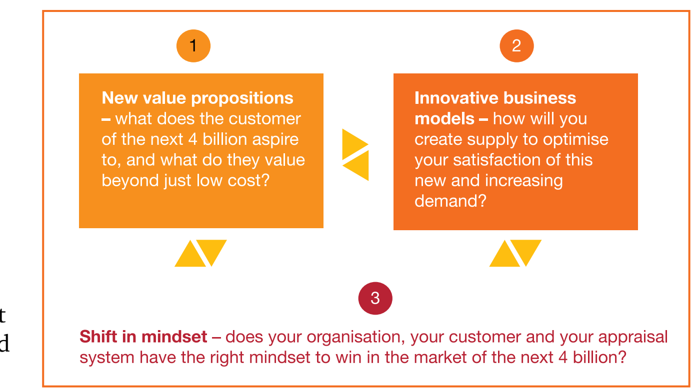
The insights gained from our research reveal that successful pioneers focus on three key areas:

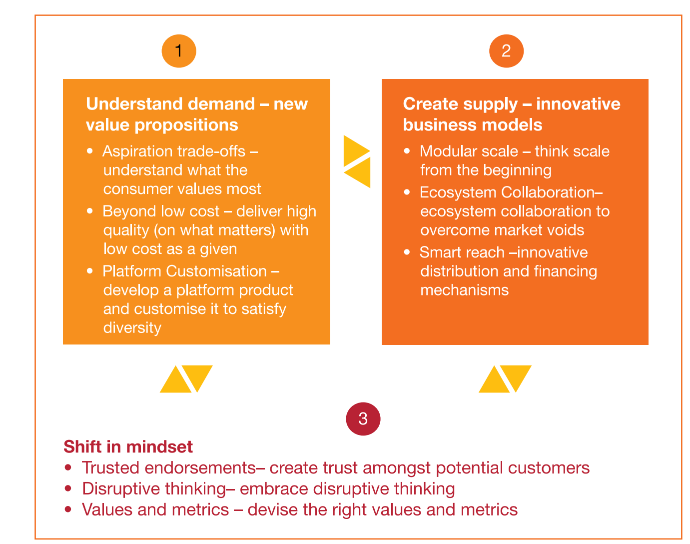
- **New Value Propositions –** Understanding Demand
- **Innovative Business Models –**
- Creating Supply
- **Shift in Mindset –** Managing the Consumer and Organisational Mindset

Strategies for profitable growth in the emerging middle need to address all three areas for success.

In turn, each of these areas contains three key strategies for success. Together, these nine elements form the framework and themes of our analysis.

The PwC Framework - How to win in the market of the Global Emerging Middle (GEM)





New Value Propositions – Understanding Demand

Aspiration tradeoffs (Consumer assessment) – Solutions must be developed that cater to the aspirational needs of this consumer segment. Companies need to understand the tradeoffs (some counterintuitive) that the consumer is forced to make in purchasing decisions.

Beyond low cost (Pricing and positioning) -- Businesses must position their solutions around performance, aspirations, and unmet needs. Leading with a value proposition based just on low cost is not a recipe for success in this market.

Platform customisation (Solution customisation) – Companies need to create a fundamental product, technology, or solution platform that can be customised, sometimes with the assistance of partners and the user community. This approach offers a cost effective and comprehensive way to cater to the diversity of this market.

Innovative Business Models – Creating Supply

Ecosystem collaboration (Local alliances) -- To overcome institutional and market voids in emerging economies, businesses must focus on building an ecosystem. They will need to work with the government, key figures in the local informal economy, and others. And they must create value in the system before extracting part of the value for themselves.

Modular scale (Design for scale) – New entrants must aim for economies of scale from the beginning. A modular business model can lower costs for the consumer as well as the company, provide maximum reach, and enable consumption.

Smart reach (Value chain design) -- Organisations should use a cluster approach to deal with the diversity in these markets. Innovative distribution models, novel applications of information technology, new financing mechanisms, and offline interventions are crucial for effectively penetrating this sector.

> ### Aspiration Tradeoffs
> *Fundamental needs of the market are the same – compromises you are willing to make will be different based on your target demographics.*
>
> Ex-CEO,
> Medical Services Company

Shift in Mindset – Managing consumer and organisational mindset

Trusted endorsements (Managing the consumer mindset) -- In order to seed and accelerate demand, companies must build trust through unconventional proxies and partnerships within the community.

Disruptive thinking (New markets, new sources of value) – To win a place at the table, organisations must have a mindset that is open to creating disruptive products, services, and business models.

Values and metrics (Managing performance) -- To profitably serve the 'Emerging Middle,' companies must adopt a different set of values for risk taking, customer orientation, research methodology, and collaboration with external players. They also need to apply different metrics for success, particularly at the beginning.

The goal for companies entering any of these markets, and guided by our framework, is to create a product or service that is designed for the requirements of this segment and for the same product feature is an order of magnitude less expensive than what is currently offered to other consumer segments. This new product or service will inevitably lack some of the "nice-to-have" features of a luxury Western product. But on the key purchase criteria, it must fulfil the same high standards used in other segments or globally. In this sense, a business must produce more for less.

New Value Propositions

Key themes	Key Questions	Evaluation Parameters
• Aspiration Tradeoffs	• Do your solutions differentiate this consumer segment from other (upper middle, middle+) segments? • Do you have a clear understanding of what drives purchasing behaviour of this consumer segment for your product/service base? • How close are you to the end-consumer?	Consumer Assessment Positioning and Pricing Solution Development
• Beyond Low Cost	• Are you delivering distinct sources of value to the consumer segment beyond price? Does your positioning reflect that?	
• Platform Customisation	• Does your solution have key features that the consumer wants? • Do you vary your solution to cater to regional diversity? Do you have the right mix (profitable) in solution variation?	

Innovative Business Models

Key themes	Key Questions	Evaluation Parameters
• Ecosystem Collaboration	• Have you partnered with the government to penetrate this segment of the population? • Does the unorganised sector provide a powerful source of competition via substitutes? Have you partnered with unorganised sector to serve this customer segment? • Based on institutional and market voids for your industry, what investments do you make to fill these gaps?	Strategic alliances and Extent of Collaboration Solution Design Value chain strategy Delivery channels
• Modular Scale	• Is your solution "modular"? Can it be scaled in a cost effective manner? • How do you aggregate demand, given the cash flow constraints of your end consumer?	
• Smart Reach	• Does your distribution strategy involve a clustered approach for better reach to this consumer segment? • Do you have online as well as offline interventions to deliver your solution to the consumer segment? Is it profitable? • Have you deployed an innovative financing strategy for this consumer base? Do you have the risk appetite? Do you know if your competitors have done it?	

Shift in Mindset

Key themes	Key Questions	Evaluation Parameters
• Trusted Endorsement	• What is the promise that your brand makes to the consumer? What choices do you need to make to deliver on that promise? • What counterintuitive consumer perceptions do you need to manage with this consumer segment? • Does your product design suit this consumer segment?	Branding Organisation Strategy Innovation assessment and Innovation Strategy Strategic Planning
• Disruptive Thinking	• Does your organisational have an innovation capabilities? Is innovation a priority within your organisation? • Do you have a robust idea to commercialisation model within your organisation to test and scale new disruptive ideas?	
• Values & Metrics	• How is growth and success measured in your business? Do these barometers need to change for sustained growth with this cash strapped segment? • What research methodology do you favour to understand the needs of this consumer segment ?	

Demographics and Growth

Market size

The Indian emerging middle class will constitute a trillion dollar market, with 570 million people by 2021.

Characteristics

The "Emerging Middle" consumers aspire for products and services catered to the upper income classes, however, they are extremely cash strapped, and >60% of their income is spent on essentials

Rise of the 'Global Emerging Middle' Class and the 'Next 4 Billion' Nations

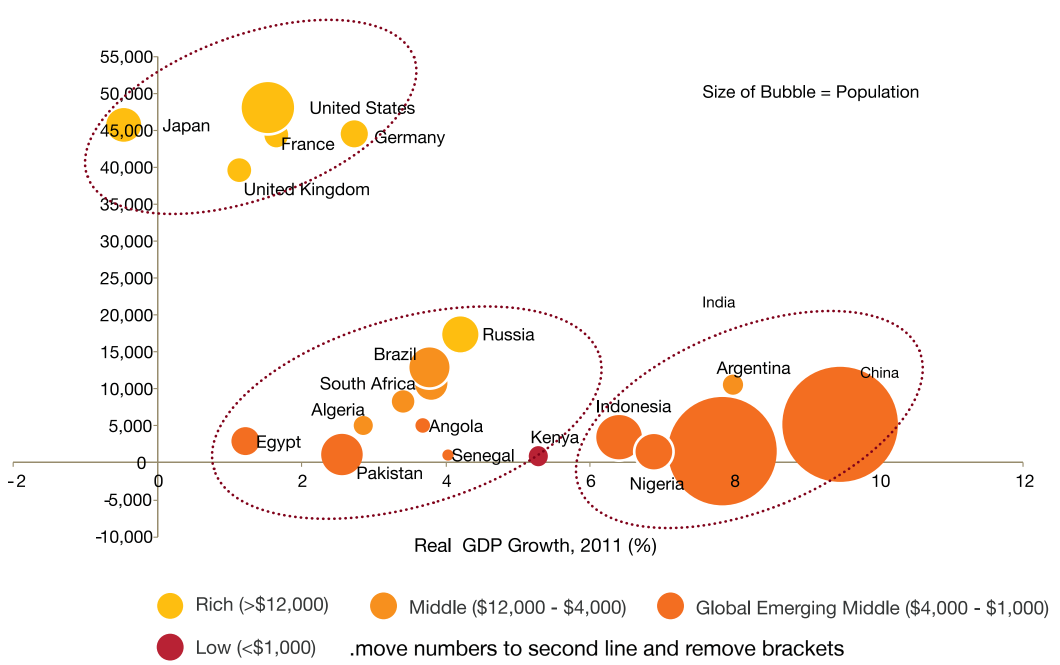
A demographic shift is under way throughout the world's developing countries that promises over the next 10 years to profoundly affect their societies and economies as well as the companies that do business there.

Huge numbers of consumers are making their way up from the bottom of the economic pyramid to form an Emerging Middle class. Though they still earn modest sums -- $1.70 to $5 per capita per day in India, for example – these consumers collectively have purchasing power that already will reach $6 trillion a year over the coming decade. And their numbers are still growing, thanks to high birth rates in many of the countries as well as bustling economies.

In India, for example, about 470 million people were in the Emerging Middle class in 2010[1].

We estimate that this segment will grow to 570 million by 2021. At that time, the segment, sandwiched between the lowest-income group and the middle class, will constitute about 42% of India's total population.

Globally, we estimate that the segment now encompasses about 2.3 billion people[2], with the income level defining the group varying from country to country. Majority of the Emerging Middle class live in nations with annual per capita income of between $1,000 and $4,000. Together, these countries are home to about 4 billion of the world's total population of 7 billion. This group, which we are calling the 'Next 4 Billion,' is at the epicentre of the demographic shift, serving as the crucible in which companies are developing the new value propositions, business models, and mindsets that are needed to operate profitably in this increasingly important consumer segment.



Source: IMF and World Bank

India's Income Distribution (millions)					
Household income/year (INR)		$*/day per capita	2010	2021 (Projection)	(%)
> 850,000	Upper Middle +	>$10	75	190	14%
300,000 – 850,000	Middle	$5-$10	166	307	23%
150,000 – 300,000	Emerging middle	$1.7-$5	472	570	42%
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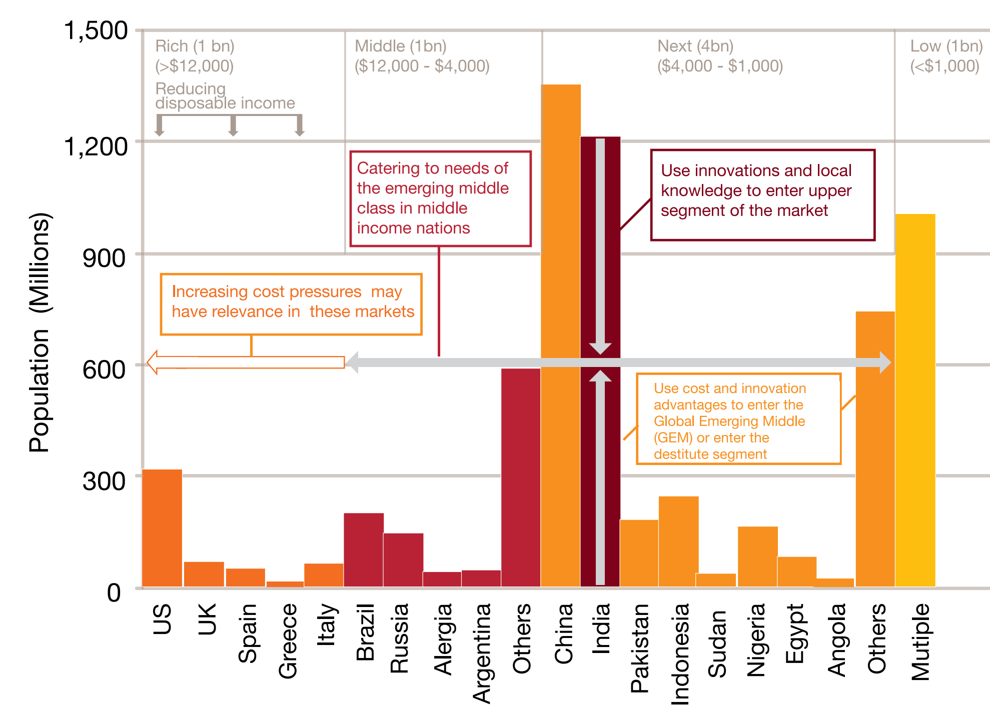
Sources: PwC Analysis, NCAER (National Centre for Applied Economic Research), CMI.



Source: PwC Analysis, World bank, IMF

Population	Upper 1bn	Middle 1bn	Target population Next4bn	Low 1bn
Average GDP/capita	> $ 12,196	$ 3,946 - $12,195	$ 996 - $ 3,945	< $ 995
Years of education	14.5	13.8	10.3	7.9
Urban population (%)	78	74	41	27
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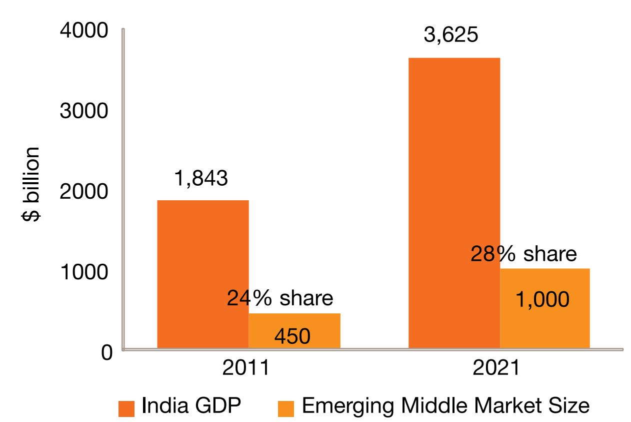


India's Trillion-Dollar Market

In India, the Emerging Middle will constitute a $1 trillion market (2010 prices), by 2021[3], representing about 28% of India's GDP and about 16% of the Emerging Middle's global market of some $6 trillion[4].

Not only is this segment of the population increasing rapidly, but so is its share of disposable income. The average annual disposable income for the Emerging Middle class is expected to reach $2,190 (international dollars) per capita by 2021 compared to $2000 per capita in 2011[5].

Given that this consumer segment is largely underserved, there is significant commercial opportunity for companies to establish first-mover advantage and build loyalty early.

Youth Is the Mainstream in India

India also enjoys a demographic dividend over other emerging and developed economies, by having the youngest median age. Currently 58% of the population are below 30 years[6]. While 73% of the young are literate -- the rate is 62.1% in rural areas[7]-- only 9.6% are graduates with higher education, which poses a challenge for skilled labour requirements in India[8].

Businesses cannot afford to ignore this growing segment of the population. Although many businesses have broadly targeted the youth group, they need to develop a more nuanced and segmented understanding, especially with regard to the young in the Emerging Middle, and develop products, services, and marketing strategies that cater specifically to this segment.

Largely Rural Population

Approximately 67% of India will still live in rural areas in 2021[9], posing unique marketing, sales, and distribution challenges to companies.

To be sure, urbanisation is continuing in India, primarily due to migration from rural areas, the natural increase in population, and the designation of new areas as 'urban'. However, from a 10-year strategic point of view, India, especially its Emerging Middle segment, will remain largely rural. Therefore, strategies for the segment must address the unique challenges posed by this reality in five key areas:

- Distribution efficacy and cost effectiveness
- Gaps in the unorganised sector
- Role of government and policy
- Different socio-economic circumstances
- Different price-quality tradeoffs.

Cost warriors

In my view, over the upcoming decade, India will need a lot of innovation, to do more than labor arbitrage"

CEO,
Leading Telecom player

New Value Propositions

The value propositions designed for countries at the upper end of the global income spectrum seldom work sustainably for the needs of the Emerging Middle class. The problem persists when companies try to export value propositions developed for the Middle and Upper-Middle+ tiers, with some customisation, to the Emerging Middle class.

Defining the Problem and Managing Diversity

While lower spending power and lower disposable income of the Emerging Middle class partly explain why value propositions developed for the upper income tiers are seldom applicable, the misalignment is broader in scope. Our view is that companies need to develop a nuanced understanding of the set of problems that this consumer segment is facing, and develop innovative solutions to meet its needs.

Additionally, companies cannot treat the Emerging Middle class as a homogeneous set of customers. Differences based on geography (proximity to a city or industry cluster, for example), age, employment, religion, language, and gender pose enormous challenges for businesses.

Defining the problems, in the context of diversity, will enable businesses to think of solutions that consumers need and are actually willing to pay for.

Our extensive primary research proposes three key themes that must be considered to create compelling value propositions for the Emerging Middle class:

Aspiration Tradeoffs - Solutions must connect on an aspirational level with this consumer segment. While those in the Emerging Middle frequently aspire for products and services that cater to the upper-income tiers, businesses must have a deep understanding of the unusual tradeoffs that are at the heart of many buying decisions. A solution that can cater to aspirations, while factoring in tradeoffs, has the best chance for sustained success.

Beyond Low Cost - Should a solution that was developed with significantly lower cost be positioned as a low-cost product to attract the Emerging Middle? Our Research shows that while lower price points (or other innovative pricing strategies) are critical for this segment, businesses must position their solutions around performance, aspirations, and unmet needs to be successful.

Platform Customisation - Companies must create a fundamental product, technology, or solution platform that can be customised, sometimes with the help of partners or the user community. Although a mass-market solution needs to have a standardised set of features that are most relevant to that market, the diverse nature of the Emerging Middle requires customisation, carried out in a cost-effective manner.

Aspiration Tradeoffs

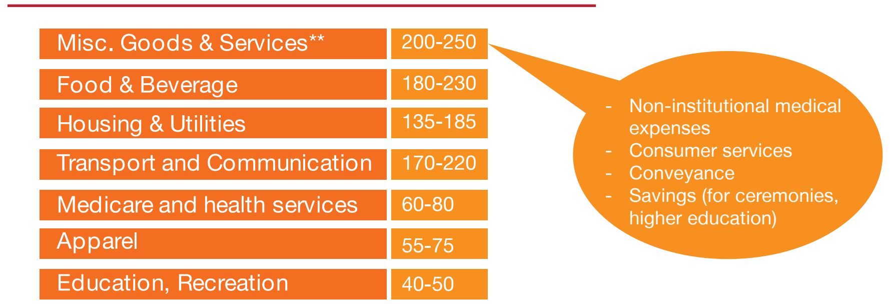
Changing social dynamics, rapid urbanisation, increased media exposure, and the proliferation of mobile services have helped to lift a significant portion of India's population into the Emerging Middle. These factors have also created a powerful push for aspirational products and services. But with per capita income of $1.70 to $5 per day, members of this segment remain perilously close to the bottom of the pyramid. For that reason, these consumers are forced to make unusual tradeoffs that determine their buying behaviour.

Rise of Aspirations of the Emerging Middle Class

The shift toward aspirational purchases has been accelerating for years in India, especially since economic liberalisation took effect in 1991. About 20%[10] of consumer spending has shifted from essentials to non-essential goods and services, including consumer durables (white goods, automobiles, electronics), clothing, beverages, and cosmetics.

The share of spending for miscellaneous goods and services – such as non-institutional medical expenses, consumer services, and savings for education -- is expected to increase from 15% [11] in FY 2010 to 23%[12] in FY 2021.

Emerging middle market size by 2021* ($ Billion)



Source: PwC Analysis; NSSO (National Sample Survey Office)
**Non PPP adjusted; ** Includes non-institutional medical expenses, consumer services, conveyance, savings for ceremonies, higher education.*

Major players in fast-moving consumer goods (Marico, Dabur, Parle, and Emami)[13] are betting heavily that key consumer demands -- related to convenience and health, for example – as well as impulse purchases will drive growth. Although pricing innovations and distribution strategy had been the focal points of such efforts, CEOs interviewed during our research stressed the importance of innovations that cater to convenience and a sense of prestige, while also taking account of the segment's survival needs.

Aspirational purchasing behaviour is also making its way into the rural household. In a sense, urban aspirations are entering the rural mindset. For instance, value-added services from mobile phone operators -- such as Bollywood caller tunes, astrology daily bytes, and participation in SMS-based contests -- have become extremely popular in rural India.

Such successful penetration of Emerging Middle India by established players is uncommon. In the apparel category, for instance, consumers in this segment tend to purchase look-alikes of well-known premium brands. This grey market thrives not just because of the affordability of counterfeits but also because of the easy access it provides to products that are aspirational, at least in terms of brand association. The challenge for legitimate businesses is thus twofold: to reach this segment with affordable and aspirational products and also to gain an incisive understanding of the segment's true demands – given its different economic and social environment.

Unusual Tradeoffs

Would you expect someone who is struggling to make ends meet to purchase a cell phone that makes a style statement? Did you know that India's Emerging Middle is expected to triple its spending on recreation and entertainment by 2021?

Although all consumers make tradeoffs based on their economic and social realities, the Emerging Middle consumer makes a set of tradeoffs that are counterintuitive, a characteristic that is crucial for businesses to understand. Survival (basic necessities) certainly takes a large portion of this consumer's mindshare. However, we found that (Prestige) *Izzat,* Convenience, Entertainment, and Children's Education figure disproportionately in the consumer's mind as well.[14]

Alam, a taxi driver in Mumbai who was a part of our consumer study, sacrificed meals to save enough money to get his children admitted to a good school. His situation is not as dire as it may seem – Alam and his family own several durables (a refrigerator, cell phone, television, and mixer grinder) as well as a small apartment in a Mumbai *chawl*[15]. Alam is very proud that he migrated to Mumbai and now has a reasonably comfortable life compared with that of his peers back home in a rural part of the country. He emphasises the favourable comparison several times during our interactions with him. Signalling progress in life is a common phenomenon across all income segments.

If survival is as important as prestige, convenience, and entertainment, businesses need to go beyond cost when they design value propositions and position their solutions for this segment.

Tata Sky did just that. It disrupted India's TV transmission industry, dominated by cable operators, by positioning itself as an aspirational product at affordable prices. It identified the unmet needs of Emerging Middle consumers and then filled those needs with differentiated service.

Tata Sky demographically profiled its customers and introduced relatively expensive (compared with cable) direct-to-home (DTH) service. This connection gives the customer choice, convenience, and control, all tied to the individual's demographic background. Customers are offered regional channel packages, superior transmission quality, and such value-added services as Activ and Showcase. Payment is made easy via the Internet and mobile phones. In 2010, 85%[16] of Tata Sky subscribers used the Internet and mobile phones to pay their renewal fees. Tata created a new benchmark in customer service and invested heavily in it – even underwriting soft-skills training for its installers.

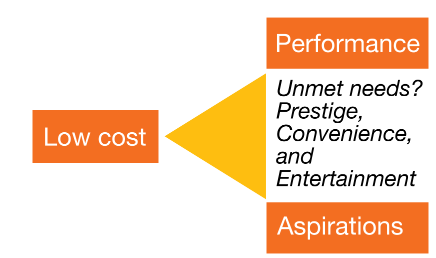
The service was launched in urban areas before it was introduced to smaller towns. This created an aspirational halo around the product. When the service finally came to the towns, lower-tier consumers were offered the same brand and product that had been sold to city customers. But to meet the financial and 'value' aspirations of Emerging Middle customers, the price of the least-expensive package was kept fairly low. The company focused on improving regional content for these customers and also on steadily reducing the price of its hardware.

Beyond Low Cost

Should a solution that was developed with significantly lower cost be positioned as a low-cost functional product to attract the Emerging Middle? Our view is that while lower price points (or other innovative pricing strategies) are critically important, businesses must position their solutions around other sources of value to win over this segment.

Bajaj, one of India's leading motorcycle manufacturers, recently launched the Bajaj Boxer, targeted to the rural consumer. The Boxer is a 150cc motorcycle (offering more power) that provides the functional benefits of higher cartage capacity and greater resilience to punishing rural roads – features that are both highly relevant to the target consumer. The Boxer was positioned as an SUV of motorcycles, directly aimed at the male consumer pool on the dimensions of power, sporty looks, and functional benefits. The Boxer has been one of the biggest success stories for Bajaj.

Positioning challenge



Value over Substitutes

As businesses make a transition from focusing only on low cost to also including such dimensions as performance and aspirations, they must understand what 'job'[17] the consumer is 'hiring' the product to perform. For the Emerging Middle market, substitutes are often abundant. Since it is tough to compete against substitutes on affordability alone, businesses must design and position their solutions on other dimensions of value. Defining the consumer 'job' is a critical step. The litmus test during product development comes down to these questions: "Does our product provide superior performance vis à vis substitutes? Does it cater to aspirations? Does it factor in the tradeoffs that this consumer segment will make?"

New Category, New Market

This approach often leads to the creation of a whole new category of product or service. Godrej, one of India's leading refrigerator manufacturers, realised that it could not develop an effective product for the Emerging Middle by just cutting features from its standard offering. Not only would such a stripped-down product underperform, but its positioning also would not work – it would be too hard to sell a 'poor man's fridge'.

Godrej's consumer research team spent a significant amount of time understanding the needs of Emerging Middle India. Their key insight: the consumer was 'hiring' a fridge to preserve food, supplies (when the buyer was a small entrepreneur such as a fruit seller or vegetable vendor), and necessities for at most two nights. These consumers often changed their residence, making portability a key requirement. Additionally, power outages and the high cost of energy to run a regular refrigerator were important considerations for potential buyers.

Armed with this information, Godrej engineers designed the new ChotuKool refrigerator for the mass market. The ChotuKool is a small refrigerator (1.5 feet X 2 feet) catering to small living spaces. Instead of a compressor it uses a cooling chip and a fan, similar to those in a computer. It can survive power surges and outages common in India. In fact, its high-end insulation enables it to keep its contents cold for hours without power. Priced at about $80, it fits the budget of this consumer pool. Arguably, the ChotuKool isn't really a 'fridge' at all, at least not in the traditional sense. But how it is categorised is not as important as the fact that it is solving a specific set of consumer problems that were inadequately addressed by other products and substitutes.

Ballpark Pricing

"If your price it too low, people will think there is a quality issue; if your price it too high, it will be out of reach for too many consumers," says K. Srinivas, CEO of Bajaj Auto India.

Clearly, the challenge with pricing for this market is the uncertain and relatively small cash flow that this consumer segment can afford. Additionally, price is a critical signal for this market in terms of quality. When introducing a new product in an established category, businesses should try to stick to a ballpark price range.

There are no hard and fast rules for ballpark pricing. The Tata Nano created significant buzz in the market when it was introduced in 2008 with a price of $2,000. Tata identified the price gap in the automotive sector in India -- between $1,600 for two-wheelers and around $7,000 for a small-car-for-the-masses segment. The Nano was affordable for the Emerging Middle class and the Middle class, and suitable for a family of four.

Tata is now turning the tide on sales of the Nano by repositioning the brand as a smart car. Nano's new advertising and marketing efforts are geared toward establishing aspirational connections with its target consumers. Additionally, Tata has introduced a financing plan that calls for a downpayment of just $300, with monthly payments for five years to match the cash flows that Emerging Middle consumers can handle.

Even though there are no fixed rules for pricing in this market, companies should evaluate the environment in which they are operating and adhere to certain principles:

1. Consider the impact of ballpark pricing: Understand what the price is signaling
2. Match the consumers' cash flows: Think 'bite-sized' payments
3. Position the product on value and aspirations: If the price is extremely attractive, it is not necessary to lead with the price.

Platform Customisation

The diverse nature and very different needs of the Emerging Middle nations call for an approach that goes beyond localisation. What is often required is a complete redesign and reengineering of the product solution. However, taking a redesigned solution and then localising it to account for regional and social differences can push costs up and make the business hard to manage.

To deal with this challenge, companies should create a fundamental product, technology, or solution platform that can be customised by the organisation, sometimes with the assistance of partners and the user community. While a mass-market solution needs to have a standardised set of features, cost-effective customisation is a critical requirement for serving the Emerging Middle.

An international electronics manufacturer, entered rural India by introducing a new line of TVs. It launched colour TV at a price point of $60 to bridge the gap between colour and black-and white models in the rural market. It focused on value engineering and design innovations to reduce costs without compromising on quality for this lower-income segment. It achieved these economies by building new versions of its products with a more compact set of features and cost-efficient materials, thus lowering its manufacturing expenses.

> ***Access to information***
>
> *Data and decision support systems will be critical for scaling as it is harder to get skilled labor, so if you have to use Para-skilling, you must provide enabling systems.*
>
> Promoter, Hospital Group

The company also focused on product localisation and introduced Hindi and regional language menus for this consumer segment. In addition, it integrated technology features to provide better picture and sound reception, overcoming the poor signal quality in rural areas.

As the standard of living has improved in rural India, the company has raised the prices of its rural television line, which currently is sold at a premium to other competitors. Despite the price differential, sales have been strong because of the 'value delivered' beyond cost.

There are many other examples of businesses creating completely redesigned 'platform' solutions that can be customised to cater to the heterogeneity in this market in a cost-effective way.

Each of these solutions, besides catering to aspirations and correctly positioning products, should address at least one of the following crucial demands:

1. **Demand for information: bridging information asymmetry** For example, ITC, the Indian conglomerate, created a platform through its e-chaupal initiative to deliver real-time information and customised knowledge to farmers to improve their decision-making ability. With this platform, ITC enriched the farmers with useful data, elevating them to a new order of empowerment.
2. **Demand for services: providing product support** Idea Cellular, the Mumbai-based mobile operator, has focused on its after-sales and service delivery. It has built a network of 2,000 service centres across the country, making sure that its customers don't have to travel more than 30 minutes to reach one. The availability of services has improved customer satisfaction while building rapport.
3. **Demand for quality, affordability, and accessibility: opening the door to more** GE Healthcare, a British-based unit of General Electric, found an opportunity to provide new mother-infant care with its baby warmer incubators. The baby warmer is part of GE's healthymagination initiative, which is geared to 'reducing cost while improving quality and access through local solutions'.

In short, Indian consumers, and more generally Emerging Middle consumers throughout the Next 4 Billion nations, are demanding value for their money. It is up to businesses to fully understand the kinds of value they are seeking and to create the cost-effective solutions that will address the full spectrum of those needs.

Relevance in Other Next 4 Billion Nations

The need to develop new value propositions to serve the Emerging Middle is a common challenge throughout the Next 4 Billion nations.

The lessons and experience of companies doing business with this segment in India are of particular relevance to those entering the sector in Africa. As in India, the Emerging Middle in Africa is young and increasingly conscious of its needs, and is just as diverse and spread out.

International Case Study

Bajaj Boxer: Innovation from India for Egypt

Recently, an innovation in India by Bajaj was adapted for the Egyptian market. The Bajaj Boxer motorcycle, which was designed for the Indian Emerging Middle, is now serving the needs of Egypt's emerging middle class. The Boxer is viewed as both aspirational and practical, a product that will improve living conditions as it helps consumers with their trade and professional projects.

The Boxer has an engine capacity of 150cc, giving it more power than its competition, and is equipped with ExhausTec technology, which is environmentally friendly as well as fuel-efficient. The bike has been designed in accordance with the requirements of the Egyptian market: It has been made safe, solid, stable, and reliable for the toughest road conditions. Previously, the bikes being sold in Egypt had a lot of problems with vibration, engine overheating, and noise, making those models very unreliable. The research conducted by Bajaj Auto revealed a need for a better bike as an alternative to the Chinese brands being sold in the market.

Bajaj Auto's candidate was the Boxer, which it marketed as a 'No Problem' bike. The company organised a Bajaj Marathon to showcase the strength and quality of the bikes. Starting at the foot of the pyramids, 15 riders toured throughout Egypt over 13 days, travelling 2,500 kilometers to introduce the bike to potential buyers.

To assemble and market the bikes, Bajaj Auto partnered with Ghabbour Auto, the leading company in Egypt's automotive industry. Ghabbour has a wide network of branches and dealers across the country.

> ***Beyond Cost Position***
>
> *While low price is a consideration, the Indian market is complex. In recent years while Indian consumers wants low price they would not sacrifice comfort or prestige for it.*
>
> Vice Chairman, Automotive Company

CASE STUDY

GE and Embrace

Baby Warmers

Background

GE Healthcare in India has identified reducing high infant mortality rate as a core component of their mission. In alignment with the United Nations' Millennium Development Goals (MDGs), GE is focusing its efforts on MDG 4, "reducing by two-thirds the under-five mortality rate by 2015".

Customer Insight

GE conducted consumer research by partnering with non-government organisations (NGOs) and local hospitals to understand consumer needs and difficult operating conditions such as power requirements, delivery of equipment, training of personnel and other localised needs[18].

GE introduced low cost baby warmers, 'Lullaby' and 'Embrace', the latter developed by an NGO called Embrace (initially conceptualised in Stanford university[19]), suiting the price limitations of rural and semi-urban India. GE also adopted a hybrid distribution model, with direct and collaborative distribution, to expand its reach within India. The warmers for India are reengineered products to meet mass market requirement; unlike traditional warmer-incubators that cost up to US $ 20,000, these simplified warmers (without the incubator which is rarely used) cost between 1 ('Embrace') to 15 ('Lullaby') per cent of this price, and suit the local conditions of India. The warmers are designed to care for newborn infants, primarily to help them adjust to room temperatures[20]. GE also has a range of other maternal-infant-care products developed and marketed for India to cater to localised needs, while keeping costs low.

Innovative Strategies

Value Proposition

Lullaby: The Lullaby warmer provides high quality care, while removing sophistications such as software to monitor infant's pulse, digital scale to monitor the infant's weight, and LCD monitors to display data, to reduce the cost of device in this warmer. They made it simple yet powerful by understanding local needs: introduced visually coded panels and colour-coded safety alarms that are simple to understand, regardless of user's language; incorporated large LED screens to provide direct access to the most critical functions; created a Jaundice attachment[21], since 50-60% of infants contract such waterborne diseases in emerging middle India. The Lullaby warmer is priced at US $ 3,000[22].

Embrace: one of the major contributors to death and illness in infants is hypothermia, a reduction in core body temperature below 95° Fahrenheit.

The Embrace warmer is an ultra-low cost innovation (priced at US $200), developed by an NGO Embrace, initially conceptualised in Stanford University for rural areas and the poorest communities, to operate under extreme conditions such as uncertain electricity supply and hard to reach geographies for delivery and servicing.

Embrace has three components--a sleeping bag, a sealed pouch of wax and a heater. The warmer swaddles the baby and a heated pouch of wax is placed in an adjacent compartment in the sleeping bag. The technology in this warmer involves heating the wax that goes in a compartment of the warmer. The pouch is heated via the electric heater. The wax heats to 98.6 degrees Fahrenheit, a critical temperature for a child's survival. The wax will keep the bag warm for at least six hours with an indicator signalling when it's time for reheating.

GE has entered into a distribution agreement with Embrace to use ensure availability across remote parts of India.

Business Model

The 'Healthymagination' initiative at GE is about "reducing cost while improving quality and access through local solutions".

GE adopted design thinking, and an end-to-end solution driven approach. The company adheres to a broader mandate of reducing Infant Mortality Rate (IMR). They have made investments in education for user base, training of tertiary healthcare provider technicians to provide healthcare for infant after they leave the healthcare centre.

GE adopted a hybrid model of using its own and collaborative distribution network. They used their own distribution network to sell warmer units to primary and community healthcare centres in India. While GE brought product and application expertise, they also piggybacked on Johnson & Johnson's distribution network to tap their 3000-4000 dealers' channels and brought in indirect resources through other dealer operations as well.

Additionally, GE has established product and distribution partnerships with local manufacturers with a track record for innovation not only get access to differentiated technology developed "in India for India", but also to find partners who will bear portion of the risk in developing and delivering these new disruptive product lines[23].

Shift in Mindset

GE decided to launch the product in the emerging markets of India and then scaling it globally subsequently.

Moreover, they were able to introduce a product which suited the requirements of the consumer at affordable prices without compromising on the quality.

GE was also able to partner and collaborate effectively with a smaller non-profit organization to achieve effective cost structures and disruptive technologies and therefore add value to their offering both for the consumer and the organization.

Through the baby warmer, GE Healthcare gets an opportunity to further their commitment to maternal-infant care while increasing local access and reducing infant mortality.

Innovative Business Models

Besides developing new value propositions, companies that want to engage with the Emerging Middle class must reinvent their business models and processes. Traditional models are simply not up to the task of addressing the broad diversity and variety of this segment. At the same time, companies must regularly reinvent the technology used to reach Emerging Middle consumers and to secure economies of scale.

According to our research, the new business model must create a collaborative ecosystem, achieve scale via modularity, and employ a counterintuitive approach to reach:

Ecosystem Collaboration - Partnerships with the unorganised sector, the government, and other stakeholders are critical in Emerging Middle nations. Businesses must build an ecosystem to fill or overcome the institutional and market voids in this sector.

Modular Scale - Within this ecosystem, organisations need to employ a modular approach that will increase logistical efficiency and lead to lower costs, of benefit to both the company and the consumer. Aiming for economies of scale from the beginning and aggregating demand are crucial for a profitable business.

Smart Reach - A cluster approach is needed to deal with the diversity in these markets. Innovative distribution and financing mechanisms are also essential. Moreover, appropriate technology, along with offline interventions, is key to providing important features to consumers.

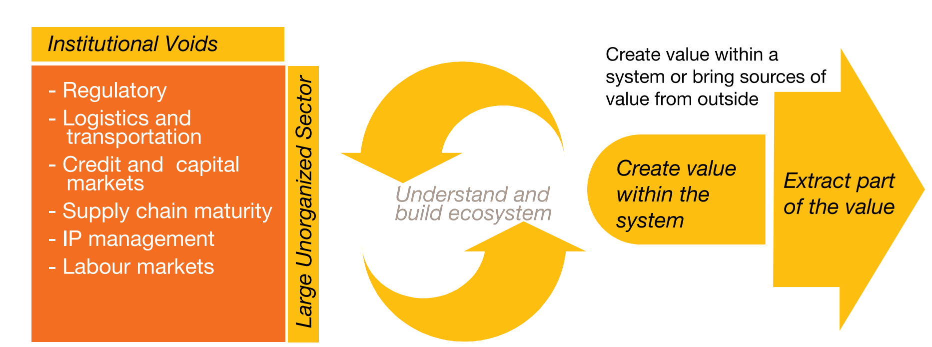
Ecosystem Collaboration

Collaborate to Overcome Institutional Voids

The customer value proposition needs to be built and delivered despite institutional voids in emerging markets. These gaps are numerous and deep, affecting areas as diverse as government regulation, logistics and transportation, credit and capital markets, supply chain maturity, IP management, and labour markets. We found that CEOs repeatedly point to the lack of a functioning regulatory framework as a major impediment for growth in an emerging economy like India. Poor infrastructure, shortcomings in the supply chain, skills shortages, and the questionable quality of education are some of the other cited reasons.

To overcome these challenges, companies need to create a collaborative ecosystem that identifies and fills the voids, or finds ways around them.

Nokia Money, the financial arm of the Finnish communications company, had to build a new ecosystem when it decided to become the first company to offer basic financial management and payments from a mobile phone in India. Initially, the Nokia Money service was operated in conjunction with Obopay. But then Nokia made it interoperable with other payment companies. Designed to work in partnership with mobile network operators and financial institutions, Nokia Money enlisted distributors and merchants in a dynamic ecosystem to seamlessly provide the new service to consumers and thus overcome a void in the market.



Smart Reach

Financing is an enabler to get the product within the reach of consumers. If you have to tap the market, you have to understand the financial ability of the consumer and have a different model of selling.

Vice Chairman,
Automotive Company

Unorganised Sector

The unorganised sector understands local needs best, and newcomers from the outside have developed a collaborative model to gain access to the consumer's trust. More than 80% of the workforce in India belongs to the unorganised sector, accounting for about 60% of the net domestic product. Because the sector is essentially composed of 'one person enterprises', it is usually efficient but tough to scale.

The corporate sector must learn how to collaborate with the unorganised sector. Tremendous value can be created through such efforts.

For one thing, important players in the unorganised sector – often belonging to the Emerging Middle - are proxies of trust and reliability for the consumer. To promote its Boxer motorcycles, for example, Bajaj Auto contacted 300 (village heads) *sarpanches* to show them how the bikes were made. The result was extremely powerful word-of-mouth support for the brand.

For another thing, collaboration can reduce the threat posed by substitutes, particularly counterfeit branded goods. The use of banks and microcredit can make it possible for more consumers to buy the 'real' thing.

Indeed, organising the unorganised sector creates value for the consumer in many ways, including greatly improved efficiency. Handling financial transactions through a mobile phone, for example, has numerous advantages over traditional dealings with local loan agents. Finally, because they understand local needs so well, key actors in the unorganised sector can show newcomers the way. National and regional retail chains benefit greatly by forging relationships with small local players like the (mom and pops) *kirana* stores.

Public-Private Partnerships

In addition to working with the unorganised sector, successful companies in the Emerging Middle have learned that they must also collaborate with the government. But that isn't always easily done.

So far, evolving PPP models have been implemented in India in these sectors:

- Healthcare services for reaching out to the poor
- Education for skills development
- Infrastructure development for the effective delivery of services

The private and government sectors bring different assets and capabilities to the table. The private sector offers industry skills, resources, technology, capital, and innovation. The government can provide help in areas such as legal clarity, seed financing, payment systems, and administrative structures.

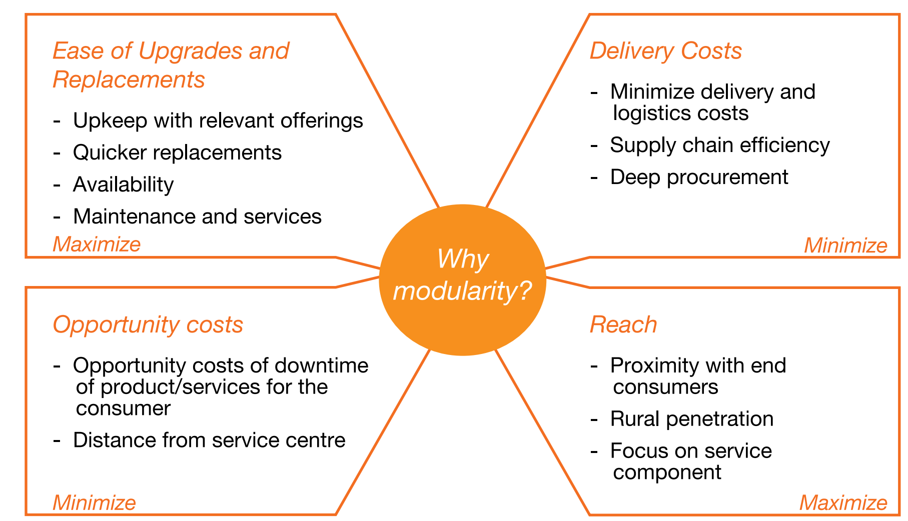
More business sectors would benefit from a PPP model and the role the government can have as a buyer, channel, and catalyst to influence demand in the Emerging Middle.

Given the huge size of this market, companies have no choice but to collaborate and invest in creating an ecosystem. Working in partnership with the unorganised sector and the government as well as other key stakeholders allows companies to overcome institutional voids as well as to achieve smart reach and economies of scale.

Modular Scale

Modular Design and Economies of Scale

As a result of ecosystem collaboration, companies will be able to achieve economies of scale by increasing the efficiency of their processes. A modular business model can lower costs for the consumer as well as the company, provide maximum reach, and support growth.



A modular approach will help the organisation by minimising delivery and logistics costs while maximising reach and increasing proximity to end consumers. For the customer, it will minimise the costs of product downtime by making it easier to obtain upgrades and replacements and by improving overall maintenance and service.

Dr. Devi Shetty, founder of Narayana Hospitals, radically reduced the cost of heart surgery by using a combination of economies of scale and specialisation. Narayana Hospitals is able to provide efficient, affordable surgeries by focusing on certain procedures for which the operating equipment is used at a higher rate and the surgeons can become more proficient. Narayana has established video and Internet links with hospitals in India, Africa, and Malaysia so that senior surgeons can advise those less experienced. It also runs 'Clinics on Wheels' in nearby rural hospitals to test for heart diseases. The mortality rate within 30 days of coronary artery bypass surgery is 1.4% at Narayana, compared with 1.9% in the United States[24]. It has achieved that low rate while managing to cut the cost of the typical cardiac procedure by 50% or more.

Demand Aggregation

Aggregating demand in a cost-effective manner is crucial for a scalable and profitable business model. Since the size of an individual transaction in the Emerging Middle will inevitably be small, aggregating demand is essential in order to determine demand fluctuations, settle on supply plans, and make decisions about risk. It can also often serve as an effective means to involve other stakeholders. Demand aggregation involves the following elements:

- Bundling of demand - An aggregation of customer demands for the mass play
- Cross-collateralisation of risk – Minimising portfolio risk
- Predictability of demand - Estimating demand and thereby managing the inventory for an optimum supply chain
- Partnerships with informal players - Collaborating with informal channels to maximise demand
- Supply-side aggregation - Streamlining and aggregating the supply side to improve its potential and operate more efficiently

Smart Reach

Cluster Approach

The immense regional diversity in the Emerging Middle sector calls for a 'cluster' approach to maximise reach. Clustering can center on various criteria, such as economic orientation, trade flows, migration patterns, income, and demographics[25].

Nokia Money, for example, conducted a year-long analysis of migration clusters in India, and targeted specific clusters with customised advertising and services, acquiring new customers with an optimised spend.

A cluster approach can produce insights about consumer behaviour and preferences through an analysis of the segment's marketing, distribution, financing, demand, technology, and information needs.

Collaborative Distribution Mechanisms

A collaborative distribution mechanism is key to solving the challenge of supplying products and services at the right cost. Distribution solely through a company's own channels is typically cost prohibitive in this market, not to mention limited in reach. Instead, companies must also piggy-back on the distribution networks of already established players. Finding informal local channels is another must.

Bharti Airtel, the Indian telecommunications company, decided to piggyback on the pan-Indian distribution networks of such consumer product companies as Godrej and Unilever. To penetrate rural India, Bharti Airtel teamed up with a large microfinance institution. The partnership enabled customers to take loans for the Nokia 1650 and pay for the phone through 25 instalments of 85 rupees a month. Bharti Airtel also collaborated with a fertilizer manufacturer, IFFCO (Indian Farmers Fertiliser Cooperative), selling co-branded subscriber identity module cards through retail outlets and providing free voice updates to farmers about market prices, farming techniques, weather forecasts, and fertilizer availability.

For its part, Bajaj Auto tapped a local organisation to create a new channel to serve its needs. To sell its Boxer motorcycles in rural areas, Bajaj Auto entered a partnership with local authorised service centre agents and made them sub-dealers. These sub-dealers had a better understanding of local economics and were excellent judges of credit. Moreover, the agents were trusted by the community, and that trust was extended to the Boxer brand.

Cluster criteria	Type
Economic orientation	- Services vs. Manufacturing - Agriculture - Infrastructure and connectivity
Trade flows	- Direction and pattern of trade flow - Nature of trade - Trade hubs/SME hubs
Migration patterns	- Rural to urban/semi-urban - Migration to SME hubs - Reverse direction of money transfers
Income	- Distribution - Disparity - Human development indicators
Demographics	- Language - Ethnicity - Networked (e.g. mobile penetration)

Consumer Behavior and Preferences

↓

Cluster approach:
1. Marketing, distribution
2. Demand analysis
3. Financing
4. Technology, system design
5. Information relevance

In India, migration from rural to urban areas tends to follow a predictable geographic pattern. While migration to centers of trade and SME clusters occur from rural areas), the remittance flow tends to be reverse.

Nokia Money conducted a oneyr+ analysis on such migration clusters in India, and targeted specific clusters with customised advertising and services – acquiring more customers with optimised spend

Local Financing

Another insight from our research was that information asymmetry between the lender and the borrower in the Emerging Middle significantly pushes borrowing costs up. Establishing the borrowers' trustworthiness and the nature of their business takes time, effort, and money and results in higher interest rates.

Microfinance bridged this gap in three fundamental ways. First, it aggregated borrowers, collateralising the risk but also enlisting the borrowers in an arrangement to keep checks on each other. Second, it held out the threat of no further loans in the event of a default. And third, it was less flexible than the informal lending system because of its structured payback mechanism. However, the lack of flexibility in payback terms remains a key issue for the Emerging Middle consumers[26]. For that reason, local lenders continue to be a significant source of borrowing.

Our research shows, an empowered local financier is the better option – providing flexibility to the consumer, albeit imposing credit decisions on the lender. This option must provide for checks and balances to avoid predatory lending and to ensure that the local agent has 'skin in the game'.

The hard reality is that the Emerging Middle consumer is cash strapped -- and to drive an aspirational value proposition, a relevant financing mechanism is key.

Companies proceed at their peril, however, if that mechanism doesn't have enough safeguards. Bajaj Auto Finance suffered losses as it came to realize that this segment was not only cash strapped but had no access to formal credit documentation. It then devised a Direct Cash Collection (DCC) model to provide easy financing for its motorcycles while ensuring a low default rate. With this model, the customer's one-time contact with the company after the purchase is with the Authorised Service Centre (ASC). The ASC owner is a local entrepreneur who is responsible for judging the buyer's credit-worthiness. The ASC owner is also empowered to 'let people default', based on personal knowledge of the buyer's financial situation. The default rate is now below 1% with losses reduced significantly to about 2-3%.

Technology and Offline Intervention

Appropriate technology, along with offline interventions, is another key element in the Emerging Middle business model. Technology enables the delivery of important consumer features, customised to meet the appropriate needs of this diverse sector. Technology serves as an enabler by:

- Bridging language and regional barriers
- Connecting industries
- Building smart systems
- Training and para-skilling
- Providing access to information
- Managing supply chains

Using technology as an enabler, ITC's e-chaupal initiative provided farmers with valuable information about crop prices, weather, scientific farming practices, farmer peer groups, and soil-testing services, enhancing their buying power. At Columbia Asia, the Kuala Lumpur-based chain of hospitals, technology was used to build a better system: all medical records and lab reports are maintained digitally and are accessible via computer by doctors across all of Columbia Asia's hospitals, in India, Indonesia, Malaysia, and Vietnam. The company charges 15 to 20% less than comparable hospitals in the same service area.

But technology alone is not enough to effectively serve the Emerging Middle segment -- a brick-and-mortar infrastructure has to stand behind it. Offline interventions are necessary to build trust and to provide consumers with the education and experience that they need to take full advantage of the wide range of products and services that are now becoming available to them.

Nokia Money educated its prospective customers by using offline interventions. When Nokia launched its Mobile Money software, it partnered with retailers, both self run and franchisees (300,000+), and with banking institutions to use their brick-and-mortar facilities as the sites for those interventions.

An international electronics manufacturer deployed a tiered approach to reach out to towns and villages, building offices in the remote small towns that could not support a larger channel. The company soon blanketed the country with a distribution network encompassing close to 4,000 access points.

Similarly, ITC's physical presence in villages was critical to the success of its e-chaupal initiative. The company opened countless Internet kiosks that were managed by village farmers – the kiosks not only provided the latest information to the farmers, but they also served as classrooms in which Internet training was offered and trust was won.

Relevance in other Next 4 Billion Nations

Many of the innovative elements of the Emerging Middle business model developed in India are directly applicable in other Next 4 Billion nations.

The need for ecosystem collaboration is just as deep in China and Africa as it is in India. So, too, is the value gained from liaising with the central government and local agencies. And keeping the diversity of this segment in mind, along with its vast numbers of customers, it is increasingly important for companies to achieve economies of scale and employ a modular design no matter which country their business is in.

But one aspect of the model, smart reach, is of particular relevance to the complicated mosaic of Africa's markets. (see section VII, page XX). As is the case in India, companies entering partnerships in Africa with local players and networks can reach customers faster and more efficiently.

Offline interrentions

Appropriate technology along with offline interventions is a key element in the emerging middle business model

International Case Study

Vodafone's M-PESA initiative in Kenya

Africa's Emerging Middle has been getting a lot of attention recently from big corporations around the world. Walmart, the world's largest retailer, set up a base in Africa by acquiring Massmart, a South African retailer that has a presence in 13 countries across the continent. Similarly, Bharti Airtel acquired the African assets of Zain, the Kuwaiti-based mobile telecommunications company, to take advantage of this sector's growth.

One of the most successful examples of innovation in the Emerging Middle African market is that of M-PESA in Kenya. This initiative by Vodafone, the London-based mobile telecommunications giant, tapped into the exponential growth of mobile telephony in Kenya. M-PESA is a service that offers mobile money transfers to its customers. It fulfilled a need that existing money-transfer methods were unable to satisfy. PostaPay had a presence in rural areas but there were complaints of inefficiency and cash shortages. M-PESA introduced a model that was faster, cheaper, safer, and more convenient.

The model was piloted first to ensure success, and the marketing and technical teams worked together to create a simple product that was promoted aggressively through the mass media and supported by offline interventions via a network of service agents.

Recalling the experience of Nokia Money in India, M-PESA gained success by targeting Kenya's large and sprawling unbanked population, offering low transfer charges and broad availability in rural areas. Its customer base soared, growing from 52,000 in April 2007 to 9,673,000 just three years later[27].

Unmet need

M-PESA fulfilled a need that existing money - transfers methods were unable to satisfy

Smart reach

Model was faster, cheaper and more convienient offering low transfer charges and broad availability in rural areas.

CASE STUDY

Wipro GE Public-Private Partnership

Background

As recently as five years ago, the public health infrastructure in India suffered from broad shortages of technology, skilled resources, and capital. Surgical procedures and other treatments were often delayed because of a lack of sophisticated diagnostic equipment to perform Computerised Tomography (CT) and Magnetic Resonance Imaging (MRI). Many patients received the wrong diagnosis, sometimes with heartbreaking results.

In 2007, things started to change, thanks to a new regulation from the Medical Council of India (MCI). From that point on, all teaching hospitals offering postgraduate degrees in radiology, known as radio diagnosis in India, had to have CT and MRI equipment.

In response to the new regulation, Wipro, the Bangalore-based IT services and consulting company, joined forces with GE Healthcare in an initiative to build high-quality but low-cost imaging centres at the country's teaching hospitals. The effort took the form of a Public-Private Partnership (PPP), with the first centre planned for the government-run medical college hospital in Jabalpur.

Customer Insight

Wipro GE identified its key stakeholders as the consumer, the government and its healthcare regulators, and the hospitals.

The partnership aimed at fulfilling the needs of all three groups: for the consumer, providing high-quality, speedy care that was also inexpensive; for the government and regulators, access to large pools of investment capital and private-sector expertise; and for the hospitals, a steady supply of skilled labour and first-rate maintenance of cutting-edge equipment.

Innovative Strategies

Value Proposition

The Wipro GE partnership participated in the government tender that grew out of the MCI regulation, offering the latest CT and MRI equipment. In addition to selling the machines, the goal of the partnership was to reduce the cost of treatment by 30 to 50% for disadvantaged patients. In the partnership's view, installing the equipment was just part of the solution. If key consumer needs weren't also addressed, the utilisation rate for the new devices would be poor.

Business Model

Wipro GE partnered with government agencies and clinical service providers, which helped them create a financially viable ecosystem. While Wipro GE became the technology provider, installing and maintaining the equipment and steering the PPP project, it roped in clinical service providers to create the infrastructure. The government provided rent-free land on which to build the centre. The performance risk was shouldered by Wipro GE; the service providers assumed the clinical risk.

What made the model profitable was that the private sector augmented the patient flow from the medical college hospital. Local clinical service providers sent referrals that accounted for about 60% of the imaging centre's volume.

Separate fee systems were devised for patients referred by the medical college hospital and patients from the outside. The government subsidised 30 to 40% of the costs and it fully reimbursed the service provider for certain patients that were below the poverty line.

Shift in Mindset

Although most companies shy away from PPP projects because of concerns about government lethargy and red tape, Wipro GE had implicit faith in this partnership's potential. They saw the PPP model as the vehicle for securing a sustainable volume of patients, thus ensuring profitability.

Business Benefits

Spurred by the success of the pilot project at Jabalpur in 2007, Wipro GE replicated the model in other states. In May 2008, it sealed its second PPP agreement, with the government of Gujarat, to upgrade the imaging facilities in five government-run medical college hospitals, in Ahmedabad, Baroda, Bhavnagar, Jamnagar, and Rajkot.

In July 2010, Wipro GE entered into an agreement with the government of Andhra Pradesh along with Chennai-based Medall Healthcare to provide similar imaging services in four more medical college hospitals, in Kakinada, Kurnool, Vizag, and Warangal.

In conjunction with upgrading the imaging facilities, Wipro GE plans to develop at least 100 'cost-effective' health-care products and pieces of equipment by 2015.

Shift in Mindset

Shift in Mindset

Don't focus on product innovation, instead focus on aspirations and innovate in marketing mechanisms such as channel, differentiation strategy to reach out to the mass market. Channel and finance innovation are critical for reach and affordability.

CEO,
Automotive Company

Trusted Endorsement

Brand is a crutch or an ally.

Managing Director,
Telecom Handset Manufacturer

Organisations and consumers have become accustomed to traditional paradigms associated with serving the Emerging Middle market. Broadly speaking, affordability is at the top of mind of both the consumer and the business side. Any shift from that paradigm, toward other sources of value, is met with scepticism from the consumer over the actual value ultimately provided and with cynicism from executives over the sustainability of such an approach.

This cycle of distrust must be broken, however, if companies are to create a business model for the sector that can remain profitable. Shifts in mindset are needed to understand both the unique ways in which this segment adapts to the market and how organisations can respond with their own adaptations. Based on our research, we have identified three key areas for change:

Trusted Endorsements (Managing the consumer mindset) - Building trust through unconventional proxies and partnerships is essential. Capitalising on that trust, a company can then use its marketing channels, messaging, and packaging to convince the Emerging Middle consumer that its products and services will cater to the consumer's special aspirations by delivering value that goes beyond low cost.

Disruptive Thinking (Managing the innovation mindset) - Organisations must create disruptive products, services, and business models to succeed with the Emerging Middle consumer. The consumer is looking for affordability, quality, service, and other sources of value that existing, cost-squeezed products are unable to provide. A company must, of course, have a disciplined investment process to meet these needs. But a company's leaders must also foster an environment in which employees are afforded the independence and structure to take risks to create offerings that have the values these consumers want.

Company Values and Metrics (Managing the organisational mindset) - The genesis of organisational culture is frequently top-down. But to profitably serve the Emerging Middle, company leaders need to inculcate a different cultural dynamic involving values that disperse the decision making and metrics that are customised to this sector. This shift includes a heavy emphasis on risk taking, customer orientation, and collaboration with external players as well as the development of new research methodologies and measures of success. Ironically, this change in culture needs to be closely managed from the top down as it develops over time.

Trusted Endorsements – Managing the Consumer Mindset

CEOs from many of the pioneering businesses serving the Emerging Middle in India say that the key to success is to establish trust between the consumer and a brand, which involves a process that is significantly different from what works with upper-income tiers.

Before going too far, a company has to answer these questions: What promise is its brand making to the consumer? What choices does the company need to make to deliver on that promise? What counterintuitive consumer perceptions have to be managed? Does the product design suit this segment?

Building a Brand by Building Trust

Consumers in the Emerging Middle often rely on local 'opinion leaders' and sources of information to form a judgement about a product. These opinion leaders essentially are proxies of trust. Organisations need to build trust through these leaders, and through other proxies and partnerships, to highlight the quality and affordability of their products. These trust-building arrangements are unconventional and require skills quite different from those needed to sell products to upper-income segments. Our research has revealed these promising approaches:

Working with proxies of trust – As noted, organisations could establish relationships with local proxies of trust such as *ardityas* (local money lenders), *sarpanches* (village heads), and other community leaders. For example, Bajaj Auto, as mentioned earlier in the report, used 300 sarpanches to market its Boxer motorcycle

Forming partnerships – Liaising with non-government organisations (NGOs) also helps to establish trust with this consumer. A major Indian FMCG player,for instance, partnered with a NGO to develop content for its rural sales initiative. Co-branding with successful products is another option for partnering.

Establishing emotional connections - The use of celebrities, sports personalities, and other role models creates an aspiration around a brand. Understanding regional differences and marketing products accordingly gives a brand a favourable reputation. Tata Sky followed both paths: it used a leading film star to market its brand and introduced channel packages that were customised by region.

Managing Consumer Perceptions from the Bottom Up

Consumer perceptions in Emerging Middle India are a challenge for companies to manage. Marketing requires a bottom-up approach, involving a combination of word of mouth, traditional media, and partnerships.

Providing extraordinary value can actually backfire, in terms of counterproductive consumer perceptions. The CEO of a hospital chain catering to the Emerging Middle Indian market cites one example: "A doctor who spends a long time with his patient to understand the patient's history would be perceived as incompetent, as the local doctor spends less time with the same patient."

Word of Mouth: Driving Awareness and Seeding Demand

Word-of-mouth marketing is a critical means of building trust for a brand in this segment and requires a de-centralised approach. Generating the right buzz, via community leaders, can be a cost-effective way to create awareness and accelerate demand.

Using mass media is another effective way to build awareness, and to cater to the aspirations of this segment. But besides being expensive, that channel is not sufficient to drive adoption. What are also needed are local partnerships and offline interventions. Although these vehicles, too, are expensive, not to mention time consuming, they are both essential for accelerating demand.

Engaging the Consumer – The Case for Design

Besides marketing, the way a product is presented is a key element in attracting customer awareness and winning acceptance in this segment. The goal is to keep the local customer engaged on a number of levels, by providing superior and aspirational design, packaging, and technology.

Attracting attention with colourful packaging
Procter & Gamble launched its Tide detergent powder – aimed at Emerging Middle customers – in bright packaging to attract attention.

HUL's Sunsilk shampoo comes in colourful bottles and disposable packages to stand out among other brands.

Customising product design
Considering the space constraints in the houses of these customers, Godrej Industries launched a small portable refrigerator, the Godrej Chotukool, which was customised in accordance with the living conditions – and budgets -- of this consumer class.

Leveraging technology
In 2008, Nokia launched Nokia Life Tools, a package of agricultural, educational, and entertainment services designed especially for consumers in small towns and rural areas of India. The package provided timely and relevant information customised to the user's location and personal preferences and sent directly to a mobile device.

Disruptive Thinking – Managing the Innovational Mindset

Innovation is the hook that will connect a company to the consumers in this segment. What they want in a product – quality, service, and other values in addition to affordability – is often not available. Innovation is needed to come up with the prize.

Businesses must assess their innovation capabilities and identify gaps in their culture and process. Is innovation a priority within the organisation? Does the company use a commercialisation model to test and scale new disruptive ideas?

The 'AND' Approach: Quality AND Affordability

K. Srinivas, CEO of Bajaj Motors, made an astute remark that sums up the AND approach. He said, "If you are chasing product innovation only, you are chasing the wrong goalpost."

This market requires companies to think AND, not OR. Consumers in this segment are extremely aspirational in their demands and therefore require both quality and affordability. For a company to deliver on that combination of needs requires a shift in mindset. The company has to understand that serving the Emerging Middle is not just about making a product bite-sized, which is the typical approach, but also about making it beyond and within their reach at the same time. Companies must indeed be innovative to bring all that to market in a profitable way.

In conducting our research, we spoke to several other CEOs who added to this line of thought. As V. Raja, Ex-president and CEO of GE Healthcare India, put it, "You must focus on quality and affordability -- quality is the fulcrum." Marten Pieters, CEO of Vodafone India, had a similar view on affordability and service delivery. "India needs to move beyond labour arbitrage and IT," he said. "The next wave of growth will be from services."

The Disruptive Leapfrog Mindset

Leapfrogging, via disruptive changes, is a necessary partner to 'AND thinking'. Companies must be prepared to offer leapfrog products and services as this market often misses a generation of technology and is ready for the next generation.

Nokia Money used leapfrog technology in offering its mobile financial services to the Emerging Middle. The new services included sending money to another person, making product purchases, and paying bills, all taken care of via a voice call or SMS and available 24 hours a day.

Nokia Money was disruptive because the company used mobile devices to address an unmet global demand for access to financial services. Nokia provides that access to the unbanked and under-banked population, 'empowering people and their businesses' through their mobile phones and eliminating the need for intermediaries.

Nokia Money has built a dynamic new ecosystem for mobile payments. It is designed to work in partnership with mobile network operators, financial institutions, distributors, and merchants to seamlessly provide the new services.

The 'unbanked' have most to gain – Nokia Money might be this group's only access to financial services. The services are simple to use, secure, and available across different operator networks and on virtually any mobile phone.

A Mindset for Partnership

Partnerships between small and large organisations are necessary to deploy disruptive technologies at scale. For large companies, the hunt should be on to find a small innovative partner, one that has an efficient cost structure and can be the source of disruptive innovations.

A larger organisation brings with it the advantages of a brand, an established network, access to capital, and a roster of already proven processes and technologies. For its part, a smaller organisation, in addition to serving as an incubator for breakthrough ideas, contributes its agility and the trust it has won from consumers.

Company Values and Metrics – Managing the Organisational Mindset

Once companies understand the value propositions for the Emerging Middle, they will realise how very different they are from those of other segments. Coupled with challenges relating to delivery, market maturity, and the constant pressure to achieve scale, the reality of radically different value propositions requires organisations to re-evaluate how growth and success is to be measured: Do these barometers need to be treated differently in this cash-strapped segment?

The challenge is not only about learning how to operationalise and track progress via unconventional metrics, but also about how to adapt the organisation's own values to the special needs of the sector. The changes required on that front include a new emphasis on risk taking, customer orientation, and collaboration with external players. Although there is no one-size-fits-all approach, we have synthesised a set of strategies that pioneers have used to succeed in this market.

Limiting the Innovation Resource Pool

One very effective strategy that successful businesses utilise repeatedly is limiting the resource pool available for developing innovative products. This is a counterintuitive approach, since most businesses believe that providing ample resources for innovation is the best strategy.

We found success stories in which significant limits were put on the innovation team on multiple dimensions, including budget, market research, product price (often less than three times the market price of competitive products), and company resources. The idea was succinctly encapsulated during our interview with a leading innovation expert in India, Dr. Ramesh Mashelkar, a board member at the National Innovation Council: "Companies need to have the mindset of More for Less for More." In other words, provide significantly more value, for significantly less price, for a large consumer pool.

Shifting to Lateral Research (Need vs. Demand)

Although conventional market research may show that consumers need a certain category of products, it does not necessarily follow that they will pay for that need. Ultimately, the need could be ignored, deemed by the consumer to be frivolous or purely aspirational. In rural India, for instance, a biogas fuel stove that was proven to be a better option than the carcinogenic-linked alternative found very few buyers. The same set of consumers purchased cell phones, invested in gold, and indicated that they would prefer to purchase the latest durables endorsed by celebrities. Businesses must understand the consumer's situation at a nuanced level, and solve a problem that was being poorly addressed before, thus ensuring that demand for their product already exists.

To make sure that biases do not creep into the consumer research process, several organisations undertake 'lateral' research, where they hire a partner organisation with expertise in a related field to conduct research for them. For example, a leading healthcare devices manufacturer hired a local eye-care provider to help create the requirements for the healthcare company's next line of products. The research process tends to be more challenging. On the plus side, however, the insights gained have very little bias toward the existing product base.

Counting on Unconventional Metrics –

Businesses need to recognize that metrics that have been traditionally used to measure performance in the upper-income tiers might not work as well in this market.

For instance, analysts typically base their ratings of cellular-service providers on Average Revenue Per User (ARPU). The market also reacts to fluctuations in ARPU that an organisation reports on a quarterly basis.

But one of the most successful cellular-service providers in India understood that revenue per customer from the mass market would never match the upper- income tiers. Despite the risk of drawing an unfavorable market reaction, the company decided that its governing financial metrics would be return on capital, and gross margins, in essence favoring a long-term view. It has been tough for other companies to follow suit and compete against this firm's first-mover advantage in the mass market.

Keeping an Eye on Value

Investments in this sector require a considerable appetite for risk and a penchant for patience – it can take some time before an initiative produces returns above the cost of capital. Companies have to adjust their breakeven expectation, take time to establish partnerships, and set realistic time projections for producing returns. Leaders must take an active role in setting these expectations when a business decides to target the Emerging Middle.

Globally, the segment is ripe for change – it is the biggest underpenetrated market ready to accept new thinking. The challenge for businesses is to capitalise on this opportunity by changing how they fundamentally view this market – not as the bottom of the pyramid with a social lens, not as the rich with a commercial-only lens, but as a very different and aspiring Emerging Middle with a value-based lens.

Relevance in Other Next 4 Billion Nations

More than anything, it is a company's shift in mindset that will make the difference in tapping into emerging markets. This shift not only is important for consumers in India's Emerging Middle, but also for that sector's consumers in other parts of the world.

At the center of success is the ability to win the customer's trust. Many companies have tried, and some – both Indian and non-Indian – have succeeded. The winners have gathered up their trusted endorsements and focused on localisation. They have used disruptive thinking and deployed strategies to unleash the sector's potential. And they have offered customers both quality and affordability, without compromising on the value propositions that the customer has demanded.

International Case Study

Carrefour's success in China -- how it localised its business to attract Chinese consumers

Carrefour, the world's second-largest retail chain, began operations in China in 1995. It was immediately well received by Chinese consumers. The company owes this success to the insight it gained into the Chinese consumer's habits through its experience in the Taiwanese market since 1989; this laid a solid foundation for the business to proceed into China's mainland market.

Carrefour did so well because of the high level of localisation that it carried out. This localisation could be seen across departments like stocking and selling – the chain established 15 City Commission Units (CCU) throughout the country, using them to stock and sell 95% of its commodities in China[28]. Even the company's recruitment strategy was hugely localised, which helped bridge cross-cultural gaps. The company made great efforts to hunt for and cultivate local retail professionals. In 2003, Carrefour set up a training centre in Shanghai, with a focus on local personnel. In 2008, it appointed 60 store managers, and 57 of them were Chinese[29].

Thanks to its low prices, excellent service, and comfortable shopping environment, Carrefour developed rapidly from an unknown organisation to a hugely popular one. Its one-stop shopping mode was a fresh notion to local consumers, and its related services also proved popular, allowing the consumer to enjoy 'happy shopping.'

Carrefour China is also extremely conscious of its sustainability practices. It introduced recycled shopping bags. And it adopted a new purchasing model for buying commodities directly from farmers, which was considered a revolution in the retail space.

Leadership Mindset

Organisations need to focus on achieving scale from the beginning.

Innovation Leader

CASE STUDY

Idea Cellular

Background

Idea Cellular is a leading mobile services operator in India. Not only has it established high market share over the past decade, but it also enjoys a favourable brand reputation.

Idea's strong growth in the telephony market comes from its deep penetration in non-urban & rural markets. It has the highest share of rural subscribers as a percentage of total subscribers, amongst other GSM players. two out of every three new Idea subscribers come from rural semi-urban India.

Customer Insight

Since Idea did not contain any licenses in the 1990s in any of the top 6 metros of India, they had an early taste of building businesses in relatively smaller towns. They followed the hub-and-spoke model to run their business.

The turning point came in 2007 when the demand for mobile telephony was galloping. An anecdotal incident highlighted that sales, marketing, and servicing was failing to keep pace. The level of intensive management that the sector was calling for in undeveloped population centres had not been done before in India or anywhere in the world. Idea went back to the drawing board and redefined from first principles.

Innovative Strategies

Value Proposition

Keeping the customer in mind, Idea introduced products and services customised and tailored for rural and low-income consumers. In this low-income category, the products were further customised based on factors such as age.

The initial communication was also extremely versatile across age groups and income segments. Idea signed on a leading actor in India as their brand ambassador adding to the aspirational value and charisma of the brand.

Business Model

To target the villages and tier 3/4 cities in India, Idea built a distribution network of 1,520 branded service centres and over 700,000 multi-brand retail outlets across the country to achieve economies of scale.

After achieving a considerable market share and gaining popularity, Idea then moved on to targeting tier one and two cities with added services such as 3G. They even launched economical 3G services for rural and semi-urban subscribers to target the youth in these segments.

Shift in Mindset

In 2007, Idea redefined its sales network from hub-and-spoke to a completely local one – focusing on productivity of the end salesperson. It first defined what it considered a productive day for a sales person in a rural market. Then it did everything necessary, to achieve that objective, including throwing overboard so called 'tenets of management'. The supervisory set up thereafter was developed to support the front-liners. Similarly, the service, finance, training, HR practices were built around this sales person. The new model was about getting it right at the microscopic level, and following through at all other levels. There was a lot of thinking-through, detailing, documenting, which ensured that an intellectual insight became a way of life for Idea.

They ran a pilot in 5 villages in India. The personal relationships of the salesperson with the residents of the villages helped increase the trust in the brand and resulted in word-of-mouth publicity for Idea. Post the success of this pilot programme, Idea made investments in scaling and integrating change in their sales approach across the country.

Along with that Idea focussed on their after-sales and service delivery; they established 2000 service centres within a 30 minute travel distance from their customers across the country.

This approach helped Idea achieve economies of scale while also establishing a rapport with each of their customers through their local sales representatives. Besides adding to the trust factor, Idea as a brand became more approachable and relatable for the low-income mobile users.

Business Benefits

Over the last 4 yrs, since the change in their strategy, Idea increased its revenue market share from 8% to 14%. Idea Cellular is today the 3rd largest mobile services operator in India with wireless revenue market share at 13.9% in Q1 FY2012.

A Financial Point of View

Long term goal	Core components	Decision variable	Nature of decision(s)
Long Term ROCE*	Operating Margin	Operating costs (Opex)	'Asset Lite': Focus on converting capex ⇨opex Mostly Opex Mostly Capex
	Capital efficiency	Fixed costs and working capital investments (Capex)	• Focus on converting capital expenditures to operating expenditures E.g. Leases, rapid prototyping and pilots, partnerships in distribution • Collaborate and borrow: Focus on building partnerships and co-investing in ecosystem building to control capex spending • Manage operating margins and organisational learning curve - Focus on efficiency of operational spend. E.g. Sales per unit marketing spend should trend upward in the long run

Scale of spend	Adoption	Acceleration	Steady-State
Capex			
Opex			

Long term goal	Core components	Decision variable	Nature of decision(s)
Long Term ROCE*	Operating Margin	Operating costs (Opex)	Capex heavy: Focus on capital efficiency Mostly Opex Mostly Capex
	Capital efficiency	Fixed costs and working capital investments (Capex)	• Heavier investments in ecosystem building and Capex early on • Higher operating margins by nature of investment decision • Focus aggressively on capital efficiency and faster capital turns - Manage operating working capital needs - Smart reach: geographic choices which can drive maximum volume

Scale of spend	Adoption	Acceleration	Steady-State
Capex			
Opex			

A company's financial approach to the Emerging Middle market is fundamentally determined by the level of its appetite for risk. However, there are some key decision levers that also come into play.

It is clear that the 'Emerging Middle' market is a price/volume game. In other words, price mostly should be low, and therefore volume needs to be high to produce a sustainable revenue flow. Thus, organisations must make choices on operating costs and capital efficiency for driving long-term returns on capital.

The basic strategic choice for companies is to go 'Asset Lite' or 'Capex Heavy'. That said, different phases of the business lifecycle are likely to require midcourse adjustments.

'Asset Lite' Model – Focus on Converting Capex to Opex

The Asset Lite model is ideal for companies that are entering new markets and are unsure about making upfront investments in fixed assets. This model helps to manage risk by stressing the need for rapid prototyping and co-investments through partnerships, enabling a quicker reaction to fluctuating demand.

Companies can control their initial capital expenditure outlays by converting capex spending to operating expenses in some or all of the following ways:

- Leasing property, engaging in rapid prototyping and pilots, forging partnerships for distribution
- Collaborating with other companies and co-investing in ecosystem building
- Managing operating margins and the organisational learning curve
- Focusing on efficiency of operational spending

Later, during the acceleration and steady-state phases, companies can increase their capital expenditure investment or continue with the 'Asset Lite' model.

'Capex Heavy' Model -- Focus on Capital Efficiency

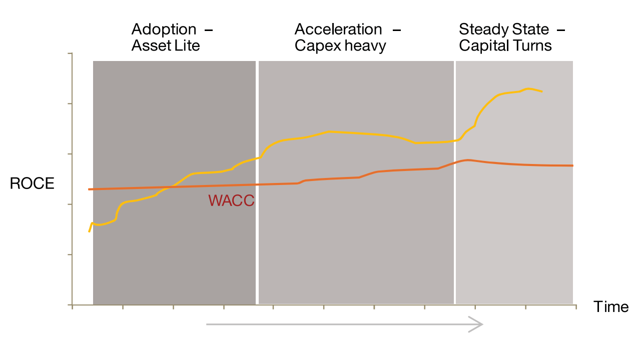
A 'Capex Heavy' model is appropriate for companies that are first movers in this market. For them, upfront investments can pay off in ecosystem building and in fashioning a preemptive advantage over competitors.

Although these companies will make heavier capital investments early on, they will benefit from higher operating margins in the adoption phase. Moreover, they can focus on capital efficiency and faster capital turns by savvy management of their working capital needs and through "smart reach" geographic initiatives that will drive maximum sales volume.

In Practice – Combination of Asset Lite and Capex Heavy

A sample investment timeline: Although investment scale and timing will vary significantly by industry, we took a sample set of experiences from the telecom sector and mapped them on a timeline to illustrate key themes for success.

The typical curve for ROCE (return on capital employed) is shown in this chart:



The **adoption phase,** the first three years of the project, is essentially a period of Asset Lite investment, with these highlights:

- Controlled capex spending for buying licences and building a retail infrastructure (hub and spoke) in select tier two and tier three cities and in certain rural areas
- High spending for SGA (selling, general expenses, and administration)
- A focus on demand generation, with emphasis on marketing and sales staff, positioning, and pricing innovations
- Channel building, through partnerships designed for collaboration and co-investing

As the typical telco adopts the Asset Lite model during this phase, it must spend heavily on the marketing side in order to create awareness and drive conversions. Therefore, operating margins are weaker. During this phase, the key strategic focus should be on tightly managing the 'learning curve' to get more bang from operating costs.

During the **acceleration phase**, following the third year of the project, the company has a choice to make: shift to a Capex Heavy model or continue with Asset Lite and focus on a core competency of attracting and retaining consumers.

Our hypothetical company opts for the Capex Heavy model as a pre-emptive strategy, and therefore invests in market entry in other cities and rural areas (buying licences and building infrastructure). Its gross margins increase thanks to the introduction of value-added services. During this phase, the company must focus on capital efficiency.

In the **steady state phase,** we see a major emphasis on capital turns. Our surrogate telco begins to focus on institutionalising the lessons its has learned about operating and capital efficiencies. And it manages to reduce the cost of marketing per unit sales. This combination will ultimately drive long-term ROCE and boost shareholder value.

This financial picture is admittedly simplified, but its key point is important: a company operating in this market must carefully assess the need to adopt very different financial approaches at different points in its business lifecycle. In addition, it must understand that driving long-term ROCE will take patience.

The Global Emerging-Middle Framework

How India's Experience Applies to China and Africa

Although each market in the Emerging Middle sector is unique in certain respects, the lessons learned in India have broad applicability. The framework we have proposed – and the need for new value propositions, innovative business models, and substantial shifts in mindset – have relevance throughout the developing world.

The Global Emerging Middle

Globally, two major demographic shifts are under way that are causing companies to view the developing world in a dramatically different light.

First, developing countries will account for almost all of the increase in global population over the next 10 years. Second, the population in developed, high-income countries (and in China) is aging significantly.

The biggest contributors to this increase in global population will be India and Sub-Saharan Africa, excluding Nigeria and South Africa. Despite its one-child policy and overall aging population, China will also be a huge contributor.

These new realities will heavily influence employment growth, demand trends, savings and investment behaviour, and productivity and output throughout the world. With their population expanding, and their Emerging Middle sector growing ever larger, India, Sub-Saharan Africa, and China are at the heart of these economic changes.

Because a majority of the Next 4 Billion reside in these three markets, the framework discussed in this study takes on added importance, offering insights and guidance for doing business in all three areas.

In the following sections, we discuss how the concepts and hypotheses that we developed in India are adaptable to China and Africa.

India and China

The emerging economies of India and China are among the fastest growing in the world. India and China are also home to the biggest populations with more than 60%[30] of whom are of working age. However, the countries are dissimilar in certain ways, requiring a careful evaluation of the Emerging Middle framework before it is applied in China.

Due to its one-child policy, China is facing the rapid aging of its population and a subsequent decrease in its working-age population, starting in 2014[31]. On the other hand, India is expecting a 'demographic dividend' because of its largely young and growing population. That surge in young people could be a source of instability, but it will prove to be a great advantage for growth if the government can provide education and opportunity for the new generation.

China's per capita income and urbanisation levels are higher than India's, leading to fewer tradeoffs for the Emerging Middle. The Chinese consumer is far more 'confident' and brand conscious. India's cultural, religious, linguistic, and social diversity also set it apart from China, which is largely a homogeneous society with a common language, Mandarin.

Moreover, cultural and social homogeneity in China makes smart reach, and its cluster approach, less relevant than in India. Besides, China's infrastructure is significantly better, compared with India's, and the country is more connected via the Internet and telecommunications. The improved infrastructure and better connectivity, together with a very different regulatory landscape. reduce the need for ecosystem collaboration in China.

However, as in India, collaborating with the local government is an important step for companies to take to establish their presence in China since the government plays such a dominant role.

That said, China's government agencies, more than India's, promote and provide easy access to loans for manufacturing, making China a global manufacturing hub.

India and Africa

The situation in African countries is more similar to India's. Sustained economic growth in Africa has produced for the first time a broad Emerging Middle class, one that cuts across the continent and is on par with the size of the billion-person Emerging Middles in China and India.

During the past decade, the number of Emerging Middle consumers in Africa has expanded by more than 60%[32]. In 2010, that sector accounted for 34%[33] of Africa's total population. The sector's rise has made Africa a potentially huge and enticing frontier market for global investors. Africa is beginning to beckon as a consumer of what other nations produce, thanks in part to a young population more upwardly mobile than ever before.

Africa's Emerging Middle class, and the accompanying consumer demand, is seen as an increasingly powerful economic engine, one that can complement the continent's traditional reliance on agriculture and on energy and mineral production and exports.

Africa's long-term growth will increasingly reflect interrelated social and demographic changes. As in India, these changes will include urbanisation, an expanding labour force, and the rise of the Emerging Middle consumer.

Moreover, as in India, Africa is marked by a high degree of regional diversity, with a large rural population and many cultural, linguistic, and religious differences. This mix makes concepts like smart reach, platform customisation, and modularity extremely relevant.

To fill gaps in the unorganised sector and to overcome institutional voids, partnerships with government are extremely important, another similarity with India. Finally, also as in India, companies can achieve greater economies of scale by spreading their fixed costs over a larger customer base.

Other Case Studies

CASE STUDY

Nokia Money

Background

Nokia, the world's top cell phone maker saw great potential in mobile financial services and launched Nokia Money, mobile financial services for the masses. Nokia Money offers basic financial management and payments from a mobile phone. Nokia is building an open ecosystem for mobile payments in India with multiple partners (banks, merchants, billers, service providers), to drive mobile money services across the country.

Customer Insight

Nokia realised the need for such services as mobile phone ownership significantly exceeds bank account usage, suggesting that many mobile phone users have very limited or no access to basic financial services.

There are 4 billion mobile phones but only 1.6 billion bank accounts in the world, and therefore a huge market of 'unbanked' mobile phone users. In India alone, there are 800 million people using mobile phones, and about 50 per cent of them do not have bank accounts.

Innovative Strategies

Value Proposition

Using Nokia Money, customers can send money, securely, to friends and family easily from the mobile, pay utility bills, recharge prepaid SIM cards, check balance and get a mini statement, use the mobile to purchase goods from merchants, pay insurance premiums, etc. The software comes preinstalled in most Nokia phones and customers can also get this software installed from the nearest Nokia authorised agent or can download it over the air. It is simple to use, secure and available across different operator networks and on virtually any mobile phone in India.

These services can be accessed via SMS- IVR (voice call) or customers can also access this application via a GPRS connection and are available 24 hrs a day.

Business Model

Nokia implemented a business model combining the use of mobile devices with financial services to address the global demand for access to such services. Nokia retail outlets serve as Business Correspondent agents for Union Bank Money services, in compliance with RBI guidelines. Prospective customers can register for the service, deposit money, or withdraw cash from their accounts at these BC agents. Thus, bringing banking services to the remotest parts of the country. Nokia provides access to financial services to the unbanked and under-banked population through mobile phones, 'empowering people and their businesses. It eliminates the need for intermediaries in these transactions.

Nokia Money has built a new ecosystem for mobile payments. It is designed to work in partnership with mobile network operators and financial institutions, involving distributors and merchants in a dynamic ecosystem to seamlessly provide the new service.

In India, migration from rural to urban areas tends to follow a predictable geographic pattern (migration to centres of trade and SME clusters from rural areas), the remittance flow tends to be reverse. Nokia Money conducted a detailed analysis on identifying such migration clusters in India, and targeted specific clusters with customised advertising and services – acquiring more customers with optimised spend. Nokia Money educated its prospective customers by presence through offline interventions.

Nokia launched its Mobile Money software and partnered with retailers and banking institutions with brick and mortar presence, to deliver its services.

Security: The service is completely secure as it uses most advanced security technology available to prevent unauthorised access to account holder data. Users are also required to authenticate each transaction. The data transmitted via the service is protected by advanced security technology against unauthorised access. To provide this level of security, multiple layers of advanced encryption algorithms are used so that transmitted data cannot be intercepted or compromised. Encryption technology is used for securing transactions between the mobile application and a user's account and for securing data transmissions over the cellular or data network.

Shift in Mindset

Nokia offered a leap frog product through its Nokia Money services. They realised the gap in the financial services market and introduced disruptive technology that allowed for people especially in emerging markets to fulfil their banking requirements through the ease of their mobile phones.

The 'unbanked' have most to gain – Nokia Money might be only access to financial services. The global mobile financial services market is estimated to reach 18 billion euros ($27 billion) by 2014.

CASE STUDY

Bajaj Auto

Background

The Bajaj Group is amongst the top 10 business houses in India. The group's flagship company, Bajaj Auto, is ranked as the world's fourth largest two and three wheeler manufacturer and the brand is well-known across several countries in Latin America, Africa, Middle East, South and South East Asia.

Customer Insight

Bajaj Auto launched a new bike – Bajaj Boxer – early in 2011. The bike was designed keeping the lower middle class of India in mind. Based on the customer insight Bajaj received from their research, they created an aspirational bike for the 'emerging middle class' of the country. Boxer is an innovation, offering rural customers more power to do more. This bike was not only designed keeping the customer and their needs in mind, but also promoted and distributed using appropriate channels.

Innovative Strategies

Value Proposition

The bike was designed to appeal to the aspirations of the target customer. As opposed to its competitors, Bajaj Auto gave the bike a higher engine capacity of 150cc instead of 100cc along with a lower mileage. The reason for this was to make the bike more powerful which firstly dealt with issues such as heavy cartage, poor roads in villages/towns and multiple people riding on the bike and secondly appealed to the younger males in this segment and their underlying need for power and control. The bike was marketed as the 'SUV of motorcycles' which gave it an edge over competitors as it appealed to certain aspirations unique to this segment.

Business Model

The product was launched with several financing and distribution innovations which have been activated across India.

The promotion of the vehicle was the most innovative model. Bajaj Auto contacted 300 Village Heads (Sarpanch) and showed them how the bikes were made. This resulted in word-of-mouth promotion for the brand, which was extremely powerful as these figures stand for trust, reliability and proximity.

Further, Bajaj Auto appointed local ASC owners as dealers of the bike. These local dealers created a network of camaraderie, trust and created a rapport with the customers which helped increase the brand reach. This arrangement was profitable for Bajaj Auto as due to the personal relationship the ASC owner had with the customer, it was easier to keep a check on their creditworthiness.

Bajaj Auto also implemented a direct cash collection (DCC) model. DCC is an innovation to make financing options available to the remotest corner to ensure all bikes (which are sold in cities too) are accessible to the rural customers. Under this model, the customer's one-point contact with the company after the purchase was the ASC. This worked in their favour as the rapport between the ASC owner and the local customers proved to be very profitable. The company had a loss of only 0.2% instalments under this model. It has turned out to be extremely profitable for the company as well as the ASC owner as they are incentivised with a 50% share of profits.

Shift in Mindset

What the company realised, and probably got right, was that this segment is not price-sensitive but value-sensitive. Quality of the product being offered is as important, if not more, than the price. The pricing also has to be done carefully as too low a price would stand for an inferior product, while an overpriced product would be out of reach. Chinese bikes that were at least 30% cheaper could not do well in these markets due to the poor quality even at affordable prices.

The aspirations of this segment were understood by Bajaj Auto, as they did not focus on product innovation but on innovating with packaging and promoting the product in a way that would appeal to the desires and needs, of the customer, from a two-wheeler. The focus on engine capacity rather than mileage appealed to the quality as well as price sensitive emerging middle class consumer.

Business Benefits

The low customer default rate of less than 1% speaks for the success of the financing model Bajaj Auto has in place.

Bajaj already has 600 dealers and 2500 sub dealers selling all products across India.

Being a pioneer in this category, Bajaj Boxer has already been accepted well in the emerging middle class. At an extremely competitive price and with unmatched specifications designed especially for rural customers, the bike is set to be a huge success.

Working with unorganised sector

Incentivise and engage key stakeholders in the distribution and marketing process to keep them motivated.

CEO, Automotive Company

Research Methodology

We conducted in-depth interviews with more than 30 CEOs and other leaders of major corporations as well as with a number of grass-roots organisations and innovation experts. Additionally, we conducted a structured consumer study with individuals and families from the Emerging Middle class to develop a solid understanding of their needs and demands. We have also relied on several secondary sources of information.

Finally, we validated the applicability of our study to Emerging Middle markets in countries other than India, we interviewed senior leaders of the PwC Global network to identify common trends and strategies.

Combining the views and insights from all of these sources led us to the framework on which this paper is based.

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