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Markets · Innovation · Sustainability

Thought Paper | RETAIL & CONSUMER

Capturing the Hearts & Minds of the New Middle Class



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Consumer Durables in Developing Markets

- *Asia's aspirational middle class is emerging as a dominant force in consumption, driving immense growth in the global consumer durables industry.*
- *Consumers are increasingly willing to pay higher prices for products demonstrating better price-performance ratios. Frugal Engineering is now being applied to the mid-market, removing unnecessary capacity and makes it cheaper to own energy efficient products.*
- *Global brands are gaining market access with word-of-mouth campaigns, celebrity endorsements to connect better with customers, modernised rural distribution, and dealer financing to ease affordability.*

Juneja is a 30-year-old production worker who lives 90 minutes away from downtown Mumbai in a small 1-room apartment with his two young children and wife. To improve his family's standard of living, Juneja has been deliberating over the purchase of an air-conditioner and CTV. However, before that purchase decision is made, there are a few important factors to consider.

"I want to purchase a well-known international brand, preferably Korean or Japanese. I also want a model that is not too expensive, something that gives me more value for money. The electricity cost in India has been increasing, so I am looking for a small and energy efficient air-con that is cheap to operate. I will visit the dealer near my home as travelling to Mumbai will take too long. Hopefully, I can pay in instalments as I do not have enough money to pay everything upfront."

Juneja's situation offers a glimpse into the market development challenges of converting the middle-class and aspirant segments into realised top-line returns for consumer durables companies in India. In this paper, we seek to address the overall potential of the consumer durables market in developing markets such as India and highlight the key and unique issues that must be adequately addressed by industry players in order to compete and succeed.



1. Tradewinds of Change

Global consumer expenditure patterns are transforming as a result of the shift towards a single global commercial market, driven in large part by the emerging markets in Asia. As consumers in the US and Europe begin to recognise the importance of saving, Asian countries are becoming dominant as key markets for consumer spending. Total consumer spending in the region is expected to reach US\$32 trillion by 2030, representing 43 percent of total global expenditure.

The rapid increase in size and purchasing power of Asia’s middle class, especially in its fast growth economies, will drive a rebalancing of the global economic order. Nearly 56 percent of the population in Asia, or about 1.9 billion people, have pulled themselves into the ranks of those earning US\$2 to US\$20 per day, with China contributing 800 million people to this in the past two decades, and India alone contributing another 205 million.

The middle and lower segments of the pyramid represent a major opportunity among these markets, particularly for the consumer durables industry. The potential is driven by a strong and discernible shift in the definition of needs and wants of such consumers, as witnessed by a growing indulgence in the marketplace for consumer durable goods to be perceived more as necessities than wants. Such products sit on

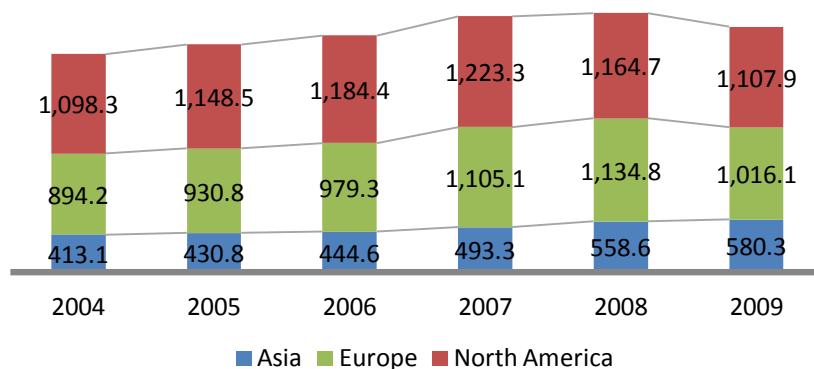
the edge of growing universal aspirations for a better quality of life.

The Consumer Durables industry in transition

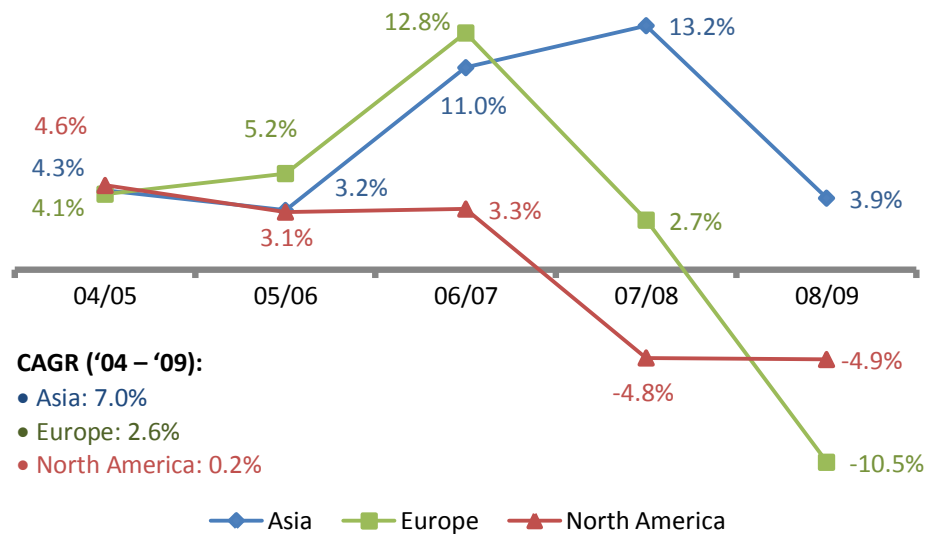
The global consumer durables industry has witnessed considerable change and impressive growth in recent years, despite strong competition and relentless price cutting. Given the strong correlation between demand for durables – both new and replacement – and income, industry growth naturally suffered during the 2008-2009 global recession. However, projections for current year going forward are very optimistic, as consumers resume spending and producers launch new enticing variants to attract new customers.

Fast-growth Asian economies such as India, China, and Indonesia, relatively shielded from the recession, will drive future consumer demand for basic appliances. Changing lifestyles, higher disposable incomes, greater affordability, a surge in advertising, as well as consumer financing and hire-purchase schemes, have been instrumental in creating widespread demand for even more expensive goods. For instance, retailers are joining forces with banks and finance companies to aggressively sell products such as refrigerators, washing machines, and colour televisions.

Consumer Expenditure on Durable Goods (US\$bn)



Y-o-Y Growth in Consumer Expenditure on Durable Goods (%)



Thought Starters

To succeed in an increasingly dynamic and complex Asian market and to test their strategic readiness to compete, industry players will have to revisit the following fundamental questions:

- *How will the uneven recovery of different markets affect the demand for our products?*
- *Are we poised to address the changing consumer behaviour in different Asian markets?*
- *Are our product development and marketing efforts customised to monitor, understand, and anticipate the diverse customer needs in each market?*

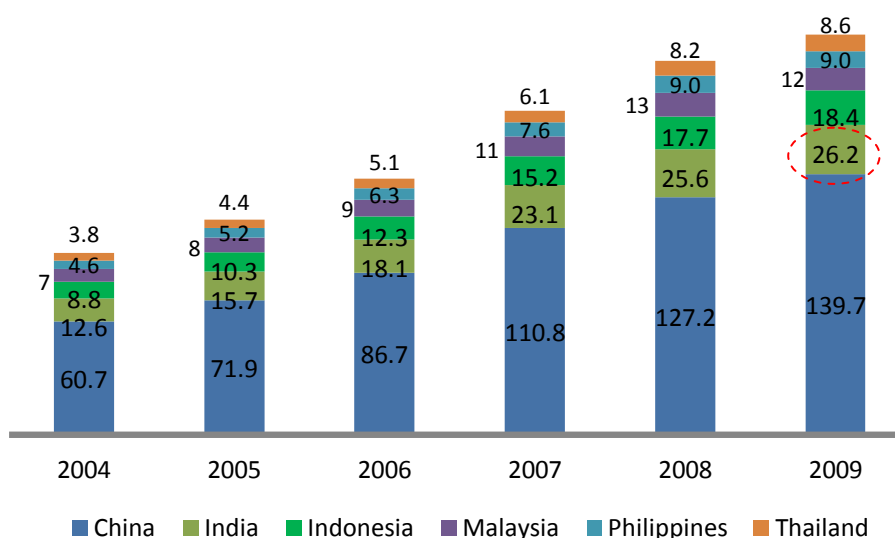
2. India in the Spotlight

While China remains the undisputed ‘Economic Dragon’ of Asia, India has emerged as one of the most attractive markets for retail investment among emerging economies. Rising disposable incomes have made India the 12th-largest consumer economy globally. The aggregate level of consumer spending in India is expected to quadruple to US\$1.78 trillion over the next 15 years, propelling it to become the fifth-largest consumer economy in the world by 2025.

India’s strong domestic economy and expanding high-income population have

buoyed demand, leading to aggressive market growth. The urban consumer durables market is growing at 10 percent per annum, while the rural durables market enjoys 25 percent growth each year. High-growth categories within this segment include mobile phones, TVs, and air-conditioners. The new-found wealth of the Indian consumers, coupled with a strong aspirational drive to improve their overall quality of life by purchasing durable goods, will continue to be the twin pillars of growth for consumer expenditure.

Consumer Durable Expenditure in Asia's Emerging Economies (US\$bn)



Thought starters

While most companies find the Indian consumer market to be appealing, many international players have yet to develop successful go-to-market strategies. Given the country’s unique characteristics, successful entrants are challenging their fundamental assumptions about this market:

- *Are we applying a one-size-fits-all mentality when developing our strategy across India’s vast geography?*
- *Is our product and distribution strategy aligned with the pockets of growth among India’s middle and lower population classes?*
- *Do we understand the thoughts and feelings that shape our customers’ purchasing behaviour better than our local competitors, or are we too focused on price cutting?*

3. From Price Sensitivity to Value Sensitivity

Tier-1 and emerging satellite cities in India continue to feature the largest economic contribution and population, and will fuel the demand for consumer durables well into the medium term. Eden conducted a longitudinal study showing that the middle-class and aspirant segments in these cities account for nearly 85 percent of demand for all categories of consumer durables. Due to rapid urbanisation, by 2016 more than 50 percent of Indian households are expected join a middle class that earns between US\$4,000 and US\$13,000 per annum.

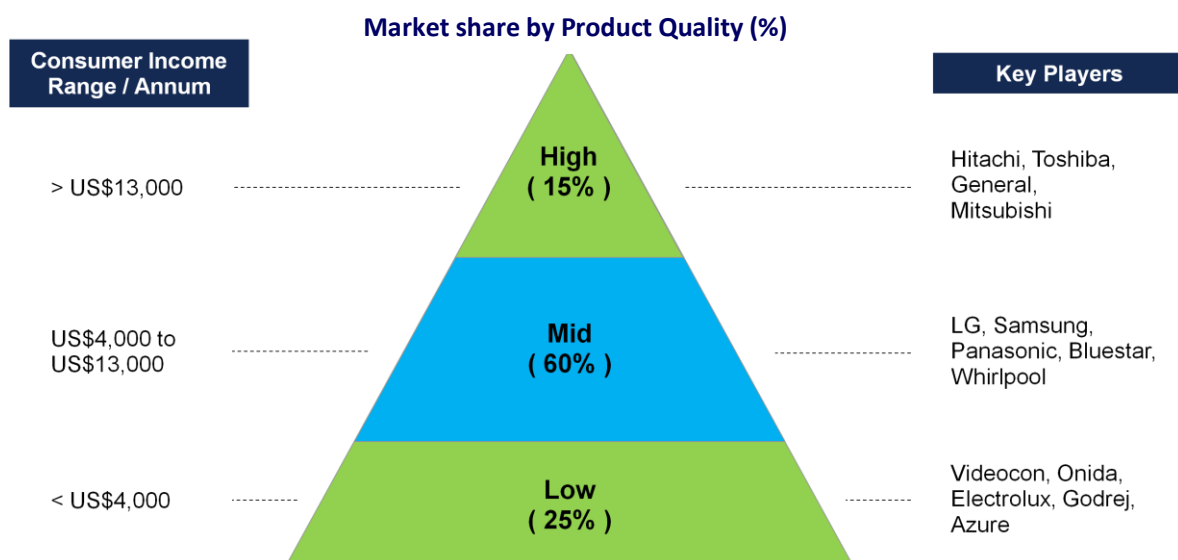
Industry players need to address emergent consumer requirements and associated challenges, in order to develop a fully aligned strategic approach that taps India’s tremendous market potential.

Consumers in India have traditionally been price sensitive; marketers have always struggled to drive sales without resorting to price cuts. Eden’s research has identified a distinct shift from *price sensitivity* to *value sensitivity*: Mid-market consumers in India are increasingly willing to pay a higher price for products that demonstrate better price/performance ratios, rather than purchase the cheapest product. Correspondingly, mid-end product segments now occupy market shares of over 60 percent.

Demand for low- and high-end products has been in decline, as Indian consumers opt to purchase middle-range products and mid-end brands perceived to offer greater value-added features such as energy efficiency or aesthetic design. Manufacturers are finding that they need to become more sensitive to mainstream consumer preferences, by introducing innovative new products with value-added features at affordable price points, without sacrificing quality.

Korean brands such as LG and Samsung enjoy the largest market shares in India, and are widely recognised by mainstream consumers as benchmarks of value-for-money. Local brands like Godrej and Onida, already successful in the bottom-of-the-pyramid segments with products such as the \$70 fan-powered refrigerator, are also looking into the immense potential of the mid-market.

Japanese brands have not performed as well due to their product prices that are on average double that of the Korean brands, despite being recognised for their superior product quality. However, Panasonic, Hitachi, and Toshiba have all recently launched mid-end consumer durable products priced just 10 – 15 percent above the benchmark prices of LG and Samsung, in a bid to enter the low-end, high volume segment.



Thought Starters

Indian consumers are voraciously hunting for value-for-money products that can decidedly enhance their overall quality of life, albeit at slightly higher price premiums. Companies need to provide unique value propositions in line with the distinct needs and potential of different consumer segments:

- *Are we too focused on price and not on value?*
- *How can our innovation efforts continually delight our target consumers, when they may not articulate their unmet needs?*
- *Are our operational processes, organisational structure, and marketing strategies aligned with our target consumer segments?*

4. Consumption Capacity & Energy Efficiency

Global brands that simply import their product range into developing countries like India, Indonesia, or China are finding unsold inventory among their higher-end models. Successful firms are instead accessing the capacity of their lower and middle-class customer segments to consume, before designing products whose capacities suit every requirement and pocket.

Even mid-market product designers are taking a page from the Thrift Engineering playbook, to offer product choices with smaller – and therefore more affordable – unit capacities. This may at first seem counter-intuitive to the typical engineering race for higher performance and larger capacities. Such disruptive innovations have however been readily accepted in India, where many products otherwise operate at capacities well exceeding the actual requirement. Companies such as General Electric, Godrej, Tata, Mahindra & Mahindra, Nokia, Quanta Computer, Reliance, Tata, and Unilever provide rich examples of successful Bottom-of-the-Pyramid innovations that create entirely new product development platforms to cut out unnecessary costs.

Quanta's \$150 laptop



Increasing congestion within India's urban and sub-urban regions has seen dwelling spaces decreasing in size. Until recently, most residential air-conditioner suppliers were focused on selling a range of air-conditioning

units operating at 1.5 tonnes of refrigeration (TR). Manufacturers such as Hitachi are now instead learning to promote their 0.9TR and 1.2TR range, by educating consumers on the sufficiency of lower capacity units for small spaces up to 140 sq ft. These options not only reduce the upfront expenditure, but also reduce overall running costs in the long term.

The Bureau of Energy Efficiency (BEE) in India issues Star-ratings classifying consumer durable products by their energy efficiency, with a 5-Star rating being the most energy efficient and a 1-Star rating being the least. Although manufacturers have been promoting BEE-certified products for the last few years, ratings were only made mandatory in January 2010. The government has since embarked on a widespread sustainability campaign to educate the public on the benefits of Star-rated products.

Consequently, energy efficiency is now emerging as a key factor of consideration for consumers; almost 70 percent of consumers surveyed in the past year have proactively inquired about star-ratings for refrigerators and air conditioners. Eden's interviews with

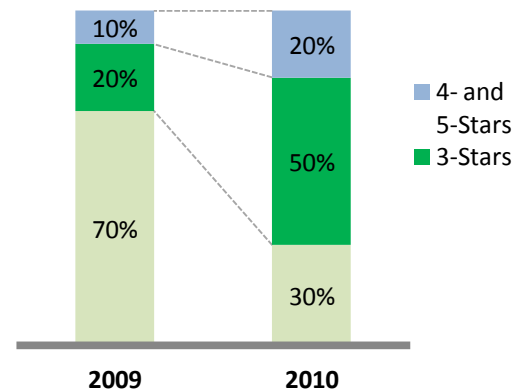
Tata's \$2,000 Nano car



over 50 suppliers and dealers in India indicated a resulting increase in demand for 3 to 5-Star rated consumer durables in the past year.

Consumers are increasingly aware of the long-term cost savings of energy efficient appliances. For a single unit of 1.5TR split air-conditioning unit for a 1 bed-room apartment, assuming 6-hours of usage per day for 300 days in a year, the unit cost differential between a 2-Star and 3-Star is around US\$24 – a break-even period of just one year. With the rising cost of electricity all across India, investments in consumer education programs stressing the long-term cost savings of energy efficient appliances have been paying off handsomely for suppliers.

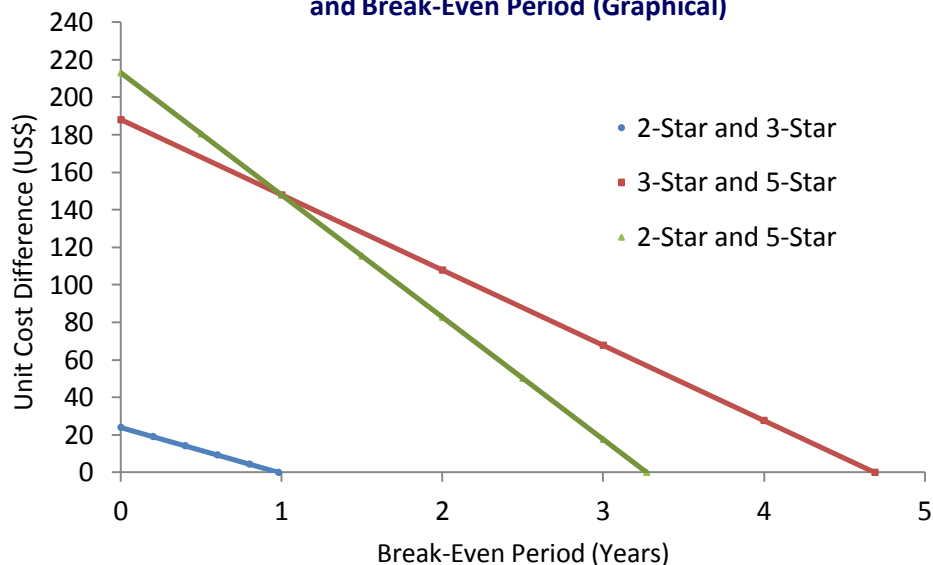
Market Share of Star-rated Durable Goods in India (%)



Comparative Analysis across Different Star-rated Air-cons

Energy Rating	Unit Cost Differential	Savings Differential (Annual)	Break Even Period (Years)
2-Star and 5-Star	US\$213	US\$65	3.27
3-Star and 5-Star	US\$188	US\$40	4.69
2-Star and 3-Star	US\$24	US\$25	0.98

Comparative Analysis of Unit Cost Difference and Break-Even Period (Graphical)



Eden's research further concludes that middle-income households that purchase 1- to 3-Star rated appliances have an average monthly household income of Rs880, an income-to-unit cost ratio of 1.6. This similarly demonstrates that with the average middle-class household spending a lower proportion of its income on appliances with higher star ratings, it can indeed be argued that more energy efficient products do in fact boast lower total costs of ownership.

Star Rating	Avg. Cost Per Unit	Avg. Annual Electricity Cost	Avg. Monthly Income of Middle Class Households	Ratio of Household Income to Unit Cost
1-Star	US\$670	US\$375	US\$880	1.66
2-Star	US\$556	US\$346		1.58
3-Star	US\$580	US\$321		1.51
4-Star	US\$680	US\$300		1.29
5-Star	US\$770	US\$281		1.14

Thought Starters

- *How do we eliminate over-engineering, legacy systems, and excess materials or components, to introduce the next Disruptive Innovation?*
- *Might energy efficient certifications help our specifications to become the industry standard?*
- *Can we demonstrate a lower Total Cost of Ownership for our products?*

5. Localising Brands

Consumers in the middle and lower segments of the pyramid are found to be surprisingly discerning about the brands they use, despite being extremely value-conscious. Above-the-line advertising, branding, and word-of-mouth campaigns that communicate a unique value proposition of *attainable aspiration* to the target audience, can develop mass market brand consciousness, recall, value, and activation.

Indian consumers have a strong affinity to the Hindi language, their cultural norms, traditions, and community values. It is imperative for industry players to develop localised messages that are centred on themes such as family ties and roles, affordability, and energy efficiency. The use of Bollywood personalities can significantly enhance a brand’s overall appeal, for the Aspirational Consumer identifies with celebrities as status symbols and role models.

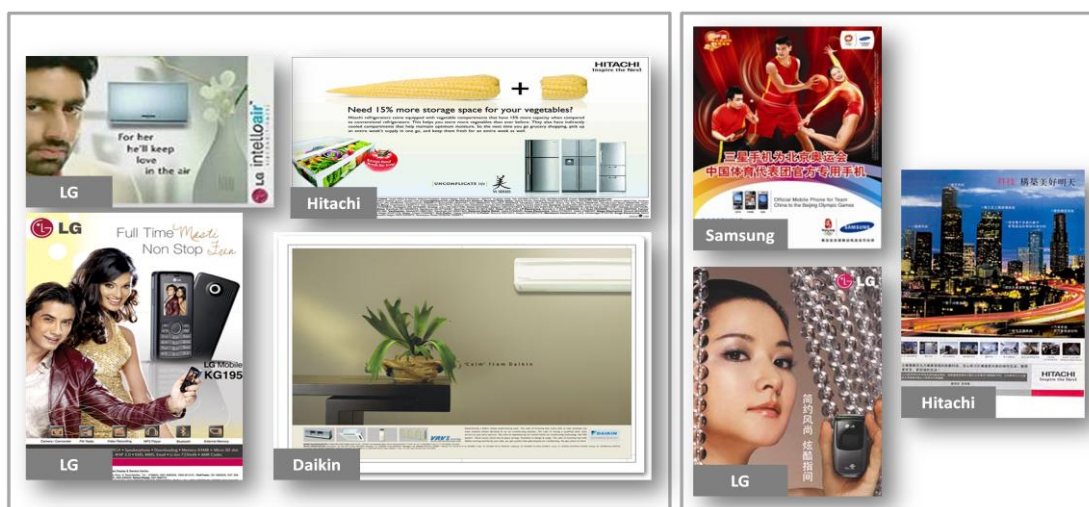
International brands have been outperforming and winning market share from local players in recent years. Korean brands such as LG and Samsung have consistently been the star performers in terms of brand recall, aspirational appeal, and

ownership due to their international presence, affordable products coupled with quality features, and heavy investments in above-the-line marketing initiatives. They have successfully launched aggressive brand promotion campaigns that span across print and visual media, with localised content driving home the key messages of Family, Energy Efficiency, and Comfort.

Premium Japanese brands rank lower in terms of consumer brand aspirations despite being recognised as being superior in quality, for they are perceived to be too expensive and unattainable. In addition, word-of-mouth and direct advertising promotions via dealers have traditionally focused on the upper-class consumers. These efforts have not been able to scale across to the middle-class consumers.

Few Japanese brands have localised their branding efforts, with the exception of Panasonic, which has successfully leveraged on its established ‘National’ brand legacy to emphasise its Japanese quality, affordability, and energy efficiency. It has also appointed a popular Bollywood artiste as brand ambassador, to capture consumer mindshare and expand its audience base.

EXAMPLES OF LOCALISED AND INTERNATIONAL ADVERTISEMENTS IN INDIA AND CHINA



Thought Starters

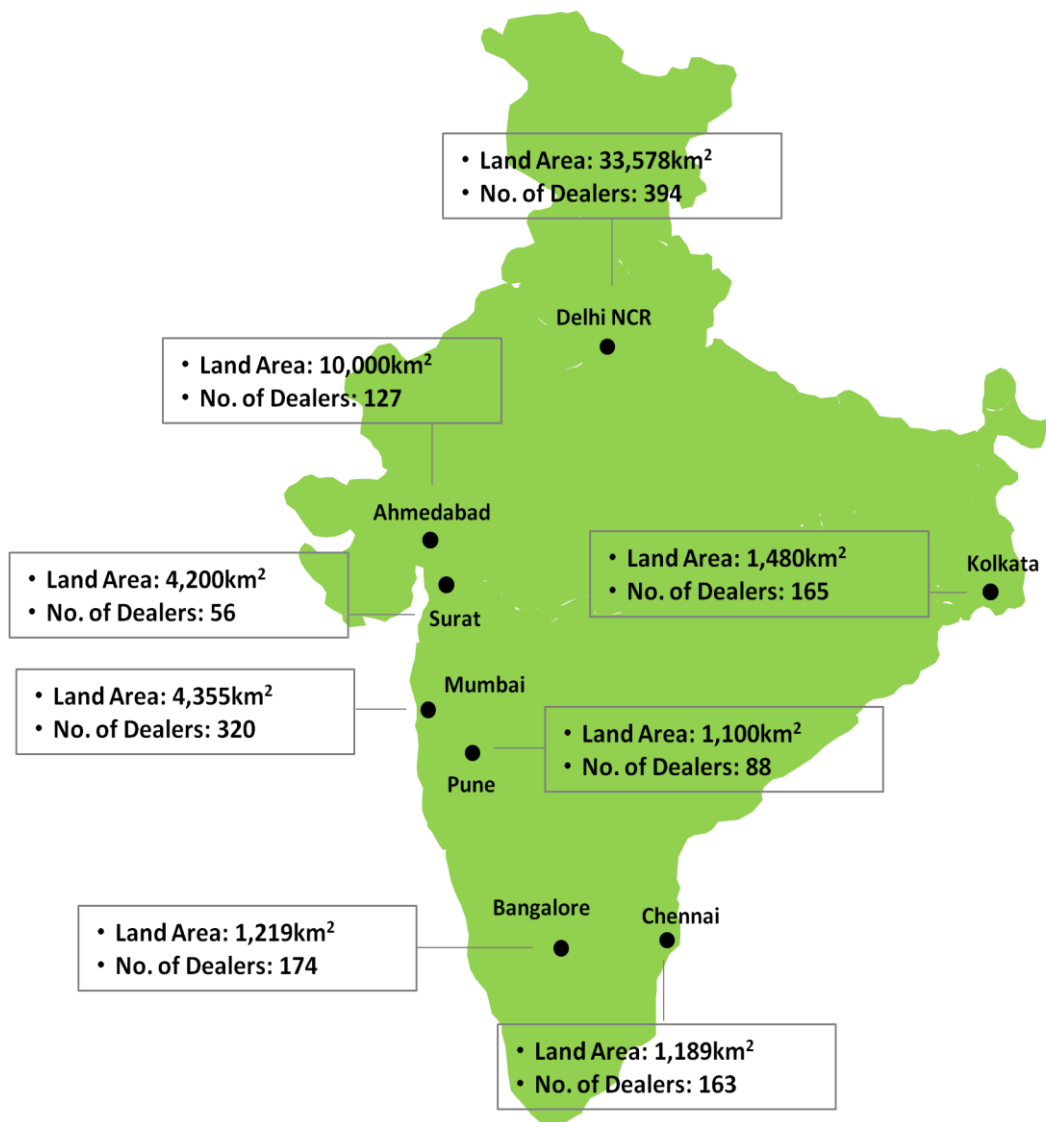
- *Does our brand positioning in India help our different target segments attain their aspirations?*
- *Have our outreach initiatives been localised to help our audiences better identify with us?*
- *How can our brand architecture be structured across our products, our different geographies, and customer psychographics?*

6. The Competitive Edge of Distribution

A sound distribution strategy is especially critical for success in emerging countries like Brazil, China, India, Indonesia, or Russia, where the addressable base of customers is spread over vast geographies. The lack of well-developed distribution infrastructure in the fastest-growing suburban and rural areas presents a key barrier to growth.

In India, tier-1 cities such as Mumbai, Delhi, Chennai, and Bangalore collectively account for nearly 70 million people, with an average population density of 20,000 people per

square kilometre. The high density of these settlements magnifies the need for companies to establish extensive distribution networks in order to adequately serve the local markets. To illustrate this, the relative distribution intensity of the major economic regions across India is highlighted below with the aggregated total number of dealers for LG, Samsung, Hitachi, Panasonic, and Bluestar. With its vast geographic footprint as a Tier-1 economic region, Delhi NCR features the highest distributor network, followed closely by Mumbai.



A resilient distribution strategy requires both *access* and *availability*. The distribution patterns for products and services must take into account where the consumers live and make purchases, in order to provide adequate *access* to products. Distributors and dealers must be easy to reach, ideally within walking distance. This calls for a balance between creating a sufficiently intense penetration of distributors, and demotivating them by over-saturating the market. Customers have also highlighted product *availability* as a key driver of brand visibility, recall, and satisfaction. Investing in preventing stockout situations similarly needs to be managed against excessive inventory holding costs.

The high-volume, thin-margin strategy by consumer durable majors such as LG and Samsung has led to an increase in the use of distributors and modern retail stores in India. Of late, modern retail chains in particular have emerged strongly in urban areas, and are expected to set the pace of growth for India's consumer durables industry. Modernised retail, constituting merely four percent of India's total retail sector in 2007, is expected to grow at 45 - 50 percent per annum to quadruple to 16 percent of the retail sector by 2011-2012¹.

However, customer complaints abound about poor installation quality and after-sales service from modern channels. Sales and service dealers are therefore still widely-regarded as the most important consumer touch-points, due to their ability to develop close relationships, influence brand choices on a local level, and provide high quality after-sales service. To optimise supply chains, formal dealership networks need to be extended to outlying urban fringes, who residents typically prefer to purchase consumer durables from dealers located near their homes.

Reaching the rural poor presents a different challenge. Access to distribution in rural markets continues to be problematic due to

the lack of infrastructural development. No single distribution solution has yet been found sufficient for Bottom of the Pyramid customers, and a wide variety of experiments to find efficient distribution methods are underway.

For instance, Hindustan Lever Ltd's (HLL) Project Shakti created a direct Peer-to-Peer distribution network in hard-to-reach regions that do not enjoy traditional dealer or distributor coverage. HLL selected entrepreneurial women from these villages and trained them to become distributors, providing education, advice, and access to products to their villages. These village entrepreneurs, called Shakti Amma ("empowered mother"), have unique insight about what the village needs and which products are in demand. They are able to earn between US\$65 and US\$153 per month from these roles, creating a new capacity to consume for themselves and their families. More importantly, these entrepreneurial women are increasingly becoming the educators and access points of knowledge for consumers in their communities.

Many leading consumer durable companies are now increasing their presence in rural India. Nokia is collaborating with various microfinancing institutions to serve a growing rural market of 93 million mobile subscribers, and using mobile marketing and servicing vehicles to bring its 'showrooms' and 'service centres' to rural villages. LG has also set up 45 area offices and 59 rural and remote-area offices, while Samsung has rolled out its 'Dream Home' road show, visiting 48 small towns in 100 days in an effort to increase its brand awareness.

¹ Working paper, Indian Council for Research on International Economic Relations (ICRIER)

Thought Starters

- *What should be our optimal distribution structure for each city, between urban and rural areas, across store formats, and for different products?*
- *How do we avoid stockout situations while containing inventory holding expenses among rural distributors, who are not connected to electronic enterprise planning systems?*
- *How do we differentiate the incentives, merchandising, marketing, training and service support for our various channel types?*

7. Growing Markets with Dealer Financing

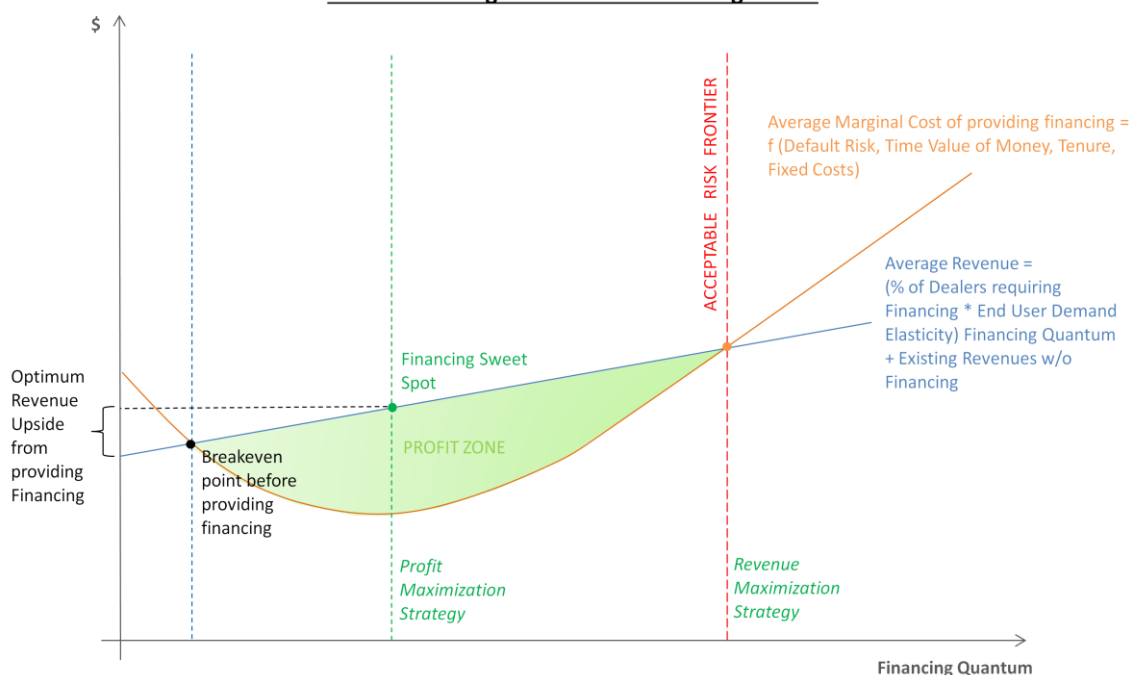
While the latent demand potential for consumer durable goods in the middle-class and rural market is without question, a major barrier continues to be the lack of access to loans and financing schemes for the lower income consumers. While loans and hire purchase schemes by formal financial institutions and commercial banks have been made increasingly available, they are still targeted mainly at the urban market and remain out of reach to the lower income who are unable to meet the minimum qualifying criteria such as collaterals or banking accounts. Penetration of consumer durables would be deeper in the lower income groups and rural India if banks, financial institutions, and even brand owners or master distributors are able to come out with more liberal incentive schemes for the white goods industry segment.

Consumer goods companies are coming up with attractive and easily payable financing schemes to consumers through their extensive dealer networks. For instance, LG India provides 0 percent instalment schemes to consumers who purchase from their mono-brand stores (LG Shoppes). The intent behind the scheme is to attract the low-mid income consumers who do not have access to credit cards and would otherwise be unable to afford the cost of purchase. Under this scheme, the total cost of the product is split equally across twelve months and consumers only need to pay the first four months upfront in cash and the remaining cost can be paid with eight Post Dated Cheques (PDCs).

To increase access and affordability to the middle and aspirant class of consumers, consumer durable majors could consider extending the interest free instalment schemes to top performing dealers located in densely populated regions. Currently, dealers on the ground operate through informal instalment schemes where they allow customers within their sphere of operation to pay in monthly cash instalments, with default risks mitigated by trusted relationships and a firm knowledge of customer credibility. However, with the current upfront payment requirement for purchase of products from manufacturers, dealers are unable to offer the instalment schemes proactively due to cash flow limitations.

Eden created a Dealer Financing Model that allows financing providers to establish the optimum levels of financing support required. By incorporating data on factors such as cost structures, risk of default, dealer financing requirements, and demand elasticity, principals can offer responsible dealer financing to expand the addressable size of any particular market segment.

Mid-Market Segment: Dealer Financing Model



In view of the correlation between potential increase in sales volume and affordable purchase schemes, companies can even extend the formal cash instalment schemes to top performing dealers and waive upfront cash payment requirement in-lieu of a Principal – Dealer instalment scheme – this would serve the dual purpose of pushing volume sales and reducing cash-flow issues on the dealer front.

In a similar approach of making it easier for low income consumers to purchase mobile phones, Nokia has also rolled out the Easy EMI Scheme across 176 Nokia Priority Partners (NPPs) in major cities across India. This scheme will allow Nokia buyers to buy Nokia handset and accessories of their choice and pay for it in three equal monthly instalments (EMI) at 0 percent interest. Nokia has tied up with Citibank, HDFC Bank, Standard Chartered and ICICI Bank for the Easy EMI scheme and the offer is available to consumers with credit cards (only) from any of these four banks.

Other innovative approaches to creating capacity to consume can be referenced from different developing economies. In Brazil, low income consumers are able to buy appliances through Casas Bahia because the firm provides credit even for consumers with low and unpredictable income streams. Through a very sophisticated credit rating system coupled with counselling, Casas Bahia is able to provide access to high-quality appliances to consumers who could not otherwise afford them. At the same time, the firm ensures that its consumers are not overstretched. The default rate is very low at 8.5 percent, compared to over 15 percent for competitor firms.

Cemex, one of the world’s largest cement companies in Mexico, follows a similar approach in its "do-it-yourself" business focused on the low income market. The idea is to help the consumers learn to save and invest. By creating a pool of three women who save as a group and discipline and pressure each other to stay with the scheme, Cemex facilitates the process of consumption by bundling savings and access to credit with the ability to add a bathroom or a kitchen to their homes.

Thought Starters

- *Do our current consumer financing options adequately meet the needs of helping the middle- and lower-class population gain access to new products that will definitively improve their quality of life?*
- *What other interest-free micro-financing models could be applied to our business to gain access to a large volume of consumers with no access to existing offerings of financial institutions?*
- *How can we work with our channel partners to achieve a win-win scenario regarding optimized cash flow, increased sales volume, and wider consumer access?*

The Road Ahead

Back in Mumbai, Juneja will join nearly 25 million people who are expected to become part of the middle and aspirant class segment over the next five years. It is this future scenario that has made the Indian consumer durables market one of the most strategic and high growth markets globally.

Consumer durables companies looking to succeed in India require significant investment into innovation and customisation; traditional products, services, and management process will not work. This means focusing on selling the right products with best-fit features aligned with consumer needs, becoming more strategic about creating value rather than pricing, extending network to where consumers prefer to shop, crafting a brand message that is localised and pervasive, and creating access to consumers through innovative financing schemes.

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We help organizations create value in addressing the world’s pressing issues

Eden helps leading global corporations, governments, and non-profit organizations profitably achieve social impact by aligning their growth platforms, operations, products, and services with market forces and developmental opportunities

- Capitalism, trade, and technological advances have driven unprecedented growth in the world’s population, knowledge, and economy. These have however been accompanied by a widening income divide, ecological devastation, and a stretched socio-political fabric... the greatest challenges of our generation.
- The mega-trend of Social Innovation is only starting to surface in our collective awareness. However, forward-thinking organizations that embrace problem-solving mindsets, disruptive innovations, and new business paradigms, are truly engaging the hearts and minds of their customers, shareholders, employees, partners, and constituents – to achieve superior, long-term financial performance by creating positive social impact.
- As Asia’s leader in Social Innovation, Eden Strategy Institute approaches global poverty, disease, illiteracy, and exploitation head-on, and is relentless in formulating strategies, models, processes, products, and designs that create quantum value in solving these issues. We help organizations generate and grow additional profit in addressing such challenges, not *in spite of* them.
- We believe in the power of ideas to positively shape our world, one case at a time. Our focus is unparalleled in bringing to bear the world’s foremost experts on our clients’ most pressing sustainability and business issues. In turn, we only collaborate with clients who are seriously committed to strategic action that produces true sustainable advantage.



Management Consulting



Think Tank



Social Venture Capital

