

The
86%
SOLUTION

How To Succeed In the Biggest
Market Opportunity of the 21st Century



VIJAY MAHAJAN | KAMINI BANGA

PRAISE FOR *THE 86 PERCENT* SOLUTION

“This book demonstrates that the dramatic differences of emerging markets create tremendous opportunities. The authors present powerful solutions for unlocking these opportunities. The 86 Percent Solution is a wake-up call for any company, consultant, or educational institution that has not given these markets sufficient attention in the past. And it can serve as a rich guidebook for those who want to understand and grow their businesses in the 86 percent world.”

—Rajat Gupta, senior partner worldwide, McKinsey & Company, and chairman of the board of the Indian School of Business, Hyderabad

“The 86 Percent Solution makes it abundantly clear that while emerging markets are the future, the path to this future will not be a smooth highway. Emerging nations advance in the balance between tradition and innovation. The solutions presented in this book are based upon a deep understanding of the complexities of these markets. The authors offer insights not only for companies engaged in these markets, but also for policymakers, NGOs, and worldwide organizations that want to understand the role that business can play in innovation and economic development.”

—Chandra Babu Naidu, former chief minister, Andhra Pradesh, India

“[The 86 Percent Solution offers] a unique insight for those who need to understand what will be the key driver of the global economy in the first half of the twenty-first century.”

—Niall Fitzgerald, chairman of Reuters and former chairman of Unilever

The 86 Percent Solution

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**How to Succeed in the
Biggest Market Opportunity
of the Next 50 Years**

**Vijay Mahajan and Kamini Banga
with Robert Gunther**

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This book is dedicated to the consumers, business executives, political leaders, thought leaders, and government and nongovernment organizations who are offering solutions that make a difference to the developing countries—the 86 percent markets.

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ABOUT THE AUTHORS

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Mahajan is author or editor of nine books. He is one of the world's most widely cited researchers in business and economics. He edited the *Journal of Marketing Research*, and has consulted with Fortune 500 companies and delivered executive development programs worldwide.

Kamini Banga is an independent marketing consultant and managing director of Dimensions Consultancy Pvt. Ltd. Her clients have included Cadbury, Philips, Johnson & Johnson, Coca-Cola, and many others. She has traveled extensively in Asia and Southeast Asia,

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Banga writes and edits business articles for *Economic Times*, *The Smart Manager*, *Business Today*, and other leading Indian business publications, and is a non-executive director on several company boards. She is a graduate of the Indian Institute of Management, the premier institute for MBA education in India. A former resident of Mumbai, India, she now lives in London.

SEEING GEETI

As she begins her day, Geeti is amazed at how much her world has changed. She works as a customer service representative on the campus of an outsourcing company in Hi-Tech City in Hyderabad. It looks and feels more like Silicon Valley than India. She has a cell phone, a Sony television, and a Dell computer with a high-speed Internet connection that links her to relatives, information, and markets around the globe. Her Haier refrigerator hums in her 1,000-square-foot apartment. So many new products from local and global companies have flooded into the market. She has just bought her first car, settling on a well-equipped model from Maruti, costing about US\$3,000 (138,000 rupees), with only US\$45 (2,000 rupees) down.

She realizes that her new car won't be gliding down the smooth highways shown in the Western television commercials. It will have to navigate crowded streets and rural highways jammed with bullock carts, bicycles, scooters, pedestrians, and beggars. And her electricity is often out several hours a day as she stares at her blank computer screen in the light of battery-operated lamps. She is looking into buying an inverter (an uninterruptible, battery-like power source).

Still, this life is a far cry from the simple, rural Indian village where she grew up. That village exists only in her memory now. The other day, her older sister, Laju, who still lives there, called from a cell phone operated by a telephone lady during the weekly haat, or market day. Hindi music from the latest Bollywood films was blaring in the background. Laju talked about the sachets of branded products crowded onto tables with traditional spices and clothing. She told how her husband, Shiv, and other rural farmers track grain prices on the Chicago Mercantile Exchange through a satellite Internet hub called e-Choupal. And she reported how her son, Anil, working in the Middle East with his wife, Sudha, deposits money in an account in Dubai that allows Laju to draw cash from an ICICI Bank mobile automatic teller in the village. Of course, Laju didn't miss this opportunity to ask her little sister again when she and her new husband are planning to have children. Geeti doesn't know how she will ever find the time.

Geeti's maid, Lakshmi, arrives on a bicycle driven by her husband, Ghelu Mohan. They are thinking about trading up to a scooter and have asked Geeti for a recommendation. She has had a good experience with Bajaj, the brand she owned before she bought her car. Geeti bought her maid a cell phone so that she could relay messages about schedules and dinner plans. The maid and her family live in a crowded one-room shanty with no indoor plumbing, but their life is changing as well.

At the other extreme, when Geeti was chosen to accompany her supervisor to the airport to pick up a visiting client from the U.S., they rented a fully equipped Mercedes from a local company competing with Hertz. A GPS system offered directions, and the satellite radio was tuned to Western classical music on their way to the ITC Kakatia Sheraton. The air-conditioned automobile sat in traffic next to sidewalks jammed with garbage. Noisy generators were audible through the closed windows. As she looked out, Geeti saw the children of construction workers defecating in the street. She also thought

about the spreading AIDS crisis sweeping Andhra Pradesh, the state where Hyderabad is located, which has the highest incidence of the disease in India. The response to the crisis has brought out the best from outside and inside the country, from the initiatives of the Bill & Melinda Gates Foundation to a new Hyderabad 10k run (www.hyderabad10k.com), an idea imported from America to raise money for children's health and other causes. Even the most luxurious car could not insulate one completely from the realities of an under-developed infrastructure and society. How long would it take for India to become a developed nation?

Geeti finds herself at the center of a complex and rapidly changing world. She is part of the 86 percent of the world that has a per capita gross national product (GNP) of less than \$10,000 per year. So is her sister. So are the executives driving Mercedes. These are markets that have largely been invisible to companies outside of them (and even to some firms within them), who have focused their attention on the 14 percent of the world's population in the developed world.

Not only do these 86 percent markets represent the future of global commerce, but they also present rich opportunities for companies that have the imagination and creativity to envision Geeti and other consumers. But you won't recognize these opportunities through the lens of the developed world. You won't reach these customers through the market strategies that work in the 14 percent markets. Developing markets have no smooth superhighways, no established consumer markets, no distribution networks, and, in many cases, no electricity. Developing markets are younger, behind in technology (but rapidly catching up), and inexperienced as consumers. These markets are very different. Yet with creative solutions tailored to their distinctive characteristics, as we will discuss in this book, you can realize the rich opportunities of these 86 percent markets.

PREFACE: DO YOU WANT TO BE IN THIS MARKET? CAN YOU AFFORD NOT TO BE?

Managers at a major U.S. office equipment manufacturer were considering how to market an overhead projector to the developing world when we asked a simple question: How would the overhead projector work without electricity? There was silence. It was a question that they had never even considered. But this is a question that must be answered every day in the developing world. By asking and answering this type of question, Hewlett-Packard has created battery-operated digital cameras and printing systems that allow entrepreneurial photographers to operate completely off the grid. Ask yourself: Do you know what an inverter is? If you don't, you probably haven't thought enough about the weak infrastructure and other distinctive conditions of emerging markets. These differences, and the strategies needed to address them, are the focus of this book.

To appreciate the complexities of these markets and solutions designed to meet their needs, consider the toilet. China is now second only to the U.S. in web users. It is expected to have more broadband and mobile-phone users than any other nation by 2006. Yet

more than 60 percent of Chinese citizens do not have access to proper sanitation. This means about 700 million people in China (along with another 700 million in India) do not have a basic toilet. Think about that. Researchers at MIT's Media Lab are creating wearable computers, but wouldn't a computer built into a toilet be a more appropriate solution for the developing world? The airport in Frankfurt, Germany has toilets that automatically clean their seats and flush themselves. South Korea, as the logical outcome of a national obsession with technology, has set a goal of having 10 million "smart homes" online by 2007, including toilets that relay body temperature, pulse rates, and urinalysis results to your doctor. Yet a market of more than a billion people has gone virtually unmet. Where are the innovations focused on the parts of the world that lack sanitation?

This is not about altruism. In creating solutions for the developing world, companies can solve one of the most pressing problems facing them today: sustaining growth. IBM's Global CEO Study in 2004 found that four out of five CEOs believe that revenue growth is the most important path to boosting financial performance.¹ Where will this growth come from? With the largest populations and fastest growth rates on the planet, developing markets represent the future of the global economy. To seize the opportunities of these 86 percent markets, we need different mind-sets and market strategies. We need managers who can envision creating a business selling sachets of shampoo for pennies, distributing products in stores the size of phone booths, or offering credit cards to people whose idea of banking is storing rolls of coins in a money belt. As you will see in the following pages, the creative companies that serve these markets are willing to provide refrigeration along with their bottles of cola and design cars that are modeled after bullock carts. They can sell a product to a customer in California that is picked up by a relative in Mexico City. In short, they have used a distinctive set of market strategies to recognize and realize the opportunities of these 86 percent markets.

This book is designed to challenge the thinking of managers from developed markets about strategies that have worked well in the past. Managers in developing countries will find some new insights from different parts of the developing world that will very likely work in their region. Entrepreneurs will see the rich opportunities in the emerging world. Finally, leaders of governments, nongovernmental organizations (NGOs), and other organizations can gain insights into the dynamics of business in this environment.

This book started with a phone call to Vijay in the mid-1990s from Wharton Professor Jerry Wind, who had been contacted by the organizers of a conference at the United Nations. They were looking for creative strategies to encourage developing nations to stand on their own two feet rather than relying on handouts from the developed world. The question was insulting. Many hugely successful companies have grown up in these developing nations. Entrepreneurship is alive and well. While well-meaning people in developed countries were discussing foreign aid, industrious citizens of the developing world have left their homelands for jobs in the developed world and were already sending billions of dollars back home. How could these compassionate and intelligent people from the developed world not see this?

After this discussion, Vijay, Jerry, and Marcos V. Pratini de Moraes, then minister of agriculture for Brazil, joined in writing an article on principles for reaching the forgotten 86 percent of the world in “The Invisible Global Market,”² published in 2000 in *Marketing Management*. Vijay continued to study this topic at the University of Texas at Austin and as dean of the Indian School of Business in Hyderabad, writing a second article on “The 86 Percent Opportunity” in India.³ He spoke with executives and government officials in several developing countries. The growing interest in these ideas was so encouraging that he decided to work with Kamini on this book. As a consultant, Kamini is in direct contact with diverse businesses in India that are applying new strategies for these developing markets. We have seen firsthand the creative strategies they are using.

Around the same time that we were engaged in this work, C.K. Prahalad and others were focusing attention on the same areas of the world from a different perspective. In his insightful work *The Fortune at the Bottom of the Pyramid*, he points out the potential of the poorest citizens of the world. But the poorest of the poor are just one segment of these markets. Will you know how to meet the needs of the growing middle class or luxury segments? In 2004, a single Rolls Royce was sold in India for more than \$700,000, some 1,500 times the average per capita gross national income in that country. This book focuses on the entire spectrum of business opportunities in these emerging markets, for both very poor and more affluent consumers. It also discusses the characteristics of these markets that must be addressed in market strategies.

In addition to the specific strategies explored in this book, we hope the examples in the following chapters will encourage you to think more broadly about the approaches that might work in your part of the world. Every day, innovative companies are coming up with new ways to address or overleap the limitations and respond to the distinctive needs of emerging markets. They are developing the 86 percent solutions. Challenge your thinking, and you can do the same.

Vijay Mahajan, Austin, Texas

Kamini Banga, London

Notes

- 1 "Your Turn." The Global CEO Study 2004, IBM Business Consulting Services, IBM Corporation, 2004.
- 2 Vijay Mahajan, Marcos V. Pratini de Moraes, and Yoram Wind. "The Invisible Global Market: Strategies for Reaching the Forgotten 86 Percent of the World." *Marketing Management*, Winter 2000, pp. 31-35.
- 3 Mahajan, Vijay, "The 86% Opportunity," *The Smart Manager*, Quarter 1 (2003) 17-25. Reproduced in *Business Today*, (India), Collector's Edition, 4 (2003) 50-58.

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1

THE LANDS OF OPPORTUNITY

The rapid development of the 86 percent of the world population in countries with a per capita gross national product (GNP) of less than \$10,000 has made these areas the new lands of opportunity. But their complexity and distinctive characteristics will require different market strategies to realize these opportunities.

With growth slow at home, Procter & Gamble (P&G) stormed out of Cincinnati to increase its presence in India in 2004, slashing prices on detergents, shampoos, and other products. Unilever's Hindustan Lever, which had been in a much smaller and quieter Indian market since it first entered in 1888, responded aggressively. Prices on some

products dropped by as much as half. Unilever, like other companies with small domestic markets, had a long presence in the developing world, but P&G and other U.S. firms had focused on the large and attractive at home or high-end segments abroad. P&G and many other companies were now waking up to the broader opportunities in India, China, Russia, and other developing markets. But they could not capture these opportunities with the same strategies used in developed markets. They needed new solutions.

Why the sudden interest? The US\$10 billion Indian market for “fast-moving” consumer goods is expected to double in the next decade. Even if this revenue comes in a rupee at a time (about 2 U.S. cents)—the price of a sachet of detergent—the market cannot be ignored. While selling shampoo and detergent for pennies may seem like a distraction from big-ticket items of developed markets, these sachets account for more than US\$1 billion in annual sales in India for Hindustan Lever alone.

In China, retail sales have increased about 15 percent annually over the past 20 years, reaching \$628 billion in 2004, making it the third-largest retail market in the world. While the US\$47 billion Chinese market for packaged foods is growing at 8 percent per year, Nestlé was the only major global brand among the top five packaged foods companies in China in 2003. (The others were Ting Sin and Uni-President Enterprises from Taiwan, followed by Hai Pa Wang International Food and Long Fong, with Nestlé bringing up the rear. These may not be familiar brands today, but who had heard of Haier or Lenovo a decade ago?)

Emerging Markets Start Their Engines

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(Courtesy of Saatchi & Saatchi)

ried for three days on Chinese national television, sponsored by state oil company Sinopec and international companies such as Mobil and Toyota. Meanwhile, youthful Indian Formula One driver Narain Karthikeyan dominated front-page news during the Australian Formula One race in March 2005. Karthikeyan already has a billion fans, which is a boon for sponsors such as Bharat Petroleum's, Tata Motors, and tire maker Bridgestone (see ad above). The Iranian woman driver Laleh Seddigh has become a celebrity and symbol of change by racing fans across cultural and gender lines. Racing is so popular in developing countries that it has spawned the creation of a new rival to Formula One. Backed by a member of Dubai's ruling family, the new A1 Grand Prix has invited 25 countries—including Mexico, Brazil, Lebanon, Pakistan, South Africa, and China—to field one team each, with races scheduled during Formula One's off-season. While only a small percentage of the population of the 86 percent economies can afford automobiles, these markets are clearly revving their engines.

Youthful markets and rising automobile ownership have made racing a growing sport in developing countries. In addition to the Olympics in Beijing, Shanghai hosted its first Formula One Grand Prix race in late 2004, perhaps the first ever in a developing country. China spent more than \$300 million for the rights to host the race and the construction of a new track with 200,000 seats. It is shaped like the Chinese character *shang*, which stands for “high” or “upward.” The race was carried

Markets for scooters, cars, refrigerators, beer, and many other products in developing countries are heating up. Shanghai hosted its first Formula One Grand Prix race in 2004—a sign of growing interest in the sport across the developing world (see sidebar). The “consumer class” (defined as people with incomes of greater than \$7,000 in purchasing power parity) has an estimated 1.7 billion members throughout the world. Nearly half of them live in the developing world. By this measure, these consumers include more than 240 million in China, only slightly below the 270 million members of the consumer class in the U.S., and 120 million in India, equivalent to the consumer class in Japan. In fact, the size of this consumer class in China and India alone is greater than in all of Western Europe (although their spending power is certainly not as great).

These developing-world numbers are growing very rapidly. By 2003, China had more than 10 million private cars, including more than 1 million in Beijing alone. In China, a quarter of the population owns color televisions (more than 300 million), and more than 16 percent (more than 200 million) have mobile phones. Companies from countries such as Japan, China, Korea, India, Brazil, and Turkey are now dominating markets in the developing nations. In India, Samsung, LG, and Hyundai have each notched up sales of about \$1 billion in the past decade. These companies from the developing world understand from their own experience what it takes to meet the needs of these markets.

While major developing nations such as China and India are now clearly on the radar screens of global companies, some firms have had a very difficult time capitalizing on the apparent opportunities. They have launched products and pulled back, changed their branding, or seen their positions undermined by local rivals. Multinational cell phone companies in China initially focused on the big cities, but Chinese firms such as Ningbo Bird and TCL ran circles around them

by targeting the rural areas and designing for local tastes, taking half the market. (The global players, smarting from the hard knocks, have shifted their strategies dramatically and are winning back market share.) Beermakers in China and other developing markets saw their seasoned global brands go flat in the face of scrappy local rivals. What these companies learned the hard way is that the 86 percent markets behave differently from the 14 percent markets of developed nations. Developing markets may be the new lands of opportunity, but do you have the right market strategies to reach them?

The 86 Percent Opportunity

For generations, the developed world has been seen as the land of opportunity. Immigrants crowded into ships or trucks to cross into the land of promise. Companies poured their resources into serving these populations. Developed markets have high incomes and well-developed infrastructures, so it is no wonder that the developed world is where most companies have devoted the lion's share of their attention, and they are still attractive markets. But now these developed markets represent a shrinking part of the world market. Just 14 percent of the world's more than 6 billion people live in countries with a per capita GNP of greater than US\$10,000 (see Figure 1-1). Kenichi Ohmae has called this cutoff for developed nations "the \$10,000 club," although there are diverse definitions of developing countries (see the sidebar).¹ Yet the developed world is where most companies have concentrated their resources, based on essentially the same argument that Willie Sutton used to explain why he robbed banks—because that was where the money was. The rest of the world, 86 percent of the population, was deemed too poor or too far away to matter. But this is no longer true, and it becomes less so every day.

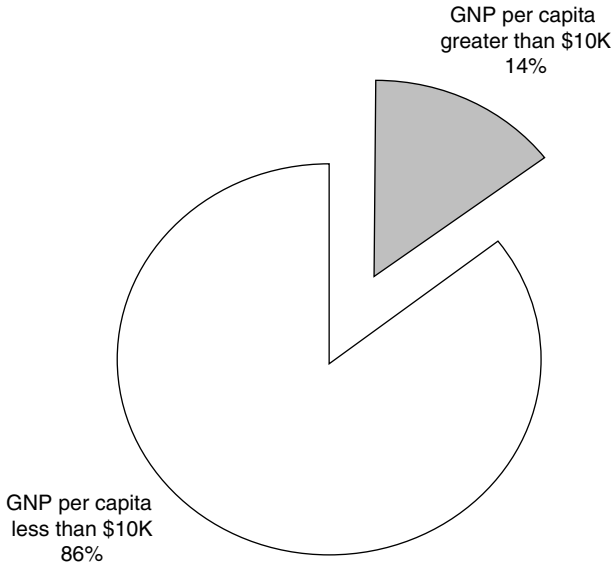


FIGURE 1-1 While many companies have focused on developed markets, 86 percent of the world population is in developing countries with a GNP per capita of less than \$10,000. This percentage will continue to increase in the coming decades.

When Do Emerging Markets Emerge?

Although the \$10,000 GNP per capita is a convenient cutoff, there are many definitions for emerging or developing countries. Some have used membership in the Organization for Economic Cooperation and Development (OECD) as a sign of development, but the OECD includes countries such as Turkey, Mexico, and Poland that are usually classified as emerging. Other systems, such as a list from *The Economist*, use more fluid classifications that place countries such as Hong Kong or Singapore in the emerging world despite relatively high incomes. Some assessments are based on purchase power parity (PPP). In drawing the line between the developed and developing world, we have chosen the \$10,000 GNP per capita cutoff, identified by Kenichi

Ohmae as a significant milestone in national development because of the real implications for disposable income and market development. This is not to ignore the substantial variations and distinctive characteristics of countries that might share a similar GNP per capita.

We Can't Wait for Them to "Grow Up"

Doesn't it make sense to wait for these developing nations to become developed before pursuing them? The risks will be reduced, and we will have business problems that we know how to solve. At that point, these populations will have enough disposable income and mature infrastructures to make it possible to easily create profitable businesses based on models from other developed nations. But we can't wait. It will take too long. How many companies have become developed nations in the past 50 years? How many will become developed in the next 20 years? Excluding Japan, only a handful of countries with relatively small populations have become developed since the 1970s, including Israel, Singapore, Taiwan, Kuwait, Ireland, and possibly South Korea. Not a single developed nation exists in South America or Africa, and Asia has only a few. It took Japan more than 27 years to advance from a per capita GNP of less than \$1,000 to reach the \$10,000 club. Although other countries aspire to follow this example, one wonders how many of them will be able to achieve the phenomenal growth needed to join this club in the next two decades.

By 2020, in China and India only an estimated 5 percent of the population will have a per capita GNP of more than \$10,000. As shown in Figure 1-2, many countries have a long way to travel before they reach the \$10,000 mark. Assuming a constant growth rate of 5.5 percent, it would take India almost 60 years to enter the \$10,000 club.

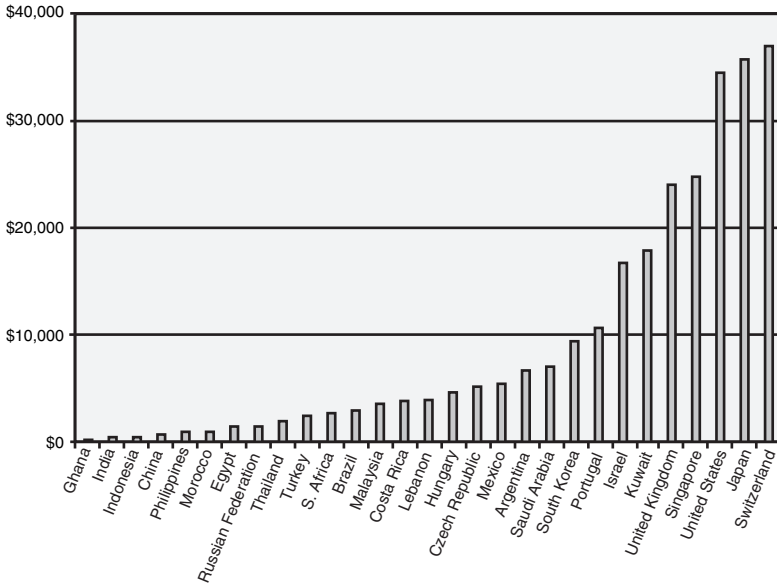


FIGURE 1-2 Although they are growing rapidly, many developing countries, particularly the most populous ones, have a long way to go to enter the “\$10,000 club.” (Source: World Bank, World Development Report, 2003, GNI per capita for 2001)

During this time, fortunes will be created or lost, and companies and brands will be built or destroyed. In the long run, these emerging economies will be developed nations, but as economist John Maynard Keynes observed, “In the long run, we are all dead.”² We cannot kid ourselves that we can wait for these markets to mature.

These Markets Contain Entire “Developed Nations” Today

Even though development will be slow, given the sheer size of populations of developing markets, there may soon be more rich people in the 86 percent markets than in the 14 percent markets. For example, if just a little less than 6 percent of the developing world achieved the \$10,000 per capita GNP mark, this would represent a population of more than 350 million, greater than the size of the entire U.S.

These Markets Are Where the Growth Is

As consumer markets and economies expand, companies such as General Electric are staking their future on the developing world (see the following sidebar). These companies recognize that this is where the growth is. While developed countries posted GNP growth rates of less than 3 percent from 1980 to 1995, developing countries averaged almost 6 percent growth in the same period. The U.S. still accounts for about a third of the global GDP, but its growth is slower than the developing world—about 3 percent. China's aggregate GNP has grown about 10 percent per year since the late 1970s, and India has been posting about 6 percent annual growth since 1991.³ The sheer size of populations in the developing world should give companies pause. They represent more than 5 billion of the 6 billion people in the world and are expected to grow to more than 6 billion of 7 billion in the next two decades. Remove Japan, the U.S., and the European Union, and less than 2 percent of the world's population is in other developed markets.

Finding Growth in a Slow-Growth World

General Electric, which was a pioneer in developing Indian outsourcing and technology businesses under CEO Jack Welch, now sees the developing world as a key driver for its future growth. As its 2004 annual report noted, "We have prepared to make our own growth in a slow-growth world . . . Global revenues grew 18% and reached \$72 billion in 2004. The most exciting global opportunities for GE are in the developing world, where our 2004 revenues were \$21 billion, a 37% increase . . . We believe that 60% of our growth will come from developing countries in the next decade versus about 20% for the past 10 years. It is important for us to understand future customers, suppliers, and competitors in these regions, where we believe GE has a meaningful competitive advantage."³

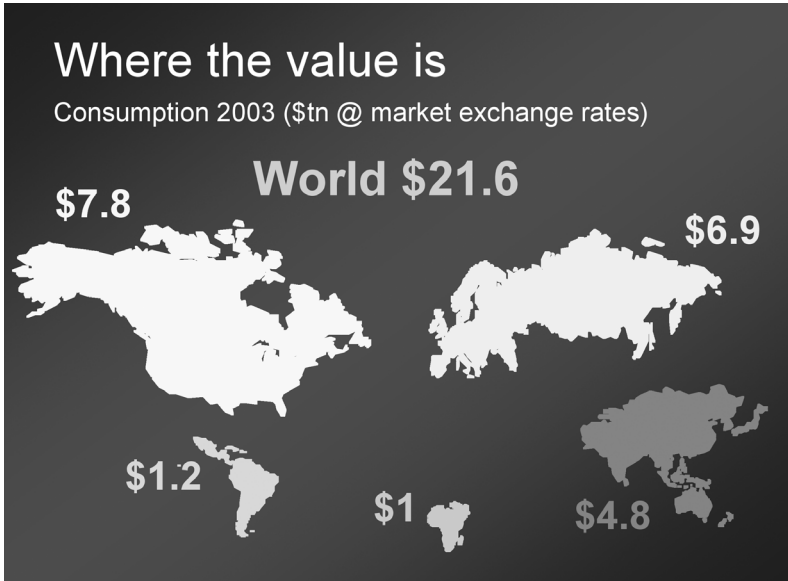


FIGURE 1-3 As global consumption rises from \$14 trillion to \$21 trillion between 2003 and 2010, the center will shift from North America to Asia and other parts of the developing world. (Source: Donald Hepburn, Unilever, 2004)

These developing markets have consumers spending real money today, and with more on the way. Large populations and high growth rates translate into rapidly growing markets, as shown in Figure 1-3. An estimated 35 to 40 percent of profits among the U.S. companies on Standard & Poor's 500-stock index come from outside the U.S. Despite anti-American sentiment after the launch of the Iraq war, U.S. companies earned profits of \$102 billion from overseas affiliates in the first half of 2004, up 38 percent from the year before. Goldman Sachs estimates that in less than four decades, the combined GDP of Brazil, Russia, India, and China (the "BRIC economies") could be larger than the G6 in U.S. dollar terms. Of the top six countries based on GDP, only the U.S. and Japan would remain on the G6 list by 2050.⁴

These Markets Are the Future

As developing markets experience rapid growth in populations and income, they are becoming more central to defining the future in many industries. They are now helping shape technology standards and are playing a growing role in culture and entertainment. For example, Bollywood in India releases nearly 1,200 movies per year, compared to 450 for Hollywood. Indian box offices sell 12 million tickets per day. The arrival of the musical *Bombay Dreams* on Broadway in April 2004 (despite its questionable financial performance) is a further sign of what the show's coproducer, Bollywood director-producer Shekhar Kapur, calls a process of "reverse cultural colonization." Kapur foresees the day, not too far off, when Spiderman will remove his mask to reveal an Indian or Chinese face. (Already a comic-book version of the arachnid superhero story has been released, set in Mumbai with an Indian hero.) This view may be shocking to folks in the insular world of Hollywood, but it's not at all surprising from the perspective of Bollywood. The success of films from China, such as *Hero* and *Crouching Tiger, Hidden Dragon*,

which grossed \$128 million in U.S. markets, also indicates the emergence of new centers of filmmaking. Some 600 international film festivals take place each year in the world, many of them in the developing world.

It is not just the faces that are changing, but also the themes. While Hollywood may make movies like *Waterworld* and *The Day After Tomorrow*, envisioning a time when the Earth is covered with water, Bollywood is focusing more on developing-world themes. In the movie *Water*, for example, factions in a futuristic city battle over scarce water supplies in India. In the 2004 Indian movie *Swades* (“We, the People”), Shah Rukh Khan stars as a NASA engineer who returns to a rural Indian village, working to improve the electricity and water supplies, living in an RV stocked with bottled water and a satellite connection to the Internet—a home on wheels with all the modern facilities that the village lacked. These films are very much grounded in the realities of the developing world. To understand where the world is headed, companies need to have a presence in this world.

If You Can Make It Here, You Can Make It Anywhere

According to the popular Frank Sinatra song, New York used to be the proving ground for individuals and companies. But the companies that have cut their teeth on the challenging markets of the developing world have often found ways to export their solutions to the rest of the 86 percent market and even to the 14 percent populations of the developed world.

TCL came out of China to become the largest television manufacturer in the world, purchasing the venerable RCA brand in 2003 to

create a \$3.5 billion company with factories in China, Vietnam, the Philippines, and Germany. In December 2004, Chinese computer maker Lenovo (formerly Legend) bought a majority stake in IBM's PC business for \$1.75 billion in cash and stock, making it the third-largest PC maker in the world and giving it control of the IBM ThinkPad brand. IBM retains a minority stake in the merged company. The US\$600 million in cash that IBM took from the deal is insignificant, representing less than 1 percent of the company's US\$89 billion 2003 revenue. But the move positions IBM's brand for growth in China and the rest of the world, with an on-the-ground partner in the world's fastest-growing market for PCs.

Appliance manufacturer Haier, in just two decades, went from having a single plant in China to become the second-largest refrigerator maker in the world and a fixture in college dorm rooms in the developed world. Mexican cement company Cemex, after meeting the tough logistical challenges of its home market, has risen to become the world's third-largest cement maker with operations in more than 30 countries. Turkish conglomerate Koc Group, which offers products and services from appliances to financial services, posted 2003 revenues of more than \$11 billion. More than 45 percent of these revenues were drawn from international sales, fueled by purchases of local brands in Germany, Austria, Romania, and other parts of the world. Brazilian aircraft manufacturer Embraer became the world's fourth-largest commercial aircraft manufacturer and Brazil's second-largest exporter in 2004.

The solutions to the challenges of these demanding environments lead to products that are cheaper and better. Brands that have built a broad base of support in the developing world can use this momentum to enter developed markets.

Opportunities at Many Levels

One of the dangers of talking about the “developing world” or even the “86 percent markets” is that it may seem to imply that a monolithic market opportunity exists. Nothing could be further from the truth. It is overly simplistic to focus on only the very poor or luxury segments of these markets. There is, in fact, a continuum of segments—all of which are moving rapidly upward. The 86 percent market represents a patchwork of very different markets, across countries and within countries, as can be seen in the demand for vehicles from bicycles to automobiles.

Bicycles, Motorcycles, and Automobiles

The head of Daimler Chrysler in India sold just one dozen Mercedes SL500s in 2003, priced around 8.2 million rupees each (US\$179,000). That’s an average of just one car per month, but he considers that a good year. At the same time, companies such as Tata Motors are finding opportunities by working with scooter designers to develop an automobile with a remarkable price tag of about \$2,000 to make it easy for motorcycle owners to trade up.

But even automobiles do not represent the full spectrum of the market. Some 76 percent of the 40 million vehicles on Indian roads are not cars at all, but two-wheelers, including motorcycles, scooters, and bicycles (see Figure 1-4). Two-wheelers, considered “family vehicles,” are cheaper than cars and cost less to run. While slightly less than 1 million passenger vehicles were sold in India in 2003–2004, more than 5.6 million two-wheelers were sold in the same period.⁵ Why is all the media attention focused on the automobile industry in the developing world?

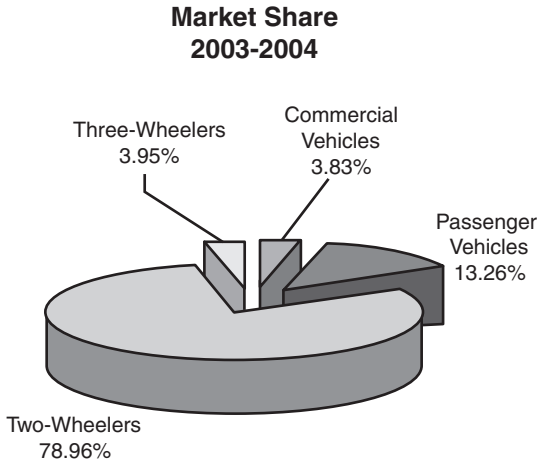


FIGURE 1-4 A large market rides on two wheels. (Source: Indian Automobile Manufacturers, 2004)

Bicycles represent a large part of this two-wheeled market, which is dominated by companies from developing markets. China is the world's largest producer of bicycles. It exports 500,000 bicycles per year to the European Union. Other major bicycle producers come from countries such as India, Vietnam, and Poland. Companies in these countries understand that two-wheeled transportation means something different from the X Games and the Tour de France.

Is focusing on these low-priced two-wheelers worth it? By meeting the needs of this two-wheeler market, Hero Group in India has become the world's largest manufacturer of bicycles and created one of the top brands in India. Its Hero Honda partnership with Japan's Honda Motor Company has become the world's largest manufacturer of two-wheelers, particularly motorcycles. By 2003, Hero Group sales surpassed \$1.8 billion, roughly equivalent to the global sales of Pier 1 Imports (801 on the 2003 Fortune 1000 list). Hero has put more than 55 million bicycles and 7 million motorcycles on

Indian roads. While car companies were slowly building their businesses in India and China, Hero Group in India rode its humble two-wheelers to 29 percent compound annual growth in revenues and 40 percent compound annual growth in profits between 1998 and 2003. For 2002–2003, it posted nearly 46 percent return on equity. Hero now exports bicycles, cycle components, motorcycles, mopeds, and castings to more than 70 countries and also has branched into services.

Diverse Segments

As the market for vehicles illustrates, developing markets have diverse segments:

- **The rich and super-rich**—In 2004, a Beijing man paid \$215,000 in an auction for the ultimate lucky cell phone number (133-3333-3333). Although the buyer was not identified, even the developing world clearly has people with money to burn. The 2004 *Forbes* list of billionaires included newcomers from Kazakhstan, Poland, and Ukraine, and Indian steel baron Lakshmi Mittal moved into third place behind Bill Gates and Warren Buffet. While an estimated 400 million Chinese live on less than \$2 per day, *Asia Money* estimates that 50,000 Chinese have fortunes of more than \$10 million. Although nearly half of Mexico's citizens live in poverty, that country had more than 85,000 millionaires in 2004, more billionaires than Saudi Arabia, Switzerland, and Taiwan. Most of Vietnam consists of poor rural areas, but World Bank economists estimate that the average household of four people in Ho Chi Minh City or Hanoi spent the equivalent of \$20,000 in 2002 (based on purchasing power parity). It is no wonder that Louis Vuitton tripled its floor space in Hanoi in 2004. In the two decades since the first Chinese golf course was established in 1984, more than 200 have been constructed on the mainland, a figure expected to double in the next decade. Even a luxury yacht

factory has set up shop in China, although the domestic market may be years away from emerging. Yet the Mercedes and Bentleys of the developing world are rolling out onto muddy country roads that are often choked with other traffic. Automakers also had to add lights and air conditioning to the backseat because, with low labor costs, these cars are usually chauffeur-driven.

- **The middle class**—Sales of consumer durables, cars, and mobile telephones are growing as the disposable incomes and aspirations in emerging markets surge upward. In 2003, the Chinese Academy of Social Sciences concluded that the middle class accounted for 19 percent of China's 1.3 billion population in 2003, nearly 250 million, and it was expected to rise to 40 percent by 2020. The middle class in China could surpass the middle class in the U.S. within a decade or two. (While other estimates were lower, all indicate that there is a significant and growing middle class.) For this segment, the price-value equation is the most critical factor. The Housing Development Finance Corporation Ltd. (HDFC), founded by Hasmukhbhai Parekh, became India's top housing finance company by offering loans at minimal rates with low down payments. This made it possible for people to dream of owning their first homes. These growing middle-class markets also have driven demand for automobiles, appliances, student loans, and many other products.
- **The poor**—About 1.1 billion people in developing countries live on an income of less than \$1 per day, including one-third of the population of India and Brazil. Rapid economic growth in East and South Asia has helped decrease the number of people living in extreme poverty from 40 percent of the global population in 1981 to 21 percent in 2001. However, the very poor still represent a significant portion of developing markets. Contrary to popular perceptions, these low-income segments still consume products such as potable water, electricity, tea, low-cost laundry

detergents, toothpaste, transportation, and communication services. Although prices and margins are low, large numbers can make these very profitable markets, particularly for products that address people's pressing needs. There are strong opportunities to build markets among the poor, as C.K. Prahalad has demonstrated in *The Fortune at the Bottom of the Pyramid*.

- **The rural**—By 2004, it was estimated that rural India's share in total consumption of fast-moving consumer goods (such as toothpaste, cream, and food products) and consumer durables exceeded urban India's share. A study in smaller towns of India suggested that revenues from rural STD and ISD (booths offering domestic and international phone calls) are greater than for larger towns. Different rural segments present different opportunities. For example, the rich farmer is a good potential market for farm equipment, transport for rural roads, TV sets, consumer durables, gensets (generator sets), and cell phones. There is a need for low-cost housing and information on weather, daily crop prices, and availability of raw materials and other products. Globally, areas known as "teledeserts" are beginning to blossom with high-speed satellite links. Bedouin nomads in the Middle East negotiate deals for their sheep and goats on cell phones. In the West African countries of Ivory Coast and Ghana, shared cell phones are enabling rural coffee and cocoa farmers to call produce markets in the cities and negotiate their own prices. While it can be a daunting task to reach these markets, companies are beginning to unlock their potential.

Companies have built successful businesses by catering to the poorest of the poor, by offering luxury products to the rich, or anywhere in between. Yet all these segments share a common environment and characteristics that shape the opportunities of developing markets. These distinctive characteristics, as summarized next, are the focus of the market strategies discussed throughout this book.

Characteristics of Emerging Markets and the Opportunities They Create

Each of the specific differences in developing markets presents challenges for companies entering these markets but also creates opportunities for companies with the right solutions.

Characteristic #1: Markets and Culture Are Demanding

Dust and heat, lack of electricity, narrow highways, and low budgets all place strains on products in the developing world. While companies might be tempted to produce second-rate products for the developing world, consumers are very demanding, expecting high value for their scarce cash. Products and services also have to be adapted to local cultures and traditions, which can be very different from those in the developed world. How do you sell jewelry and clothing in Islamic countries, which do not allow you to show women's faces? How do you sell food and beauty products to a market that is concerned about their being *halal*? Customers in these markets also have not yet developed a culture of consumerism. They don't know how to be customers, so strategies used in developed markets, such as money-back guarantees, can have unexpected effects. The *memsahib* (Indian housewife) and other social networks can have a major impact on the growth of products, brands, and markets.

Opportunity: By adapting to different cultures, rugged environments, and demanding price-performance targets, companies can develop breakthrough designs for product and service offerings. Sometimes these solutions may look more like a motorized "bullock cart" than a traditional automobile. From meeting the demand for *halal* foods to offering Islamic banking services and cell phones that

point the way to Mecca, companies can reach a Muslim market that accounts for one in five customers in developing markets. How do you need to modify or create products and services designed for the local conditions of developing markets? How can you build consumerism and use social networks to build markets for your products?

Characteristic #2: There Are High Rates of Emigration to the Developed World

The developing world is exporting not only products and services to the developed world, but also people. The foreign-born population in the U.S. rose to 31 million people in the last census in 2000, up 57 percent from 1990. These immigrants are in touch with family and friends back home. Globally, immigrants sent home an estimated \$93 billion in 2003, second only to foreign direct investment as the largest financial flow from the developed to the developing world. While immigrants are formally a part of developed markets, they are part of something much bigger. These global diasporas are redefining the borders of markets and creating social networks that stretch across the developed and developing world.

Opportunity: By understanding the global social networks of immigrants and their friends and family back home, companies can draw on the resources of the developed world to meet the needs of end users in the developing world. Companies can develop “bank shots” to sell products that are paid for in the U.S. but delivered to relatives in Mexico or India. Companies also can serve immigrants abroad and create services to weave together the far-flung networks of this “ricochet economy.” How can you build businesses across these global social networks?

Characteristic #3: Markets Are Fragmented

Developing markets are highly fragmented, with few national brands that have a commanding presence. For example, beer companies initially saw China as a huge monolithic market waiting to be tapped with their global megabrands. After the first push failed, however, it became clear that this market would be won one local market at a time. Local beers were thriving, and large companies began to acquire them. In the words of Wai Kee Tan, vice president for corporate affairs in Asia for Belgian-based Interbrew SA, “China is a nation, but not a national market.”⁶ MTV and HSBC have succeeded by making their global brands local, market by market around the world. Branding strategies and portfolios need to be tailored to the reality of fragmented, market-stall economies.

Opportunity: By developing or acquiring strong local brands and tailoring global brands to local markets, companies can tap into the power of regional communities. They can leverage their global brands and capture the imagination of the local market. What is the right balance of global and local brands needed to connect with the market?

Characteristic #4: Populations Are Youthful and Growing

While Japan, Europe, and the U.S. are worried about pensions and the rapid aging of their populations, emerging economies are young. Peter Drucker has declared that the “youth market is over,”⁷ but in the developing world, the youth market is just beginning. While only 21 percent of the U.S. population is under the age of 14, this figure is 33 percent in India, 29 percent in Brazil, and 33 percent in Iran (and remember, these percentages are on a much larger population base). Most of the world’s population growth will take place in developing countries.

Opportunity: A young population creates markets for education, games, entertainment, apparel, fast foods, cafes, fashion, magazines and books, beauty products, music, and other products and services. While young people are globally attuned, the youth in developing markets can be different from those in the developed world, and companies need to be aware of the pushback from tradition. By thinking young, companies can connect with these burgeoning youth markets. How can you create the offerings and positioning to reach these youthful markets?

Characteristic #5: There Is Limited Income and Space

Incomes and cash flows in the developing world are much lower. In rural and poor segments, low income limits purchases. But even in more affluent sectors, there is a tendency to limit purchase size. In environments of past or present scarcity, cash is kept liquid rather than being tied up in household inventory. Saving rates in China and nine other rapidly developing countries climbed from 20 percent to 34 percent between the early 1970s and early 1990s, at the same time that savings in industrialized countries fell. While consumers are buying “super size” or “economy size” in the developed world, sachets of shampoo and other products are accounting for billions of dollars of revenue in the developing world. In the developed world, customers pay a premium for convenience. In the developing world, customers buy small for different reasons. Homes are much smaller, so furnishings and other products need to be scaled accordingly. India, with 342 people per square kilometer, is more than 11 times as densely populated as the U.S. (31), and China is more than four and a half times as densely populated (135).

Opportunity: By reducing package size, offering small payments, using demand pooling, and tailoring products to small spaces, companies can build billion-dollar markets a few pennies at a time. Like the just-in-time inventory systems of Toyota or Dell, companies need to design systems to help consumers fill their “just-in-time pantries.” How can you grow a large business by thinking small payments, packages, and products?

Characteristic #6: Infrastructure Is Weak

Most of the rural population of the 86 percent markets is inaccessible by motor vehicles, and they lack good sanitation and electricity. At the same time, the cities are growing very rapidly, and this fast urbanization has placed tremendous strains on the urban infrastructure. Infrastructure everywhere in the developing world is fragile or underdeveloped. Transportation networks are nonexistent. Power failures are frequent. Clean water and sanitation are often lacking. Underdeveloped economic systems and restrictive regulations have created thriving informal or parallel economies in developing nations. It is estimated that the informal economy accounts for at least 40 percent of the GNP of low-income nations.

Opportunity: The weak infrastructure creates opportunities for companies that can fill the gaps with water purification systems, generators, inverters, and other products. It also creates opportunities for companies that can find ways to work around holes in the infrastructure, such as through ready-to-eat meals that don't require refrigeration. The informal economy may present opportunities for legitimate businesses. How can you find opportunities in the holes in the infrastructure?

Characteristic #7: Technology Is Underdeveloped

The developed world has had a head start of many decades in land-line telephones, computing, and other technologies. The developed world has had a much longer time to build technology-intensive industries such as pharmaceuticals and biotechnology, with the support of academic institutions and supplier networks. How could developing countries ever hope to compete? Won't the market for technology be slow to develop in the 86 percent world?

Opportunity: Powerful new technologies can leap across the boundaries of the developing world. Without the constraints of legacy systems, companies have opportunities to create new systems from scratch, often leapfrogging old technology. Technology can spread very rapidly as consumers quickly adopt it without the switching costs of developed-market customers. How you create the technologies, or ride the technologies, to allow your business to leapfrog with the market?

Characteristic #8: Distribution Channels Are Weak

Developing nations have poor distribution systems. In large cities, distribution is often through small, hole-in-the-wall shops such as the *paanwalla* shops in India, the *tiendas de la esquinas* in Mexico, and *sari-sari* stores in the Philippines. A market of 600 million is locked in India's villages, 42 percent of which have populations of less than 500, with weak connections to the outside world. The lack of media, roadways, and electricity creates seemingly impenetrable barriers. Some villages don't have retail outlets at all, and some distribution opportunities, such as market days or carnivals, are temporary in nature.

Opportunity: By building distribution or utilizing the existing idiosyncratic systems in the developing world, such as small shops and market days, companies can find ways to

“take the market to the people,” meeting the diffused and fragmented markets of the developing world where they live. How can you create the distribution networks to reach the dispersed markets of developing countries?

Characteristic #9: Markets Are Changing Rapidly

By definition, the global 86 percent markets are *developing*. Although it will take decades for these markets to become developed, the certainty is that they will continue to change rapidly. In a year, or even a matter of months, these markets can shift. Look at the rapid emergence of South Korea over the past decade or the growth of India and China. Consumers become upscale. The precise trajectory this development will take will depend on factors such as government regulations, traditional business practices and culture, and companies' actions. Rising incomes and improved economic conditions will change consumer habits and society itself, creating predictable shifts, such as the increasing empowerment of women, as these markets mature. These markets will present new challenges and opportunities at each stage of their development.

Opportunity: By understanding the complex path to development, companies can evolve their businesses to meet the changing needs of the developing world. They can experiment with new products and business models in one country and export the successes to another, or even to the developed world. Companies also can import successful ideas from the developed world as the 86 percent markets mature. How can you develop your business with the market?

Because of these distinctive characteristics of the 86 percent market, companies often need to employ market solutions that are quite different from those of the developed world, as summarized in Table 1-1. Each characteristic creates market opportunities with the right strategies, as we will examine in more detail in the following chapters.


TABLE 1-1 Unique Characteristics Create Market Opportunities

Market Characteristic	Strategy for Realizing Market Opportunities
Markets, culture, and environments are demanding.	Don't build a car when you need a bullock cart.
There are high rates of emigration to the developed world.	Aim for the "ricochet economy."
Markets are fragmented.	Connect brands to the market.
Populations are youthful and growing.	Think young.
There is limited income and space.	Grow big by thinking small.
Infrastructure is weak.	Bring your own infrastructure.
Technology is underdeveloped.	Look for the leapfrog.
Distribution channels are weak.	Take the market to the people.
Markets are changing rapidly.	Develop with the market.

Finding Solutions

Success in the 86 percent markets often means challenging conventional wisdom. In banking, for example, Grameen Bank, founded by Professor Muhammad Yunus, offered microloans to village businesses that wouldn't have received a second glance from mainstream banks. Grameen began in one village in Bangladesh in 1976 and now has more than 3 million borrowers and a staff of more than 11,000 in more than 43,000 villages. With a loan recovery rate greater than 99 percent, Grameen Bank has been profitable every year since 1992, financing its loans almost entirely from its own funds and the savings of depositors. Grameen has become a trusted brand name that has led to other related businesses. According to UN estimates, somewhere between 70 million and 750 million microloans were offered by thousands of lenders worldwide in early 2005. The microlending model has been picked up by for-profit microlenders such as Basix in India, which provides financial services to rural borrowers in nearly 10,000 villages in India. Microlending has swept into the mainstream,

along with a mind-set that allows companies to see the hidden opportunities in these markets. This shift in thinking is reflected in a 2004 advertisement for global investments by U.S.-based Franklin Templeton Investments that proclaims: “You see an ancient culture. We see modern homeowners.” (See Figure 1-5.)




**YOU SEE AN ANCIENT CULTURE.
WE SEE MODERN HOMEOWNERS.**

Templeton fund managers spot global investment opportunities others might miss.

TEMPLETON FUNDS In 1998, our fund managers recognized the investment opportunity presented by a mortgage company serving India's rapidly growing middle class. We purchased stock in the company, and our fund shareholders were able to get in on the ground floor of a dynamic housing boom.

Taking advantage of a global opportunity like this requires a unique perspective. One that comes from having offices in over 25 countries and on-the-ground analysts utilizing research techniques that have been honed for over 50 years. It's what's made Templeton a pioneer in global investing.

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Investors should carefully consider a fund's investment goals, risks, charges and expenses. To obtain a prospectus that contains this and other information, call us at 1-800-342-5236. Investors should read the prospectus carefully before investing.
Foreign investing involves special risks including currency fluctuations and political uncertainty. Holdings subject to change.
Franklin Templeton Distributors, Inc., One Franklin Parkway, San Mateo, CA 94403.

SBI4

FIGURE 1-5 A Franklin Templeton advertisement recognizes that there are more opportunities in the 86 percent markets than meet the eye. (Courtesy of Franklin Templeton Investments. Copyright 2004–2005. Franklin Templeton Investments. All Rights Reserved.)

Millions of customers for financial services were invisible until someone created a business model to reach them. At the other end of the spectrum, companies are competing for private banking customers among a growing pool of affluent consumers in the developing world. These customers also only recently emerged or have been recognized. How many other potential customers are waiting out there for an organization to come in with the right solutions? Companies that have created strategies tailored for the 86 percent of the world's population in developing markets have found tremendous opportunities, but this requires rethinking products, branding, distribution, and many other market strategies.

Developing markets can present very difficult challenges, with poor sanitation; lack of water, food, and clothing; housing shortages; and lack of education. But in the midst of these challenges, tremendous opportunities exist, in both the segments of the market that already have comfortable incomes and the segments that are still aspiring to rise from poverty. Companies can work with non-governmental organizations (NGOs), governments, and other organizations to address the pressing needs of these countries while building profitable businesses. In the following chapters, we'll explore in more detail the opportunities created by the unique characteristics of the 86 percent markets and some of the solutions for realizing them.

The 86 Percent Solution

- Examine each of the characteristics of the 86 percent market, and consider how you need to change your market strategies and products for these markets.
- Identify your current successful market strategies in developed markets that will not work in the markets. How do you need to transform these strategies?
- Assess the total market size for your product or service offerings in specific developing markets. Do you have rivals who can capitalize on these markets? What can you learn from their models?
- Look at the initiatives of NGOs, governments, and entrepreneurs in meeting the needs of specific developing markets. What can you learn from them? How can you work with them to develop business opportunities while meeting social objectives?

Notes

- 1 Kenichi Ohmae. "The \$10,000 Club." *Across the Board*, October 1996, p. 13.
- 2 John Maynard Keynes. *The General Theory of Employment, Interest and Money* (1936).
- 3 General Electric 2004 Annual Report, February 11, 2005.
- 4 Dominic Wilson and Roopa Purushothaman. "Dreaming with BRICs: The Path to 2050." Goldman Sachs, Global Economics Paper No. 99, October 1, 2003.
- 5 Society of Indian Automobile Manufacturers, <http://www.siamindia.com/General/production-trend.aspx>.
- 6 Gabriel Kahn, Dan Bilefsky, and Christopher Lawton. "Burned Once, Brewers Return to China—with Pint-Size Goals." *The Wall Street Journal*, March 10, 2004, p. A1.
- 7 Peter Drucker. "Meeting of the Minds." *Across the Board (The Conference Board)*, November-December 2000.

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