Roasted or Fried
How to Succeed with Emerging Market Consumers
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EXECUTIVE SUMMARY

The global economic landscape is in upheaval. Emerging markets are more than just a rising force: They’re now the main game in economic growth. Companies around the world and across industrial sectors are drawn by the business opportunities these markets represent—especially the billions of potential new consumers in India and China. It’s important to recognize, however, that these emerging markets are fundamentally different, even from one another. Groupings such as BRIC (Brazil, Russia, India, and China) hold little meaning when it comes to planning to win in these markets. A detailed understanding of the differences is essential, and rethinking product development and go-to-market strategies is key to meeting the needs of new consumers. A willingness to not just alter but in many cases fundamentally transform existing operating models to adjust to a non-Western business environment is required. Companies that have done so—Coca-Cola in Asia, KFC and VW in China, Hyundai in India, and many others—have enjoyed success, while others, such as Ford in China and GM and KFC in India, have fallen short in achieving their growth and expansion objectives.
WHERE THE GROWTH IS

Muhtar Kent, Coca-Cola’s chief executive officer, recently unveiled the company’s plan to double its business over the next decade. To meet its goals, Coke will focus on the billion people worldwide expected to join the middle class by 2020.

Kent noted that Coke’s global growth must make up for weak sales in the United States. Coca-Cola is not alone. Growth has stalled in the developed world, not only in the U.S. but in Europe and Japan too. Multinationals everywhere are turning to developing markets to make up the difference. Population is growing rapidly in emerging markets, but slowly or not at all in Western markets. In emerging markets, spending power is on the rise. In the West, incomes are stagnating.

During the global downturn, India, China, and Brazil outpaced global markets and for the most part shrugged off recession. They will likely continue outpacing the traditional growth engines by large margins, as they’ve already been doing for years. This year China is on pace to expand GDP by 10 percent, and India by 8 percent or more. China has focused on manufacturing and export of goods, while India’s thrust has been export of services. India lags behind China in foreign investment, but its growth has tracked that of China when considered from the time of liberalization (see Exhibit 1). While India and China represent the world’s emerging giants, Brazil, Egypt, Indonesia, Poland, Russia, South Africa, and others will figure prominently in the growth mix too.

The mature markets cannot be ignored, of course; the total size of the G7 developed economies is nearly four times that of the BRIC countries. But power is shifting. By 2050, the biggest global economic powers are expected to be China, the United States, India and the European Union, in that order (see Exhibit 2).

That date might seem far off, but there is no time for complacency. BRIC countries are projected to contribute almost half the growth in global consumption in 2010. Emerging market growth is influencing consumption patterns, as rising living standards move huge segments of the population beyond bare survival. From basics to luxuries, demand is rising for food and clothing, transportation, entertainment, and services with the level of quality and features that until a few years ago only Western consumers were able to enjoy (see Exhibit 3).

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*Exhibit 1*

*India vs. China*

<table>
<thead>
<tr>
<th>GDP GROWTH</th>
<th>GDP PER CAPITA GROWTH</th>
<th>FOREIGN DIRECT INVESTMENT TRENDS</th>
</tr>
</thead>
<tbody>
<tr>
<td>In US$ Bn</td>
<td>In US$</td>
<td>In US$ Mn</td>
</tr>
<tr>
<td>$0 to $4,000</td>
<td>$0 to $3,000</td>
<td>$0 to $100,000</td>
</tr>
</tbody>
</table>

Source: Economist Intelligence Unit
Attention thus far has focused on the rise of the middle class in emerging markets. Now the “bottom of the pyramid,” or the billions of people around the world just now emerging out of poverty, is drawing attention too. The Economist magazine recently concluded that half the world’s population can be considered the “emerging” middle class, defined as living on US$2 to $13 a day at 2005 purchasing power parity prices. The recently deceased C.K. Prahalad, author of the influential book The Fortune at the Bottom of the Pyramid, said 5 billion people worldwide represent a mostly invisible unserved market that is only now drawing the attention of multinational corporations.

**Exhibit 2**
GDP Growth vs. GDP per Capita, 2007–2050

- **Note:** Size of bubble is proportional to GDP of the economy.
- **Source:** Economist Intelligence Unit; Goldman Sachs BRIC Report, 2003

**Exhibit 3**
Emerging Markets Consumption Patterns

1. Other includes household and other goods and services.
2. Transportation includes communication costs.
3. Food includes beverage and tobacco costs.
- **Source:** Economist Intelligence Unit

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Booz & Company
Finding new sources for growth is one reason Western companies are vigorously investing in emerging markets, but it’s not the only reason. These economies are beginning to produce their own powerful multinationals—Haier in China and Tata in India are just two examples. By entering emerging markets, Western multinationals are playing both offense and defense. They know they must be on the ground in emerging economies, investing for the long term, physically close enough to learn the ways of markets that differ from those they’re accustomed to. “The biggest threat for U.S. multinationals is not existing competitors,” Vijay Govindarajan, professor at the Dartmouth Tuck School of Business, recently told the Wall Street Journal. “It’s going to be emerging market competitors.”

Embraer and Vale in Brazil, Cemex Mexico, and South African Breweries have learned this lesson well. Emerging market companies now succeeding as global players have thus far been confined mainly to the B2B sector. But the makers of branded, aspirational consumer products are coming up fast. The day when the emerging markets create major brands to compete with the established giants is not far off. The Indian five-star hotel chains Taj and Oberoi are making forays into Western markets. The Taj Group recently bought the Ritz-Carlton in Boston, renaming it the Taj Boston. In fact, an Indian company—financial services provider

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ICICI—appears this year for the first time on media company WPP’s BrandZ Top 100 Most Valuable Global Brands list. In total, 13 companies from emerging markets are included: seven from China, two each from Russia and Brazil, and one each from India and Mexico.

Any move into emerging markets will require innovations in products, technology, and services, as well as major changes in operating procedures. No longer can a company simply export a product to a distribution network in an emerging market and expect it to succeed. The world’s customers, even the poorest, have become too sophisticated for that. In fact, companies may have to rethink repetitive business models to compete effectively. Dell, for instance, sells computers through storefronts in China while maintaining its traditional direct-to-customer model elsewhere. Yum Brands entered the traditional Chinese cuisine market with its East Dawning fast-food chain to cater to the local palate. In India, McDonald’s advises local farmers on growing specific potato varieties to ensure consistent french fry quality. Levi Strauss sells jeans on a pay-as-you-wear basis (akin to layaway) for Indians who can’t afford to pay a lump sum for their purchases. Nokia understands that the consumer of its cell phone will share it with multiple users, as opposed to the single user per phone typical in Western markets.

A company that assumes uniformity across emerging markets is mistaken. Each nation differs in its laws, politics, business environment, and culture. Even within a country, vast regional and local differences must be taken into account. Addressing these differences may well determine success or failure. Companies doing well in one region often falter in another. Renault’s “people’s car,” the Logan, was a hit in eastern Europe and other parts of the world, but it failed in India, where this larger vehicle that lacked luxury features met with little demand except as a taxicab. The Logan was optimal for a virtual global customer, but not for a real Indian one! One size fits all is not practical at the product level. Success in one country rarely predicts success in another. General Motors and Volkswagen have done well in China; GM, VW, and Fiat in Brazil; Ford in Russia; and Hyundai in India. But for the most part, these same companies have struggled in other emerging markets.
Booz & Company has developed a growth framework to clarify the issues that companies must consider when entering emerging markets. The six-point framework is divided into two main sections. The supply side looks at how to get internal operations right. The demand side looks at how to approach end customers (see Exhibit 4).

The Supply Side

The supply side focuses on operations—setting up a business in a country or locality and then getting products or services to the customer.

Local Regulations
Every country presents businesses with its own set of complex rules and regulations. Many rules are shaped more by politics than by economics. They range from the grand to the mundane—from what share of a local venture a foreign company may own, to whose signatures are required on a business license. When entering an emerging market, it’s essential to focus first on the regulations that affect overall strategy. For example, foreign investors are limited to 20 percent stakes in Chinese banks. India, on the other hand, is far less stringent: Wholly owned subsidiaries established by foreign companies are welcome.

In retail, the situation is reversed. China’s regulations are relatively liberal, with big-box stores from overseas companies like Carrefour...
and Walmart popping up in major cities. In contrast, India has been slow to accept organized retail. Its political system favors mom-and-pop stores. Regulations barring the entry of foreign multi-brand retail stores effectively ban the big-box players, with implications not only for the retailers but for the multinational brands that sell through them. Successful companies have worked around these regulations by setting up partnerships with local retail companies—Calvin Klein and Tommy Hilfiger with the Murjani Group, DKNY with DLF Brands, and Versace with Blues Clothing Company, for example.

Perhaps no sector better exemplifies the hard realities of local market regulation than the motor vehicle industry. Every car sold throughout the world is subject to “homologation”—local regulations that cover everything from safety rules to environmental requirements to the amount of locally sourced content that must be included in any auto sold. Homologation varies dramatically from country to country, and the details can be mind-boggling, yet they must be mastered. BMW and Daimler’s Mercedes brand are industry leaders in their ability to design and build a car in one market but sell it around the world while still meeting local requirements.

Companies interested in entering emerging markets must thoroughly understand local regulations and treat them as a cost of doing business. Better yet, companies can work regulations to their strategic advantage. Although direct multi-brand retail is restricted in India, Walmart entered the country through a joint venture with a local Indian company that front-ends the retail operation. Leveraging local regulations and strategically adapting to them is critically important.

**Localized Sourcing**
Localized sourcing of components is key for global companies to be competitive with local companies. Even if there is no local competition, localized sourcing is essential to lowering the cost base and maximizing profits.

Entering an emerging market without a well-conceived plan for localized content is a recipe for failure. The cost of engineering and manufacturing goods in developed markets will be too high to be price competitive. Cost structure and revenue structure won’t produce adequate profits if a common currency is not employed to link them.

Volkswagen has succeeded in China in large part through aggressive sourcing. More than three-quarters of its vehicle components are locally sourced; the far lower cost structures of those suppliers are reflected in VW sales. VW has become price competitive, while maintaining high engineering standards.

Hyundai, meanwhile, sources 90 percent of parts locally for its Santro compact car. The Santro is a big success in India for many reasons—for one, it was designed specifically for India’s tight traffic and narrow streets—but without such a high level of local sourcing, it never would have been affordable for most of its customers.

The sourcing issue affects every industry, not just autos. Sony Ericsson switched to local sourcing in India very soon after entering the market, resulting in dramatic gains in market share. McDonald’s sources most of its food locally in India, because frozen food prepared in the U.S. cannot withstand the Indian heat: Too many gaps break up the infrastructure and distribution “cold chain” to guarantee that foods will stay frozen in transit. Given the strong influence of India’s agriculture sector, local food sourcing also turned out to be a smart political move.

Companies can expect initial challenges in achieving cost targets, productivity levels, and quality standards with local sourcing. These challenges can be overcome only
with a committed sourcing strategy. A strong supplier-development organization in the local region will strengthen ties.

Tuning the Go-to-Market Model
The value chain for a consumer product is, in broad terms, the same across the world: design it, make it, distribute it, and sell it to the individual. But in emerging markets, the details become far more complicated. Tuning the go-to-market model to meet the realities of the developing market is essential. The main component of the go-to-market model—distribution strategy—depends on the region’s geographic makeup, its infrastructure, the distribution of manufacturing facilities, and the size and format of the stores at the end of the chain. Generally in emerging markets, of course, the infrastructure is still being developed, the retail chain is not consolidated, and the manufacturing facilities and warehouses tend to be widely distributed.

In developed markets with large stores, 18-wheel semitrailer trucks carry goods from manufacturer to distributor right up to the point of delivery just about everywhere. In emerging markets like China, that’s true only in larger cities, where modern infrastructure and large retail outlets make for a routine delivery system. To get to smaller retailers in smaller cities, smaller trucks with smaller loads naturally are required. Reaching farther to distant rural areas, or into the congested quarters of a massive city like Mumbai or São Paulo, requires truly creative thinking.

Here is where the realities of tight living spaces and small-scale economics dictate product distribution. For billions of potential customers at the base of the economic pyramid, square footage is scarce. An American or a European might shop at a big-box store and stash 48 cans of Coke for later consumption. Not only do most customers in emerging markets lack the storage space for that form of shopping, but their cash flow does not allow them to buy in bulk.

The same constraints apply to mom-and-pop retailers. The inventory of a typical neighborhood shop in rural India or Burundi or Costa Rica rarely tops $100. Yet it’s possible, by turning to alternative forms of distribution, to make a profit selling to such shops.

Coca-Cola learned that its product is in high demand even in rural India. But the typical Coke customer there buys a single can at a time and is likely to save it at home as a luxury. By breaking product lots down into ever-smaller sizes through the distribution channel, to the point where a couple of cans of Coke are delivered inexpensively to each retailer by bicycle, Coca-Cola was able to get its volume high enough and its costs low enough to make a profit. The system could be applied to cereal or dish soap, or just about anything else that could be delivered on a bicycle.

Unilever bypassed the retail end of the retail chain altogether with a low-cost laundry detergent. It trained 25,000 Indian village women to distribute the detergent door-to-door, reaching 80,000 villages and gaining $250 million in annual revenue.

In contrast, multinational yogurt maker Danone entered Brazil lacking
a full understanding of local product distribution. When Danone began operations in São Paulo, it focused on direct distribution to major retail grocers. Eighty percent of yogurt distribution there, it turns out, goes through 10,000 small shops. Local dairy distributors were able to subsidize their yogurt prices with their other dairy products, putting pressure on yogurt prices across the board and hurting Danone’s profit margins. That eroded the company’s market position significantly.

The problem is not so much the choice of distribution channels—in the 1990s, Procter & Gamble consciously chose to stick only to megacities in India, while Unilever decided to go broad. Either alternative can work, as long as its limitations and implications are well understood. In fact, the challenges of the emerging markets give advantage to the larger consumer packaged goods players with broad portfolios, because they are able to invest in the right infrastructure. This is markedly different from the U.S. market, where size doesn’t necessarily account for much and big retailers like Walmart make it a point to reward small suppliers.

No single distribution strategy fits all emerging markets. Even within the same market, the population distribution, urbanization trends, and development of Tier One and Tier Three cities vary greatly—for example, Shanghai and rural China are very different in many aspects. One has to understand the market structure and develop a strategy to gain competitive advantage, or the business unit will be left saddled with a delivery system that is not only uncompetitive with respect to cost but also well behind the competition in customer service levels.

The Demand Side

The demand side focuses on consumer-centric issues: designing products, customizing features, and branding, all specifically for the local market.

Local Market Dynamics

A market’s local dynamics include culture, language, lifestyle, economic buying power, infrastructure, and many other factors. These dynamics combine to produce a unique set of demand-side characteristics for each country or region. Companies must design their products with these differences in mind. In some cases a mere cosmetic change or a modest repositioning could be sufficient. For example, Pizza Hut maintains the same dough, cheese, and sauce formulas across markets but varies the toppings to suit local tastes. In other cases—such as with the McDonald’s menu in India or China—a complete redesign of the product to meet local market dynamics may be required.

Washing machines provide another good example. For most households in emerging markets, laundry loads and machines will be relatively small because people own fewer clothes and space is tight. But smaller size is just the beginning. In India, LG sells a washing machine equipped with speech technology that provides instructions in several regional languages. Samsung offers a machine with a “sari” cycle, which prevents the six-meter-long garments from tangling.

**Samsung offers a machine in India with a “sari” cycle, which prevents the six-meter-long garments from tangling.**
tangling. The Chinese company Haier developed a machine specifically for rural regions to wash both clothes and sweet potatoes.

Infrastructure, too, plays a major role in product development, but depending solely on rule of thumb metrics can cause major problems. Due diligence on local market dynamics is required. Chrysler, for example, saw India as a large country with 3,000 miles of paved roads and figured that its 300C, a large, eight-cylinder car, would sell well. But looking at total highway miles didn’t reveal that those roads are built more narrowly than in the United States. The 300C literally didn’t fit.

Hyundai’s careful study of the Indian market, on the other hand, led to great success for its Santro economy car. The roadways in Indian cities are narrow, and horrific traffic jams are endemic. The average speed in Mumbai is 10 mph. Because cars there will rarely be driven at high speeds, horsepower is not as highly desired as in the U.S., Europe, or even China. The fuel-sipping Santro has a slim body for navigating narrow streets, but its roof sits high. The high roof offers more interior space, which may not be “usable” in the Western sense but provides a feeling of openness that makes a slow journey in a car full of people easier to bear.

The importance of local dynamics isn’t limited to hard goods. Google’s problems with hacking and censorship in China are well known. Less understood is the fact that in China, Google is an also-ran, bested by local search competitor Baidu. Google basically applies the same search algorithms in markets around the world. In China that means a lot of internationally relevant information ranks much higher than the local information a customer is probably searching for. Baidu has done a much better job of tailoring its algorithms to favor local, hence more relevant, results.

Food provides the clearest translation of local market dynamics into product customization. In the fast-food industry, McDonald’s has done the best job of customizing its menu to markets around the world: The Netherlands has the McKroket, a deep-fried patty of beef ragout on bread; South Korea, the Bulgogi Burger, a pork patty marinated in a soy-based sauce; and India, the McVeggie, a vegetable patty spiced with hot pepper and other seasonings.

Customization
What works well in one market may well flop in another. McDonald’s understands this well. After its fried chicken restaurants took off in stir-fry-happy China, the company expected similar success in India. Instead, the foray was a disaster. Indians prefer their chicken roasted. Even in the 21st century, mistakes like these, which are obvious in hindsight, continue to be made.

Subway, by contrast, studied the Indian market closely. Not only is its menu customized for local tastes, but the company also sells smaller sandwiches than the six- and 12-inch versions that are routine in most of the world. A four-inch sandwich is on the menu in India, and many Subway stores there will even cut those sandwiches into smaller pieces offered at a lower price.

The fuel-sipping Santro has a slim body for navigating narrow streets, but its roof sits high, which offers more interior space and lends a feeling of openness.
A failure to respect local market dynamics and product customization often results in products that customers won’t buy. In the late 1990s, after the liberalization of India, Korean companies were far more successful in India than their Japanese counterparts. The Korean companies customized products for local markets while Japanese companies tried to sell the same products in India that they sold in Western markets. It was a difference in attitude: what’s right for India versus what’s good enough for India. Sometimes a brand can succeed with a product that’s exactly the same around the world—for example well-known luxury goods like Rolex watches and LVMH accessories. But for most products, standardization won’t work.

Branding
Because buyers in emerging markets are unfamiliar with many companies and products in the developed world, some global brands are put in a fragile position. On the one hand, the lack of familiarity offers a chance to shape brand images from scratch, including brands that are well known elsewhere. At the same time, a company may have to go far deeper into the value chain to preserve brand integrity, because the slightest mistake could cause reputation problems from which it would be difficult to recover.

For example, in emerging markets, brands like Samsonite, Pizza Hut, Holiday Inn, and Van Heusen are positioned as premium brands, not the midmarket brands they are in Western markets. These companies have grabbed the opportunity to upgrade their brands’ position, succeeding in part because their product quality compares favorably to that offered by local companies.

Even brands that are well known in emerging markets require special attention. The brand might mean something entirely different than it does in Europe or the U.S.—for good or ill. In the years before the revolution in China, the emperor and his royal court rode in Buicks. Even under communism, the brand memory stayed alive enough to stand for high class and high quality. General Motors has leveraged this reputation to the point where Buick sales in China now outnumber those in the United States. Buick has successfully rekindled the Chinese affinity for the brand with a new generation of younger consumers.

It was a different story in India for Opel, a GM brand popular in Europe. In India, Opel was viewed as an old-fashioned brand whose quality wasn’t worth a high price premium. GM invested too little in marketing to counter a dowdy impression.

Branding offers new opportunities for companies planning to enter emerging markets. A careful analysis of competitive positioning will highlight opportunities to grab a premium position no longer possible in Western markets. The reverse is also true—in India, Ford is perceived as less worthy than Hyundai because Ford squandered its branding there by trying to sell older versions of cars popular in the West. Trying to attach a premium price tag to hand-me-downs not only doesn’t work but can mar a brand for decades.
Emerging markets offer the best opportunities for economic growth, but the time to act is now. Local competitors for multinational products and services are beginning to show muscle. Chinese automakers such as BYD and Chery provide a good example of low-end products that are quickly improving and soon will be competing with global automotive brands.

Simply exporting Western products to developing nations may have worked in the past, but not anymore. Neither will an approach that treats all emerging markets the same. Understanding the laws, politics, business environment, and culture of each market is key—not just country by country, but region by region as well.

Globally known brands making new entries into emerging markets have an opportunity to position themselves as premium “aspirational” brands relative to those already available in local markets. In any case, success requires long-term local investments and a deep understanding of consumer preferences in each of the new markets.

Succeeding in emerging markets is difficult. Many companies have succeeded in some countries while failing in others. No multinational company has mastered emerging markets across the board. A strong commitment and a systematic approach to the challenges, however, can produce great rewards.

CONCLUSION
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