

A billion buyers: Product innovations for a new consumer class

Emerging markets are characterized by more than just low-cost production. Economic growth is lifting millions out of poverty and leading to a rise in consumerism. Will players in telecoms, media, and high tech be prepared to meet the specific demands of a growing middle class around the globe?

By now, most companies have heard the siren's song of emerging market growth. Still, today's shifting global economy may result in a scale and implications that could indeed be more dramatic than most believe. For instance, predictions that emerging markets will collectively add more growth to the world economy over the next decade than all mature-market countries combined suggest that such countries could be an important component in multinational corporation (MNC) strategy. This is the first time such significance has been achieved since the industrial revolution, when the United States was itself an emerging market. Thus, having a plan to address new customers in today's emerging markets seems more like an imperative.

China has headlined the growth story, racing from being an economic afterthought twenty years ago to its current position as the world's second-largest economy. It has accomplished this, not merely as a manufacturer of low-cost goods, but by developing its own advanced industry base and making its way toward employing the largest population of R&D workers in the world. Companies still thinking that China only excels at manufacturing based on intellectual property from abroad should consider firms like Huawei. It applied for more patents than any other company in the world in 2010 – no US corporation was among the top 10 in applications.

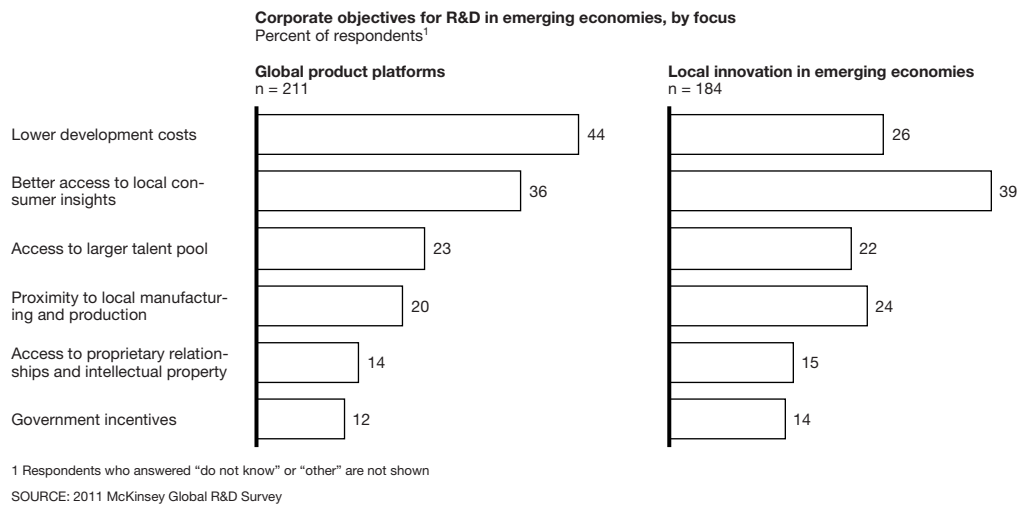
This story, however, extends well beyond China as countries throughout Asia, Latin America, Eastern Europe, the Middle East, and Africa play their roles in global economic rebalancing. The demographics of emerging-market demand are shifting: by 2020, 40 percent of the world's population will have reached middle-class status – compared with less than 20 percent today. This means that real per capita income will double in emerging markets and unprecedented levels of new middle-class consumer demand will arise. In pursuit of addressing the appetite for modern improvements from these new consumers, many companies are failing to recognize the essential distinguishing features of the demand they are attempting to satisfy.

The face of a new consumer

In emerging markets, there are a multitude of distinct customer groups with very different needs. These customers number in the hundreds of millions, but addressable market concentrations are distributed across many nations and scores of cultures and ethnicities. Geographic and societal differences are reflected in diverse consumer needs and wants. Emerging-market consumers are exhibiting extremely sophisticated and continuously evolving purchasing behaviors. They are less influenced by global brands and are no longer satisfied with “yester-tech” and products that have been discontinued in the mature markets. Consumer tastes and preferences in emerging markets will evolve just as rapidly – if not more so – than those of consumers in developed markets. They will demand products tailored to their needs and of the same quality as those found in more advanced economies, but at much lower price

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Conducting R&D locally helps to achieve better local insights and to lower development costs



points – as little as 30 percent of developed market prices. In this melting pot of opportunities and challenges, local and global innovators will have to compete to identify the best solutions.

In the past few years, the primary competitors in most emerging-market segments transformed into local innovators. Given their understanding of local needs, they were able to gain market share with tailored products, low price points, and broad customer reach.

By using customization to meet user needs, local companies have proven to be inventive in creating new markets. Galanz, for example, decided to design and manufacture microwave ovens tailored to the domestic market. These have six different cooking programs for rice. Individual units were priced at USD 50, and the product targeted China's newly emerging middle class – at a time when only 2 percent of Chinese households owned microwave ovens. Today, Galanz has become the world's largest microwave oven manufacturer.

Successful product innovation

Hundreds of individual products – most of which are designed and produced within and for emerging markets – are revealing a trend in which price and cost

structures are radically reengineered. Such products are derived directly from a deep understanding of the particular needs and resources of projected end users. They span every consumer category from telecommunications and high tech to durables and household goods, differing in significantly qualitative ways from their "global" counterparts. Local, contextual insight into specific concentrations of emerging-market demand has thus become the engine that drives leading-edge innovation (Exhibit 1; also see text box).

Unilever serves as an example of such localized innovation success. This MNC entered emerging markets in a competitive market space with its Wheel brand laundry detergent. At first, the price points were too high: Wheel was priced 40 percent higher than the local competing product, Nirma. Unilever quickly identified the challenge and reduced the concentration of active ingredients in order to meet local requirements and the local price point. The company also innovated products to meet local, out-of-pocket spending behaviors with small-sized packages. Following these initial experiences, Unilever significantly broadened its knowledge base for each product category.

In the area of medical devices, GE developed one of the first heavily market-tailored products by collaborating

Tailored telecoms: Indian insights and innovation

Nokia looked to India as an emerging-market laboratory. As the first multinational company to enter the consumer electronics market, Nokia invested heavily, establishing R&D facilities and a design studio in Bangalore, and developing the first mobile phone with menus in Hindi in 2000. The team researched the needs of the rural population. The results were eye-opening.

While language is consistently a region-specific differentiator, other segment needs are often less obvious. Nokia's research revealed the pervasive-

ness of unreliable electricity in many rural areas in India. This led to developing new features – including longer battery life and a one-touch flashlight function – all delivered at a cost of not much more than USD 10. Nokia also found out that users consider agricultural information very important to better equip them to negotiate with agents, but are constrained by access distance and cost. Armed with this insight, Nokia invested in services that provided agricultural market price information and weather forecasts – plus cricket match results and other local, entertainment-related information.

with small Indian hospitals and with paramedics to design the MACi ECG device. Problem areas for the local market were the product's dependence on electricity, its high price, its lack of durability, and poor usability for non-trained paramedics. The result: a MACi device that is battery-operated, portable, and capable of completing 500 three-channel ECGs for every three hours of battery charge. At USD 500, the price is low compared with that of a "regular" ECG machine, typically costing USD 1,500. GE also innovated within the value chain, structuring financing through national banks to offer zero-interest loans. More importantly – after being successfully introduced in emerging markets – this innovative product was successfully launched to create a new market in developed countries.

Given the mismatch between price points and features and local needs, standardized products frequently fail to address the requirements of diverse emerging-market populations. For mature-market leaders, the reduction of product cost structures by 50 percent (or more) is the key to reaching and meeting the massive new emerging-market demand. This requires breakthrough innovation – experience suggests that 30 percent is the upper limit for "cost-out" potential in existing designs.

Meeting market demand

Only groundbreaking innovation can fulfill the majority of emerging-market aspirations, providing new and savvy consumers with the solutions they want at a

price they can afford – and all of this at the right time and the right place. Innovations must be holistic solutions. Innovators need to master the overall value chain, choose the right infrastructure, and build capabilities and mindsets. In their rush to build presence in emerging markets, even the best-performing global companies have not always considered what they needed to do to achieve sustainable success. On its many journeys with global clients, McKinsey has worked with top management to transcend conventional thinking and the static strategies responsible for early failures. In these relationships, McKinsey established numerous paths to emerging-market success.

Among the few constants of the innovation approach are granular local knowledge, substantive local input, and relentless top management commitment. Successful paths to innovation have overarching themes that can be summarized by four interconnected requirements.

Contextual insight. Clearly identify and frame the problem in context. Of particular importance is determining who the consumer population is. A typical first step toward fulfilling this requirement is the granular segmentation of customers and compiling in-context insights. McKinsey research has, for example, identified "12 Indias" and "6 Chinas," each with distinctive local customer preferences and unmet needs. The contextual toolkit includes ethnographic studies, shop-alongs, competition scans, and in-context interviews. Some global companies have bypassed the granular analysis

that would reveal this differentiation and deployed strategies focused on introducing preexisting products to emerging markets as fast as possible. The lessons they have learned by taking such static approaches have proven costly, e.g., missing price points, failing to provide local features. In contrast, low-cost solutions that use “copycat” design (known as “shanzai” in China) have proven to be successful on many occasions. This is especially true if improved features and extensions have been included. The success of shanzai mobile phones – with their improved texting, dual SIM cards, and other advanced features that meet local customer needs – demonstrates that companies should consider “copycat” design solutions, despite the fact that these phones are often dismissed as inevitable brand name “knock-offs.”

Holistic solutions. Use technical and commercial insights to build in profit for all stakeholders. Holistic concepts address the entire local value chain with durable and complete stakeholder-focused solutions. The overall objective of achieving extreme cost targets involves active collaboration and support in concept development from value chain partners. Product tear-downs yield key insights, robust cost benchmarks provide a basis for accurate cost targets, and “should-cost” models accelerate solution development. To account for limited technology reach to emerging-market consumers, visual quantitative surveys and in-depth respondent orientation can replace traditional conjoint analyses.

McKinsey has observed that holistic solutions can arise from frugal local engineering, especially in financially disadvantaged emerging markets. Behind this “do-it-yourself” phenomenon is urgent consumer demand that remains otherwise unsatisfied. Dozens of small companies in China, for example, are producing electric cars at a cost of USD 2,500 to 5,000. These cars travel at slow speeds (around 50 km/h) and have limited range (100 km), but they are a dramatic step up from bicycles and they meet the needs of a large consumer base.

End-to-end systems. Sustainable performance requires an end-to-end system that covers the supply chain, manufacturing footprint, and go-to-market strategy. Key questions regarding the manufacturing footprint are the extent to which manufacturing should be outsourced to local partners in the supply chain, and how

sustainable supplier partnerships can be initiated and developed. A go-to-market strategy requires innovative approaches to effectively reach fragmented distribution and remote areas. An example of such an innovative approach is the thousands of micro-entrepreneurs in India deployed so effectively by Coca-Cola and Unilever.

Organizational setup, capabilities, and mindset. Global companies are learning through experience that success demands considerable knowledge and investment – and an intense focus on emerging-market innovation. In China, for example, 1,000 multinational companies already have operating R&D centers. Manufacturing can often involve non-standard supply chains, and delivery can require assembling complex, localized distribution networks. Some global leaders have hesitated to make the required investments, however, and have done so for understandable, if short-sighted, reasons.

Experience has shown that preexisting mature-market innovation organizations are inadequate for meeting the challenge. When entering emerging markets, key talent needs to be hired or trained – often in a very short time frame. New organizations must retain local top talent using a tailored model to be attractive to the local population. In India, for example, this means fast promotion cycles and a hierarchy that works in the context of the local culture. New structures must encourage technical and commercial functions to work together using cross-functional task teams. To effectively mobilize the local team, the company needs to understand and adapt to local mindsets, rather than transplanting its own mindset to the new geography.



A burgeoning global middle class is putting disposable income in the pockets of hundreds of millions of consumers for the very first time. Their needs, however, are just as varied as the geographies in which they live. Companies who want to take full advantage of these new emerging-market segments will abandon the one-size-fits-all mindset. The successful and sustainable approach to product innovation in these markets will consider a host of local realities such as language and culture, economics and price points, and environmental landscape and infrastructure.



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