

Rethinking Indian Business

**—The Indian Consumer Market Begins to
Undergo Structural Change—**

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- I The Indian Consumer Market Begins to Undergo Structural Change
- II Market Characteristics and Business Development Methods as Seen in the Activities of Companies that Already Operate in the Indian Market
- III Suggestions for Japanese Manufacturers

India's consumer market is undergoing continuous change. The number of middle- and high-income households (with minimum annual income of around 180,000 Indian rupees) is increasing rapidly, not only in metropolitan cities with populations in excess of four million, but also in cities with populations of only one million.

Even looking from an Asia-wide view, the scale of the middle- and high-income Indian markets as well as its growth potential is large as compared to the same in ASEAN countries. Thus, targeting only high-income households limits the overall scale of this market. However, taking an approach in which only low-income households are targeted by business providing solutions to social problems is more like an investment in the future rather than a generally adopted business strategy. Such an approach would take a long time to ensure a sufficiently large business scale and profitability. Thus, gaining access to the middle- and high-income markets that are already large in scale and have a high growth potential is essential for establishing a company's business in India's consumer market.

In this paper, home appliances is used as a representative consumer market. The following key points are required to access the middle- and high-income markets: ① ability to develop low-cost, high-performance products in which lifestyle characteristics are taken into consideration, ② ability to enable local procurement and production, and ③ establishing strength in logistics, sales and distribution channels to ensure maximum penetration spreading over wide areas including rural India.

In order to break into the low-income market, it is essential to clearly narrow down the target consumers. If a company's sole purpose for entering this market is to generate profits, then it should target the "Next-MoP" (future middle of the economic pyramid) market that will grow rapidly as a result of the expansion of urban infrastructure.

For developing business not only in the Indian middle- and high-income markets but also in the Next-MoP market, the strategies for all these three markets should be integrated. In addition, consideration should also be given to positioning India as an export base for serving demand from South Asia, the Middle East and Africa.

I The Indian Consumer Market Begins to Undergo Structural Change

1 Anticipated structural change: consumers, channels and regions

(1) India’s already attractive consumer market

India has seen steady growth in the number of middle- and high-income earners. In order to analyze the Indian consumer market based on the number of households, Nomura Research Institute (NRI) prepared estimates based on the survey of household income and expenditure undertaken by the Center for Monitoring Indian Economy (CMIE) as well as on the forecast for real GDP (gross domestic product) growth published by the International Monetary Fund (IMF). Please note that this paper adopts the same classification as that defined by CMIE for income hierarchy. Specifically, in this paper, Indian households are broadly classified into the following three segments.

- High-income households with annual incomes of “one million rupees or more”
- Middle-income households with annual incomes of “180,000 rupees or more and less than one million rupees”
- Low-income households with annual incomes of “less than 180,000 rupees”

As will be described later, the income segments that could be targeted by Japanese manufacturers would be the high- and middle-income households with annual incomes of “180,000 rupees or more.” In 2010, the

number of households in these income segments stood at about 41 million, which is expected to grow to around 78 million by 2020 (Figure 1).

When added to the number of high-income earners, this increase in the number of middle-income earners has already led to the Indian consumer market being a major presence in the Asian market. As listed in Table 1, which compares the markets for typical consumer goods in Asian countries, the size of India’s market for home appliances, toiletries/cosmetics and processed foods is second only to that of China.

When we look at the scale of the market for the five typical home appliances (washing machines, microwave ovens, refrigerators, air conditioners and vacuum cleaners), we see that the scale of the Indian market for washing machines, microwave ovens, refrigerators and air conditioners is larger than that of any of the five ASEAN (Association of Southeast Asian Nations) countries (Table 2).

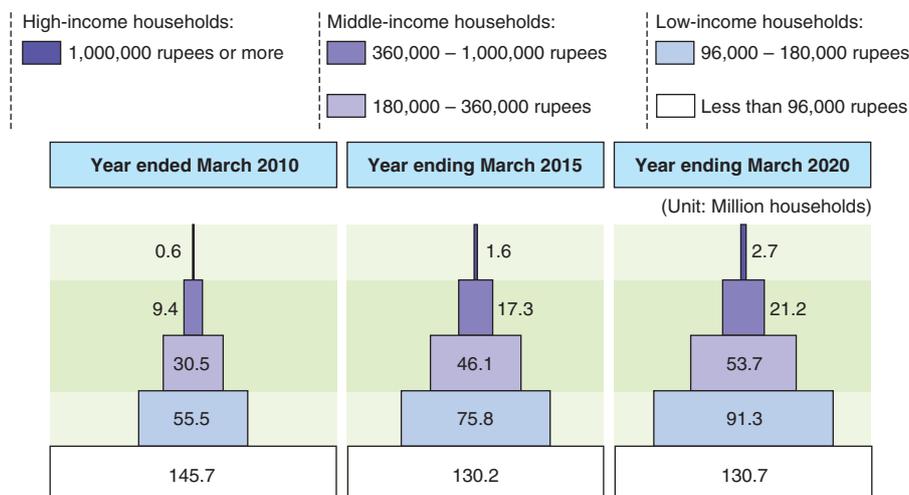
(2) Anticipated structural change (A): Change in consumers

Against a backdrop of various factors such as increased real income, the time is approaching for the Indian consumer market to undergo structural change, as shown in Figure 2.

① Greater purchasing power

As mentioned in Item (1), in India, real household income, as well as the number of middle- and high-income households, has been increasing. Once households reach the CMIE income categories of “at least 180,000 rupees per annum,” the penetration of a variety of consumer goods will increase, as described below. The CMIE estimates that, as of 2010, the number of households in these categories was about 41 million. In addition, the

Figure 1. India’s trend in the number of households by annual income segment



Note: The figures for the year ended March 2010 are based on real incomes. Sources: Year ended March 2010: Results of a survey conducted by the Center for Monitoring Indian Economy (CMIE). Year ending March 2015 and year ending March 2020: Estimates prepared by Nomura Research Institute based on CMIE surveys of the number of households by income segment for the years ended March 2010, March 2011 and March 2012; surveys of population and the number of households through the Census of India website and real GDP (gross domestic product) forecast by the International Monetary Fund (IMF).

Table 1. Size of consumer goods market in each Asian country

(Unit: \$Million)

	Home appliances	Toiletries/cosmetics	Processed foods	Beverages (soft drinks)
China	207,488	32,020	184,377	54,605
India	39,964	8,864	29,506	4,235
Indonesia	20,749	3,554	24,261	5,807
Malaysia	8,098	1,816	6,312	1,287
Philippines	4,869	3,151	10,030	5,433
Thailand	9,053	4,488	9,956	4,461
Vietnam	6,237	848	6,664	1,063

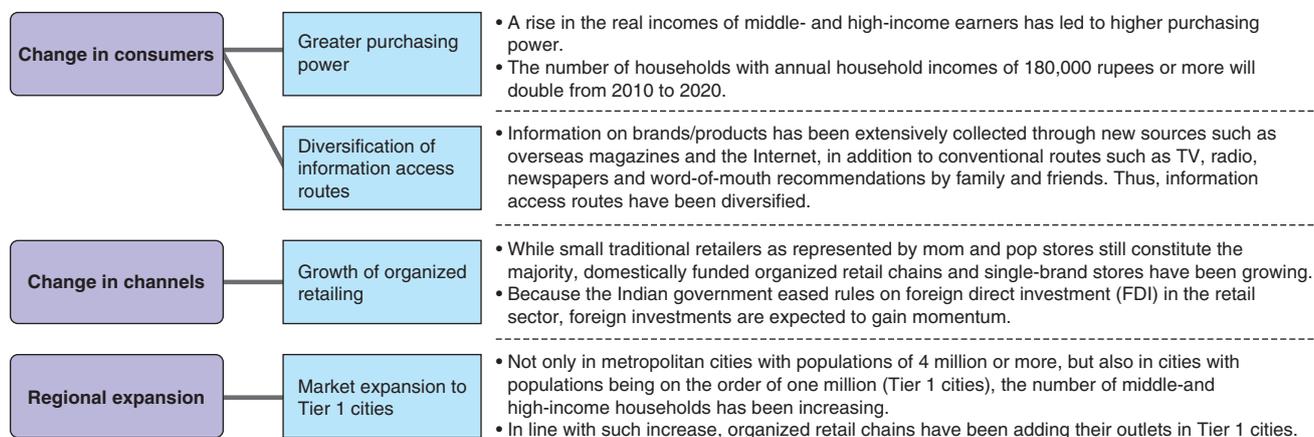
Note: Dark shaded boxes represent the top three countries in terms of market size.
Source: Compiled based on Euromonitor International 2012 data.

Table 2. Size of home appliance market in each Asian country

(Unit: \$Million)

	Washing machines	Microwave ovens	Refrigerators	Air conditioners	Vacuum cleaners
China	8,134	1,444	21,355	27,970	588
India	1,367	248	2,510	1,502	40
Indonesia	483	12	2,485	586	14
Malaysia	249	26	304	336	40
Philippines	161	29	299	360	3
Thailand	420	70	734	690	70
Vietnam	177	110	1,483	525	12

Note: Dark shaded boxes represent the top three countries in terms of market size.
Source: Compiled based on Euromonitor International 2012 data.

Figure 2. Structural change in the Indian consumer market

results of NRI's estimates that have considered real GDP growth and so on, point to the number of such households doubling to about 78 million by 2020. Although India faces serious inflation, the increase in the number of households with high real incomes means that the number of consumers having high purchasing power is increasing despite inflation.

Regarding low-income households, in particular, those with incomes of 96,000 rupees or less, the majority are small- and medium-scale farmers who rely on the sale of foodstuffs and milk for their income, as well as day laborers, all of whom are susceptible to price fluctuations. In addition, because the prices of day-to-day

necessities are continuously rising, it is likely that their real incomes are scarcely increasing.

② Diversification of information access routes

Through mass media sources such as TV and magazines, there has been a spread of western culture throughout India. In addition to the mass media, recent years have also seen the rapid increase in Internet access and smartphones. Communication using social networking services (SNS) is widespread in India. The number of Facebook users in India is said to be around 80 million. To accommodate the variety of languages that are spoken in different regions of India, Facebook now

provides service in eight languages in order to increase the number further.

(3) Anticipated structural change (B): Change in channels

Retail in India is still dominated by small traditional outlets that are typified by “mom and pop stores,” with organized retail chains accounting for only 10 percent of the total retail sector. However, as shown in Figure 3, organized retail chains are expanding rapidly in India. Some retail brands already have more than 500 outlets (Table 3).

For home appliances, there are three main types of retailers. These are: ① major consumer electronics retail chains, ② manufacturers’ stores (stores that deal only in the products of a particular manufacturer) and ③ independent stores. At present, the independent retailers are by far the most common. However, these retailers can service only a small area, have low procurement power and are staffed by personnel with limited sales abilities. These stores are also much less likely to be visited by manufacturers’ representatives. Over time, it is thought that these stores would gradually be displaced, and that any surviving stores would become part of local chains.

(4) Anticipated structural change (C): Regional expansion

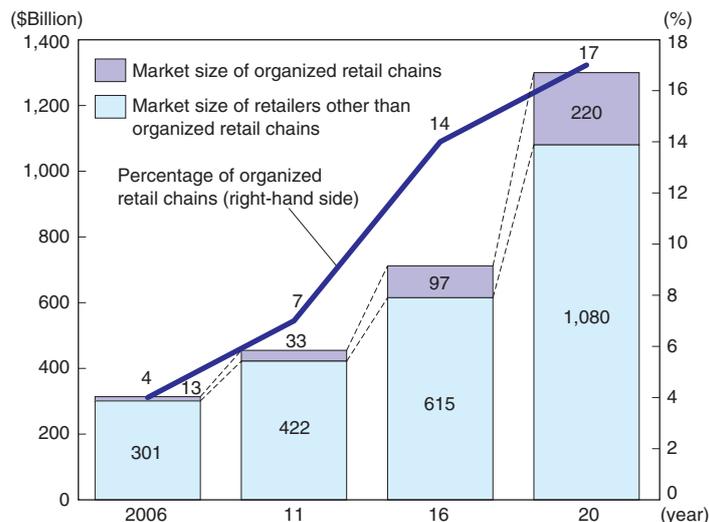
When one thinks about the Indian consumer market, attention tends to be paid to metropolitan cities having populations in excess of four million such as Delhi, Mumbai, Bangalore and Hyderabad. However, cities with populations of one million (Tier 1 cities) are also beginning to make their presence felt in the market.

As shown in Figure 4, the percentage of increase in the number of households in the high income bracket, with annual household incomes of “one million rupees or more,” is greater in Tier 1 cities than it is in metropolitan cities. For this reason, organized retail chains are expanding their store networks in Tier 1 cities. For example, as shown in Figure 5, Big Bazaar, a major hypermarket chain, has opened stores in many states.

2 Growing consumer goods market —spread of home appliances and related products

To gain a more detailed understanding of Indian consumers, the following sections look at the penetration of consumer goods in households classified by income

Figure 3. Outlook for India’s retail market and percentage of organized retail chains



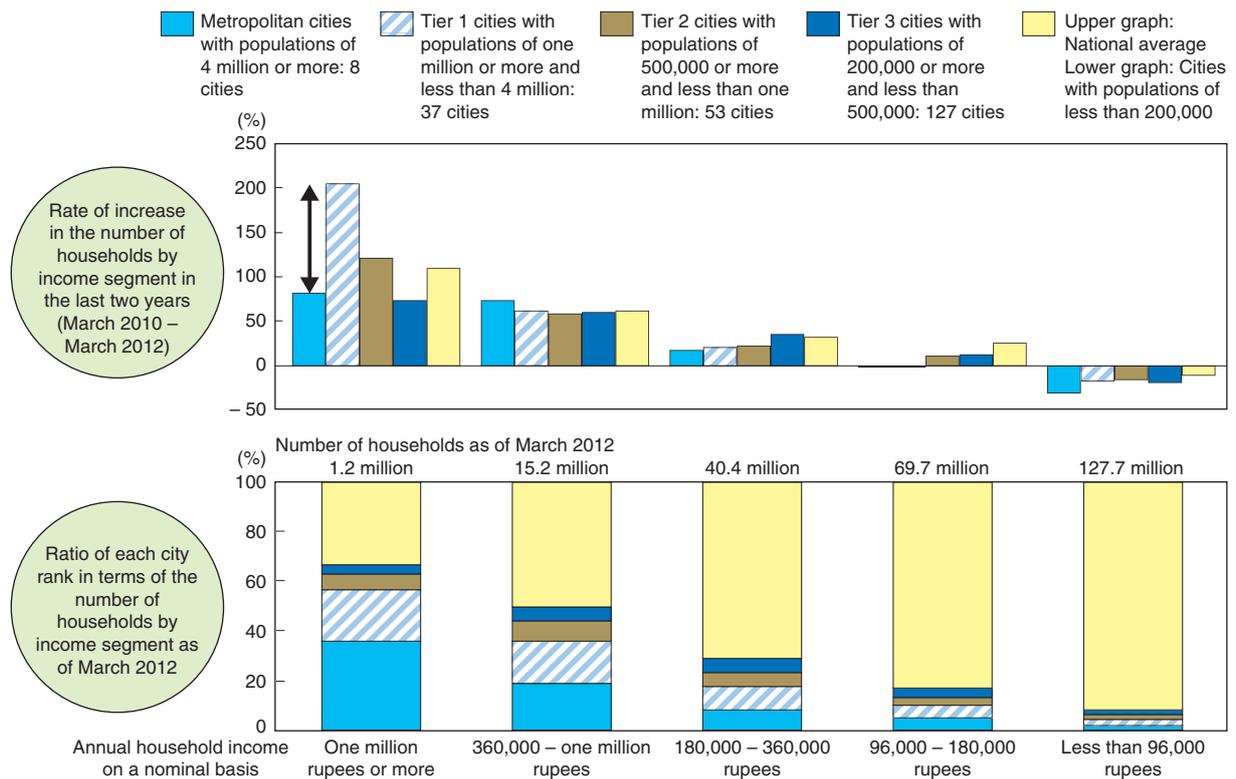
Sources: Compiled based on Federation of Indian Chambers of Commerce and Industry (FICCI) publications: “Driving Indian Consumption Through Integrated Multichannel Retailing,” September 2012, and “Report on FDI in Retail,” November 2012.

Table 3. India’s major organized retail chains

Brand	Format	Operating company	Number of stores
More	Supermarket	Aditya Birla Retail (Aditya Birla Group)	541
Reliance Fresh	Supermarket	Reliance Retail (RIL Group)	500
Big Bazaar	Hypermarket	Future Value Retail (Future Group)	199
Food Bazaar	Supermarket	Future Value Retail (Future Group)	175
Easyday	Supermarket	Bharti Retail	165
Vishal Mega Mart	Hypermarket	TPG Wholesale (Vishal Group)	141
KB’s Fairprice	Department store	Future Value Retail (Future Group)	135
Spencer’s Neighborhood Stores	Department store	RPG Group	134
Nilgiris	Supermarket	Nilgiris Dairy Farm	115

Source: Compiled based on the website of each company (as of January 2013).

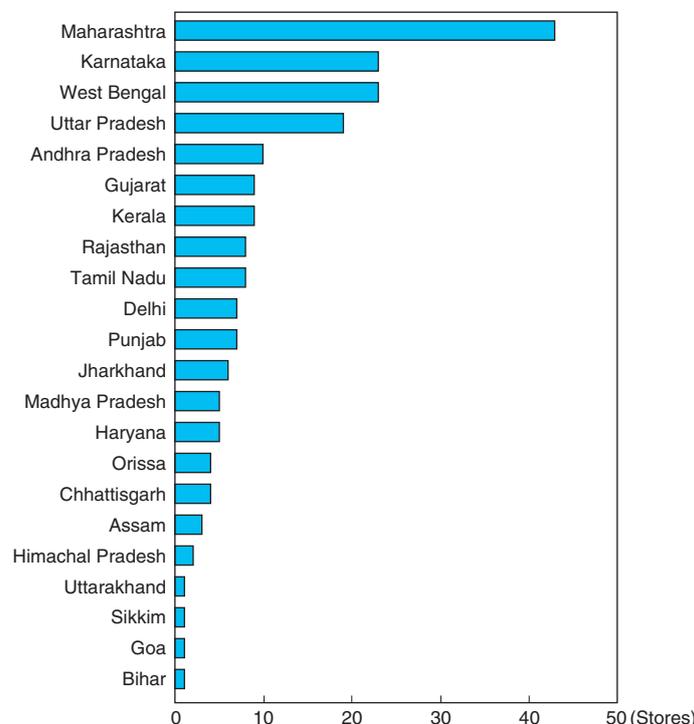
Figure 4. Number of households by income segment as seen from the perspective of city ranking in India



Note: For city classification, cities for which CMIE data are available were targeted; CMIE data on population estimates as of March 2010 were used for classification.

Source: CMIE data were used for analysis and graph creation.

Figure 5. Number of Big Bazaar (India's major organized retail chain) stores by state



Source: Compiled based on Big Bazaar's website (as of January 2013).

segment based on the results of CMIE's household survey.

In general, as shown in Figure 6, more than 70 percent of households with annual incomes of "180,000 rupees or more" (41 million households as of 2010) have

equipment and devices such as refrigerators, blenders/grinders, irons, CRT TVs and audio systems. These households with annual incomes of "180,000 rupees or more" present a source of revenue that Japanese manufacturers could target. Among high-income households

with annual incomes of “one million rupees or more,” many have products such as electric water purifiers, juicers, microwave ovens, toasters, automatic water heaters, air conditioners and personal computers.

Figure 7 is a breakdown of ownership in terms of product categories. Among five typical home appliances, that is, refrigerators, microwave ovens, air conditioners, washing machines and vacuum cleaners, given India’s hot climate, the ownership of refrigerators is high among households with annual incomes of “180,000 rupees or more.” However, the ownership of vacuum cleaners is low even among high-income households earning “one million rupees or more.” This low

ownership is thought to be a result of India’s “maid culture.” The higher the household income, the stronger the tendency for household members to avoid doing any of the cleaning themselves.

Looking at cooking appliances, the majority of households in the “180,000 rupees or more” bracket own a blender/grinder. This high ownership is related to the fact that Indian cooking is very reliant on the grinding of spices and so on. In households in the “one million rupees or more” bracket, it is usual to find appliances such as juicers, which are commonly found in advanced countries. A notable characteristic of this bracket is that because the quality of the tap water is poor, more than

Figure 6. Ownership of durable consumer goods (70% or more) in India by annual household income level

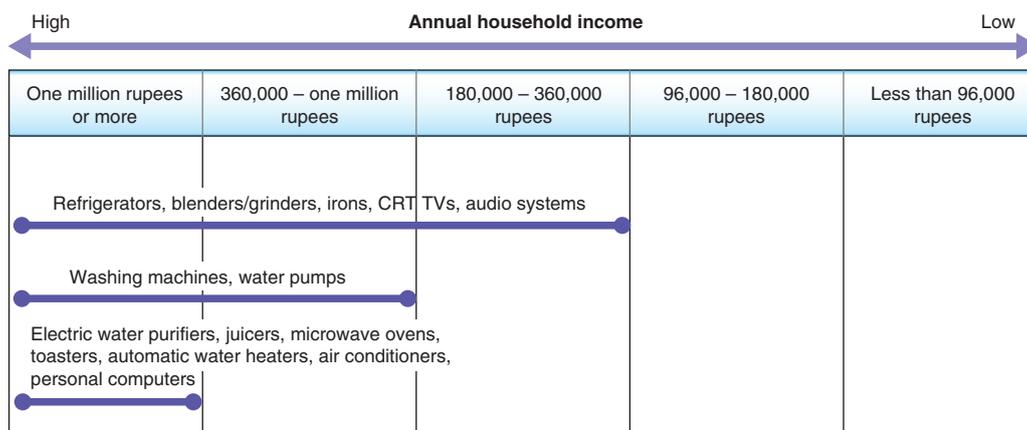
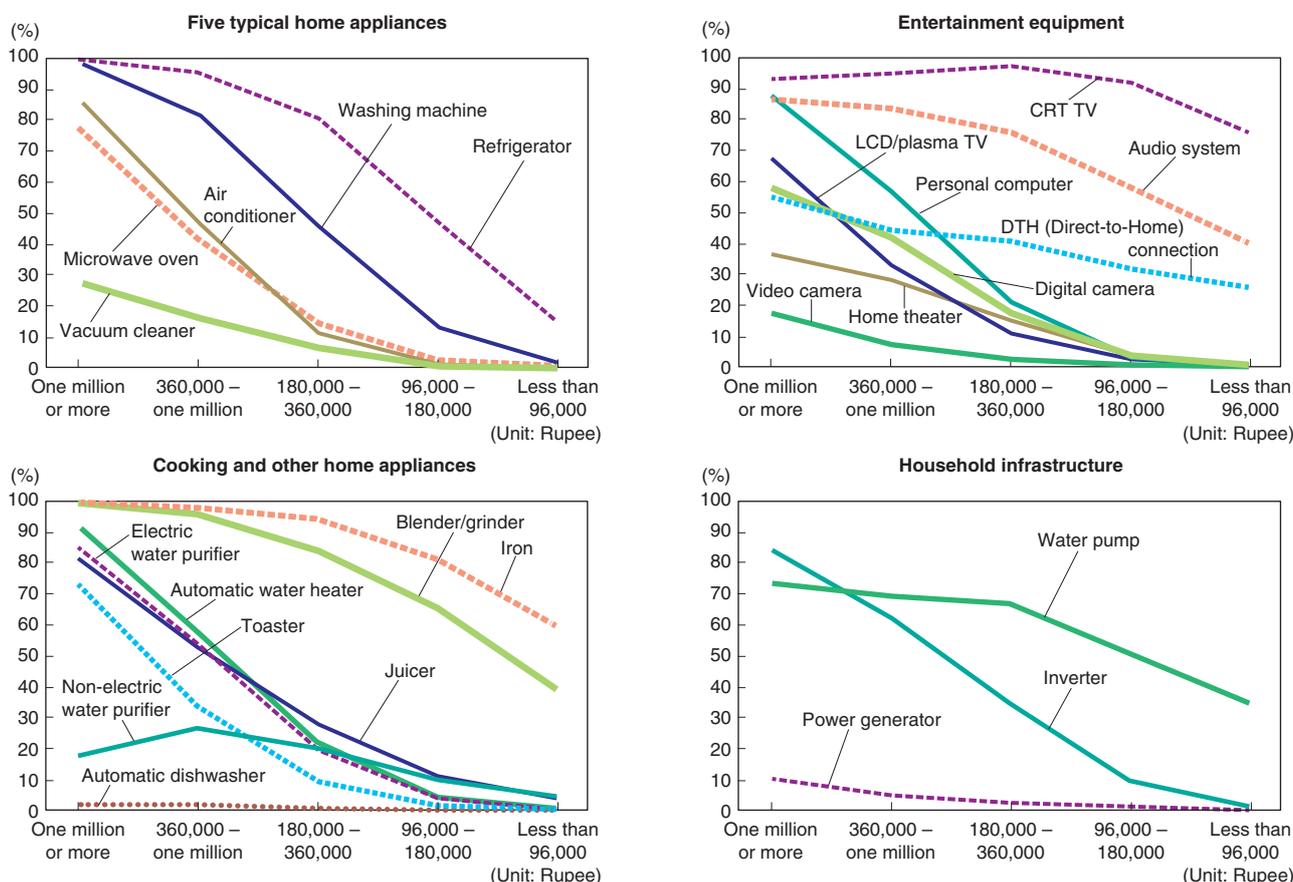


Figure 7. Ownership of consumer goods in India by income segment



Source: CMIE data were used for analysis and graph creation.

80 percent of these households own an electric water purifier.

Regarding entertainment equipment, the penetration rate of TVs is very high, which suggests that TV programs form the center of most people’s entertainment. Another notable characteristic is that, within the “one million rupees or more” bracket, nearly 90 percent of households own a personal computer; among the high-income bracket, use of the Internet is already routine.

Looking at household infrastructure, it is notable that the penetration rate of water pumps and inverters is high. Inverters are popular because power outages are quite frequent.

II Market Characteristics and Business Development Methods as Seen in the Activities of Companies that Already Operate in the Indian Market

1 Middle- and high-income markets

This chapter focuses on home appliances as an example of consumer goods aimed at consumers in the

middle- and high-income brackets to describe market characteristics and important points related to business development. For each business function, Table 4 lists what should be achieved as well as the challenges that must be overcome for business development in India’s middle- and high-income markets. Please note that these achievements and challenges are generalized, and that in actual situations, they vary depending on the business in which a company is engaged.

In the following items, important points and actual examples are introduced for each business function.

(1) Product development

When developing new products, it is important to strike a balance between providing products that will suit the taste of Indian consumers and the characteristics of India’s climate, and selling products that are offered globally while minimizing the effect of localization. In order to understand the preferences of Indian consumers and the characteristics of India’s climate, it is necessary to establish a system to identify local needs and perform test marketing.

To determine the priority with which products are introduced, as well as the method used to launch them, marketing activities are required for each product. However, many Japanese companies face an extreme shortage of personnel who can perform marketing activities without the support of Japanese personnel. Therefore, there

Table 4. What should be achieved to develop business in India’s middle- and high-income markets and related challenges

	Product development	Procurement and production	Logistics	Sales and promotion	After-sales service
What should be achieved	<ul style="list-style-type: none"> Developing “medium quality” and low price products Product tuning based on the needs of Indian consumers Rapidly launching new products in line with the growth/evolving needs of the market 	<ul style="list-style-type: none"> Ensuring the availability of land, factory and infrastructure for factory (water treatment regulations, stable power, sufficient oil, gas and coal) Locally procuring materials, parts and components in a way whereby target QCD (quality, cost and delivery) performance is achieved Dealing with labor issues 	<ul style="list-style-type: none"> Developing logistics networks by considering the need for inventory in each regional area because of India’s large geographical size and for having warehouses in each major state to avoid taxes levied on interstate trade or commerce Optimizing inventory including that of retail stores that are positioned at the end of the distribution chain 	<ul style="list-style-type: none"> Building and popularizing a brand Developing a sales/channel system for each region as well as for each channel 	<ul style="list-style-type: none"> Developing an after-sales service network having high area coverage
Challenges related to business development	<ul style="list-style-type: none"> Establishing a local product development and design system in India (including issues such as creating a mechanism for understanding local needs, developing marketing personnel, cooperating with procurement and production departments and localization including packaging) 	<ul style="list-style-type: none"> Examining multiple options such as constructing a company’s own factory or outsourcing production Selecting, managing and developing suppliers and subcontractors that are capable of meeting a company’s quality standards 	<ul style="list-style-type: none"> Finding, managing and developing capable logistics companies Introducing a mechanism for “visualization” and management of a supply chain 	<ul style="list-style-type: none"> Choosing and using promotion channels without relying only on mass advertising Choosing and managing distributors Managing and training sales representatives and distributors 	<ul style="list-style-type: none"> Choosing, managing and training local partners

is a need to create mechanisms for developing human resources as well as to establish product development cycles.

In addition, the Indian home appliance market is already well served by both local and major global manufacturers. As such, in order for a company to differentiate itself, it is essential to offer “medium-quality” products at low prices. It would be possible to take an approach that relies on offering luxury goods through imports. However, the already active presence of major global manufacturers in this market limits the number of consumers. Hence, it is difficult to expand business only through the imports of luxury products. Therefore, it becomes important to consider ways whereby products that strike a balance between cost and quality can be offered. What is important for this purpose is to locally establish a system for design and development in India so that changes can be made to product design while increasing the ratio of local procurement. Specifically, a system should be developed that enables the product development department in India to work together with local procurement and production departments as well as with the global head office and subsidiaries in other countries.

Of course, placing too much effort into Indian market localization (development of unique product specifications) will lead to an increase in research and development (R&D) costs. Therefore, it is also important to determine how to minimize the impact of localization applied to products that are offered globally, that is, how to put these products on the market without incurring excessive R&D costs.

In the area of home appliances, according to a Japanese manufacturer, “In India, merely being cheap will not lead to product sales. Consumers are very demanding when evaluating value such as functions.” Such a characteristic requires offering value that matches local needs in addition to maintaining price competitiveness. In order to develop products that would be chosen by Indian consumers, consideration should also be given to the attitude of consumers who “choose products with emphasis on product quality, price, durability and after-sales service” (rural middle- and high-income households).

The local market requires low prices by limiting the functions of products to those that achieve only the basic performance needed by Indian consumers, while maintaining quality and durability. However, a company might not be able to free itself from a strategy aimed at providing products that are full of functions and are high priced if Japan’s head office takes the lead in product development. Such circumstances present a limit to the degree to which a company’s products will be accepted by India’s middle- and high-income markets. For this reason, major global electronics manufacturers have stepped up their product development in emerging countries.

For example, Germany’s Siemens recognized the limitations of headquarters-led development, and has adopted its SMART product development strategy whereby it uses R&D functions available in China for business development in emerging markets. SMART is an acronym derived from:

Simple
Maintenance friendly
Affordable
Reliable
Timely to market

The basic idea behind SMART is to research and develop new products that can be quickly introduced to emerging markets, while minimizing the amount of localization of existing technology. Thus, 80 percent of a product is based on existing technology, with the remaining 20 percent developed in the emerging markets to meet local needs. Further to this development method, a local product development team makes the best use of locally procured parts and components to achieve significant cost reductions. In addition, by enhancing the functions of products aimed at emerging countries, the company also considers the sales of these products in developed countries as cost-competitive products.

Panasonic has established its Volume Zone Marketing Research Center in India, which works on customer-oriented product planning through research on Indian lifestyles, targeting a growing “new rich” segment (consumers in the middle-income bracket). Panasonic’s “Cube” split-type air conditioner, now popular in India, was developed based on the results of research into the lifestyles of Indian households undertaken by the Center. The Cube was developed as a solution to the typical window-mounted air conditioners, which are noisy and tend to block window space, while being priced at the same level as those conventional window-mounted units.

(2) Procurement and production

Given that the Indian market is highly price sensitive, and that India’s tax on imported products still remains high, for many consumer goods, it is necessary to procure parts and components locally and use local production facilities in order to minimize production and transportation costs. However, a major problem presented in doing so is whether industrial sites where infrastructure such as access roads, electricity, water, gas and housing has been well developed are available. Within India, there are still very few industrial parks in which such infrastructure has been developed to a satisfactory degree. Furthermore, there are cases where the ownership of land is unclear and where large compensation payments are required for the relocation of residents. One way of avoiding such problems would be to move into an industrial park that has been fully developed by

a private-sector developer or the government. Another approach would involve production outsourcing.

The local procurement of materials, parts and components is also important. Many Japanese companies are unable to achieve the target local procurement ratio that they established when they first entered the Indian market. The main reasons for such inability include: given the physical size of India, industrial clusters are widely dispersed such that appropriate suppliers (those supplying parts and components) can seldom be found in the vicinity of a company’s factory; suppliers are unable to meet the quality standards of Japanese companies; and suppliers are evaluated by the head office in Japan, not locally in India, which wastes time. In addition to developing and strengthening the local procurement function, there is a need for developing capable suppliers.

(3) Logistics, sales and promotion, and after-sales service

The biggest challenges faced during business development in India would probably be logistics, sales and promotion, and after-sales service.

Looking first at logistics and sales, Figure 8 illustrates the general structure of sales channels and logistics in India. As explained in Chapter I, organized retailing is as yet underdeveloped in India, with a distribution structure still consisting mainly of multiple steps involving distributors (described below). Furthermore, because of India’s large physical size, it is necessary to have optimum stock meeting local demand warehoused in each area. In addition, to avoid taxes incurred by trades

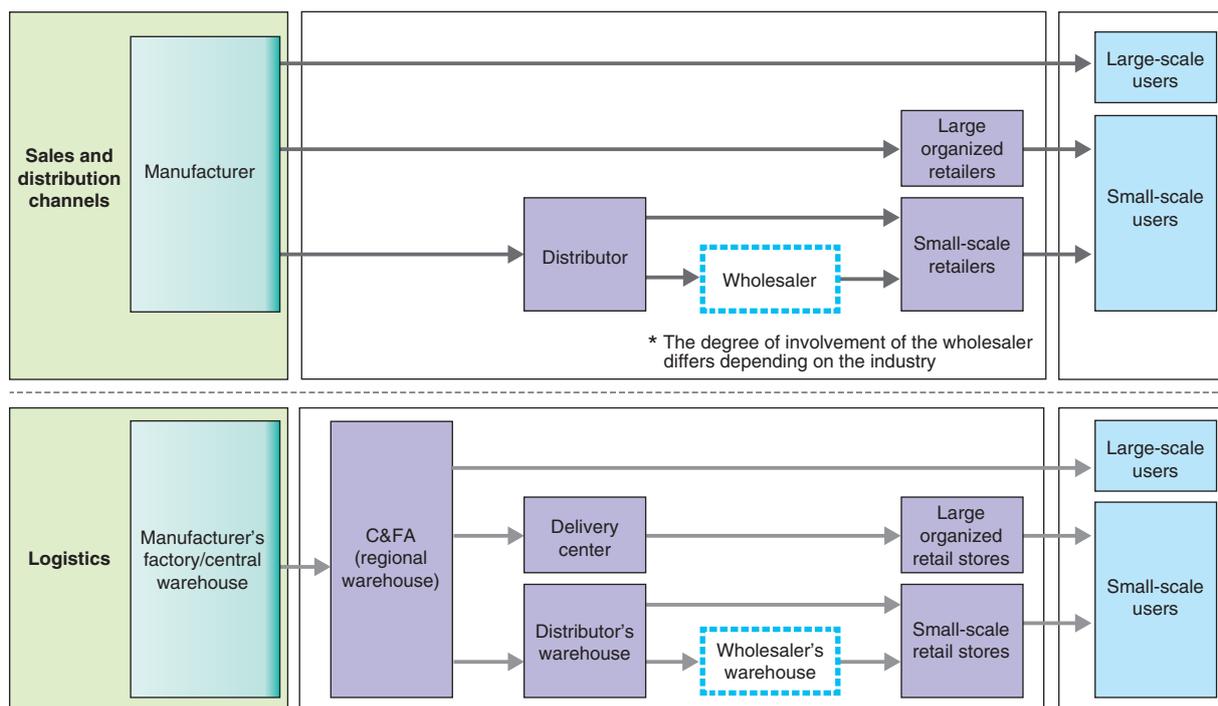
crossing state boundaries, consumer goods are often held in state-specific distribution warehouses.

These distributors and logistics companies are all local organizations, and usually do not have the resources to cover the entire country. The main functions for which distributors are responsible are the management of logistics and inventory, and the collection of payments. It would be difficult to expect distributors to undertake any marketing activities that require a high degree of product knowledge. In addition, local companies that have traditionally been distributors tend to be content with limiting their business to their current area, and are often not so willing to engage in new activities such as increasing sales volumes through opening/engaging new stores and/or conducting new marketing activities. Looking at logistics companies, generally, the quality of both truck operators and warehouse operators is poor, with delays and losses occurring on a daily basis.

As explained so far, local players responsible for logistics and sales are not organized, and their quality remains low. Therefore, for each region, it is necessary to discover relatively good players, and continue to manage and develop them. It would be essential to design an organization and create mechanisms so that a company’s local personnel can appropriately and sufficiently manage and develop these local players.

Because distribution consists of multiple stages, it is difficult for a manufacturer to be aware of the situation in stores, which are located at the end of the distribution chain, such as sales, inventories and trends among competitors’ products, making application of the plan-do-check-act (PDCA) cycle difficult. In order to

Figure 8. India’s general structure of sales and distribution channels and logistics



Note: C&FA = Carrying & Forwarding Agent.

understand the situation in the stores that have not introduced IT or that are unfamiliar with IT even though IT was introduced, it is necessary to either work with the distributor, or to create mechanisms involving IT-based operations by bypassing the distributor. If a manufacturer would be able to have its own warehouses in metropolitan areas and could be equipped with the function to collect payments, the distributor layer could be eliminated. It would be worth giving thought to building an IT system that would enable the manufacturer to directly manage retail stores and increase transparency between retailer and manufacturer. This might eventually reduce the role of the distributor layer.

Because, unlike Japan, the Indian market is not yet dominated by leading home appliance retailers, there is still the possibility of organizing independent “mom and pop” stores. In order to strengthen the home appliance sales network, which requires high area coverage for sales and after-sales service, it could be possible to establish alliances with local manufacturers that have strength in their service centers and distribution channels that include rural areas as well.

For example, Videocon, which is one of the major manufacturers of home appliances in India, has a home appliance dealer network consisting of about 50,000 stores and its own retail arm consisting of about 1,000 outlets (Next and Planet M stores), and owns 1,619 after-sales service centers throughout the country.

Godrej has a nationwide sales and distribution network consisting of 19,000 small independent and multi-brand chain stores. In addition, a tie-up with India Post has helped the company sell its products through post offices, which has enabled the company to even reach villages. Godrej provides after-sales service to its customers through 370 service centers spread all over the country.

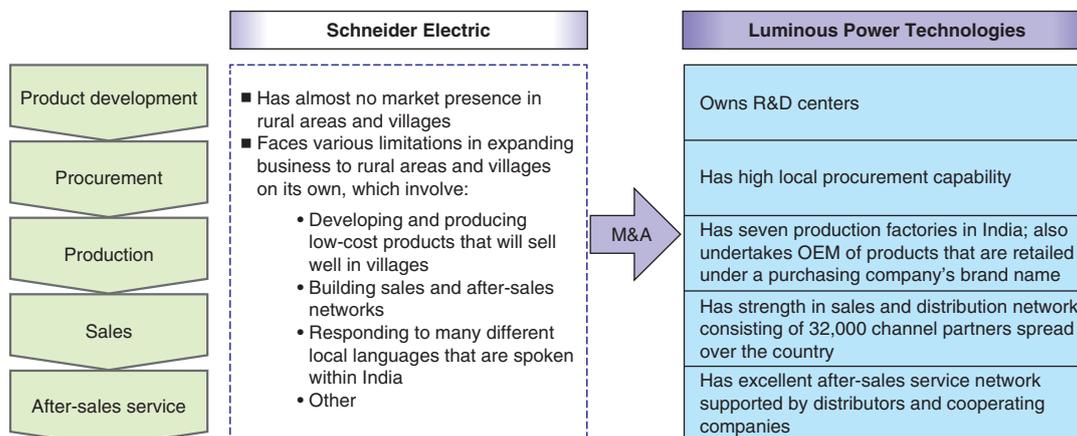
Voltas sells its products through more than 4,000 stores and has diverse sales channels that consist of small traditional independent stores (accounting for 73 percent), large multi-brand chain stores (accounting

for 24 percent) and stores that deal only in Voltas products (accounting for 3 percent). In addition, the company has been expanding its sales routes to Tier 2 (population of 500,000 – one million) and Tier 3 (population of 200,000 – 500,000) cities. Throughout the country, more than 300 after-sales service centers are serving its customers.

The acquisition of a local manufacturer that already has distribution strength in the middle- and high-income markets and in the rural areas could also be a sensible means of quickly obtaining logistics, sales and distribution resources. The French company, Schneider Electric, acquired a majority stake in India’s Luminous Power Technologies, which is a manufacturer of home UPS (uninterruptible power supply) systems, inverters, batteries, lighting equipment and other products. Because Luminous has strong brand visibility in lower tier towns and rural markets and has excellent sales and after-sales service networks, Schneider Electric aims to expand its presence by targeting middle- and high-income consumers in rural India through Luminous (Figure 9).

Sales promotion also presents a major issue. While the number of channels available for TV programs is limited in Japan, given that cable television is common in India and many different regional languages are spoken there, the number of TV channels available for household viewers exceeds 100. The same can be said for newspapers and magazines, many of which are published in a language specific to a particular region. For this reason, if a company launches mass promotions such as advertising through TV, newspapers and magazines in an attempt to cover a large proportion of the population, a huge cost would be incurred. As such, it is important to consider the evolution of sales promotion that does not rely only on promotion via the mass media and that is suitable for consumers’ information access routes for specific products and services. Measures to this end would include strengthening shop-front sales promotion by organizing and providing training for retail stores, as described above, as well as using social

Figure 9. Acquisition of Luminous Power Technologies by Schneider Electric



Notes: M&A = merger and acquisition, OEM = original equipment manufacturing, R&D = research and development.

networking services (SNS) and websites dedicated to specific products and services.

2 Next-MoP market

To date, Japanese companies that are engaged in various areas have considered business targeting low-income households with annual incomes of “less than 180,000 rupees.” However, this approach of targeting only the low-income market is more like an investment in the future rather than a generally adopted business strategy, and is very likely to be met with difficulties in that it takes considerable time to expand business scale and generate profit. Actually, many Japanese companies have such problems in India. To address such issues, a company is strongly recommended to give another thought to the method of entering the low-income market along with the middle- and high-income markets, while integrating a strategy for the middle- and high-income markets with that for the low-income market.

In this paper, consumers that should be targeted when a company approaches the low-income market are defined as those households that are one step before being middle- and high-income households and that earn annual household incomes of “96,000 – 180,000 rupees.” These households are defined as the Next-MoP (future middle of the economic pyramid) market (Figure 10). The number of such households is predicted to become about 90 million by 2020. Given the rapid development of road and railway infrastructure, farmers owning land along main roads connecting metropolitan areas and cash crop farmers are increasing their purchasing power. These farmers are included in the Next-MoP market.

However, in this paper, low-income households earning “less than 96,000 rupees” are not included in the Next-MoP market. Small- and medium-sized farmers constitute the majority of these households. Because their major source of income is the sale of crops, a rise in their income is highly unlikely to exceed any

inflation-linked increase. Thus, their potential as a consumer market is considered low.

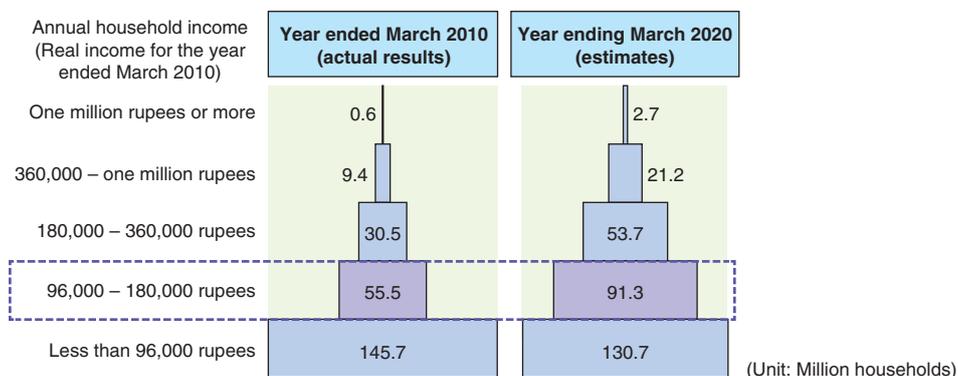
Making a profit from the Next-MoP market is no easy task because this market is even more price-sensitive than the middle- and high-income markets and profitability is difficult to ensure. In light of such market characteristics, a company should place emphasis on the following points throughout the entire business process.

- ① Setting principal target customers by understanding the purchasing power of customers
- ② Building a profitable business model by devising ideas such as creating a mechanism to recover capital invested
- ③ Refining management for product development and business creation

Moreover, specific measures that are based on the characteristics of the Next-MoP market are essential at each business process step in addition to those that take into account the key success factors (KFS) in the middle- and high-income markets.

Let’s look at the required measures at each step of the business process. For product development, in addition to meeting the needs that are derived from the characteristics of consumer lifestyles, product functions should be simplified so that products can be offered at even lower prices. For production, efforts should be made to further reduce costs incurred in procurement and production. For logistics, sales and distribution, a company must formulate ideas to promote sales aimed at consumers in the Next-MoP market who have little experience in accessing the company’s products. In particular, because sales and distribution channels are underdeveloped in suburbs and villages, a Japanese company should take the lead in establishing a distribution network to deliver products to end-users as well as in choosing sales channels without leaving such matters to a local partner company (Figure 11).

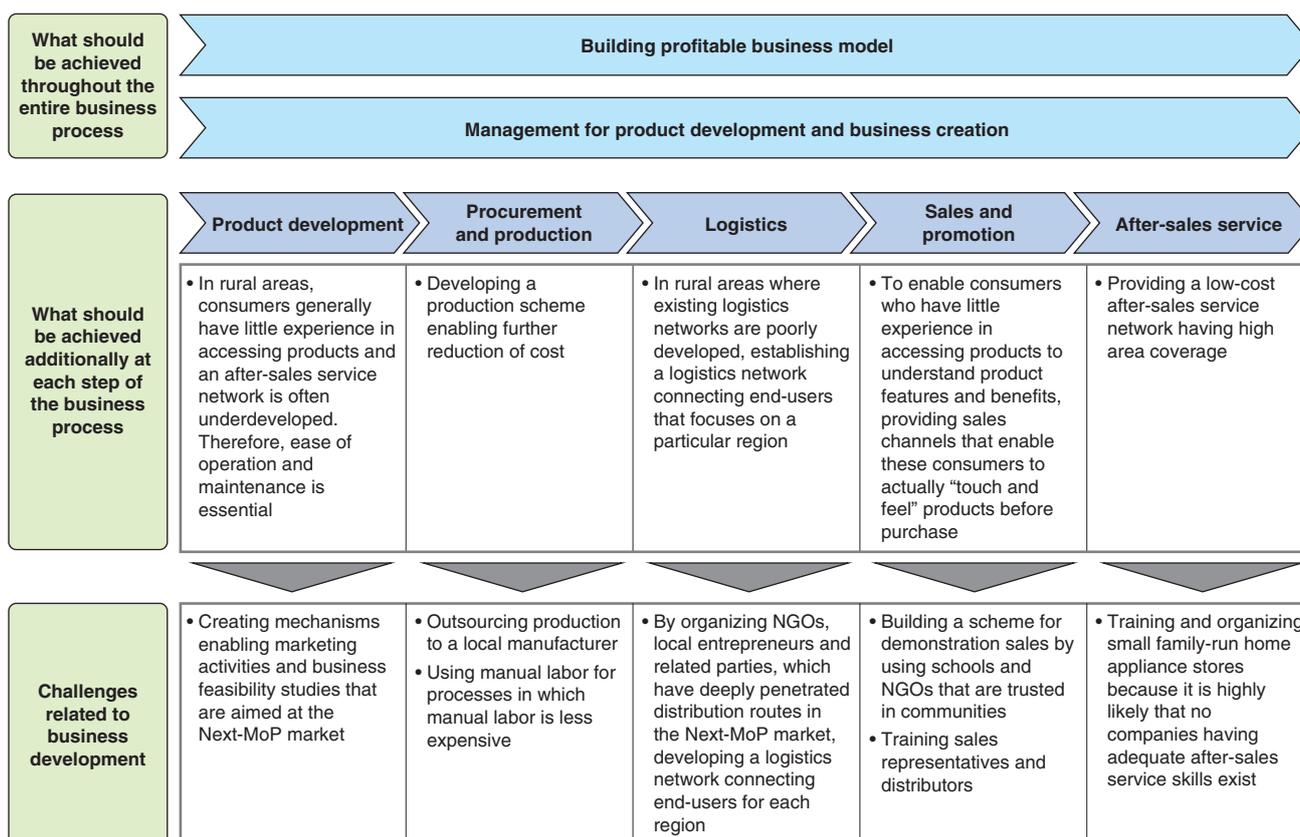
Figure 10. Definition of the Next-MoP (future middle of the economic pyramid) market



Sources: Year ended March 2010: Results of a survey conducted by the Center for Monitoring Indian Economy (CMIE).

Year ending March 2020: Estimates prepared by Nomura Research Institute based on CMIE surveys of the number of households by income segment for the years ended March 2010, March 2011 and March 2012; surveys of population and the number of households through the Census of India website; and real GDP (gross domestic product) forecast by the International Monetary Fund (IMF).

Figure 11. Required activities related to business development aimed at India's Next-MoP market



Note: NGO = non-governmental organization.

As examples of home appliances aimed at the Next-MoP market, lighting equipment and power supply service for which there is a broad need in India where grid power is unstable are discussed below.

(1) Product development

The products offered for the Next-MoP market must have functions that meet the characteristics of target consumers' lifestyles and, at the same time, must be affordable for target consumers. Compared to middle- and high-income consumers, Next-MoP consumers generally have less experience in using products, making it important to place emphasis on ease of operation and maintenance in order to increase product acceptability.

India's Thrive, which is a non-governmental organization (NGO) established in 2001 and which manufactures and sells solar devices by targeting Next-MoP consumers primarily in rural areas, has developed solar desk lamps and other solar-powered LED lights that have simple structure and are easy to maintain. The efforts to improve its products to cater to customers' various lighting needs have enabled Thrive to offer a wide selection of its solar home lighting systems, from about 500 rupees to about 2,000 rupees.

(2) Production

If consideration is given to various costs incurred such as those for personnel, transportation and tariffs, local

procurement and local production are essential for products aimed at the Next-MoP market to be price competitive. For this reason, Thrive established Thrive Energy Technologies, where products such as desk lamps are assembled and produced. By means of using simple designs, procuring components domestically in India and applying manual labor for assembly, except for some processes such as testing, Thrive has achieved low-cost production.

(3) Logistics, sales and after-sales service

Next-MoP consumers tend to carefully select products so that they buy only products that are truly necessary within their limited incomes. Considering such characteristics, sales channels that enable these consumers to actually "touch and feel" products and sense their values at first hand are most effective. Examples of such sales channels that are currently used include demonstration sales performed at stores (the end of a distribution channel) to explain product features and benefits, and product introduction through educational institutions and NGOs.

In particular, in rural areas where existing distribution networks are not well developed, a company must address the issue of securing a distribution network to deliver goods to end-users. For this purpose, local NGOs that take on the functions of sales agents and low-cost logistics companies that focus on rural areas are now being used.

For home appliances, it is also necessary to ensure the availability of an after-sales service network at low cost for product installation, inspection and repairs. While Schneider Electric gained access to an extensive after-sales service network having high area coverage through the acquisition of Luminous, Schneider Electric India, a 100-percent subsidiary of Schneider Electric, is further expanding and enhancing its after-sales service network. For this purpose, the company is providing training to electrical engineers as part of its corporate social responsibility (CSR) activity so that they are capable of installing, inspecting and repairing the company’s products.

In addition to a series of Luminous products aimed at the middle- and high-income markets, Schneider Electric India is selling the In-Diya lighting system, which is available in different models, in off-grid rural areas. In-Diya is an LED-based lighting system developed by combining light-emitting diodes (LEDs) using off-grid power and external rechargeable batteries, and is dedicated to rural areas. While selling Luminous products constitutes an income-generating business aimed at the middle- and high-income markets, the primary purpose of the company in selling In-Diya products is not the generation of income. Rather, emphasis is placed on expanding and enhancing an after-sales service network that caters to middle- and high-income consumers.

Moreover, because In-Diya is aimed at consumers having limited purchasing power, the product is sold based on a business model in which customers only buy a lighting device and use a rental battery. At a charging station, the battery is recharged every day, and the operator of the charging station delivers a newly charged battery and collects a used battery every morning.

Because this business model requires the training of charging station operators, Schneider Electric opened a pilot course to train electrical engineers. With the cooperation of NGOs and other entities, the company is now training about 4,000 operators at six training centers in India.

(4) Profitable business model

Because it is difficult to generate profit from the Next-MoP market in the short run, careful consideration should be given to target customers and business models.

Decentralized Energy Systems India (DESI Power) operates community-run biomass gasification power plants (25 – 100 kW) in Madhya Pradesh, Orissa, Bihar, Tamil Nadu and Karnataka, and supplies electricity to rural villages having limited or no access to grid power. Rather than targeting household consumers who generally present a high risk with respect to revenue collection, DESI Power deals with businesses (including use of power by farmers for irrigation) such as retail stores and micro-enterprises using power for pumping water for irrigation and powering flour mills in rural areas.

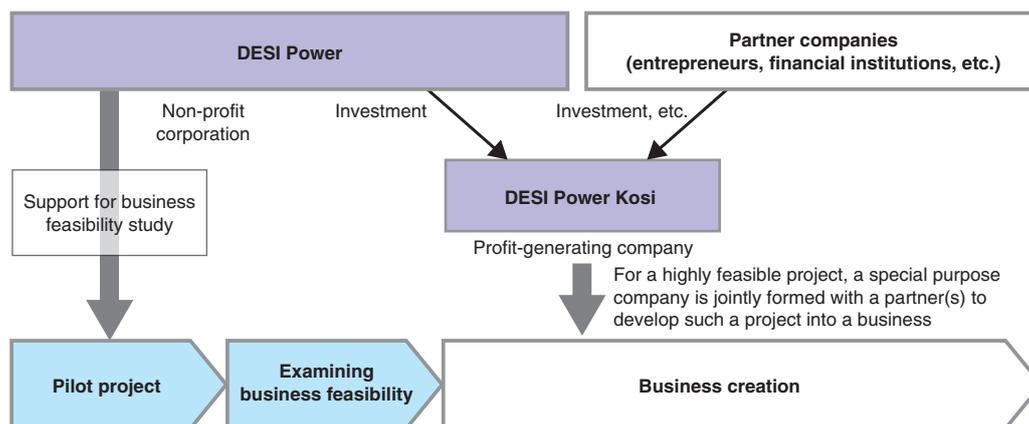
Furthermore, DESI Power links the cost to procure the biomass gas materials it uses for power generation with their market prices. A “cost plus fee” is set as the price for selling electricity so that no deficit is incurred.

(5) Management for product development and business creation

The difficulty presented by the Next-MoP market in generating profit and expanding business scale necessitates giving full consideration to the format of the organization at each stage of product development and business creation.

As a non-profit corporation, DESI Power examines business feasibility. DESI Power Kosi, which is a special purpose company established jointly with partner companies, develops feasible projects into businesses. In this way, DESI Power separates the role of the non-profit organization from that of the profit-generating organization, depending on the stage of business development. The non-profit organization studies business feasibility, while the profit-generating organization assumes business creation and subsequent business operations. This separation contributes to speeding up the launch of a business after it is created as well as justifying the generation of profit (Figure 12).

Figure 12. DESI Power’s business format



III Suggestions for Japanese Manufacturers

In concluding this paper, this chapter describes two points of view in the expansion of business aimed at the middle- and high-income markets and the Next-MoP market.

The authors wish to reiterate that while the Next-MoP market presents a large potential customer base, it is not easy to generate profit from this market in the short run. However, it may be too late for a company to win competition if it enters the market after the market has grown to a certain scale. Therefore, from the perspective of expanding the logistics, sales, distribution and after-sales service networks and reducing costs, which are major challenges facing Japanese home appliance manufacturers in developing businesses in India, it is necessary to consider the strategy for the Next-MoP market in conjunction with that for the middle- and high-income markets.

For the middle- and high-income markets, minimizing logistics, sales and distribution costs leads to being able to offer lower prices and increasing profitability. Therefore, one way of integrating the middle- and high-income markets and the Next-MoP market would be to launch products aimed at the Next-MoP market in metropolitan and urban areas, which can be sold by “piggybacking” them in existing logistics, sales and distribution channels so that the Next-MoP market can be reached with lower logistics costs.

As explained in Chapter I, products such as blenders/grinders, irons and CRT TVs are common among many income brackets. By enhancing the lineup from high- to low-end products, in addition to consumers living in Tier 1 and Tier 2 cities, Next-MoP consumers who live in neighboring villages and go to urban areas to shop would find the products affordable.

Another way of moving into the Next-MoP market is to offer only low-price products to distributors in the rural market with the aim of improving the degree of recognition and developing brand fans among Next-MoP consumers who are principal consumers there. While doing so, it would be important to identify the

capabilities of distributors. It is also possible to adopt an approach of developing sales, distribution and after-sales service networks by providing training to potential service engineers and potential distributors and by supporting their business startup in the same way as is done by Schneider Electric. However, because this approach entails the risk of accumulated distribution inventories, efforts should be made gradually by focusing on one particular region at a time.

Finally, it should be noted that India has the potential of serving as production and marketing bases when a company plans to move into the markets of emerging countries such as South Asia, the Middle East and Africa. The major reasons for such potential include India’s geographical proximity to these countries; these countries are considered unsuitable for being such bases; many Indian people live in these countries and the network of overseas Indians can be utilized for sales and marketing purposes; and there is cultural proximity that is generated behind the backdrop mentioned above. The authors hope that with an eye to moving into the markets of these countries and regions in the future in addition to the Indian market, Japanese manufacturers will swing into high gear for implementing their strategy to enter and develop business in the Indian market.

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