Opportunities for Action in Consumer Markets

India: The Next Frontier for Consumer Companies

THE BOSTON CONSULTING GROUP

India: The Next Frontier for Consumer Companies

India is fast emerging as one of the most important topics for CEOs of leading consumer companies. Witness the recent discussions in the press comparing India with China in opportunity potential; the extravagant India Everywhere show at the World Economic Forum's annual meeting in Davos, Switzerland; and the visits to India of many political and business leaders in the past year. As a colleague of ours observed, "India is becoming the next China: the go-to destination for multinational companies."

India is the eleventh-largest economy in the world and the second fastest growing among the larger economies, outpaced only by China. Its gross domestic product has increased, on average, more than 6 percent annually for the past ten years, with no year showing less than 4 percent growth. Over the past three years, the growth rate of India's economy has exceeded 7 percent. That has led to a rapid rise in domestic consumption and the emergence of a consumer class larger than the total population of the United States.

The size of the prize in India for consumer companies is breathtaking. The market for consumer durables, which stood at $4.8 billion in 2005, is expected to grow to more than $9.7 billion by 2010. Apparel, at $20 billion in 2005, is expected to grow approximately 18 percent per year, to $45 billion, in the same time frame. The retail market, worth more than $230 billion in 2005 and growing at 6 percent per year, is projected to reach $310 billion by 2010.

Unlike China, where the presence of most multinational companies (MNCs) is a fairly new phenome-

non, India has been host to consumer multinationals for several decades. Indeed, many Indians think of Unilever, Nestlé, and Philips Electronics as Indian companies. But for other MNCs, especially those in apparel, media, and retailing, the Indian market is still virgin territory. Now many of those companies are considering a move to India. And although they are excited by the large and growing market, they are also concerned about the challenges that multinationals have faced in India.

Understanding India

The Boston Consulting Group recently completed an extensive benchmarking study of MNCs in India—including LG Electronics, Samsung, and Hindustan Lever Limited (HLL), the Indian branch of Unilever—to understand how the most successful companies meet the country's challenges. What we found was very surprising. Unlike multinationals in most other developing markets, MNCs in India are more profitable, on average, than their Indian counterparts. Furthermore, the Indian branches of some companies have earned significantly higher rates of return on capital employed (ROCE) than their parent companies. Those that succeed win big.

For instance, 20 percent of LG's global revenue from appliances comes from India. What's more, the company expects that its factories in India will soon supply as much as 40 percent of the appliances it sells in the Middle East. At Unilever, three of the nine top executives worked in the company's Indian operations before they were selected to play leadership roles in the global organization. HLL accounts for 27 percent of Unilever's sales in the Asia-Pacific region and 40 percent of its profits. For these companies, India has played a key role as a market, as a

base for resources, and as a supplier of management talent. In fact, India has had a transformational impact on several companies.

Yet the performance of MNCs in India varies a great deal, with some companies struggling or even failing to gain a significant foothold. Our research shows that the factor that most separates winners from losers is the ability to recognize India's unique characteristics and to align the company's business model accordingly.

In many ways reminiscent of China but with its own special twists and turns, India is a huge, complicated, and fragmented market defined by dramatic disparities. Perhaps one-quarter of the country's 1.1 billion people earn less than $1 per day, while another quarter or more are now part of a burgeoning middle class. The country is dotted with teeming cities that increasingly are plugged into the global economy, not only with cutting-edge technology and related jobs but also with countless new stores and shopping malls. At the same time, about 70 percent of the population lives in and around India's 650,000 rural villages, half of which remain unconnected to all-weather roads.

Add to this mix the fact that India is a land of castes and tribes whose people speak 18 languages and 1,600 dialects, and the result is sharp differences in income, tastes, habits, and culture, all of which have important implications for consumer products companies.

The Five Steps to Success

Taking those differences into account, we have identified five steps that MNCs should consider in order to align their business models for success in India.

Prioritize the market rollout plan. The only way to cope with India's large variations in income and consumption patterns—and government regulations, which are somewhat different from state to state—is to prioritize product rollout plans. For example, a company might target the ten largest metropolitan areas first and then move out to smaller cities and towns. Or it could consolidate around a regional cluster. Or it might grow state by state, capitalizing on state-level benefits. The decision depends on the realities of the specific market. A company must understand the economic drivers of its business in India, as well as the nature of its customers in various parts of the country. Thus, rather than target large cities, a business with high logistics costs and high taxes might focus on clusters of towns within a state where it can get tax exemptions and better control of logistics.

Target product offerings to Indian consumers. The most successful companies have developed products specifically for India's huge mass market. General Electric, for example, created an inexpensive portable ultrasound scanner that has given it a 35 percent share of the market for these devices—one and a half times that of its closest competitor. Nokia, which has more than a 60 percent share of the mobile-phone market, offers a vast range of products priced under $150. Other companies are customizing their products for Indians. Market leader LG customized the audio system in its televisions—they feature oversize speakers with a booming bass—while retaining the regular picture tubes. Ford developed its Ikon model specifically for India and claims a 20 percent market share. Honda offers low-frills versions of its models, with modifications to horn settings, suspension height, and other features. It boasts a 16 percent share of India's automobile segment.

Develop innovations for inbound and outbound supply chains. Getting products to market is another considerable challenge in India. Faced with a dispersed population, some 12 million retail outlets, and an underdeveloped transportation infrastructure, the most successful MNCs have introduced innovative strategies to handle distribution complexity. Many companies work with more than 500 distributors, in addition to wholesalers and franchised outlets, to cover the market. The distribution structure varies significantly from major metropolitan areas to smaller towns and rural areas. LG, for instance, parks its own vans next to general retail kiosks—called *haats*—in semiurban and rural areas, and then mounts product demonstrations and picks up orders. Similarly, HLL uses vans to convey its products to some 15 million rural customers.

Innovation in logistics is also required when MNCs source products from India for the Indian market. Companies such as Nestlé and PepsiCo have integrated their sourcing networks all the way back to the villages. They provide farming assistance to villagers and buy products directly from the villages to avoid the middleman.

Reevaluate the tradeoff between labor and capital. Because the cost of skilled labor is substantially lower in India than it is in developed countries, companies moving to India would be wise to reconsider the tradeoff between automation and labor. General Electric, among other companies that manufacture in India for the global market, has been able to achieve substantial savings with low-cost labor. This strategy allows MNCs to be more flexible in manufacturing and to produce greater varieties in smaller lots, which can be a powerful way to target niche segments. Given India's prolabor regulatory environment, however, companies must manage labor well in order to

benefit from lower costs. Some have done this better than others.

Adjust metrics and profit expectations to reflect market realities. Many MNCs complain that they have a problem with profitability in India. Some of that problem has to do with the reality of low pricing in the country, but another part relates to a misperception generated by the metrics that are often used. If performance is measured in the usual way (in terms of gross margins and return on sales) and the usual corporate overhead is added on, the picture in India may appear bleak and support for operations there may weaken.

A much better picture emerges if companies use cash metrics, such as ROCE, and reconsider productivity metrics, such as revenue per employee, in light of the lower cost of labor. Looked at that way, the Indian operations of successful MNCs, as noted above, are on average more profitable than their Indian counterparts—and even more profitable than their operations globally. Some of these companies produce higher returns on a lower capital base by leveraging Indian vendors for manufacturing.

Successful companies also understand another pricing reality in India: although prices are typically low because of low per-capita income, they are very attractive in certain segments of the market, even in terms of global benchmarks. Profitability will rise sharply, of course, if companies identify and concentrate on those segments.

* * *

The readjustments we've suggested aren't difficult, yet some companies have been slow to make them. One CEO explained it this way: "Initially, we took an impe-

rialistic view. We said: 'If a product sells in North America and Europe, then certainly it will sell in India. If not immediately, then in a couple of years.' Now we have learned our lesson. You can succeed in India, but only on India's terms." Companies that do align their business model with India's unique characteristics tend to have

- a clearly articulated long-term vision for their Indian operations
- operations that are supported by a strong sponsor at the global level to help accelerate decision making
- a management team that has a deep understanding of the local environment and, equally important, strong credibility with the global organization
- several lateral linkages across the global and local organization to enhance learning and cultural integration

Do you want to participate in India's growth or watch others reap the benefits? We suggest you ask yourself the following questions to prepare for your company's future in India:

- Is there a clear top-down vision for India's place in our organization?
- Who is the senior sponsor responsible for the opportunity in India?
- How will our global business model be refined to target the Indian market?
- Is our organization ready to make the appropriate decisions and adjustments for an Indian operation?

Companies that understand what it takes to succeed in India and are willing to do it will find the market highly rewarding.

Vikram Bhalla
Janmejaya Sinha

Vikram Bhalla and Janmejaya Sinha are vice presidents and directors in the Mumbai office of The Boston Consulting Group.

You may contact the authors by e-mail at:
bhalla.vikram@bcg.com
sinha.janmejaya@bcg.com

To receive future publications in electronic form about this topic or others, please visit our subscription Web site at www.bcg.com/subscribe.

© The Boston Consulting Group, Inc. 2006. All rights reserved.

The Boston Consulting Group

Amsterdam
Athens
Atlanta
Auckland
Bangkok
Barcelona
Beijing
Berlin
Boston
Brussels
Budapest
Buenos Aires
Chicago
Cologne
Copenhagen
Dallas
Detroit
Düsseldorf
Frankfurt
Hamburg
Helsinki
Hong Kong
Houston
Jakarta
Kuala Lumpur
Lisbon
London
Los Angeles
Madrid
Melbourne
Mexico City
Miami
Milan
Monterrey
Moscow
Mumbai
Munich
Nagoya
New Delhi
New Jersey
New York
Oslo
Paris
Prague
Rome
San Francisco
Santiago
São Paulo
Seoul
Shanghai
Singapore
Stockholm
Stuttgart
Sydney
Taipei
Tokyo
Toronto
Vienna
Warsaw
Washington
Zürich

BCG
www.bcg.com
7/06