

## The BRIC Battle

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*Winning the Global Race for the Emerging Middle Segment*



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# Foreword

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The rise of emerging markets in the coming decades will have huge implications for companies. Any multinational company that aims to be a global leader must know how to capture a significant share of the largest customer segment in countries such as China, India, Russia and Brazil. These new customers make up the so-called "middle segment". This report examines the nature of this new middle segment, how it differs across its various sub-segments and illustrates why this segment is a sizeable opportunity and a significant risk at the same time. Finally, it demonstrates that successfully addressing this critical segment will require a step change in developed market multinationals' attitude towards emerging markets.

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# Executive Summary

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There is no shortage of statistical forecasts demonstrating that the emerging markets will account for the bulk of the increase in global GDP in the coming decades. For example, Brazil, Russia, India and China – often called BRIC – will account for 50% of global incremental GDP growth from now until 2030, compared with 26% growth for North America, Europe and Japan combined. Statistics like this are not just of interest to macro-economists or geo-politicians. There are also huge implications for any multinational company (MNC) that aims to be a global market leader. Unless you know how to capture a significant share of the largest customer segment in these countries, global leadership will evade you.

The largest customer segment in the emerging markets is the so-called “middle segment.” It relates to consumer and business products with a good basic functionality but without the full range of differentiating features, yet at a highly competitive price. In China, for example, it accounts for as much as 60 to 90% of the addressable market for MNCs.

Securing a strong position in the middle segment is certainly a challenge and often a must for developed market MNCs. It is a challenge because MNCs have to find ways to outperform entrenched local middle-segment champions. It is a must because champions from emerging markets will otherwise use their locally gained strengths to fund international expansion into the MNCs’ profitable home markets.

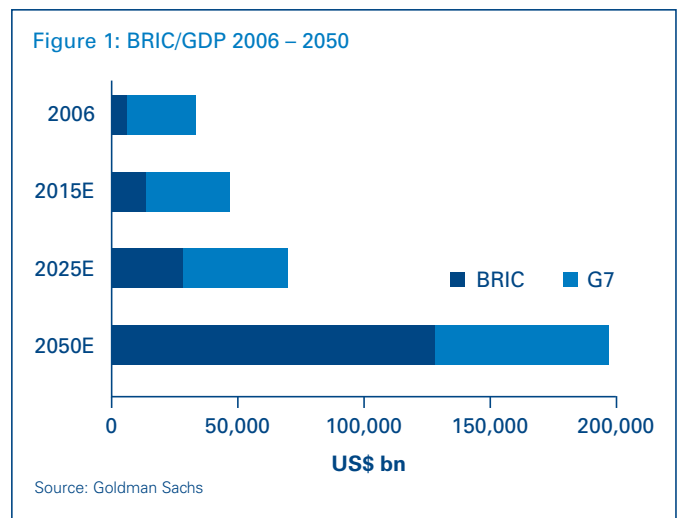
The first report in a series, *The BRIC Battle* outlines the need for developed market MNCs to go beyond their current globalization philosophy and counter emerging market champions in the middle segment through a strategy we label fight-focus-simplify. The report will be followed by a study of emerging market champions’ success strategies in 2009.

# BRIC Countries to Outgrow Mature Markets, Dominating Top-10 Economies by 2050

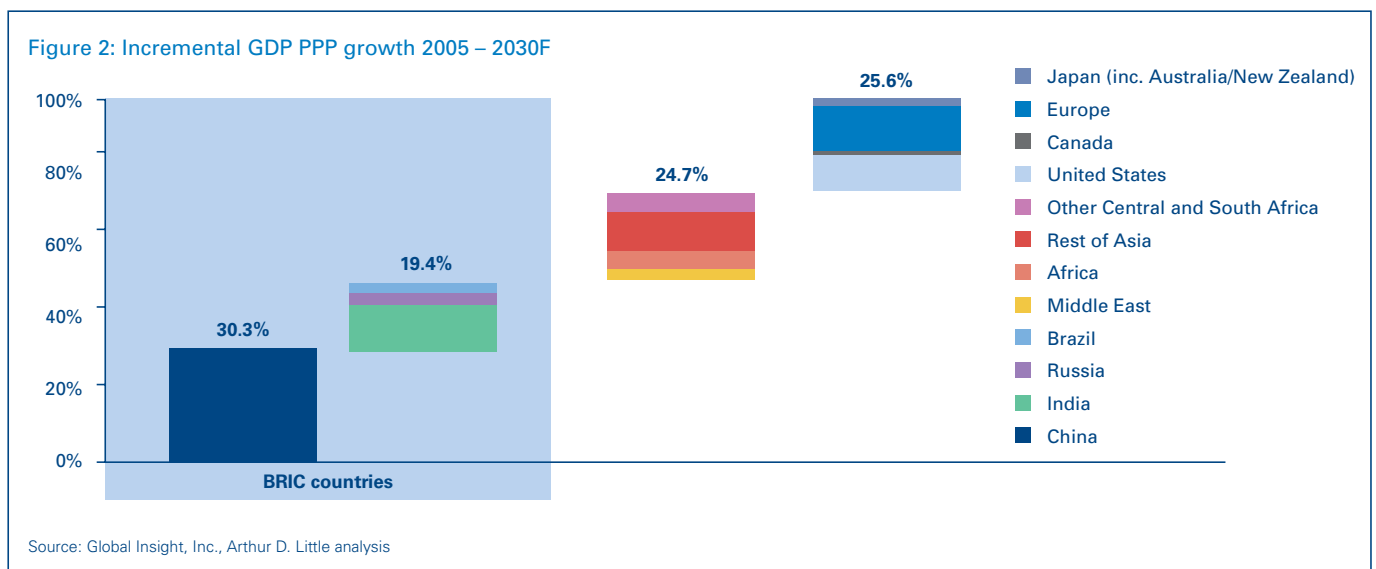
Goldman Sachs recently forecasted the cumulative GDP growth rate for today's seven largest developed economies (G7 countries) at around 2% per annum until 2050. This is low compared to the BRIC countries. China will have an annual growth rate over five times higher than that of the G7 countries, and India's economy is predicted to grow by more than 8% per annum.

This high growth leads to a strong shift in the relative importance of the economic powerhouses: whereas the combined GDP of the BRIC economies is a mere 1/5 of the combined GDP for the G7 countries today, it will be nearly at par by 2025, and by 2050 the BRIC's GDP will have outgrown the G7's by more than double. This means that in four decades, BRIC economies will be three times bigger than the entire world's economy today (see figure 1).

At a country-by-country level, this implies that by 2050, six of the 10 largest economies will be emerging markets. A review of where companies will be able to achieve big growth in the future shows that it will be vital for global leaders to be competitive in the emerging markets. The distribution of absolute GDP PPP growth over the next 20 years (see figure 2), shows that BRIC countries represent over half of global GDP PPP growth, compared to 26% for North America, Europe and Japan.



Within the BRIC economies, China takes the biggest chunk with 30% of the total growth (which is more than half of the four countries' combined growth). Bottom-line, this means that the absolute growth of the Chinese market over the next 20 years is comparable to the growth of the North American, European and Japanese markets combined. Therefore, gaining a strong foothold into BRIC markets, with a special focus on China, is key.



# The Need for a BRIC 2.0 Middle Segment Strategy

A business executive seeking to exploit the dazzling growth forecasts for the emerging markets has to look beyond countries into segments. The product positioning pyramid is a good starting point.

The current product positioning pyramid in emerging markets is split into different segments. The premium segment at the top is characterized by globally renowned brands from developed markets with high-quality products, full-service support, and premium pricing (sometimes with far higher prices than in their home markets). The segment at the bottom of the pyramid consists of offerings with limited functionality and service, and is dominated by local champions selling low-cost products.

The segment in-between, the middle segment, represents products with a good basic functionality, but without the full range of differentiating features, yet at a highly competitive price. However, the characteristics of the emerging middle segment can differ strongly from products and services labeled "middle segment" in developed markets. While it means "value for money" in mature markets, the definition in emerging markets is often defined as "good enough" (see figure 3).

Until recent years the middle segment was a relatively low priority for most MNCs, which tended to focus on the premium segment. The reasons for their lack of enthusiasm for the middle segment include:

- Inability to compete on the same cost base as local players.
- Unwillingness to jeopardize the premium product/service range.
- Inability and complexity in providing products with basic functionality.
- Low profitability.
- Perceived limited market size.
- Margin focus.

In other words, most MNCs still operate in what we call the BRIC 1.0 phase; exploiting the growth in the emerging markets' premium segment. Typical BRIC 1.0 strategies include: "de-engineering" global product offerings; go-to market approaches that merely follow global customers, thereby adopting the same strategies as in mature markets; and management-driven by expatriates.

Figure 3: Price positioning for refrigerators in China 2008

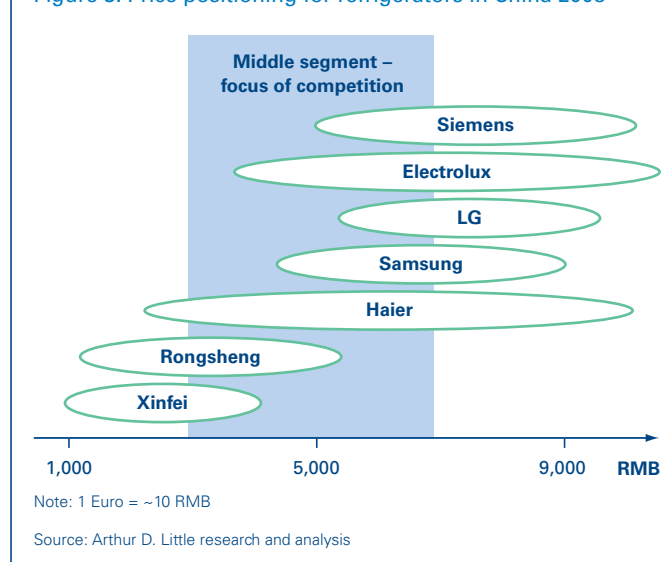
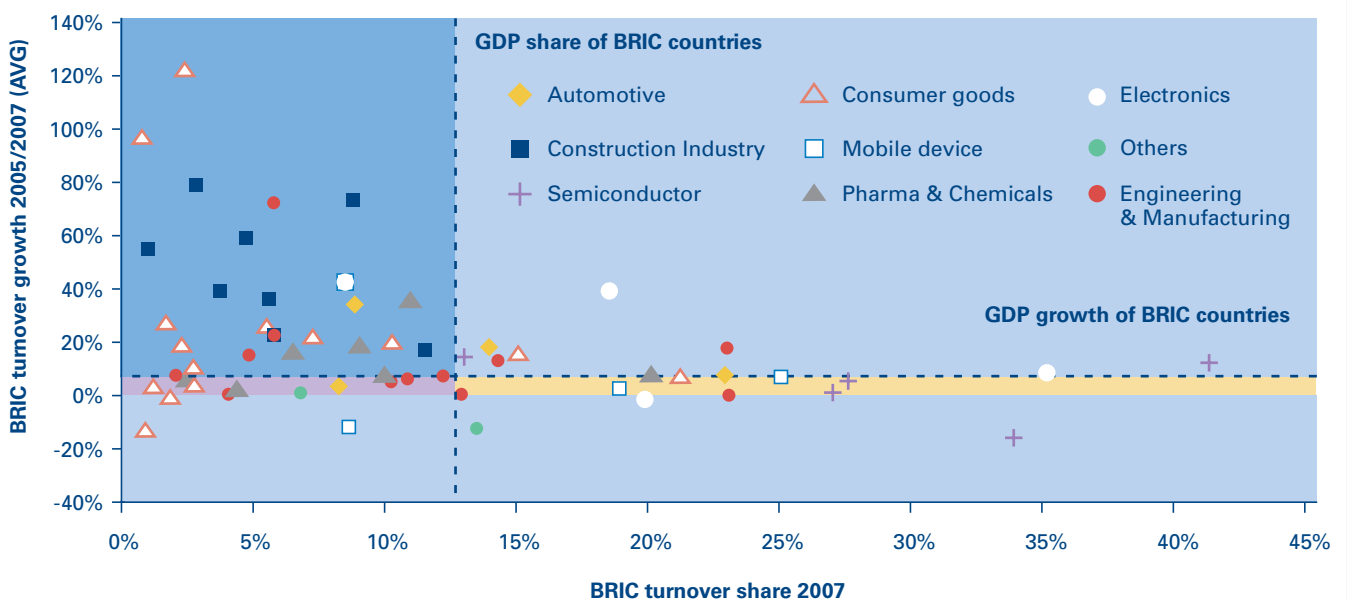


Figure 4. BRIC turnover share and growth figures (Individual company figures vs. GDP comparisons)



Source: Arthur D. Little global survey of 60 global companies

Quite a few MNCs are currently reaching the limits of BRIC 1.0 as turnover growth in the premium segment in emerging markets peters out. An Arthur D. Little's analysis of 60 international MNCs (see figure 4), highlights our hypothesis. Most of developed MNCs achieve a turnover share below the GDP share of BRIC countries.

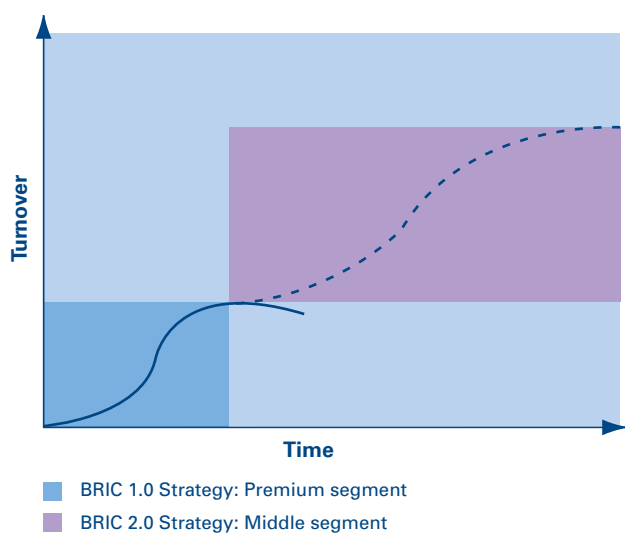
Only one third of our sample achieves an above-fair market share in BRIC markets; the majority of these companies are from the semiconductor and telecoms industries. However, their growth rate is mostly below the inherent GDP growth of BRIC countries.

Another half of the sample is currently situated below its fair market share, but growing above the inherent GDP growth of BRIC countries. Construction industry players and consumer goods companies are frequently in this group.

MNCs' current low share of the BRIC market reflects their continued desire to focus on the premium segment, rather than to begin building a significant position in the middle segment.



Figure 5. BRIC strategies



Source: Arthur D. Little research

MNCs should develop a BRIC 2.0 strategy (see figure 5) focusing on addressing the middle segment. With a BRIC 2.0 strategy, MNCs will be able to exploit an immense local growth opportunity as well as protecting their position in their home market by minimizing the threat of entry by emerging market champions. Let’s look at these two drivers in more detail.

*“MNCs’ current low share of the BRIC market reflects their continued desire to focus on the premium segment, rather than to begin building a significant position in the middle segment.”*

### Whirlpool – A Western white goods leader enters Brazil

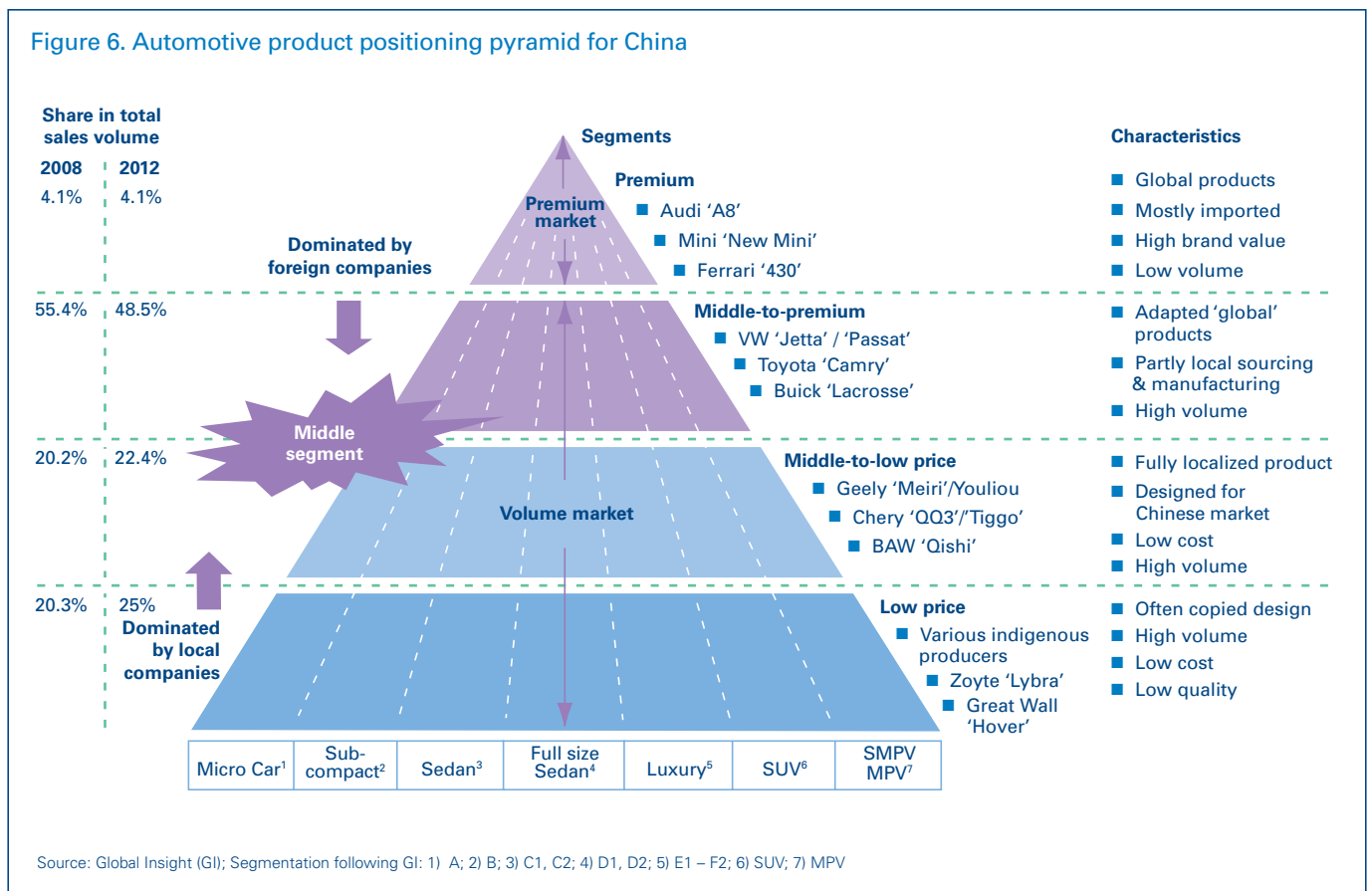
Whirlpool is a Fortune 500 company and a global home appliance manufacturer and distributor. In the company’s initial strategy to increase penetration of its washing machines in Brazil, Whirlpool took a BRIC 1.0 approach: reducing prices. In order to offer lower prices, Whirlpool took the classic “de-engineering” approach; selling older, more basic models with a narrower range of features, less technology and lower production costs. However, the outcome did not meet expectations. The launch of a US \$300 model in 1998 was a big disappointment: Brazilian market penetration did not increase.

Whirlpool realized that it had to listen more closely to customer demands. A cheaper product was not the most important priority for Brazilians; instead they wanted a product that fitted their particular needs. The older models that Whirlpool offered were heavy, bulky and energy inefficient – features of little use to consumers living in small shantytown homes with difficult access and unreliable electricity services.

The company also learned that the washing habits in Brazilian homes differed from those in developed market homes. As the average Brazilian wardrobe is much smaller compared to its developed counterpart, laundry becomes more of a daily task. Thus, there was no need for large-load capacity washers.

With these and other insights about consumer preference differences, Whirlpool did some serious re-thinking. The company invested considerable time and money to develop a new technology designed to meet the real needs of the Brazilian market. By doing this the company managed to create the world’s cheapest washer, reducing the cost by 80%. Even more importantly, the washing machine satisfied the region-specific needs better than any of the competitors’ products. Later the machine was also launched in China and India, with some modifications in order to match the regional needs there. The cheap and compact model has proven to be very successful and has played an important role in Whirlpool’s growth in emerging markets.

# Exploiting the BRIC Middle Segment Growth Opportunity



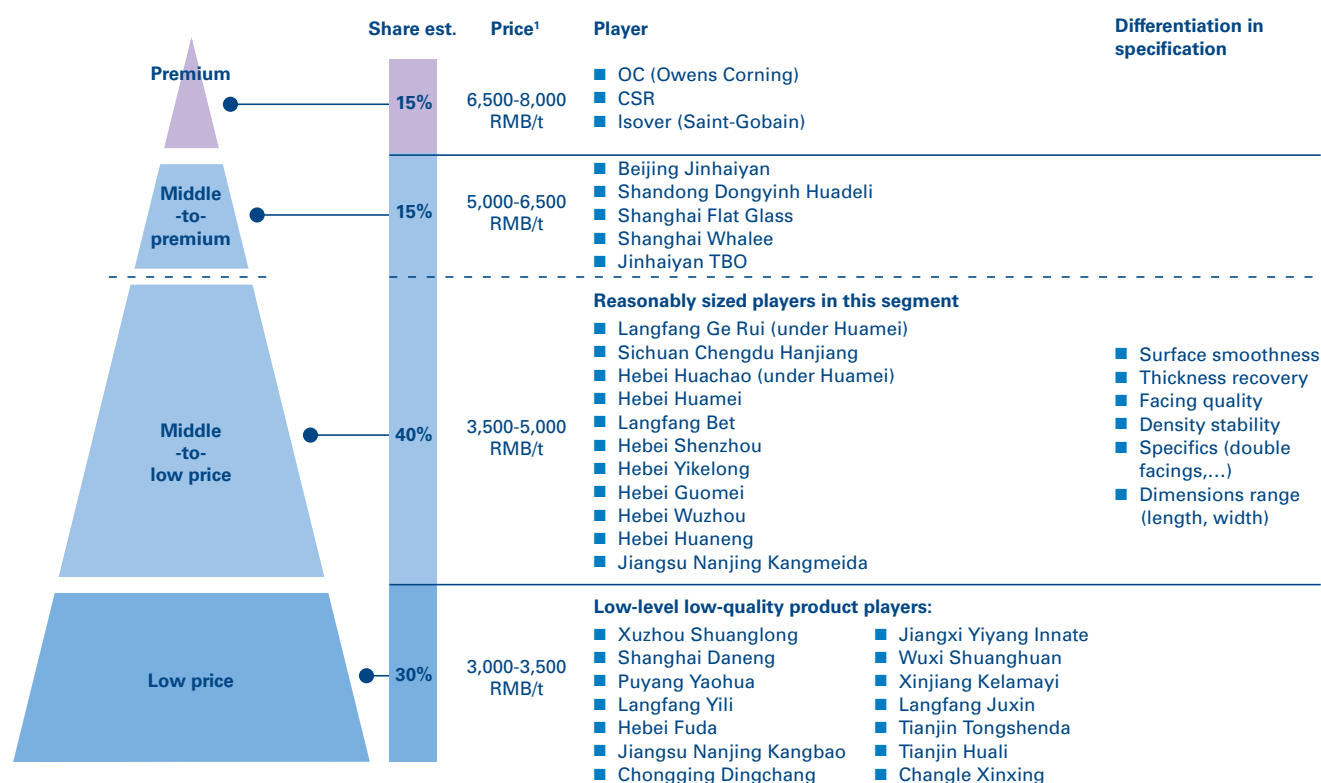
The middle segment is key for MNCs to achieve success in the BRIC markets. For example, in China it often constitutes between a third to over half of the overall market, thus representing 60 to 90% of the addressable market for MNCs. The Chinese automotive market, for example, has a premium segment served by MNCs that constitutes 4% of the market. The middle segment covers 75%, with two sub-segments; the middle-to-premium with 55% and the middle-to-low with 20% (see figure 6). Forward-thinking MNCs have already seen the value in entering this segment through various joint ventures. With these proportions, the middle segment is the hottest battleground for today's competition in emerging markets.

Another example is insulation materials. The Chinese glass wool premium segment constitutes 15% of the market and is served by MNCs, whereas the middle segment covers over half of the market in two sub-segments: the middle-to-premium with 15%, and the middle-to-low sub-segment with 40% (see figure 7). Currently no MNCs participate in the middle segment.

Increasing purchasing power, often measured by GDP per capita, is the main growth driver in the B2C arena. As GDP per capita in the BRIC countries rises, so does the global middle class. In emerging markets, middle class is defined as those households with an annual income of \$5,000-\$15,000 (see box "How to qualify the 'middle class' in emerging markets"). Tapping into this market segment, which has income levels that are not even on the scale in the MNCs' domestic market, calls for a different approach outlined as BRIC 2.0.



Figure 7. Construction insulation (glass wool) product positioning pyramid China



Source: Arthur D. Little research Note:<sup>1</sup> VAT included but outbound logistics fee excluded

### How to qualify the “middle class” in emerging markets

According to Goldman Sachs’ predictions, the United States will remain the wealthiest large economy in terms of GDP per capita in 2050. Other currently developed markets will also remain in the top 10 with GDP per capita expected to range between \$60,000 and \$80,000. By 2050 the BRIC countries will have closed this gap significantly. Russia is expected to rally to the third-largest GDP per capita economies. Brazil and China are expected to have higher GDP per capita than all developed nations today.

As GDP per capita in the BRIC rises, so does the global middle class. However, assessing the attractiveness of the “holy grail of consumption growth” first requires a clear view of how to define the typical emerging markets’ “middle class”. The simplified definition of “people who are not really poor and not really rich” leaves plenty of room for interpretation.

In developed markets, “middle class” means households with a median annual income of \$45,000. For people with a professional degree, this figure increases to \$100,000. Leaving school before your 15th birthday leads to a yearly household income of \$20,000.

By contrast the upper income class in China is defined as having yearly salaries above RMB120,000, or slightly above \$15,000. This means top earners in emerging markets are comparable to the lower income brackets in developed markets. Therefore, we define middle class in emerging markets as households with an annual income of \$5,000-15,000. While the local spending power of the Chinese upper income class may be higher than that of the middle class in developed markets, increasing urbanization and higher structural inflation (e.g. soaring real estate prices in China’s top 100 cities) are rapidly eroding part of this advantage rapidly.

In China, which represents the bulk of BRIC’s absolute GDP growth, there will be roughly 7 million households in the upper income class by 2015, roughly the same as in a country like the Netherlands. It is questionable whether this market size justifies the presence of nearly all leading global brands competing heavily. However, when expanding the addressable market to the middle class, proportions are totally different. China’s estimated 100 million middle class households will already represent a large market by 2015.

The drivers fuelling middle-segment growth in the B2B arena differ strongly from those in the B2C arena (consumers' higher disposable income). We distinguish five drivers, which together create a structural shift that is there to stay.

### Functionality and quality push

The most important driver is the B2B customers' push for more functionality and higher quality. Whereas this used to be driven primarily by international customers (developed market companies sourcing products from BRIC countries), domestic customers are now beginning to raise their requirements. Underlying drivers are continuously evolving sourcing strategies (developed market firms sourcing complex products and systems instead of parts) and higher competitive intensity forcing companies in emerging markets to differentiate – all of this, of course, at equal sales prices.

### Total cost approach

Many industries in emerging markets experience the unusual combination of very strong growth and declining prices and margins. This increases cost pressure and forces companies to think in a "total cost of ownership" logic. For example, logistics providers consider fuel efficiency, breakdown rates and maintenance costs when deciding which truck to purchase, and manufacturers include labor utilization, energy efficiency and servicing charges when identifying which machine to install. As companies enhance their management skills, they acknowledge the value of better quality and lower total costs.

### Regulation

Norms and regulations fuel quality increases, particularly in emerging markets. Whether inspired by environmental concerns, safety issues, or public health motivations, regulatory changes often aim at achieving a specific functionality (e.g. better energy efficiency for production equipment), thus directly influencing the price/quality pyramid.

### Technology

Emerging market players are increasingly making use of advanced technology from developed markets (sometimes because of norms and regulations), which leads to higher quality products and naturally fuels the middle segment. Often driven by changing norms and regulatory requirements, premium technology does not turn emerging market companies into "premium players" overnight, since they often lack the fundamental product and process innovation and know-how to become leading-edge in the short term.

*"Emerging market players are increasingly making use of advanced technology from developed markets (sometimes because of norms and regulations), which leads to higher quality products and naturally fuels the middle segment."*

### Liability

In particular, companies dealing with US customers (or their international subsidiaries) are particularly aware of increasing product liability. As a consequence many B2B players in BRIC countries, particularly those that have gained size and thus exposure, gradually diversify their product offering into higher-quality products – the middle segment.

In short, whether in the B2C or B2B arena, the middle segment in emerging markets represents an enormous opportunity. The premium segment, on the other hand, is often too small for all global leading MNCs to be successful and remain profitable, given their high overhead cost structure and orientation towards large volumes.

# Protecting Positions in Mature Home Markets

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From the above, we have seen that MNCs that do not address the middle segment risk missing out on massive growth potential in the emerging markets. However, the missed opportunity is only half the story. The other half is a threat with a long-term structural impact: local BRIC market champions expanding into global export markets and undermining the profitability of MNCs in their mature and profitable home markets.

The entry of MNCs into the premium segment of emerging markets has provided the local champions with a very valuable learning experience in multiple dimensions. These include product and service offering, go-to-market approaches and production and supply chain management. In addition, MNCs' employees who have enjoyed all of their employers' know-how transfer are often head hunted by these local BRIC champions, who are willing to pay a premium price for top management. These companies have now grown into serious competitors. The continuous increase in the number of emerging market companies on the Fortune Global 500 list illustrates this development; up from 47 in 2005 to 78 in 2008.

Building on success in their home markets, local champions from emerging markets are also targeting the mature markets. Driven by globalization and cost pressure, their products gradually slip into Western Europe, North America and Japan. Very often starting through a private-label route, hard discounters or a specific niche segment, the products gradually adopt their original home brands, gain market exposure and expand the range of variants in the catalogue. The list of examples is long, ranging from domestic appliances (e.g. Haier and Li-Ning from China – see box "Emerging champions") through apparel to electronics. These entries represent a direct attack on the MNCs' leading premium brands and their margins.

The risk of such an attack depends on the degree of both commoditization and technological pace within the product category. Product categories with strong brands and slow technology change, such as cosmetics or detergents, are at low risk. Electronics, with a high degree of commoditization and fast technology pace, have to a large extent, already been lost to emerging-market players. Next in line are low-profile industries like furniture, carpets, leather and possibly entry-level segments of high-tech categories such as cars or domestic appliances.

# Emerging Champions

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## Haier – Leveraging middle market China experience to build a US footprint

Haier is the leading Chinese manufacturer of domestic appliances with a local market share of approximately 30%. Haier has been exploring international markets for over 20 years and today at least one-third of its \$15 billion revenues are generated outside of China. With Haier products distributed by leading retail chains such as Wal-Mart, Carrefour, Home Depot and Sears, Haier is already a serious global threat to developed market appliance manufacturers.

When it first began its move into more mature markets, Haier encountered difficulty, particularly as it could only gain access to small independent retailers when entering the US market. Big retail chains were not interested in pushing an unknown Chinese brand. It took a customized product strategy for Haier to familiarize the brand with the leading U.S. distributors and to position itself next to the top three global brands in the domestic appliances sector.

From its early sales, Haier recognized that American students had special requirements when purchasing a refrigerator. In addition to having a limited budget, students also manage with limited space. In response, Haier developed a small-sized refrigerator attached to a computer desk.

The product quickly gained popularity among students and Haier's market share grew fast enough to get Wal-Mart's attention. The cooperation with Wal-Mart started with this simple product, but gradually more and more Haier products became available through Wal-Mart and more distributors followed.

Sears, another leading US retail chain, focuses on mid-to high-end products with its own national brand positioned alongside a selection of leading brands such as GE. Although reluctant to distribute relatively unknown brands, Sears was attracted by a new type of mini dishwasher that Haier developed. Normal US dishwashers are large and heavy. The new Haier type was small and made of plastic. Sears was convinced this product would win the favor of singles and students, and thus Haier gained a foothold into a second US retailing giant.

At present, 8 of the top 10 US retail chains sell Haier products. Starting as a niche player focusing on small refrigerators, the manufacturer has firmly established itself into a leading position alongside domestic appliance suppliers in North America and beyond.

### Li-Ning – Building an international presence

Li-Ning, founded by a former Olympic gymnastics champion, is the leading local brand of sporting goods in China. Before 2003 Li-Ning accounted for about half of the Chinese market. Since 2003 it has been surpassed by heavy investors in China, like Nike and Adidas, which have captured market share from Li-Ning. However, it is set to leverage its top position in China's second-tier cities to fuel its international expansion.

To avoid competing head-on with the leading worldwide brands in China, Li-Ning focused on China's smaller cities, where competition with foreign brands is less intense and where the middle class able to afford running shoes at \$20-\$50 is growing rapidly. This strategy has paid off, and Li-Ning has been able to stabilize its position in China and look actively at overseas markets, now armed with a range of higher priced products.

Although Li-Ning's pockets were not deep enough to become the official Beijing Olympics sportswear provider (a role won by Adidas), it used the Olympics to pour large budgets into international marketing.

For instance, Li-Ning has agreements with the Spanish basketball team, the Swedish Olympic Committee, the American basketballer Shaquille O'Neal and the Association of Tennis Professionals. Li-Ning is also cooperating with leading French and Italian designers to make its products more appealing to consumers in developed markets.

However, Li-Ning still faces challenges. One of them is that its brand positioning remains unclear. It is currently neither a low-cost brand nor a top brand. Furthermore, its products are associated with gymnastics, which is not among the most popular sports. As well as investing in basketball, tennis and football lines, Li-Ning aims to extend its gymnastics heritage to fitness and yoga, potentially a very interesting market.

Although Li-Ning's overseas activities are still at an early stage, it has the ambition to become a global top-five sporting brand by 2018. Its development will be closely followed by top executives at Nike and Adidas.

Rather than passively suffering from these challengers' aggressive entries into premium mature markets, MNCs should confront these companies on their home turf: the middle segments in emerging markets. Just as the local champions have learned from developed market companies in the past, MNCs should expand their activity into the middle segment by learning from the incumbents. This will enable MNCs to confront and attack current middle-segment players in their domestic markets (which is still where they make their profits), and to have their defences ready for the confrontation in their own profitable premium markets.

*“Just as the local champions have learned from developed market companies in the past, MNCs should expand their activity into the middle segment by learning from the incumbents.”*

# The BRIC 2.0 Middle Segment Strategy: Fight-Focus-Simplify

The double rationale for MNCs to address the middle segment in emerging markets should be clear by now: to exploit the immense local growth opportunity and to protect their position in their home market. But, when doing so, MNCs will have to find ways to outperform the entrenched local champions that currently serve the BRIC middle segment. In addition to a strong historic position on their home turf, these incumbents also benefit from a very low cost structure. The strategy we propose for outperforming the local champions has three components: fight, focus and simplify.

## Fight

MNCs should link their international brand power with emerging-champion go-to-market approaches to win the fierce fight for share in the BRIC markets' middle segments. In the middle segment, quality is not the key distinctive factor. International companies need to combine their international brand reputation with doing business "the local way". In many cases a "steal with pride" approach supported by selective marketing and sales mix tactics from mature markets creates a winning formula for MNCs to compete on par with local champions. Chinese customers, for example, are generally still willing to pay a premium for foreign products of a similar quality level as local ones.

MNCs should use their successful marketing skills to establish and boost this effect (see figure 8). For instance Nokia has been very successful at deploying a fight strategy in China's mobile phone handset market. In 2003 this market was led by both domestic and international players (i.e. Bird, TCL, Motorola, Nokia and others), each holding around 10% market share. With high demand for mid- and low-end mobile phones, the domestic brands seemed to have the best competitive starting position. Nokia, perceived as a premium product, wanted to leverage its key strength (the brand) and combine it with the domestic players' go-to-market approach in terms of product (functionality and quality), channel strategy, and pricing. Nokia decided to vastly expand its product offering, providing at least as much variety as the incumbents.



*“Chinese customers, for example, are generally still willing to pay a premium for foreign products of a similar quality level as local ones.”*

At the same time, it launched a "multi-channel distribution" campaign similar to those of its Chinese competitors, reaching consumers via mobile operators, national dealers, home appliance chain stores, specialised mobile handset outlets and IT channels. With its mid-end product prices comparable to those of domestic brands, Nokia's "Fight" strategy is already paying off. It holds the clear market leader position with a 35% market share in 2007, which more than doubles that of the second player, Motorola.



Another example is Unilever in India. When introducing the "Wheel" detergent brand, Unilever purposefully went beyond its traditional approach and adopted some of the key business principles of the local challengers. One critical element was product availability: India's 627,000 villages are spread over 3.2 million square kilometers, and finding the 700 million Indians who live in rural areas is not easy. Over the years, Unilever's Indian subsidiary has built a strong distribution system that helps its brands to reach all corners of the rural market. To service remote villages, stockists use auto rickshaws, bullock carts and even boats in the backwaters of Kerala.

### Focus

"Focus" is the second component of a successful middle segment strategy for MNCs in emerging markets. They should select and invest with priority in regional clusters that can still provide dominance potential. Once a strong market position (number 1 to 3) is established in one regional cluster, it can serve as a rollout platform to others. The rollout roadmap has to be defined with care, selecting geographies (e.g. for China, tier two and three city clusters, or specific regions around tier one cities) on the basis of their attractiveness and the ability to attain a leading position there (see figure 9).

*"Over the years, Unilever's Indian subsidiary has built a strong distribution system that helps its brands to reach all corners of the rural market. To service remote villages, stockists use auto rickshaws, bullock carts and even boats in the backwaters of Kerala."*

One renowned example is that of the chicken restaurant chain KFC Corporation. Beijing served as the initial platform for KFC's operations in China. Beijing is the centre for most of China's political activity and provides the necessary access to government agencies and business regulatory bodies. Furthermore, it has a large population. The numerous universities located in the city educate people with foreign ideas and, more importantly, plenty of Western tourists come to Beijing's many tourist attractions, increasing the potential for generating foreign-currency sales. After initial success in the capital, KFC later expanded into other high-flying areas such as Shanghai and Guangzhou. The chain grew very quickly afterwards and achieved solid growth success from this platform in China. The number of outlets reached 100 in 1996, 1,000 in 2004, and 2,000 in 2007.

Another example of the importance of entering BRIC markets regionally, and with the support of local partners, is illustrated through home furnishings giant IKEA's entry into Russia. Before the Swedish retailer opens its first retail outlet in a new potential market, IKEA will typically establish a supplier link within the host nation. This approach enables the company to reduce its risks by getting valuable input from local suppliers about important issues regarding the IKEA concept.



The large market in Russia had been of interest to IKEA for a long time. During the Soviet era, the company was already using a Russian wood processing factory, Priorsky, as a supplier. After the collapse of the Soviet Union in 1991, IKEA began expanding its supplier network rapidly.

By the end of the 1990s, IKEA decided to enter the Russian retail market. The first IKEA store in Russia opened in 2000; since then, nine additional outlets have opened across the country. However, IKEA's entry into Russia has been far from smooth. The company has experienced problems both with the legal system and with opposing authorities.

Two specific challenges IKEA has experienced in Russia are high tariffs set on imported material, and authorities working against the establishment of new retail stores. To address the first problem, IKEA has built several production units and a distribution centre within the Russian borders. The company has also entered joint ventures with Russian companies in order to speed up its Russian expansion.

To be successful in Russia, developed market companies must be aware of its particular operating environment and develop flexible expansion plans that take these often hidden variables into account. The rapidly increasing middle class population and its purchasing power will make Russia an interesting market for international corporations, despite its institutional complications. IKEA's manager in Russia, Per Kaufmann, remarked in an interview with e24 in February 2008 that it is too early to tell whether the heavy investments in Russia in previous years have been a good choice or not: "The investment horizon in these projects is very long, but since we continue to invest in the country, we must think that Russia is a good country to do business in."

### Simplify

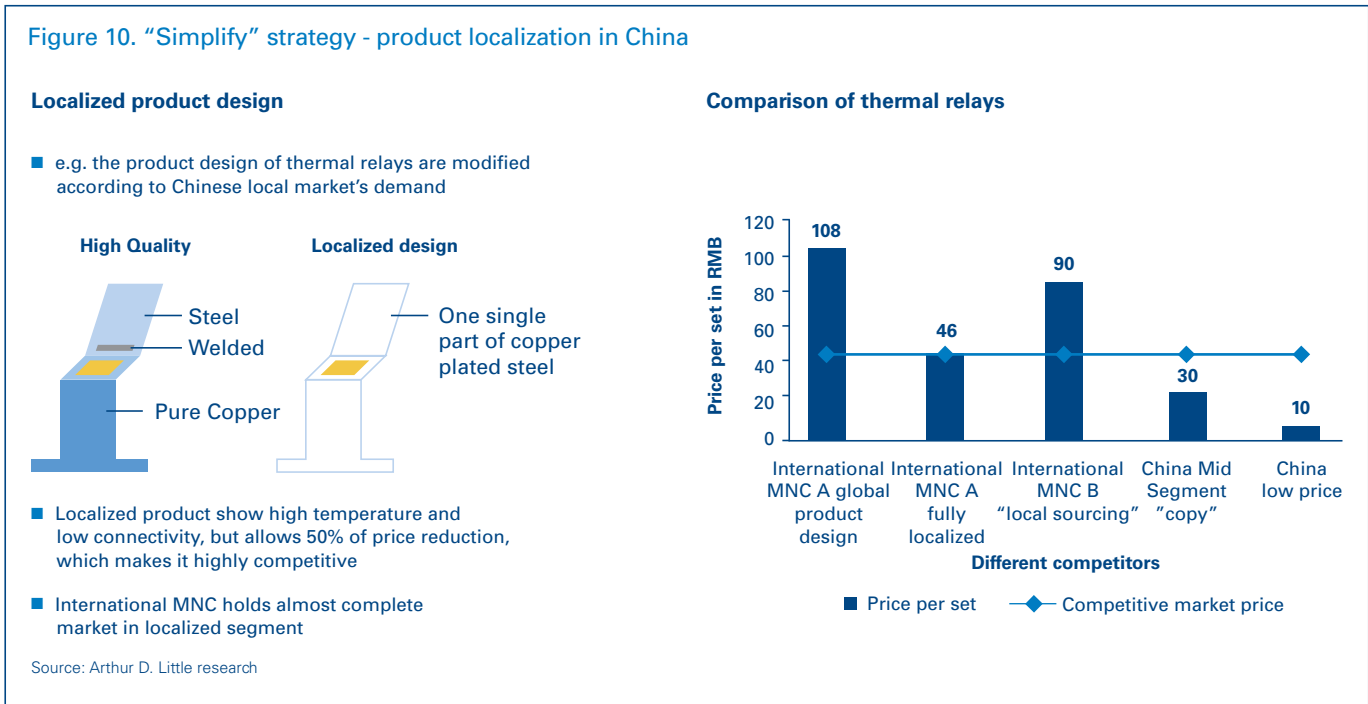
"Simplify" is the third component of a successful middle segment strategy for MNCs in emerging markets. One complicating factor for developed market MNCs is that products typically focused at the middle segment in their mature home markets are positioned somewhere between the middle and premium segments in emerging markets. As a consequence the MNCs' traditional product/service portfolios have a very limited target clientele – being successful in the middle segment in the emerging markets requires more creative ways to market than copying or de-engineering.

The Chinese heavy truck market is a case in point. China is the world's largest market for heavy trucks. Domestic companies are overwhelmingly dominant, with a total market share of 98 per cent. Until now developed market companies have been unable to compete in terms of costs, and are restricted to small niches in the premium segments. In an effort to increase their market penetration, MNCs are trying to introduce simple, low-priced truck models. For example, Volvo currently holds 0.3 per cent of the Chinese heavy truck market and wants to achieve 10 per cent market share by launching a low-cost truck by 2012. Chinese incumbents price their trucks at around US \$40,000 whereas Volvo's current prices range between US \$118,000 and US \$135,000. Volvo's new vehicle should be positioned at half the current price range, with differentiation from the premium models coming from less equipment, fewer horsepower and less technical refinement.

Rather than “de-engineer” international products, MNCs should develop fully localized platforms for emerging middle segments from the “inside out.” The definition of middle segment products in emerging markets is different from the concept in developed markets. The value proposition can be described as “good enough,” compared to “value for money.” By fully localizing product design, sourcing and production, companies will simplify their offerings in order to meet local market expectations and become cost leaders. Offering locally-tailored products that address the customers’ buying criteria is key.

*“By fully localizing product design, sourcing and production, companies will simplify their offerings in order to meet local market expectations and become cost leaders.”*

Figure 10 shows an example of how an international MNC succeeded in capturing almost the entire Chinese market for thermal relays by making a product design according to the demands of the local market, allowing a 50 per cent price reduction.



# Insights for the Executive

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Growth forecasts for the emerging markets in general and the BRIC countries in particular continue to be dazzling. Traditionally, multinational companies (MNCs) from North America, Europe and Japan have exploited emerging market growth by targeting their premium segments. That strategy is reaching its limits now, forcing MNCs to turn their sights from the premium to the middle segment: consumer and business products with a good basic functionality but without the full range of differentiating features, yet at a highly competitive price.

First of all, the premium segment is rather small and becoming a very crowded place. Secondly, the middle segment in emerging markets has massive growth potential, typically accounting for between 60 and 90% of the addressable local market. Combined with the sheer size of the economies of emerging markets, this means that an MNC that aims to be a global leader cannot afford to miss out. Thirdly, if local champions in emerging markets are allowed to grow through their dominance of the middle segment there, they will use the skills and resources gained to fund international expansion into the MNCs' profitable home markets.

In order to succeed in the middle segment in emerging markets, MNCs have to beat local champions at their own game through a fight-focus-simplify strategy. "Fight" means linking their international brand power with the go-to-market approaches of the local champions. "Focus" means investing selectively in geographies (city clusters or regions) with a potential for market dominance. "Simplify" means going for fully localized products that address local buying criteria instead of "de-engineering" international products.

*"In order to succeed in the middle segment in emerging markets, MNCs have to beat local champions at their own game through a fight-focus-simplify strategy."*

## **Our expertise: Arthur D. Little supports international publishing company's Indian expansion**

When one of the world's largest media companies was considering entering the professional services publishing market in India, Arthur D. Little was asked to evaluate the opportunities and competition in the local market, and, if it was found to be suitable, to assist in developing an entry strategy to support its investment plan.

Faced by a shortage of publicly available information, Arthur D. Little conducted a thorough primary research exercise based on interviews and focus group discussions with 90 players across India's professional publishing value chain. Based on the research findings and Arthur D. Little's prior extensive experience in India, a detailed analysis was developed of India's tax, legal, accounting and health professional publishing market.

The market study included an analysis of: key players along the value chain (value split and practices); various customer segments (size, growth, needs, buying habits); current players in the market (revenue, market share, strengths/weaknesses, willingness to partner); and the regulatory environment.

The findings of this market analysis justified that the client continue its expansion in India. Working with Arthur D. Little, the publisher developed a market entry strategy that identified and measured the size of target customer segments, their buying needs and potential acquisition or partnership opportunities. When the time came to roll this strategy out, Arthur D. Little was appointed to assist in developing a high-level implementation roadmap.

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#### History in the Making

Journalists look at the new Tata Nano during the press day at the 78th Geneva International Motor Show in Switzerland, 4 March 2008.

In 2003 a four member team from Tata Motors was asked to work on a very fluid advanced engineering brief: to create a low cost transportation vehicle with four wheels.

The resulting Tata Nano costs about \$2500 and dwarfs traditional costs associated with car production while at the same time not compromising on aesthetics, value to the customer or safety and environmental requirements.

The Tata Nano represents a perfect example of BRIC based companies creating products for their own 'middle segment' markets and demonstrates the deep insight into these rapidly growing economies that western companies find difficult to replicate.

#### Arthur D. Little

Arthur D. Little, founded in 1886, is a global leader in management consultancy, linking strategy, innovation and technology with deep industry knowledge. We offer our clients sustainable solutions to their most complex business problems.

Arthur D. Little has a collaborative client engagement style, exceptional people and a firm-wide commitment to quality and integrity. The firm has over 30 offices worldwide. With its partner Altran Technologies, Arthur D. Little has access to a network of over 16,000 professionals. Arthur D. Little is proud to serve many of the Fortune 100 companies globally, in addition to many other leading firms and public sector organizations.

For further information please visit [www.adl.com](http://www.adl.com)

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