

Busting the Myths About Emerging Markets

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Virtually every communications, media, and technology (CMT) company now realizes that emerging markets offer enormous growth promise, and senior executives have been actively investing in these markets. However, most western CMT companies have entered these emerging markets with their existing mature-market business designs and with a set of beliefs about the priorities for emerging markets customers.

Many of these beliefs have proven to be misguided; some are downright false. Acting on faulty assumptions has severe consequences for CMT companies trying to expand internationally, including handset and network infrastructure suppliers, hardware and software vendors, and telecommunications operators. Oliver Wyman's recent CMT "State of the Industry" report demonstrated that CMT companies headquartered in emerging-market countries have grown their market capitalization by 38% annually over the past five years versus 15% for companies headquartered in mature markets. Moreover, seven of the top ten best-performing companies were either headquartered in an emerging market (e.g., China Mobile, Bharti Airtel, and América Móvil) or had aggressively and successfully invested in emerging markets (e.g., Telefónica and Telenor).

To succeed globally, CMT companies must deepen their understanding of emerging markets. In this white paper, we review six of the most prevalent myths and present relevant evidence to dispel those myths, with implications for how CMT executives should reconsider strategies for emerging markets. The white paper is informed by our client work in emerging markets as well as our surveys over the past year of more than 20,000 emerging-market consumers and businesses.

Myth 1: Emerging markets are technology backwaters.

Many companies based in developed markets have long viewed emerging markets as technology backwaters. Based on this attitude, companies have targeted emerging markets primarily with low-end products that contain the same basic feature sets as mature-market products. This perspective may stem from the assumption that consumers and businesses in emerging markets have little disposable income and little access to sophisticated infrastructure.

The evidence: Our research shows rapid adoption of technology, including leapfrogging of western markets on many technologies. Moreover, emerging-markets consumers and businesses give a high priority to spending on CMT products and services over other discretionary items

Consumers' Hunger for Technology

Technology adoption by consumers in emerging markets has sharply risen in some countries. In some of these nations, consumers are set to overtake their developed-market counterparts in this respect. While demand is strong for a wide range of technologies, the biggest winner over the past five years is clearly mobile phones and wireless voice and data services. Consumer spending on telecom, for instance, is showing 10-15%+ CAGR in most emerging markets, compared to less than 5% in developed markets. As one example of the explosive growth in mobile phones, 150 million licensed mobile handsets were sold in China in 2007,

approximately the same number of handset sales in the United States during the same period. Mobile handsets have rapidly become the most common consumer electronics device in the world, with over 3 billion handsets in use at the end of 2007.

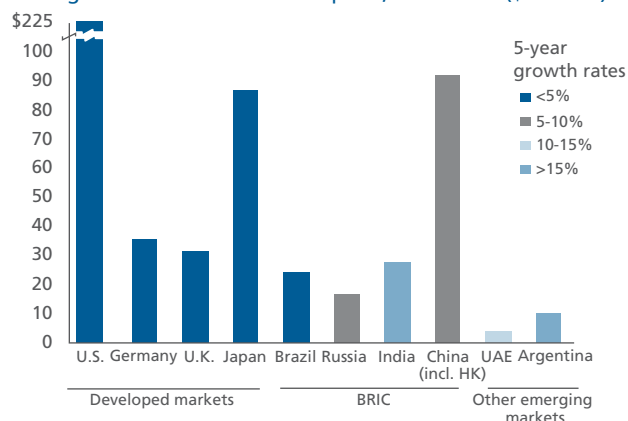
Meanwhile, growth in consumers' use of the Internet (including broadband penetration into households) has also proven explosive in many emerging markets. In 2001, the United States had 500 Internet users for every 1,000—a penetration rate of 50%. That same year, China's penetration rate was just 2.6%. But by 2007, China's rate had jumped to 12.3%. In only six years, China added more than 130 million Internet users—almost as many as the total number of Internet users in the United States. If the trend continues, as is likely, China will have more users than the United States by the end of 2008. Technology, particularly mobile telephony, is increasingly seen as a basic need—in many countries, consumers will even reduce spending on food, clothing, or cigarettes before reducing their mobile phone usage.

Enterprise and Small Businesses

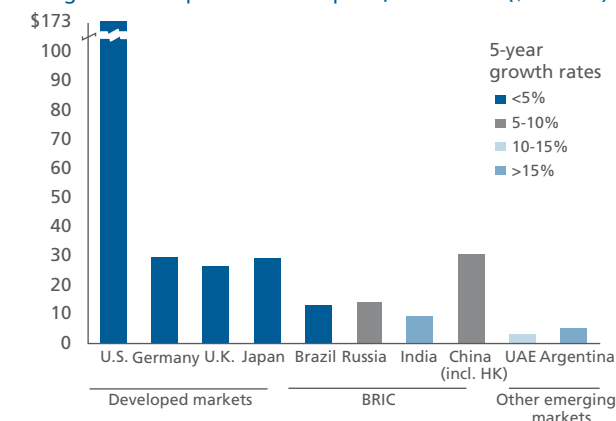
At the enterprise and small-business level, significant telecom markets already exist in emerging markets, and many of them also show rapid growth rates. Industry analysts agree on large forecasted increases in enterprise telecom spend, particularly in wireless, over the next five years, while mature European markets, though representing larger expenditures, will experience slower growth (see Exhibit 1).

Exhibit 1 Where the spend will be

2011 global consumer telecom spend, forecasted (\$ billions)



2011 global enterprise telecom spend, forecasted (\$ billions)



Source: Oliver Wyman analysis, IDC world consumer telecom spend 2006-2011 projections.

In many poor countries, mobile telephony has helped develop new businesses and improve the productivity of small businesses. In Africa, for instance, small farmers can easily access the information on the weather and market prices for their crops via their mobile phone.

Among small businesses in emerging markets, managers view technology as a vital tool. To illustrate, in China, 50% of small business managers we surveyed strongly agreed with the statement “Technology is important to me to reduce costs for my business;” 57% percent strongly agreed with the statement, “Technology is critical to create a competitive advantage for my business.”

Technology Leapfrogging

We are seeing many instances in which consumers in emerging markets, while adopting technology, have leapfrogged generations of technology. The best example is in telephony, where many emerging markets bypassed the build-out of fixed-line communications and went directly to mobile. Another example is in computing, where many consumers are going directly to laptop purchases rather than starting with the traditional desktop models. And in India, when consumers were asked in a recent survey, “Which mobile phone type do you intend to purchase?,” 66% of respondents answered “smart phone” versus only 34% for a “regular mobile.”

Why this intense interest in next-generation phones? Survey participants’ explanations included a desire to listen to music, take pictures, and “keep up with the times,” as well as use new mobile-phone services. Some operators have responded to these realities by offering targeted versions of basic products and services to capture these growth segments.

Mobile payments is another area where emerging markets are poised to be early-adopter markets and leapfrog mature markets. Many emerging-market operators have begun offering services such as cash payments and balance transfers via mobile phones. Some leading examples include:

- In Kenya, Safaricom (Vodafone) M-PESA has a service that allows mobile customers who do not

have a bank account to perform basic operations like cash deposit, withdrawal, and transfer.

- In South Africa, MTN offers full mobile banking services in joint venture with a local bank.
- In the Philippines, Smart Padala has the first international remittance service leveraging the mobile phone, coupled with Smart money cards that allow cash withdrawal at ATMs.

In short, considerable evidence suggests that emerging markets are not focused merely on the simplest, most basic versions of products and services. They are willing and able to pay for leading functionality and services.

Myth 2: Emerging markets still do not have income levels supporting technology purchases.

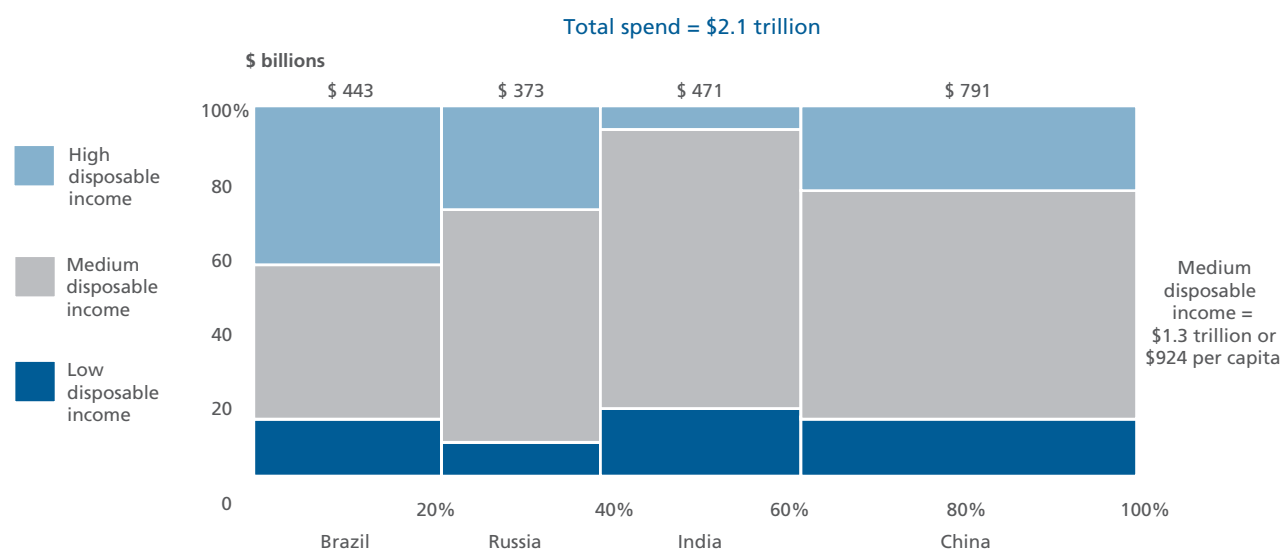
Many executives in developed markets assume that consumers in emerging markets do not make enough money to afford technology products and services.

The evidence: Our recent client work suggests otherwise, as does the fact that more than 80% of consumers in key emerging markets have sufficient disposable income to allow them to access technology (see Exhibit 2). Developing nations have affluent consumer segments—people for whom income is not a constraint on their technology purchasing. These segments already constitute up to 40% of total spend. Moreover, even middle-income consumers now have the ability to spend a significant amount on technology.

Middle-Income Purchasing Power

In Brazil, Russia, India, and China (BRIC), middle-income consumers (those who have some discretionary spending) make up more than 60% of total consumer spending. They spend an average of \$90 per year on technology such as computer hardware and software, mobile phones, and online media and gaming. While this figure appears low, it is only two to four times lower on average than annual spending by high-income consumers. Considering that the middle-income segment can represent up to 70% of the total population in some countries, these consumers clearly should not be neglected. Our research also found a

Exhibit 2 Money in the middle



Source: Euromonitor, Oliver Wyman analysis.

remarkably high penetration of mobile phones and other discretionary technologies (such as PCs and other computers) in middle-income markets, with penetration rates being 50% of those associated with high-income consumers.

Middle-income consumers also do not appear to be more price-sensitive than high-income consumers in emerging markets. In a study of price elasticity across several software products, we found only small adoption differences between middle- and high-income segments.

Willingness to Pay for Value

Our research shows that consumers and small businesses in developing countries are interested in higher-quality products and innovative features, and are willing to pay for them. One survey of small businesses in BRIC showed that respondents were willing to pay an average 20-30% price premium for printers that are more portable or smaller or that offer faster printing speed.

Myth 3: Emerging markets won't pay a brand premium.

Most CMT executives have assumed that global corporations would have difficulty commanding a healthy brand premium in emerging markets. In general, the belief was that low-cost, no-name local competitors would win most of the market share.

The evidence: For consumers and small businesses in emerging markets, international brands are at least as important (in some cases, even more so) than for buyers in developed markets.

For Consumers, the Appeal of Brand

Consumers in emerging markets place a higher value on the brand power of international technology companies than on their largest local competitors and on unbranded products. In Brazil, for example, 59% of our survey respondents said they were “extremely likely” to purchase an international brand PC as their next home computer. And in a brand-association comparison in Brazil between a leading international and a well-known local brand, consumers gave the international brand more than two times positive ratings across a multitude of dimensions, including “high quality,” “powerful,” and “stylish.”

In another example, from one of our client projects in the printer industry, we found that brand was a more important lever in driving customer decision-making in all four BRIC markets than in the Western markets. Moreover, these emerging-markets customers were willing to pay a higher brand premium than their developed-markets counterparts.

Among wealthy consumers and those aspiring to wealth, status and branding are noticeably impor-

tant. In China, consumers are willing to pay extra to keep high-status mobile numbers. *South China Morning Post* reported that a cell-phone number with six consecutive “8”s (an auspicious number) has sold for \$44,000 in eastern China.

Small Businesses: Even More Interest in Brand

Like consumers, small-business owners in emerging markets are intensely interested in powerfully branded products. In BRIC, for instance, small-business survey respondents said they were “extremely likely” to purchase an international brand PC as their next computer for their enterprise (see Exhibit 3). Moreover, small businesses seem to believe that owning the right brand is more important than price. To illustrate, 50% of small-business survey respondents in India noted that “owning the best brand is important to me,” while only 14% said that “price is more important to me than brand name.”

In another brand-association comparison between a leading international and a well-known local brand, small-business owners gave the international brand more than three times positive ratings across numerous dimensions.

One of the reasons why businesses may pay a higher brand premium than consumers is risk aversion.

Our research shows that in B2B markets characterized by a high degree of uncertainty, value propositions that take risk out of the equation for clients have an edge over those that don’t. In the minds of business owners in emerging markets, CMT firms with a strong global brand are safer than local brands with more limited track records.

Myth 4: Technology offerings from developed markets will succeed in emerging markets.

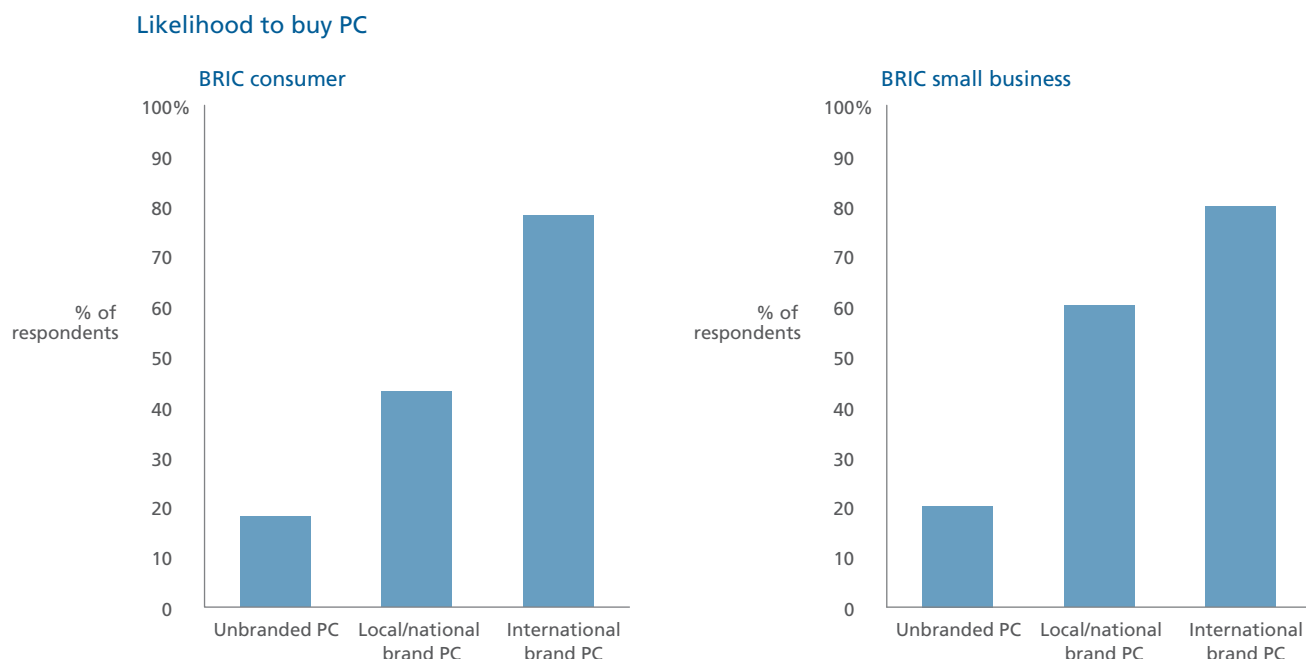
Many developed-market executives wrongly assume that their products and services will succeed in emerging markets without material adaptation to local needs. What’s good enough in developed markets, they assume, should work in emerging markets.

The evidence: Companies need to create offerings with unique product features and pricing that are carefully tailored to the specific needs of developing markets. In some cases, CMT companies should also consider completely new business models for emerging markets.

Rapid Adoption of Products Tailored to Emerging-Market Requirements

Products from developed markets that have been customized for local priorities have attracted intense interest from consumers and small busi-

Exhibit 3 Technology device preferences



Source: Oliver Wyman analysis.

nesses alike. For example, in a survey of small businesses in BRIC, 60-70% of respondents said they were “very likely” or “likely” to pay for market-targeted features that can increase a technology product’s speed and portability as well as extend product life (see Exhibit 4). The types of features that these customers value proved to be quite different from mature-markets customers.

One U.S. manufacturer of printers discovered first-hand the power of customizing an offering for emerging markets. Based on a deep understanding of customer priorities and differentiated price elasticities by segment, the firm introduced a new line of low-cost, longer-life supplies to complement its high-end, developed-market products—and gained 15 percentage points in market share.

The Wisdom of Localizing Marketing Strategy

The most successful developed-market firms not only tailor their offerings to meet the unique needs of local markets in emerging economies, they also customize their marketing strategies to make them relevant to local customers’ priorities.

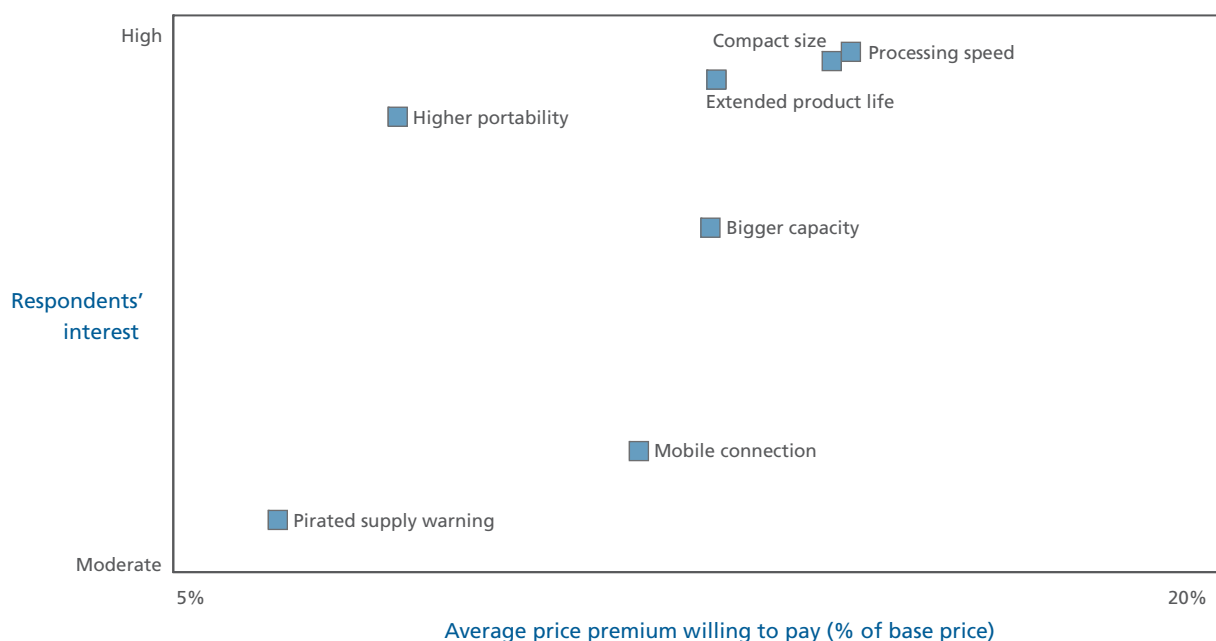
For instance, telecom giant Nokia saw a huge potential market in rural India, where 70% of that nation’s population resides. Nokia localized its cell phones by designing them with a flash-

light feature (handy in a region with unreliable electricity), a dustproof keypad, multiple address books, and individual call-time tracking (for shared use of phones). Though the phones are large and thus less appealing in developed markets, these unique features make them convenient and attractive to rural Indians. Nokia then adapted its marketing strategies to the distinctive characteristics of rural India. For example, it sent mobile vans to remote villages to tout the phone’s benefits and to gather additional insights on rural customers’ needs.

Interest in Energy Savings

Of all issues important to consumers and businesses in emerging markets, power consumption may top the list. Our research found that a technology company selling a hardware product offering a 75% saving in power consumption stood a chance of garnering a five-point gain in market share in some emerging markets. Specifically, we asked small businesses in BRIC the following question: “If a manufacturer introduced an environmentally friendly product line that consumes less power, how would this influence your perceptions of the brand?” 64% of respondents in Brazil, 44% in India, 31% in Russia, and 30% in China said that such a feature would “strongly enhance” their perception of the brand.

Exhibit 4 Interest in localized offers (printer example)



Source: Oliver Wyman analysis.

In that vein, networking equipment company Nokia Siemens Network has found success in rural areas by offering energy-autonomous base stations that operate on wind and solar power.

Myth 5: Emerging-market consumers and businesses focus on products, not services.

Executives from developed markets often assume that customers will not value or pay for additional services, such as on-site support and maintenance through a service contract.

The evidence: Many CMT firms have neglected to develop their service offerings and have missed opportunities to offer bundled solutions to emerging-market customers. There's a strong preference for services, including support, among consumers and especially small businesses in emerging markets.

Consumer Interest in Support Services

We performed several studies to investigate the role of support services, such as telephone troubleshooting and in-home setup, in driving technology product sales in developing nations. All our studies showed that these services exert a significant impact on sales. For example, for consumers purchasing a PC, the availability of support could enhance sales by as much as 10% (see Exhibit 5).

Why do these consumers value such services? Our research suggests that they're primarily interested in ensuring that their new PC operates at "maximum performance." They also want to be certain that the product is connected correctly and quickly. Consumers rely on experts for their rapid adoption of technology, and this need provides companies with a major opportunity to deliver valued services.

Small- and Medium-Size Businesses' Interest in Support Services

Similar observations hold true for small- and medium-size businesses in emerging markets. However, the potential for support services to drive product sales is even greater among businesses than among consumers—10-15% as compared to 6-8%. In a study for small- and medium-size businesses in BRIC, two-thirds of respondents

said they were "likely" or "very likely" to buy/use on-site maintenance services after purchasing a technology device, as well as auto-replenishment services for the device's supplies.

Another example comes from network equipment, where mobile operators in emerging markets have been more aggressive about outsourcing their network operations than their mature-market counterparts. In turn, this has put pressure on companies like NSN, Ericsson, and Huawei to develop a full range of professional and managed services offerings.

Myth 6: It's too early to use advertising-supported, online business models in emerging markets.

Business leaders in developed markets tend to assume that it's too early to implement online business models in emerging markets, because they believe that Internet penetration rates are too low and online advertising markets are too small.

The evidence: Consumers in emerging markets are embracing the Internet and spending more time using it, albeit in different ways than consumers in developed markets. Online business models, services, and advertising markets are already large and growing more rapidly than in mature markets.

Shared Access Models Drive Penetration Rates

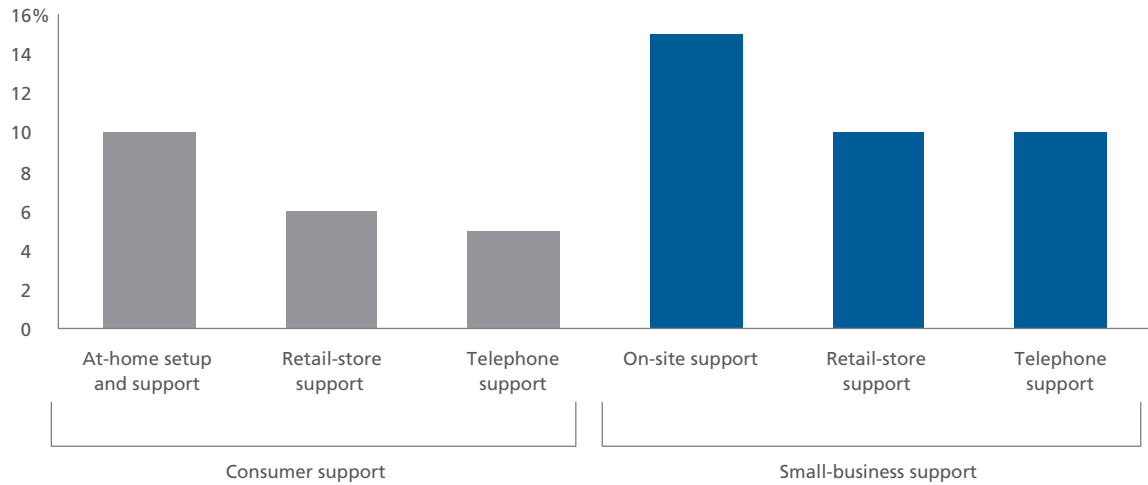
In a recent BRIC study, over 80% of our urban survey respondents said that they have used a PC and the Internet in the past year. While only 37% of them have a PC at home, the rest get access to the Internet at work, Internet cafes, school, the local library, or a friend's home.

These types of shared-access models are raising the effective technology penetration rates in emerging markets. Another shared-access example is the wholesale, time-rental market for mobile phone usage. Senegal was one early-adopter country where street vendors could rent a phone and sell minutes to passing consumers.

In addition to shared access, ownership rates are continuing to rise rapidly. Shipments of PCs to home users are expected to grow at a 20% compound annual growth rate by 2011; shipments

Exhibit 5 The appeal of support services

Potential product sales lift if support services are included (%)



Source: Oliver Wyman analysis.

to small businesses, an 18% CAGR. Meanwhile, Internet usage and time spent online are increasing as well. In Brazil, the number of Internet users jumped from 12 million in January 2006 to 20 million in September 2007.

Growing Online Advertising Markets

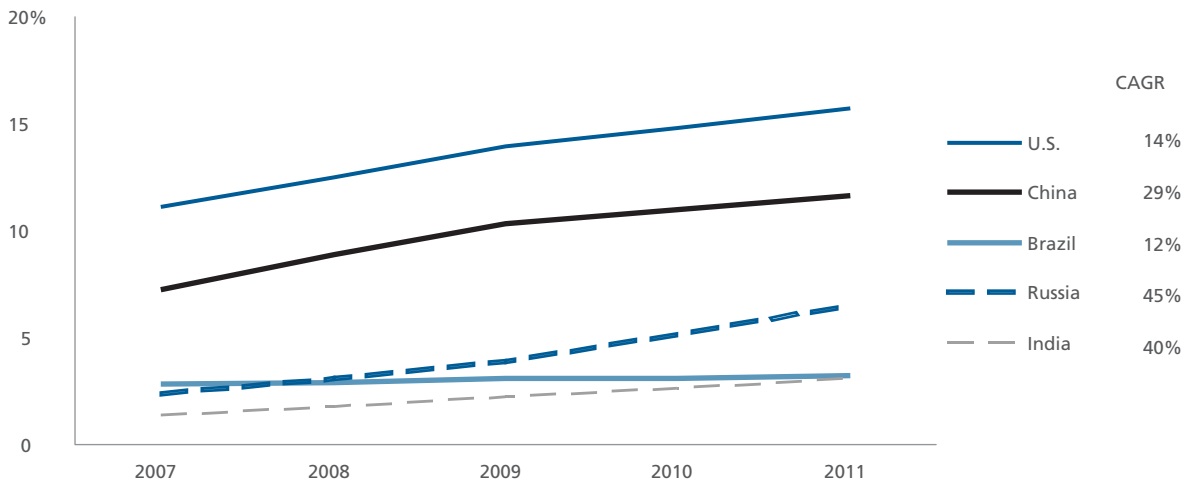
In developing nations, online advertising spending as a percentage of total spending is on the rise. We anticipate a 45% CAGR in online advertising in Russia from 2007 to 2011, a 40% CAGR in

India in that same time frame, 29% in China, and 12% in Brazil (see Exhibit 6). Many CMT executives might be surprised to learn that the online advertising market in China in 2007 had passed \$1 billion, far more than the size of the legal paid software market.

The market potential for online services models is large, and some early leaders have emerged. Consider Tencent, the investment holding company principally engaged in Internet, telecommunications, and mobile and online services to users in

Exhibit 6 Growth in online advertising

Online advertising spending as % of total advertising



Source: PWC.

China. Established in 1998, Tencent is headquartered in Shenzhen, China, employs 3,700 people, and recorded RMB1.06 billion in net profit in 2006 alone. Tencent's seven business lines provide online services such as instant messaging, interactive entertainment, e-commerce, and online advertising. Its portal website—www.QQ.com—became the most popular in China in 2006, offering a “sticky” virtual community particularly prized by young users.

Note that mobile advertising will be much more important in emerging markets, as the mobile phone is the first screen (and for many consumers the only screen) in emerging markets. This stands in stark contrast to the developed world, where the mobile phone is often regarded as the third screen after the television and the PC.

Next Steps for Global Firms

Six myths examined, six myths dismantled. What are the implications for GMT firms based in developed markets? They must approach emerging markets with a new mindset and a willingness to jettison long-held assumptions.

Consumers and businesses in emerging markets have, in some cases, very different priorities and purchasing behaviors than their mature-market counterparts. Customers' needs may vary widely within a particular country yet resemble the needs of similar segments in other countries—a group of consumers in, say, Thailand, may behave remarkably like a group of consumers in China while selecting a technology device for purchase.

While it is not possible for an international company to manage each country uniquely, our experience suggests that between four and six useful segments exist across emerging markets. By aggregating these insights, product managers and executives can develop compelling, emerging-markets-focused offerings.

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Another lever we expect to see more companies exploit is business-model innovation. Too many companies try to force-fit existing mature-market business models into emerging markets. In many cases, this does not work. As an example, given the high piracy rate in most emerging markets, most software companies should be considering advertising-supported or premium-services business models. Ericsson is one company that has been trying a more services-centric business model in emerging markets.

Evidence shows that some emerging markets already have large local competitors with unique and powerful business models. Mobile-phone company Bharti in India has deployed an asset-light business model that includes significant outsourcing of the network and other operations.

The rising tide of global economic growth allowed some developed-market companies to get away with operating in accordance with these myths over the past five years, but future success will require smarter decisions based on better information. As an added benefit, cracking the tough problems in emerging markets can improve performance in core, developed-market business. Consider the innovations that mobile handset manufacturers pursued to develop a \$20 mobile handset, or mobile operators' forays into mobile payments. Emerging-markets products, including ultra-low-cost PCs and mobile phones, are starting to infiltrate developed markets. CMT executives can no longer afford to ignore the complexities and realities of emerging markets. ❖

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