

**EXPLORING INNOVATION STRATEGIES FOR MIDDLE LEVEL CONSUMERS
IN DEVELOPED AND DEVELOPING COUNTRIES**

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ABSTRACT

Emerging markets- "Growth Bouncing Back" will start to steer their economies away from a dependence on exports toward a model of increased private consumption. Companies have an opportunity to seize a new market of unprecedented size by thinking differently about how they innovate. In particular, frugal innovation – "Good Enough" is affordable products that meet the needs of resources, constrained consumers have created tremendous demand in emerging emporia. Innovating for the next three billion will play a crucial part in these strategies. This paper focus on innovation will require companies to develop a set of key capabilities are

- *Customer insight*
- *People & culture*
- *Research & development*
- *Operation & business model*
- *Tailoring talent management*
- *Managing risk*

These capabilities are combining local relevance with global scale for building sustainable emporia for developed and developing economy. These capabilities will explore the scale of the opportunity to the companies and they have taking to develop affordable to bottom of economic pyramid, must be scalable for local use, be <90% of the cost and be the world class quality. This paper would also highlight the key elements of innovation to succeed in the markets are Outsource all non- core activities, use technology in imaginative ways, Apply mass production techniques in unexpected areas

Keywords:

Frugal Innovation, Mass Production, Talent Management, Research & Development, World Class Quality, Technology.

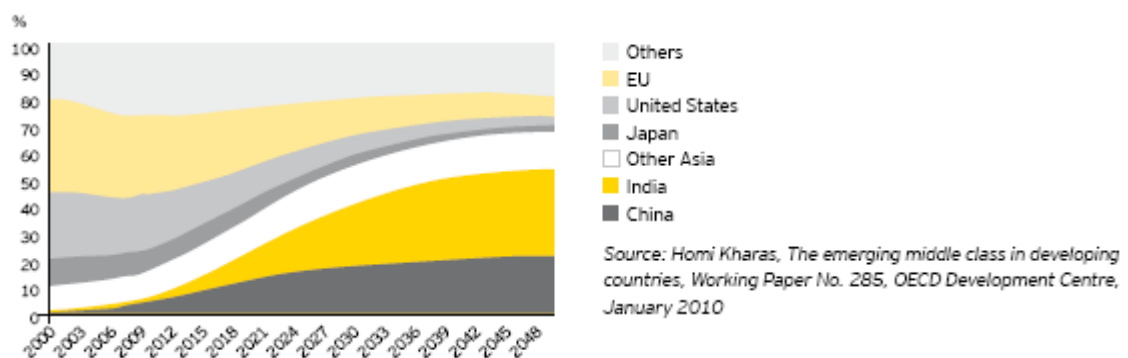
INTRODUCTION

"Successful frugal innovation requires a strong local presence in the emerging markets that are demanding affordable, good enough products"

Emerging markets are experiencing their most dramatic growth in decades, gaining a greater share of the global economy and offering significant opportunity for companies faced with faltering Western economies (Immelt, Govindarajan, Trimble, 2009). The World Bank forecast in June that gross domestic product in developing countries was expected to grow by 5.7-6.2 percent in 2010, while rich countries would manage expansion of only 2.1-2.3 percent (World Bank Global Economic Prospects Report, 2010). Recently, growth in frugal markets was dominated by investment, infrastructure and exports, but in the next decade, it is likely this picture will start to change. Although not rich by the standards of developed countries, a huge middle class is already saving less and spending more, creating big

opportunities for companies that can serve them with relevant products and services. Between now and 2030, an additional three billion people globally will enter this income bracket. Over the longer term, this explosion of spending power has the potential to make a significant contribution to a sustained global economic recovery and unwind long-standing economic imbalances between West and East. Over the next 20 years, global economic trends will completely transform the customer base for most industries. Rising per capita incomes, favourable demographics and continuing economic growth are creating massive growth in the numbers of the global middle class. By 2030, there will be an additional three billion people joining this cohort, and most of them will live in Asia. The numbers are staggering. In 2000, only 10% of spending by the global middle class took place in Asia. By 2030, this proportion could rise to 40% (Refer Chart 1). In 2009, the middle class in Asia-Pacific spent just under US\$5 trillion. By 2030, this figure could rise to almost US\$33 trillion, according to the Organisation for Economic Co-operation and Development (OECD).

Chart 1: Shares of global middle class consumption, 2000-50



Footnotes

*Homi Kharas, *The emerging middle class in developing countries*, Working Paper No. 285, OECD Development Centre, January 2010.

**Emerging Consumer Survey 2011*, Credit Suisse Research Institute, and January 2011.

*Homi Kharas, *The emerging middle class in developing countries*, Working Paper No. 285, OECD Development Centre, January 2010.

REVIEW OF LITERATURE

“Frugal Innovation” Also known as „Gandhian“ or „Reverse“ Innovations, the term "Frugal Innovation" describes products and services specifically tailored to the needs of developing countries such as India or China and their mostly rural population (Sehgal et al., 2010, Prahalad and Mashelkar, 2010, Immelt et al., 2009).

In the emerging markets innovation is about reconfiguration and re-bundling of products and processes (Henderson and Clark, 1990) to fulfill needs at lower cost and at economies of scale. While the majorities are still poor, consumers in emerging markets are rising in droves to the middle class and above. So firms need to juggle both the bottom of the pyramid and the top in the way of platform, inclusion, eco-system, drivers and discourse

Western firms are adopting “polycentric innovation” and setting up R&D centers in emerging countries. Cisco plans for 20% of its best personnel to work in its “Cisco East” (India) R&D centre. IBM has over 90K workforce in India, purported to be the largest MNC there. Of eight of Microsoft’s R&D centers, three are in emerging countries – Egypt, China, and India.

Arun Sarin of Vodafone sent his top executives to India to learn about low-cost innovation business models. Unilever and P&G have mega consumer research laboratories in Beijing which use ethnographic techniques. While “open” and “user-centric” innovation is about tapping worldwide intellectual diversity of users to help solve their own problems, “frugal” or “constraint-based” innovation focuses on low-cost innovation that works but without the frills and whistles often targeted at high-end users.

Examples of this frugal innovation are from Warren Buffett backed Chinese firm BYD with its low-cost lithium ion batteries and upcoming electric car. BYD which was previously never visible on Business Week’s most innovative companies list is ranked 8th this year. Tata with its NANO car which costs less than 2000 pounds stands at rank 17. GE with rank 9 developed a mini-handheld ECG machine in its Bangalore R&D centre costs that less than half of conventional bulky ECG machines. Procter and Gamble at rank 25 saw a transitional year in 2009 when CEO A.G. Lafley shifted P&G's focus from upscale products to new lower-priced goods more suited to recessionary times. Growing Chinese giant ZTE which began operations in just 1997 is becoming popular for its sub-30-pound smart phones. Given the recession and deficit held up markets of the West, consumers here will also be beneficiaries of this new “frugal” innovation emanating from emerging markets.

Innovation for the next three billion will require companies to develop a set of key capabilities. Companies must build these capabilities at both a local and a global level.

- 1. Customer insight**
- 2. People and culture**
- 3. Research and development**
- 4. Operations and business model**
- 5. Tailoring Talent Management**
- 6. Managing risks**

Customer insight

Successful innovation requires the companies to get close to their customers and understand the problem that needs to be solved. “Customer Insight” is a “bottom-up” approach that leverages insights into the behaviours, perceptions and needs of current and potential customers by involving them as true partners in the innovation process. This non-traditional approach brings an organization face-to-face with customers and consumers in order to glean fresh insights into both articulated and unarticulated problems and needs. These grass-roots insights position an organization to innovate at an entirely new level. Customer Insight represents a deep understanding of customer needs and the drivers of customer behaviour at a level well beyond what customers are able to articulate them. Customer Insight leads to opportunities for creating solutions that are tightly linked to the core drivers of human needs and behaviour. Developing Customer Insight includes: Understanding the explicitly stated or “articulated” needs of customers and potential customers, but more significantly, identifying their “unarticulated” needs. Customer Insight is the foundation for “Customer-Inspired Innovation”

People & Culture

Companies need to adapt a culture and mindset that are willing to tailor products to customer’s needs. Culture is vitally important to an organisation since it shapes everything an organisation does. Progressive companies encourage and empower their people to learn and

apply their knowledge and experience to confront challenges, and to be innovative in the process. A complex set of attitudes, beliefs, values, opinions, rules of behaviour, ideologies, habitual responses, language, rituals, quirks and other characteristics of a particular group. Set of collective beliefs and assumptions steering values and through them the artefacts and actions of an organisation. The deeper level of basic assumptions and beliefs that are shared by members of an organisation, which operate subconsciously and define in a 'taken for granted' fashion an organisation's view of itself and its environment. The specific collection of values and norms that are shared by people and group in an organisation that control the way and they interact with each other and stakeholders.

Operation & Business model

When a firm is entering a new market where the current business model is inappropriate (Markides, 2006), a view that translates well to the realities of low-income markets. Business model innovation, including new revenue and profit models, new approaches to manufacturing, logistics and distribution, are viewed by some as even more important than the features, functionalities and technology of a product offering (Anthony et al, 2008; Sull et al, 2003). The literature on business model innovation in low-income markets stresses the importance of revamping cost structures. Christensen et al noted that one of the major challenges for companies used to middle to higher income markets when attempting to enter lower-income markets was the fact that opportunities in low-income markets make no sense when viewed through the prism of their existing business models and structures (Christensen et al, 2001). They therefore need to create new business models, with new cost structures.

Globalizing research and development

Many manufacturers are now locating research and development ("R&D") facilities in emerging markets not only to reduce the costs of product development, through lower wages as well as tax credits and other government incentives, but just as importantly, to better incorporate local needs and expertise into product design. While the benefits can be substantial, the challenge is to effectively integrate and leverage R&D teams around the world. To foster these connections, leading companies are combining traditional face-to-face team building with technology solutions such as databases of innovative ideas and global project teams that collaborate online.

Tailoring talent management

Manufacturing executives will need to rethink how they recruit, develop, deploy, and connect the skilled employees on whom they rely. Once seen as an inexhaustible supply of low-cost labour, many emerging markets are now facing the same shortages of skilled labour that are all too familiar in developed countries. And in fast-growing emerging markets, the need to rapidly recruit and develop skilled employees is all the more critical. Companies are competing for the best talent by offering higher salaries, increased benefits, and more opportunities for professional development. Global manufacturers are finding that they need to balance the efficiency afforded by their company-wide human resource ("HR") policies with the need to accommodate local expectations and cultural norms.

Managing risks

Emerging markets present a unique profile of risks—geopolitical, regulatory, financial, currency, and governance risks among others. Among the greatest concerns facing manufacturers in emerging markets are potential threats to intellectual property rights, whether through outright theft of proprietary know-how or counterfeiting of products. Companies must not only protect themselves from these “unrewarded” risks, they also need to guard against the risk of failing to capture the upside potential of these markets. The goal is to achieve risk intelligence by systematically identifying, evaluating, and managing all the risks faced by a company across all the markets in which it operates. A key aspect of this comprehensive approach is to manage explicitly the interdependencies that inevitably exist among the different types of risk that a company faces. The ability to take a holistic approach to risk management will continue to grow in importance as companies develop increasingly complex global value chains to support their worldwide operations.

OBJECTIVES OF THE STUDY

1. To find out the company have an opportunity for frugal innovation in emerging markets.
2. To perceive the needs of middle-income customer towards Frugal product
3. To identify the key capabilities and core competencies of a firm, to build sustainable market through frugal innovation.
4. To identify the steps that are important to scale the innovation into a business model
5. To examine the implications, shortcoming and competitive advantages of promoting the business

SCOPE FOR FURTHER STUDY

This report will focus on frugal innovation at the level of the firm, through an empirical analysis based on next three billion. The analysis will include companies operating across a range of sectors, including financial services, consumer goods, retail and technology.

Limitation of the study

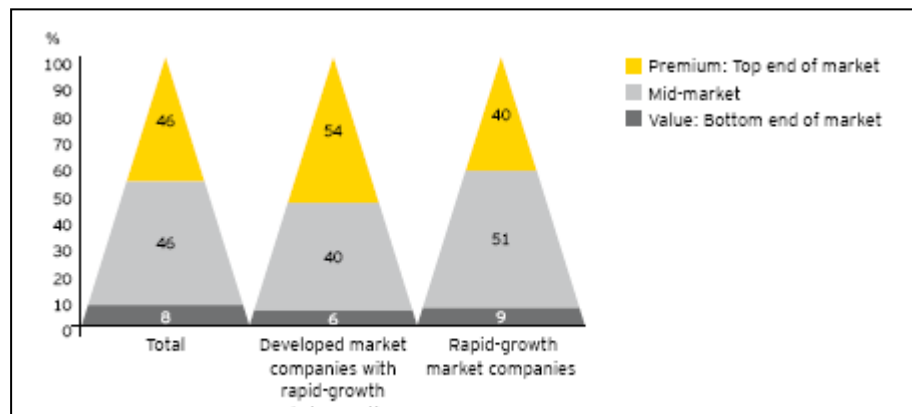
- Lack of transparency due to difficulty in establishing how the research arrived to the study's conclusion
- The conclusions and suggestions were formed based on the literature and secondary source and there is no direct conduct with the companies.

DATA COLLECTION AND METHODOLOGY

A database of Frugal Innovations and their regions of commercialization will be composed from available data sources as a basis for an empirical study. Based on a literature review, criteria for the identification of successful frugal innovation will be deducted. The gathered data will be analysed according to the evaluation criteria, so as to discover decisive properties of Frugal Innovations to the next three billion. The findings will be formulated on the basis of gathered data.

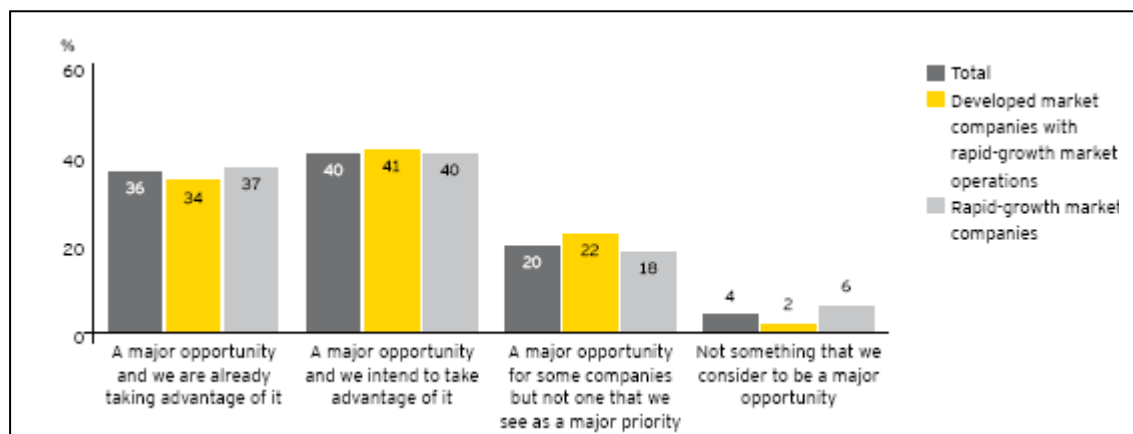
FINDINGS OF THE STUDY

Chart 2: Businesses approach pricing in rapid growth markets



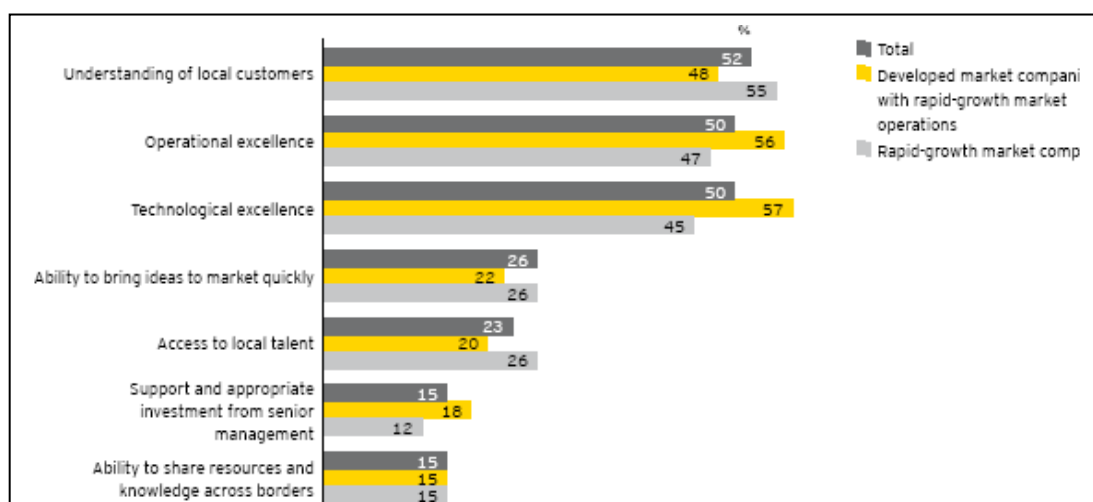
From the data (Refer Chart 2), it is inferred that 54% of companies from developed economies focus on the premium end of the market in their main high growth markets and even among rapid growth market companies, the probation that focuses on this market is as high as 40% and only 6% of developed companies & 9% of rapid growth market firms target the bottom end of the market. The most common reason given for entering lower-income markets was the fact that these markets represented a new business opportunity with potential for revenue and profit growth. Most of the respondents think that adopting frugal innovation to create products and service is a major opportunity in the market (Refer Chart 3).

Chart 3: Finding opportunity in frugal innovation



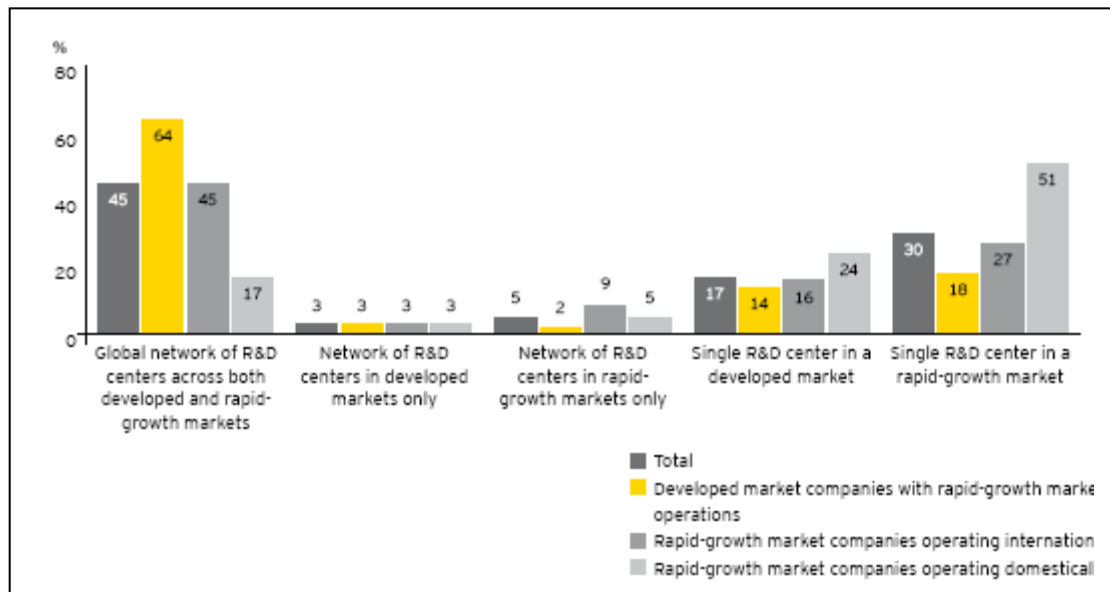
The number of developed market companies that see this is as an opportunity and it is almost identical to the number from rapid growth markets.

Chart 4: Most important enablers of innovation in rapid growth markets



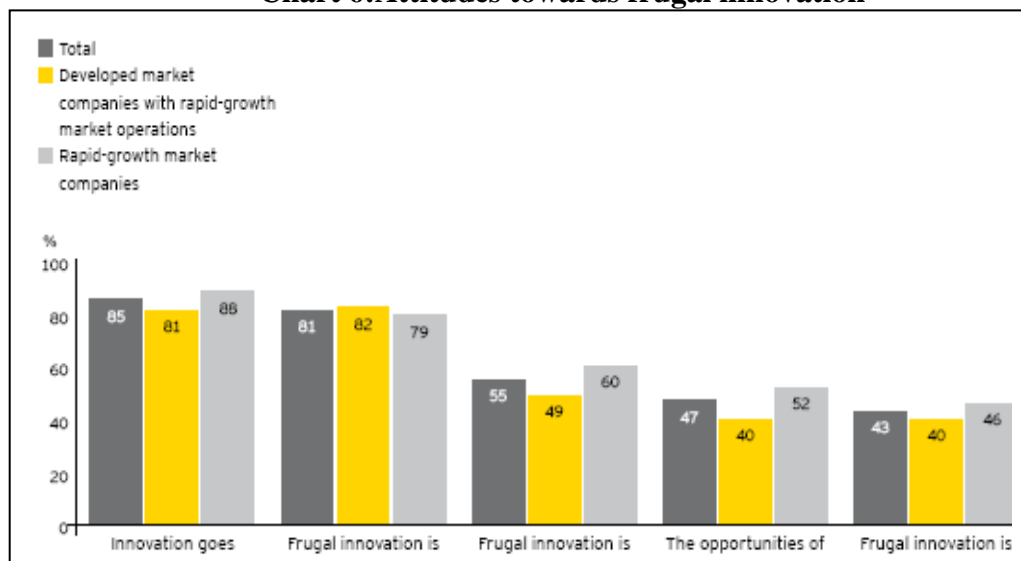
The respondents points to an understanding of local customers as the most critical factor and companies from rapid growth markets consider the capability of Operational excellence and Technological excellence to be more vital in the developed market trends (Refer Chart 4). A global network of R&D centers enables companies to leverage global resources and reapply innovation across multiple markets. In total, 45% respondents say that innovation in their company takes place across a global network of R&D centers. But this

Chart 5: Location of innovation



approach is considerably company takes place across a global network of R&D centers. But this approach is considerably more widespread in companies headquartered in developed markets (Refer Chart 5).

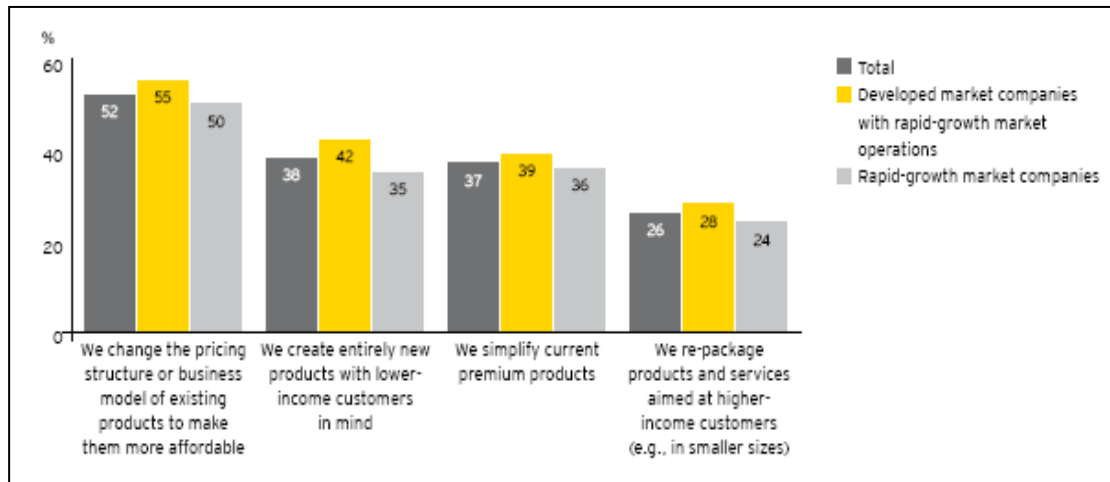
Chart 6: Attitudes towards frugal innovation



Innovations are not about data and analysis; it is more about having a vision for a new product. As living standards in developed and rapid growth markets coverage and as companies invest more widely in rapid growth market R&D and this trend is certain to

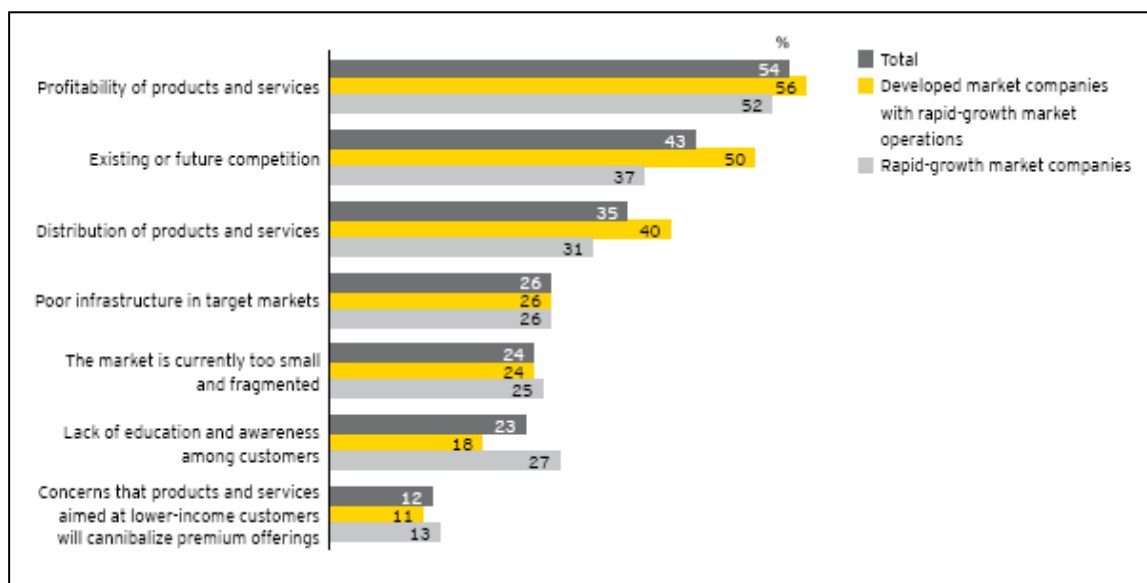
accelerate.81% respondent agree that frugal innovation is a concept that has as much relevance in developed markets as it does in rapid growth ones (Refer Chart 6).

Chart-7 Tailoring new product development to low-income customers in rapid growth markets



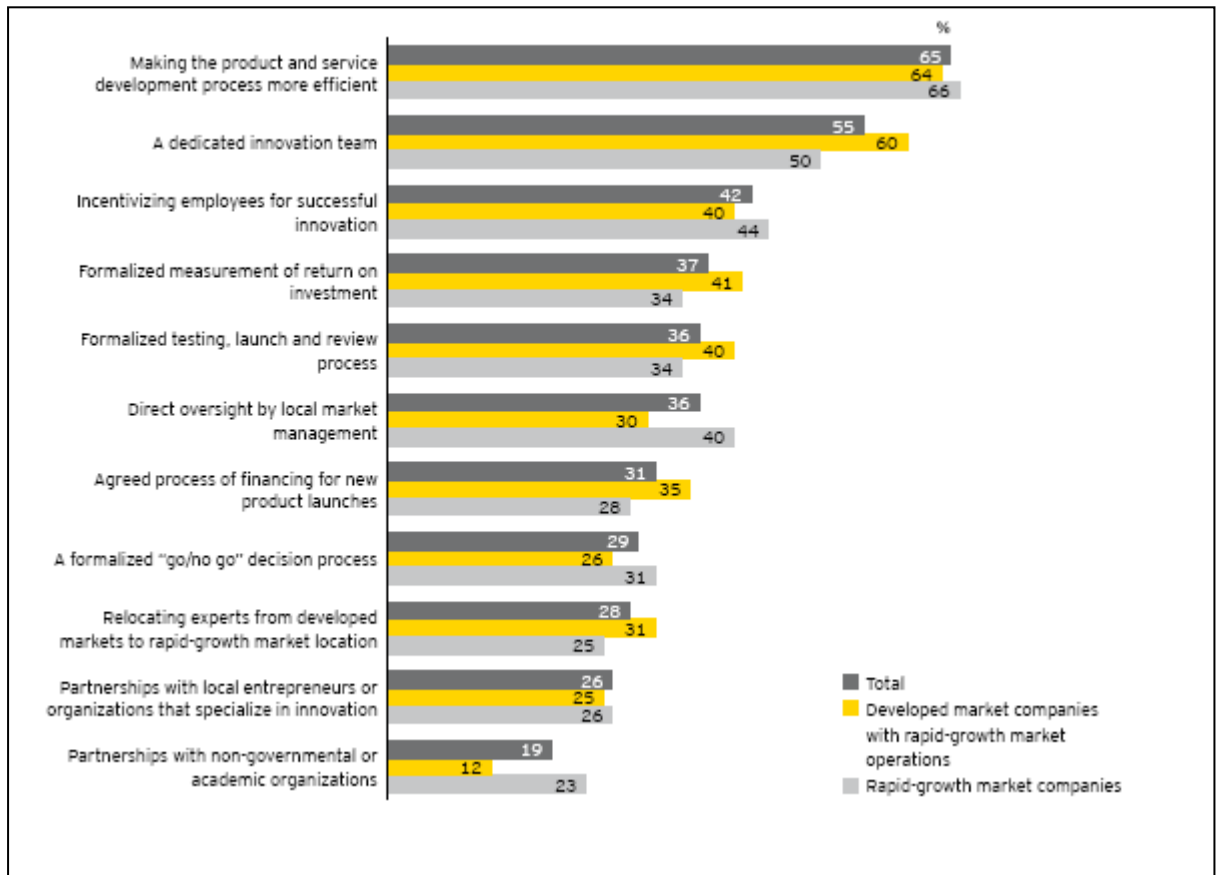
Respondents were virtually unanimous in their view that a company usually has to change or at least adapt its business model when entering low-income markets. The respondents say that,

Chart 8: Barriers preventing the development of new innovation for low- income customers



The changes of pricing structure or business model are the most widely used approach to develop products and services aimed at lower-income customers and 38% respondents take this approach as to create entirely new products with lower-income customers in mind (Refer Chart 7). From the above figure highlight the difficulties that companies face in establishing appropriate business models for innovation in rapid-growth markets because the chart point to profitability as the most important challenge. The simple fact is that many companies struggle to see how they can sell a product or service at a price that is affordable to low-income customers and yet still turn a profit (Refer Chart 8).

Chart9: Process for driving innovation in rapid growth markets



The challenge is one of shifting the perception of managers in developed markets to a low-margin mindset, and then ensuring continuous cost reduction and a laser focus on efficiency across all aspects of the value chain. Based on the chart respondents recognize that process efficiency will be success and the approaches will be use for innovation in rapid growth markets, they point to efficiency in the development process as the number one factor (Refer Chart 9).

SUGGESTIONS OF THE STUDY

Customer insight

Understanding customer needs requires resources on the ground in local markets. Companies must at a local level are have resources available to observe potential customers and assess where their unmet needs lie, develop the capability, engage customers and treat them as partners and collaborators in the innovation process and at a global level to gather information about specific markets and turn this into actionable insight, and build a rigorous understanding of market size and expected customer behaviour. This allows companies to spot linkages across markets and derive economies of scale from reapplying knowledge about customer needs.

Research and development

Meeting the needs of the next three billion will require companies at a local level, carry out an increasing proportion of their R&D activities close to where these customers are located — in rapid-growth markets, develop a “reverse engineering” approach, where affordability forms the baseline from which to develop entirely new products and services, and at a global level to set up global innovation networks that link R&D centres across both developed and rapid-growth markets to share relevant intellectual property, make decisions about how to allocate R&D resources around the globe — and move them from one location to another as the need arises.

People and culture

Talent and expertise are critical to successfully innovating for the next three billion. Companies should have at a local level, delegate decision-making responsibility to local teams in rapid growth markets, ensure that local managers have the ability to make recruitment decisions, be able to take forward new product or service ideas to meet local needs, embed local profit and loss (P&L) responsibility to ensure that managers have accountability. Have the capability to set pay and reward structures for local teams to ensure that they are appropriate for the pace and growth rate of the market and at a global level are manage talent globally so that managers can be rotated among key markets and gain experience across diverse business environments, work to build a culture and set of values that are global in scope, develop a global mindset and the ability to tolerate ambiguity and integrate multiple perspectives, understand the interdependencies among different regions and how decisions made in one region will affect another.

Operations and business model

To be successful, products for the next three billion need to be both affordable and accessible. Getting the business model right and ensuring that operations are optimized across the value chain is therefore critical. Companies need at a local level are select local partners carefully across every stage of the value chain, ensure that operations are as efficient as possible to bring down cost and maintain margins, take into account the needs of local customers and ensure that pricing and other aspects of the business model are appropriate, develop the agility to respond quickly to new opportunities and risks and at a global level are establish clear policies, including risk management and compliance frameworks, to ensure accountability and ethical behaviour across the value chain, use global supply chain and customer relationship management (CRM) systems to optimize the value chain globally and ensure that it is both efficient and resilient, make decisions about which aspects of the value chain to localize and which to maintain at a global level.

Talent Management

Companies operating in emerging markets will often need to modify their approaches to managing talent to respond to varying job expectations and cultural norms if they are to find and keep the talent they need. Accommodations to local conditions will equally be required as companies seek to employ their global supply chains and operating models in emerging markets.

Managing Risks

Companies can capture significant benefits by taking a comprehensive approach to managing all the risks they face. A consistent organizational approach is important to monitor and

mitigate risk across business units and geographies. Clear reporting channels are essential to ensure that risk intelligence can move quickly across the company when an issue arises and be quickly elevated, if necessary, to senior management, the audit committee, and the board of directors.

CONCLUSIONS

Innovating for the next three billion, then, is not just about formulating a rapid-growth market strategy. As the world becomes more polycentric, causing ideas, capital and people to flow in every direction, the key is to understand the similarities across markets as well as the differences. Product development and strategy execution may need to be local, but they should draw on global resources and re-apply ideas and knowledge in other markets — whether rapid-growth or developed. Today's leading innovators understand that they must combine local knowledge with global resources and capabilities across multiple dimensions. This ensures that products and services will meet the price points of different customer demographics, but also fulfil their unmet needs in a way that has rarely been achieved before.

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