AB Bernstein
Global Wealth Management

Seeing the World Through the Emerging Consumer's Eyes

A Grassroots Research Approach to the Emerging Consumer Theme

Source: AllianceBernstein

Consumer spending in emerging markets is likely to grow by trillions of dollars in the decades to come, creating compelling opportunities in both emerging- and developed-market stocks. To understand how this trend is likely to develop, we focus on the hopes and aspirations of ordinary people, like this family in India. "A refrigerator would change my life," the woman at left told us.

Seeing the World Through the Emerging Consumer's Eyes

A Grassroots Research Approach to the Emerging Consumer Theme

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In a small village in India, a working mother wakes up at 4 a.m. to feed her family. She says that a refrigerator would change her life. Thousands of miles to the northeast, in Inner Mongolia, China, a herdsman aspires to provide his children with an education. A continent away in Nigeria, a shopkeeper explains why her stall in a poor neighborhood of Lagos stocks premium brands.

These stories are tied together by a common theme: the consumer revolution in emerging markets. Around the world, rapid economic growth in emerging markets is transforming the lives of hundreds of millions of people. It is increasing the money they spend and changing what they buy.

We believe that rapid spending growth by people in the developing world (*Display 1*) is a secular trend that will continue to spur global economic growth and corporate profits—and create huge investment opportunities in both emerging- and developed-market stocks.

But you can't figure out who will win the battles for market share and profits in emerging markets if you're sitting behind a desk in New York or London—or even New Delhi or Lagos. That's why we began a grassroots research effort that has taken us (so far) to India, Inner Mongolia in China, Thailand, Indonesia, the Philippines, South Africa, Nigeria, Ghana, Brazil, Chile, Peru, and Colombia (*see the map on page 12*).

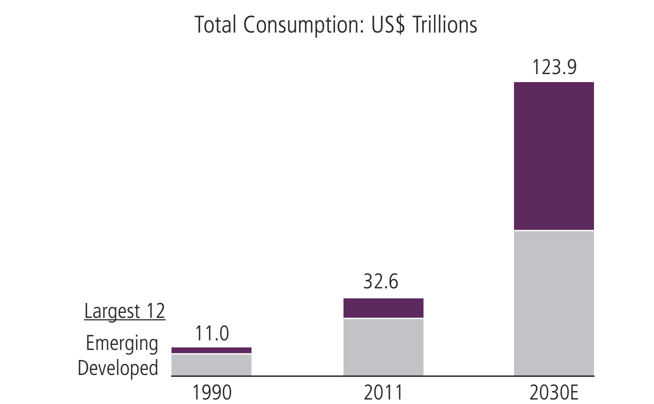
And we didn't just talk to company managements and their suppliers, consultants, or shopkeepers. We also interviewed ordinary people in their homes about their hopes, dreams, and aspirations, in order to glean vital information about future trends in consumer demand. We use this information to understand which firms are likely to succeed or fail.

Our grassroots research has convinced us that the emerging consumer investment theme is far broader than the received wisdom suggests. This paper dimensions the opportunity, explains its drivers and potential obstacles, and debunks many myths about it.

Gauging the Spending Trajectory

Global consumption has been growing rapidly for the past two decades, powered by extremely rapid growth in emerging markets. In 1990, total consumer spending in the 12 largest emerging markets and 12 largest developed markets was $11 trillion, of which only 15% was in the emerging markets, as Display 1 shows. By 2011, total consumption was almost $33 trillion, and emerging-market consumption was 26% of the total. We project that

Display 1
How Big Is the Growth Potential?



As of December 31, 2013
For illustrative purposes only. Current analysis and estimates do not guarantee future results.
Largest 12 emerging markets are Brazil, Chile, China, Czech Republic, Hungary, India, Indonesia, Poland, Russia, South Africa, South Korea, and Turkey; largest 12 developed markets are Australia, Canada, France, Germany, Italy, Japan, Netherlands, Spain, Sweden, Switzerland, UK, and US.
Source: Euromonitor International, OECD, and AllianceBernstein

by 2030, total consumption will be close to $124 trillion, with just over half coming from emerging markets.

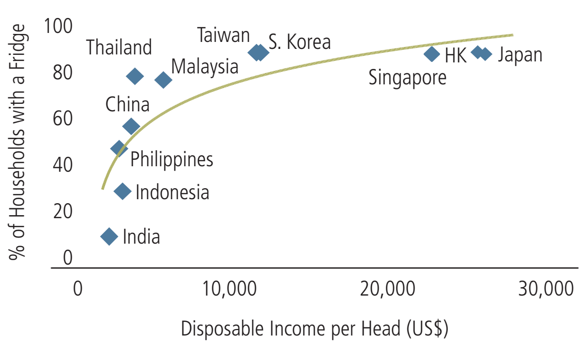
There are three key drivers to our projections:

- Economic growth in the emerging markets is likely to outstrip economic growth in the developed markets through 2060, as the Organisation for Economic Co-operation and Development (OECD) projects.

- We expect consumption in emerging markets to grow as a share of the overall economy toward the 62% average for developed markets. Some emerging markets are already there. Others—most notably, China—have favored investment over consumption, but their policies are changing.

- As incomes rise above various absolute thresholds, consumption of key consumer products tends to rise sharply. *Display 2* shows this for refrigerators: Once disposable income per person passed $1,200 a year, the percentage of households with refrigerators in many countries jumped. Similar curves describe the demand trajectory for many durable goods, from automobiles to washing machines and vacuum cleaners.

Display 2
Refrigerator Ownership Rises with Wealth



As of December 31, 2009
Source: Euromonitor International

How Grassroots Research Works

Traditional investment research often focuses on the biggest stocks in a benchmark and aims to predict short-term trends such as sales and earnings for the next few quarters. Consumer-oriented companies take a very different tack. They engage with customers around the world in their homes and look in their cupboards for strategic intelligence.

This is what our approach seeks to emulate. After several months of intensive background research on social, economic, and business trends in each country, we meet with carefully selected people in their homes, eat their food, and listen to their stories, without judging their choices. We also look in their pantries and survey their appliances and electronic gadgets.

In each country, we meet high-, middle-, and low-income people, young and old, in cities and rural villages. We also take pains to meet representatives of groups of particular importance in each country. For example, in the Philippines we met call-center workers and people who receive remittances from family abroad. In Ghana and Peru, we met with entrepreneurs. In South Africa, we met members of a *stokvel*, or savings club. (By some estimates, half of adult black South Africans belong to at least one *stokvel*.)

In our view, this grassroots research can be the key to anticipating trends in consumption habits and to discovering where companies are likely to go—even before they themselves may know.

Talking to the young is particularly important in this regard because the young are quickest to embrace change. While older people of all social classes in China, urban and rural, say that sunglasses are unacceptable because they hide the eyes, young people think they're cool. As a result, sales of sunglasses have doubled in China over the past year. In time, we expect older people to buy them, too.

Source: AllianceBernstein

In Bangkok, Pannapat takes us through her well-stocked refrigerator and pantries.

Our grassroots research also debunked many widely held myths about the emerging consumer theme, such as:

- The opportunity is greatest in China, India, and luxury goods.
- The middle class will gain most.
- Low-income consumers want cheap goods.
- Emerging-market companies are the best way to capture the opportunity.
- All multinationals can leverage brand strength in the developing world.
- Eating habits simply shift from carbohydrates to meat.
- Baby formula is for the well-off.
- Leisure is only for the rich and middle classes.

It's Not Just About China, India, and Luxury Goods

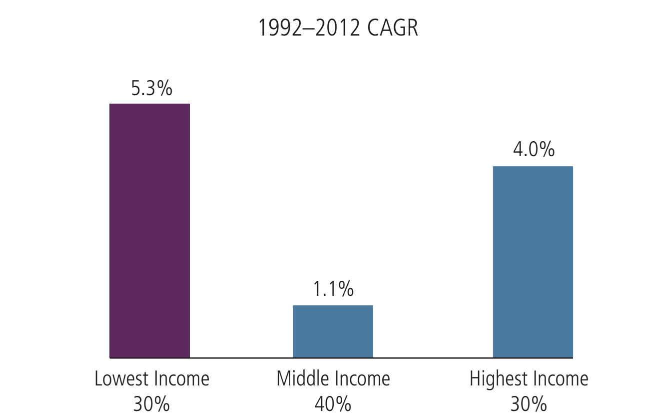
Most research into the emerging consumer theme focuses on the new rich and middle classes in China or India and their appetite for luxury goods. We recognize the importance of China and India and agree that rising wealth there is likely to spur demand for luxury goods. In emerging markets, like developed, people buy symbols of success.

But our grassroots research taught us that the emerging consumer theme is much broader. Quality goods and services at a reasonable price appeal to hundreds of millions of low-income people enjoying rising incomes in many countries. In Nigeria, we met a low-income man, Henry, who opened a dry-cleaning business to appeal to neighbors who want to show they can afford the small luxury of wearing professionally laundered shirts.

We think that the greatest—and least appreciated—growth potential comes from continued spending growth by people now in the bottom 30% of the economic spectrum (*Display 3*). Although subsistence farmers and other extremely low-income people may not have gained much, incomes for the bottom 30% in the 12 largest emerging markets have grown more than 5% a year on average over the past two decades. That's far faster than income growth for the middle- or high-income groups.

Display 3

Income Growth Has Been Fastest for the Poor



As of December 31, 2013
Weighted average for 12 largest emerging markets
Source: Credit Suisse, Euromonitor International, and AllianceBernstein

Cell Phones Empower the Poor

One key reason that incomes have grown most rapidly for low-income people is that cell phones are giving them greater economic power and job opportunities.

In India, for example, where even small villages have cell-phone towers, we met farmers and day laborers who have enjoyed income growth of 15%–20% a year for the past five years. Both groups use their phones to get more work. Day laborers find farmwork and odd jobs, such as painting a house. Farmers find work on someone else's farm when their own farms don't require attention.

Farmers also use their phones to check market prices for their crops. If they don't like the prices that local wholesalers offer, they bring their crop to market themselves. Similarly, an academic study found that in India's Kerala state the prices that fishermen received for their catch stabilized once cell-phone usage became widespread. The high, positive impact of cell-phone usage on labor utilization and pricing power isn't limited to India. We encountered it almost everywhere we went.

This has important implications for investments in cell-phone companies. In developed markets, the cell-phone market is now mature, with modest growth potential. In emerging markets—especially Africa—cell phones are still a growth market. But the expensive smartphones that are all the rage in developed markets are out of reach for all but a tiny sliver of the African population. Cell-phone makers who offer models at a wide range of prices can capture a much broader market today and build brand loyalty that is likely to persist as a much larger share of the population can afford expensive, high-end phones.

Source: AllianceBernstein

An Indian chili farmer uses his cell phone to find out where he can get the best price for his crop.

Quality Is King from South Africa to Thailand and Peru
Many investors assume that people in developing countries prefer local brands and cheaper goods. That's not what we heard from consumers and shopkeepers across the developing world. Just ask the unemployed women we met in Soweto, South Africa.

Almost unanimously, the Soweto women told us that they prefer quality goods at a fair price. Many of them get up at 3 a.m. to buy affordable brand-name clothes at a secondhand market rather than new clothes without a brand name. While consumers in developed markets typically compare products within a preferred retail chain, these women compare prices of everyday items—such as shampoo or toothpaste—across different retail stores to find affordable brand-name goods.

This penchant for branded goods derives from a risk-aversion rooted in poverty. As one South African man told us: "I worked hard for my rand, so I'm not willing to risk it."

Shopkeepers confirmed our observations that low-income people are both brand-conscious and brand-loyal. In Ikeja, a low-income neighborhood on the outskirts of Lagos, Nigeria, Emsee's street stall is focused on premium goods. Emsee says that's what her customers demand.

Similarly, in the village market of San Kamphaeng in northern Thailand, Ms. Mic's stall stocks local brands such as Twin Lotus Herbal Toothpaste and Oishi Green Tea next to global brands such as Colgate and Nescafé. The latter two products are such an integral part of the local consumer's shopping basket that Ms. Mic believes they are made by Thai companies!

Brand Wars: Global vs. Local
In street stores and corner stalls almost everywhere we went, about half the goods sold are global, not local, brands—although shopkeepers and consumers do not always know it. This observation increased our confidence that developed-market companies with quality global brands are often a better way to gain access to the emerging consumer growth theme.

Source: AllianceBernstein

In a low-income neighborhood of Lagos, Emsee says that her customers want premium brands.

Not always, of course. A Peruvian food manufacturer introduced a mayonnaise, AlaCena, in 2000 that grabbed 45% market share in three months from Hellmann's, the global leader. Today, AlaCena has 96% market share in Peru. The secret to its success: AlaCena is made with lime juice, just like the mayonnaise Peruvians make at home. Sometimes, local firms simply gain an edge from greater knowledge of customer tastes. Often, these local firms obtain overseas capital to compete with global firms.

But global brands have been gaining market share, helped by the perceived higher quality of their goods. Often, the key to success for them is finding a way to get their products into traditional markets and street stalls. That's particularly important in frontier markets like Nigeria and

Ghana, where only 5% of retail sales are in modern stores, roads are unpaved, and warehousing and trucking systems are rudimentary.

Players from China, India, South Korea, and Southeast Asia have the experience needed to conquer chaotic markets. But so do many developed-market firms with decades of experience building their brands in emerging markets. Firms based in South Africa, where 90% of the retail sector is modern, do not have this experience, so we do not share the widespread view that South African firms will have an edge throughout the African continent.

Menus Change in Many Ways

Food is the single largest expenditure for many low- and middle-income families. But the foods they are eating are changing. Meat consumption has increased enormously in China and elsewhere. It's a well-known growth theme.

What's less well known is that dairy consumption is beginning to grow rapidly in India and in parts of Africa where incomes are reaching the point at which refrigerator ownership takes off. In India, for example, only 18% of households had refrigerators in 2009; we expect penetration to reach 50% by 2018.

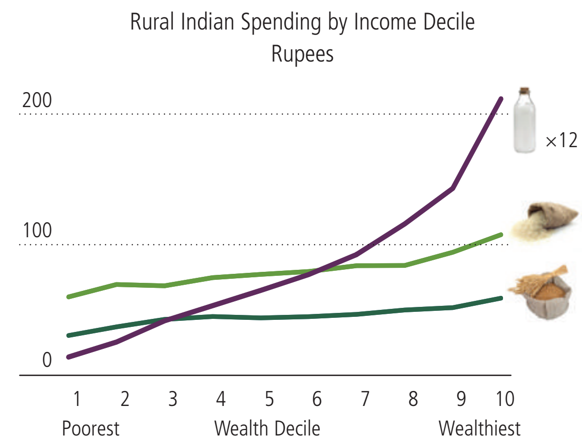
The opportunity for increased dairy consumption is huge. In rural India, the wealthiest people (who had refrigerators) spent 12 times as much on milk, cheese, yogurt, and ice cream as the lowest-income people (who did not have refrigerators), a 2010 study showed. Greater wealth doesn't lead to comparable gains in consumption of grains such as rice and wheat (*Display 4*).

We also found that in many countries, demand for baby formula is likely to spread from wealthy women to middle- and low-income women, as more women across all income levels enter the paid labor force. Breastfeeding may be best for babies, but few working women in emerging markets get paid maternity leave, so going to work means feeding their babies formula—or rice gruel.

Sometimes, children drink formula as a supplement for many years. In a Philippine village, we met a woman raising her three- and 10-year-old grandchildren while their parents worked in Manila. This woman cannot always afford to give the children regular healthy meals, so she gives the younger child formula to ensure that she gets the right nutrients. The older child drank formula as a supplement until he was eight.

Display 4

Processed Dairy Consumption Soars with Income



As of March 31, 2010
Source: National Sample Survey Office, part of Ministry of Statistics and Programme Implementation, India

Premiumization of Treats

Consumption of treats also changes as incomes rise. During our trip to India, we visited the home of Ranjana, the wife of a middle-income jeweler, who proudly showed us how she prepared healthy meals for her family. But when we gave her the equivalent of $10 to spend in a convenience store, she bought a jar of instant coffee, savory snacks, and chocolate.

Later, after studying photos we had taken of the contents of her pantry, we saw that Ranjana did indeed cook healthy meals for her family. The items she bought in the shop did not match those in her cupboard. We realized that when she spent the money we gave her, she was "premiumizing," buying goods that she would buy if she had more disposable income.

Using data from similar encounters, we developed a picture of how premiumization could spur demand for a range of food products and their ingredients. In India, low-income people traditionally eat jaggery (unrefined sugar blocks) with chapati (unleavened bread). But as incomes rise, people move to progressively more expensive treats with milk and cocoa in them—such as premium cookies, chocolates, and ice cream.

We used this progression to identify the potential risks and opportunities for companies operating in India and to assess which were likely to succeed or fail. Generally, we favor companies with products at various points along the premiumization spectrum because that should allow them to maintain and grow their market share as their customers gain income and trade up to premium goods.

Fun Times: Investing in Leisure
Leisure spending is also often misunderstood. Fast-food restaurants, Internet, and pay TV are not just for the middle class.

Take Tshilidzi, a 25-year-old freight-forwarding contractor from Alexandra Township—one of the roughest areas in Johannesburg, South Africa. Although he struggles to make ends meet and runs in an electric line illegally, Tshilidzi spends 260 rand ($24) a month on pay television and says that he wouldn't cut this cost, no matter what. "I'd rather be hungry than bored," he says.

Many other people we met also treat entertainment as a staple, and food as discretionary. They may not go hungry to pay their TV bill, but they do revert to a rice-only diet for a while, if necessary.

Downtime is also important to Abdu and Asnah, a couple from Jakarta, Indonesia. Abdu earns low wages as a service provider. Asnah is a housewife. Despite their low income, they have a television, a DVD player, and a Chinese-made tablet, as well as a PlayStation 2 gaming console. When they want a fun day out with the kids, they head to Timezone, a popular game center at the local mall.

Eating in restaurants is becoming increasingly popular, too. In almost every country that we visited, people told us that restaurants—including global chains such as Pizza Hut and Kentucky Fried Chicken—were the destination of choice. Middle-income families tend to go more often, but low-income people told us that eating out once or twice a month was a treat.

Gourmet coffee shops are also rapidly spreading in emerging markets. In the Philippines, going to Starbucks is a status symbol. In India, people who live in crowded homes see it as a haven where they can enjoy quiet time and personal space, alone or with a friend.

Source: AllianceBernstein

For these single mothers in Soweto, South Africa, a value meal in a KFC is a treasured treat.

Tale of a Mongolian Herdsman

Education is high on the agenda of traditional herdsmen in China's Inner Mongolia. Aituertai, a herder in his thirties, has been temporarily relocated from his village of Siziwang Qi to Baotou City, under a Chinese government policy to allow his land to lie fallow for five years. Government subsidies have boosted his family's income—and transformed his family's life. The family moved from a rural home without electricity to an apartment with a large-screen television, a computer, a refrigerator, and cell phones.

Yet Aituertai knows that the real promise for a better future lies in education. Aituertai's five-year-old son now goes to school in town to get a bilingual education—in Mongol and Mandarin—that will provide the tools for progress in China. But many rural herdsmen in Mongolia have little chance of empowering their children to succeed in the 21st century, because sending children to the city for a high school education, accompanied by a family member, can be prohibitively expensive.

Education and the Middle Income Trap

Families across the developing world value education and often make great sacrifices to send their children to school. Collectively, their decisions—and the education available to them—could influence the success or failure of entire economies. While many cite war and corruption as the biggest risks to growth in emerging economies, we believe that lack of quality education is the biggest risk. (For a brief overview of our take on a few others, see "Clarifying Risks," page 10.)

Several recent academic papers have argued that many developing nations will fall into "the middle income trap" and fail to develop fully. While the switch from farming to industry increases overall economic productivity and GDP per capita, it's often a one-off gain if an economy doesn't go beyond labor-intensive production of low-cost goods, using imported technology.

Source: AllianceBernstein

A temporary stay in a city apartment with all the amenities made Aituertai, the Mongolian herdsman sitting at right, eager to send his son to high school. It's a costly ambition.

We think that education is the key to avoiding this trap. Increased literacy and widespread education can transform a country's labor force and ability to succeed as a high-value-added, higher-wage economy with a significant service sector. It's a formula that worked for the US and many European countries a century ago.

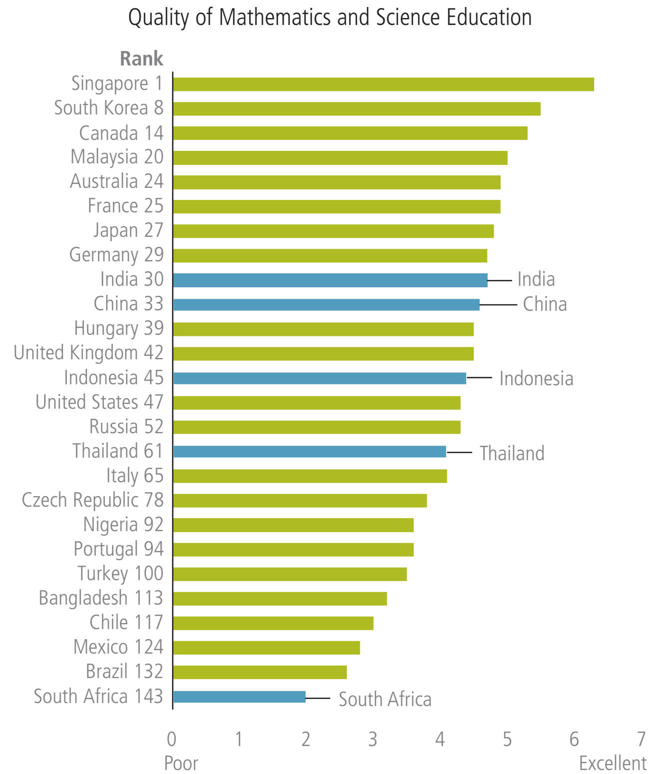
Which developing countries will avoid the trap? One hint lies in a recent survey of the quality of education in 144 countries. India and China rank high; Indonesia and Thailand are lower, and South Africa is at the bottom (*Display 5*).

Each country faces unique challenges. In India, girls are only starting to receive equal opportunities in education, but the appetite for these opportunities is large. You can see that by the results of an election in Bihar state: Women crossed party lines to reelect the chief minister after he promised a free bicycle to every girl who stayed in school.

In South Africa, by contrast, many people we met paid lip service to education's importance but showed less commitment when we asked them what they would do if they won a million rand. Typically, they said that they would buy a car or quit their jobs. In other countries, most people told us that they would use a windfall to buy a house, send their kids to a good private school, or start a business. This finding lowers our expectations for South Africa's future.

Display 5

The Quality of Education Varies Widely



As of December 31, 2012
Countries listed by rank, out of 144. Standard shown from 0 (poor) to 7 (excellent)
Source: "The Global Competitiveness Report 2012–2013," World Economic Forum

Clarifying Risks

Economic and business growth in emerging markets is not a given. Not every country will succeed in developing a more modern economy with higher living standards for most of its people. But our research suggests that some widely cited threats can be addressed more easily and at a lower cost than most people think.

Inadequate healthcare poses a manageable threat to economic growth, in our analysis. Unlike in developed countries, life expectancy in developing countries can be significantly raised at relatively low cost, which spurs economic growth. The key is to focus resources on proven strategies for reducing maternal and infant mortality, such as India's Anganwadi project, established in 1975.

The Anganwadi project pays one or more women in many villages a modest stipend to sign up pregnant women for nutritional supplements, prenatal care, and a hospital delivery—and their newborns for immunizations, hydration salts, and nutritious meals.

Limited access to credit is another manageable threat to growth, in our view. "Banks lend only to the rich," consumers told us, but self-help savings schemes flourish. In many countries, groups of 12 to 20 people contribute the equivalent of $10 a month to a pool, from which just one can borrow each month to buy whatever he or she needs—perhaps a refrigerator, or capital to start a small business.

Unreliable infrastructure is a lesser threat to development, in our view, because many emerging markets can leapfrog their way to modern systems. Telecommunications is one example. The US and Europe first installed copper wires, manual switching systems, and operator-assisted calls, only to replace them over decades with direct-dial systems, electronic switching, and fiber-optic cable—and now, cell phones. Many emerging markets are going from no phones to cell phones—often, at relatively low cost, because they can buy transmission towers and phones with last year's technology at very low prices.

Of course, emerging markets still need well-paved roads, well-run trains and ports, and reliable electrical grids, for a host of reasons. For one, improving local roads makes it possible for villagers to get to a better doctor in a nearby city without missing days of work. But physical infrastructure is less central to economic development today than it was in the first industrial revolution, more than 200 years ago. In our view, this is a smaller threat than limited access to credit or quality healthcare, let alone limited access to quality education. ■

Source: AllianceBernstein

Anganwadi workers save lives by signing up babies and pregnant mothers for checkups, immunizations, and other services.

Conclusion

What you see in the streets of Ghana, Colombia, India, and the Philippines is often hidden in plain sight. These are dynamic countries, where even very low-income people are gaining new opportunities and greater economic freedom and starting to spend more—sometimes, far more.

When societies are in flux and incomes are growing rapidly, it's particularly important not to look solely in the rearview mirror. The past can be a guide—particularly the past of other countries that went through a similar transition—but there's no substitute for looking forward if you don't want to run into a pothole. Our grassroots research is our way of looking forward. By entering people's homes and listening to their stories, we can learn what consumers are buying now and what they are likely to buy in the future.

Talking to company managements—the focus of traditional research—is necessary, but hardly sufficient. A manufacturer of inexpensive cookies now enjoying strong sales growth is unlikely to share its concerns about a looming shift to fancier products. A premium ice-cream producer is unlikely to divulge the huge potential demand for its product, and thereby alert potential competitors to the opportunity.

Besides, companies are often wrong. Companies based in emerging markets too often assume that they will gain the most from growing incomes because they know their customers best. That may have been true with regard to mayonnaise in Peru; but often, local companies are finding themselves displaced by multinationals offering new products—from designer sunglasses to fried chicken and infant formula—that their customers have learned to love via social media or more traditional marketing efforts.

Companies in developed markets too often assume that they can profit from growing incomes in developing markets by introducing the same goods they sell at home, at the same (high) prices. Our research suggests that doing so unnecessarily limits their potential addressable market—and potential earnings growth. Providing quality goods at a reasonable price can often be the key to capturing a huge

Source: AllianceBernstein

Global and local brands vie for shelf space in this Lagos market.

market of loyal customers today who will buy higher-priced goods in the future.

But for companies with the right products and the necessary skill in managing emerging-market chaos, the growth potential is huge. Some of the winners are likely to be locally based emerging-market companies. Some will be global firms based in developed markets. Some will even be global firms based in emerging markets.

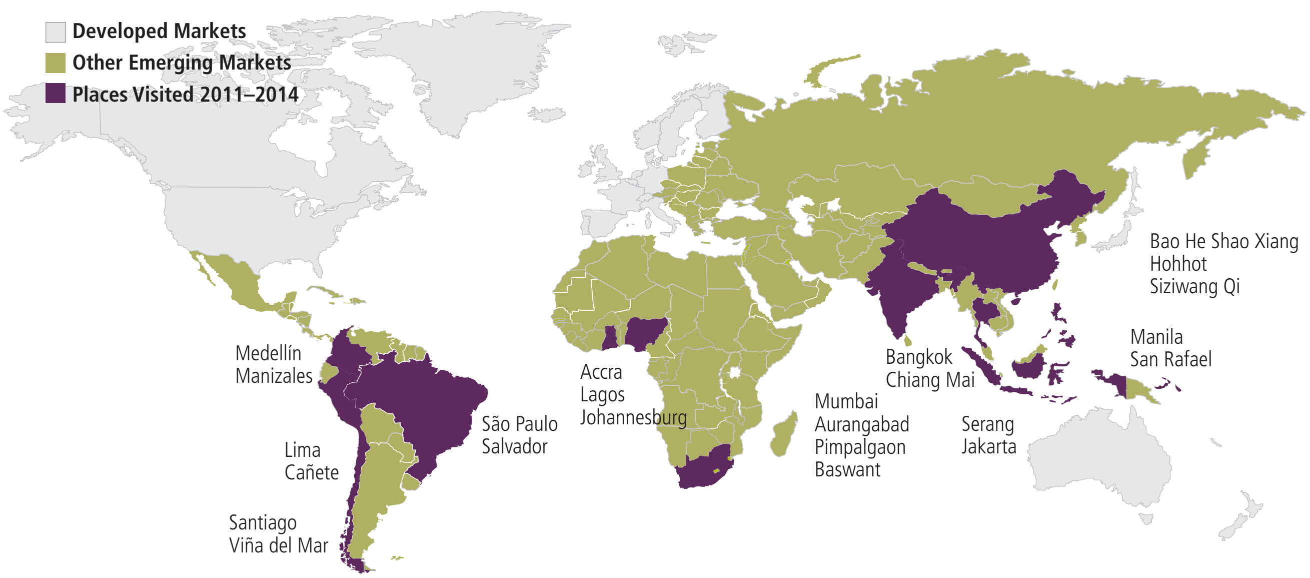
We believe that our consumer-centric, grassroots approach can be a valuable complement to traditional research because it can help us to identify these trends, and get an early read on the likely winners and losers. ■

The Philippines

Indonesia

Inner Mongolia, China

Our Grassroots Consumer Research Itinerary to Date



Peru

Nigeria

India

Source: AllianceBernstein

Source: AllianceBernstein

Outside her home in Cañete, Peru, Gabriela tells her story to the author and his team.

About the Author

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Emerging Consumer, Global Growth, and Thematic Research

Tassos Stassopoulos joined AllianceBernstein in 2007 as a research analyst covering European consumer stocks. He has previously served as a portfolio manager for the International Healthcare portfolio and consumer sector head on the International Research Growth and Global Research Growth teams at the firm. Before that, he was a managing director at Credit Suisse for seven years. For six of them, he was a senior analyst and sector head for pan-European travel and leisure coverage, and was twice ranked #1 in the *Institutional Investor* survey of analysts in his sector; in the last year, he was a portfolio manager of the firm's hedge fund, Modal Capital. Stassopoulos also spent eight years as a management consultant at Arthur Andersen, specializing in lodging and gaming. He holds an MA in economics from Cambridge University, St. John's College, and is a member of the Institute of Chartered Accountants.

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