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Summary

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Innovation in Emerging Markets

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How emerging market companies rethink innovation
and what we can learn from them

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Innovation in Emerging Markets –

How emerging market companies rethink innovation and what we can learn from them

Rama Velamuri, professor of entrepreneurship at the China-Europe International Business School, shows how innovation in emerging markets can help us solve some of the major social problems that we face in the world today.

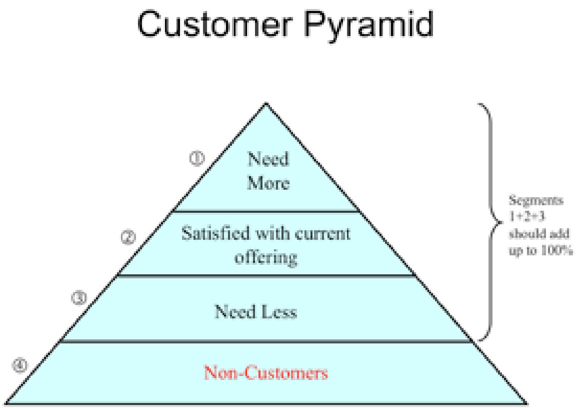
Innovation for progress

The literature on innovation is vast. If you want to specialize in innovation and dedicate the rest of your life to its study, you would not be able to cover the entire literature, which approaches innovation from many different viewpoints. One of the most widely accepted and popular definitions of innovation is the one coined by Everett Rogers: **"An idea, practice, or object that is perceived as new by an individual or other unit of adoption"** This definition looks at innovation not from the point of view of somebody who generates it but of somebody who has to adopt it.

According to Vijay Mahajan and Kamini Banga, only about 14 percent of the world's population lives in countries with a per capita income of more than 10.000 USD. India, for instance, has a per capita income of 3.000 USD, China that has grown at 10 percent for 30 years has a per capita income of only 6.000 USD per year. At the same time these **emerging countries face enormous problems that need to be solved**, like literacy: 200 million people in India cannot read or write. Other major social problems include basic health care, running and clean water, education etc. People who are uneducated can live but cannot participate as full members in a free market society, because they don't have the basic capabilities that are required to operate in this system. Hence, the question is: **How can these services be delivered to people?**

Different innovations for different customer segments

Clayton Christensen has an interesting way of segmenting the market that can be universally applied. **Every enterprise has customers who need more:** a faster car, a smaller laptop, a smarter phone. A second segment of customers is satisfied with what they have, they are happy with the product and its range of functions. For the third segment of customers the products are too sophisticated, they don't need so much functionality, so many features. Their needs are much more basic and they actually want less.
The netbook for example addresses the needs of those **custom-**



ers who need less: they simply want a light, small computer, good for surfing the web and reading documents. These people want simpler, no-frills products rather than “solutions”. They want to **pay less for simpler things.** In many industries, this customer is actually large in numbers. But for many entrepreneurs and managers from Industrialized countries, innovation automatically means more: more features, more sophistication, more functionality. Most innovations therefore focus on the customer segment that wants more. It is difficult for us to say: **innovation might actually mean less.** Finally we must not forget that a **large mass of people at the Bottom of the Pyramid BOP that so far are non-customers will one day join the economic mainstream**. They can have a strong impact on markets and profitability that is usually underestimated.

Lessons learnt from telecommunications

As recently as 15 years ago, the wisdom amongst experts in the telecommunications industry was that cell phones are products for the elites. I wrote a case-study on Vodafone Spain, which received its license from the Spanish Ministry of Communications in 1994. A consortium (called Airtel) had to present a business plan to the ministry. They forecasted that the maximum penetration for cell phones in the Spanish market would be 20 percent or approximately 8 million subscribers. When I interviewed the CEO in 2004, the penetration in Spain had exceeded 100 percent. Hence, the number of cell phones had exceeded the population of Spain! In the mid-90s people made **two kinds of mistakes**: First, they **assumed that telecommunication is a need that is felt only by a small segment of the population**. Second, they did not understand **how big and profitable the market would be, if the prices for the phones and the per-minute usage could be made sufficiently low.**

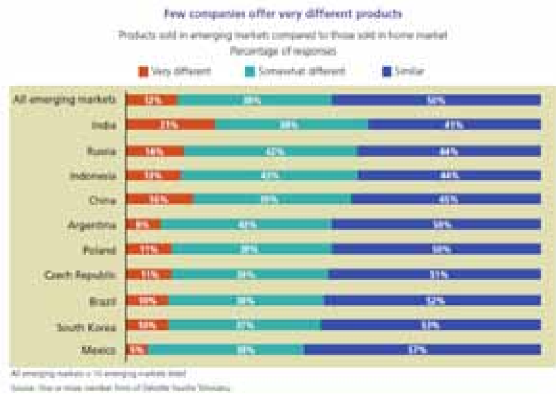
In India today there are around 550 million telephone subscribers. Every month we are adding more than 10 million subscribers, while back in 1991 there were only about 7 million phones for a country with about one billion people. In 1986, I went with my father to apply for a phone connection for him. At that time there was a national monopoly in India and the clerk said: “You’ll get your phone in eight years.” Recently, in March 2010 my sister and my brother-in-law moved back to India from New Zealand. They applied for a land line, two cell phones and broadband internet connection. They got all four of them the same day; they called in the morning and in the evening it was installed. There’s an amazing telecommunications revolution in countries like China, India and in African countries that has to be leveraged for innovation.

The telecommunications revolution in developing countries shows that we underestimate the power of the non-consumers, people who have not yet started consuming our products. But if we make it attractive enough for them to consume they can be brought into the market.

Recent Trends in Innovation

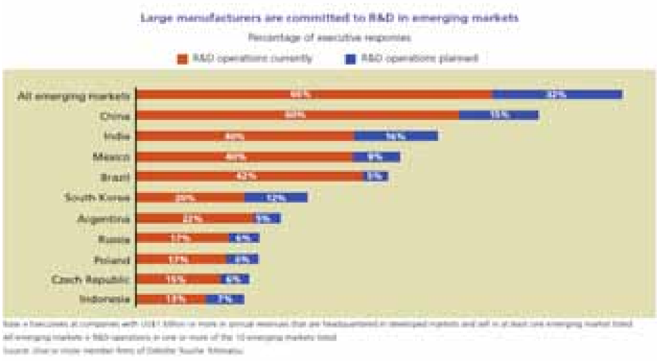
Lack of adaptation

According to a study by Deloitte Touche Tohmatsu, if you look at the products of a Western company produced for the Indian market, probably 41 percent of the products they sell in India are very similar to the ones they sell to the rest, for China this number is 45 percent, for Mexico 57 percent. A typical Western-European company by and large offers the same products in Mexico, India or China. 38 percent say that the products are somewhat different in Mexico and **only five percent say that the products are very**



different. Western companies often want to sell products that are successful in the developed world to emerging markets. Usually, western companies only adapt the pricing and tend to offer lower prices in emerging markets. Clearly that mindset will have to change.

Outsourcing R&D



Interestingly, **companies are directing more and more funds to R&D in developing countries**. GE, for instance, has 4.000 scientists in Bangalore – one in six scientists of GE is currently based there and soon it will be one in four. This happens, because in Bangalore you find **highly-qualified people at low cost**. You can hire someone with a PhD degree in India for as little as 500 USD a month. So, companies are using the resources of these countries, but at the same time are not yet realizing their market potential. Another example is China: Only 30 multinationals had R&D labs in China in 2000. Six years later that number had grown to 750. Today, **China is the top-location for offshore R&D**: There are 920 multinationals with 1100 R&D centres in China. By now, 1,5 percent of China's GDP is generated from R&D and the country is increasing its R&D specialization. Very soon, you will see more and more innovative products targeted to high-end users.

China and India are rising

The most advanced country of the world in terms of economic power is the US but the country is nowhere near being the most advanced when it comes to cell phones usage. Until some years ago you could not send text messages in the US. In China, you can communicate with your costumer online via cell phone, you can shop with your cell phone.

For SAP, India is the number 2 – after Germany – developing centre. Microsoft employs 7.000 people in India. **Innovation in emerging markets is changing**: Earlier, Western companies used to take technologies that are one or two generations old, to emerging markets. In the 80s and 90s they started setting up R&D centers in India to provide support for their centres in the west. Now, the entire development of new products often takes place there.

Innovations in Emerging markets to solve social problems – best practices

1. **Improving Literacy** The experience of PlanetRead provides a good example of how innovation can be harnessed for solving pressing social problems. Literacy has many different levels: There are so called early literates that are able to read the alphabet but not a whole sentence. Others are able to read a headline in a newspaper, but not the whole text. And even fully literate people have different levels of literacy. **Musicals and movie songs with same-language subtitles** (SLS) – introduced for the first time in India in the 1990s – provide solutions for children in developing countries to **improve their reading skills** by following programs on TV or even the internet. In India, for instance, 108 million households had a TV set, meaning that 550 million people – which is half of the population – watched TV a few years ago. Nowadays this number is even higher. First studies on the impact of same language subtitles were carried out and even though it was hard to convince the government of the usefulness of SLS at first, the whole country

now has SLS, mandated by the ministry of education and the national literacy mission. People from all social classes watch these programs. The precondition for benefitting is that people at least understand the alphabet. By 2011 80 percent of India's population will be literate according to estimations. Still, it has to be kept in mind that the standard of literacy in India is low: somebody who can sign his name or read the headline of the newspaper is considered literate.

A **precondition for the successful launch of innovations targeted at the masses in emerging markets is low cost:** When it comes to SLS one important success factor is that an investment of 1 USD can reach 10.000 people for one whole year. **A second important condition is scalability.** An innovation has to have the potential to reach a large number of people. As emerging markets don't have the resources for paying for expensive innovations, it would not work without these characteristics. In India the cost of production of SLS is funded by the channels themselves and complemented by private organizations.

2. **Improving Healthcare** 45 million people in the world are blind. A large percentage of them lives in India. Most of them suffer from **blindness that could be solved through a very simple operation**. The patients can go back to their homes and work within three or four days to produce income for the family. Still, many of the poor are not able to afford even such a simple operation. An Indian organization called Aravind Eye Care System provides these simple operations to the rural poor in India. Two thirds of the operations are free of charge and are funded by the one third of patients that pay. While it started with 11 beds, Aravind Eye Care System now has approximately 5.000 beds, making it the largest eye-care provider in the world.

3. **Cell phones** Nokia is trying to change its business model from being an exclusively product-driven company to also providing services. Recently, they came up with innovations for emerging markets called Nokia Life Tools and developed a **solution for farmers in poor countries** like Indonesia, India, Bangladesh, etc. For a fee of 1,3 USD per month the farmers receive basic, but essential information on their business via cell phone. The farmers can customize whatever information they need: daily weather updates in the morning, prices of crops, etc. After using this farmers can now decide in which market they will get the best price, which results in an increase in revenue. The cell phone penetration in urban and rural India is at 34 percent and the rural segment is growing quite fast. 70 percent of India is still rural, a large proportion of which is occupied in agriculture. A recurring monthly income for Nokia of 1,3 USD multiplied by millions and millions of customers is a very profitable business.

Agri Life Tool - Bottom of the Pyramid

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Smart in terms of pricing and payment model

Taps into the concept of bite-size pieces or small and therefore affordable pack sizes

Innovative cell phones are not necessarily smart phones, but they designed to get first-time customers in to join the market with basic services like voice transmission, text messaging and radio services. Of course you also need to focus on the people who want more, but don't forget about those who want less – especially when looking at emerging markets. **In emerging countries it is important to have R&D activities because the R&D staff can track users on a daily basis and detect opportunities for innovation**.

4. **ECG–Machines** There are many hospitals that are able to afford huge, expensive ECG machines, but there are also thousands of clinics that don't need such a big machine. They do not have such a large volume of patients. GE pioneered the development of a **hand-held machine that primarily targeted non-consumers**, i.e., clinics that had not yet invested in an ECG machine. The results were very interesting: once this product was introduced in India and China, GE found that it had application in the Western Europe and the US markets: when an ambulance responds to a traffic emergency, it is very useful for that ambulance to carry this hand-held ECG. This is referred to as **reverse innovation: an innovation that is pioneered for an emerging market but is soon introduced in a developed market in different way**.

Final Messages

- Focus on **top-end customers** – those who want more and are willing to pay more
- At the same time, **do not forget bottom two segments** – those who want less and want to pay a lower price, and the non-customers
- Managers based in emerging markets are uniquely positioned to **learn about the needs of the bottom segments of the market, and alert the headquarters about the business potential** therein

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Rama Velamuri currently works as Associate Professor of entrepreneurship and negotiation at the China Europe International Business School (CEIBS) in Shanghai. He was previously on the faculty of IESE Business School for four years. He has been a visiting professor at the Indian School of Business (ISB) since 2004 and has taught at business schools in the U.S., Spain, Germany, Mexico, Peru, Uruguay, Egypt and Nigeria. Rama Velamuri has been a facilitator for executive programs for several multinational companies and has worked with the CEO Collaborative Forum, made up of 30 CEOs of young, high-growth, venture capital-backed European technology companies. Prof. Velamuri consulted for the World Bank and the International Finance Corporation on curriculum development projects and in the setting up of entrepreneurship development centers in several developing countries.

In this corporAID multilogue Prof. Velamuri explains why the emerging world is no longer a mere source of cheap labour, but rivals the rich countries for business innovation and how it is reinventing systems of production and distribution and experimenting with entirely new business models. He shows why emerging markets are now fertile sources of innovation and what Western companies can learn from companies there.

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corporAID Initiative

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