BCG

FOCUS

The Next Billion Consumers

A Road Map for Accelerating Telecommunications Growth in Brazil

THE BOSTON CONSULTING GROUP

The Boston Consulting Group (BCG) is a global management consulting firm and the world's leading advisor on business strategy. We partner with clients in all sectors and regions to identify their highest-value opportunities, address their most critical challenges, and transform their businesses. Our customized approach combines deep insight into the dynamics of companies and markets with close collaboration at all levels of the client organization. This ensures that our clients achieve sustainable competitive advantage, build more capable organizations, and secure lasting results. Founded in 1963, BCG is a private company with 66 offices in 38 countries. For more information, please visit www.bcg.com.

The Next Billion Consumers

A Road Map for Accelerating Telecommunications Growth in Brazil

Brazil has more than 40 million fixed lines and 100 million mobile handsets in use. To date, telecommunications operators have focused mostly on the high end of the market, while viewing two-thirds of the country—34 million households—as a burden to be served out of regulatory obligation or not at all. These households constitute a distinct group of consumers—the *next billion*—whose potential to become profitable customers has been underestimated and at times misunderstood. Many of them have or have had telephone service, but products and services have not been geared toward them. With the high end of the market saturated, the next billion consumers represent a new opportunity for operators.

Categorized by income, this group sits just above the poorest of the poor and just below those who are currently targeted by commercial enterprises. In short, the next billion consumers are stuck in the middle. They fly under the radar of existing business models that target the top layer of the economic pyramid but above the sweep of government programs geared to meet the needs of the bottom. (See Exhibit 1, page 2.)

These individuals represent a challenge for businesses. On the one hand, they demand products and services. The early adopters in this group report great satisfaction with telecommunications offerings. On the other hand, many operators and technology companies consider the next billion, viewed through the lens of conventional business models and metrics, unprofitable to serve.

What steps can companies take to increase penetration of this market—and spur the growth of their businesses—in ways that are both profitable and sustainable? Two fundamental activities can facilitate the transformation required to reach the next billion consumers:

- *Incorporate deep consumer insight into products and services in order to serve the next billion's needs.* The next billion consumers do not want scaled-down versions of products that are sold to higher-end consumers. If they are making a sizable investment in a mobile handset or other product, they want it to meet both practical and aspirational needs. In order to reach and serve these individuals, therefore, companies must not only change their products but also revise their organizations, marketing campaigns, and distribution channels.

- *Create innovative business models that change the economics of serving neglected consumers.* Business as usual will not profitably reach these potential customers. Wider, more ambitious improvements, such as cross-industry collaboration, will be necessary. Companies will need to collaborate with other players in other industries. Telecommunications operators, for example, might reach out to fast-moving consumer-goods companies in order to reduce distribution costs and increase revenues by offering innovative, bundled services.

The size of the prize is gigantic for companies that crack the code of reaching the next billion. These consumers hold the key to future growth for Brazilian operators.

Who Are the Next Billion?

The Boston Consulting Group conducted a global research study during late 2006 and 2007 to develop a deep understanding of the next billion consumers and to design business models to serve them. We believe that they represent a significant growth opportunity for several industries, especially telecommunications, financial services, and consumer goods.[1]

The next billion consumers can be found largely in Brazil, China, and India, but the group also spreads across Africa and other parts of Asia. If these consumers constituted a nation by themselves, it would be the tenth-largest economy in terms of GDP, ranking after Spain but ahead of Brazil, Russia, India, South Korea, and Mexico. In its development, the next billion "nation" stands today where India stood in the 1990s and China did in the 1980s: on the cusp of high growth and voracious consumption.

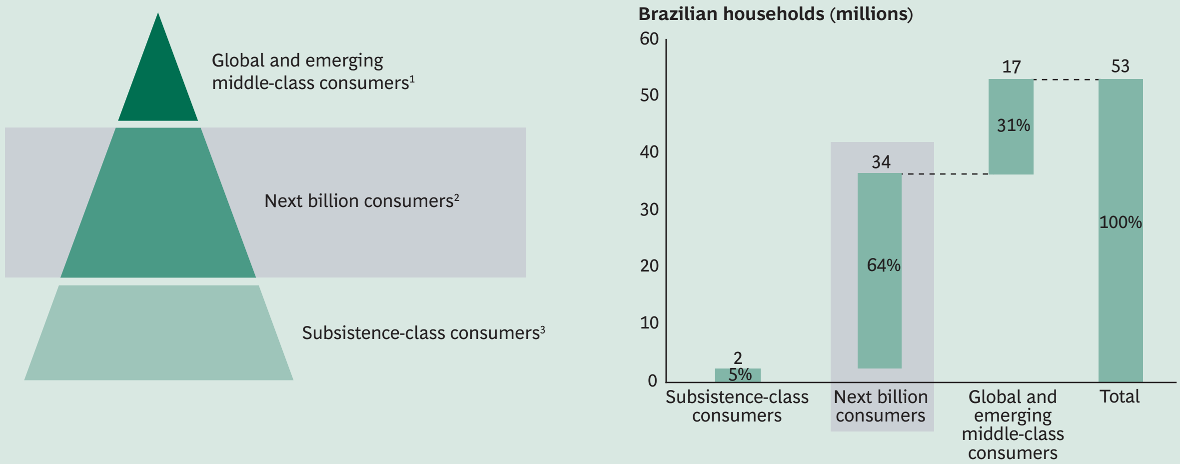
Households in the next-billion segment in Brazil have a monthly income between $100 and $700 and monthly savings between $30 and $300. They represent nearly one-third (32 percent) of the total income in Brazil but nearly half (45 percent) of total spending. The number of next-billion households is growing faster than the overall Brazilian population.

Nearly half (45 percent) of these individuals do not live close to a slum, and nearly two-thirds of them (65 percent) are married. These consumers are starting to be able to afford durable goods, financial services, and telecommunications products and services.

"Let me tell you about the very rich. They are different from you and me." That famous comment by novelist F. Scott Fitzgerald could have been written about the next billion consumers. Although they have many of the same dreams and aspirations as wealthier consumers, they are nonetheless different, and the differences influence how they respond to products, marketing, and distribution choices.

1. This report is directed mostly at telecommunications operators, but it is also relevant for handset and network infrastructure suppliers and other technology companies.

Exhibit 1. The Next Billion Are Stuck in the Middle



Sources: Pesquisa Nacional por Amostra de Domicílios survey of households, 2005; BCG analysis.
[1]Global consumers have a monthly household income above $875. Emerging middle-class consumers have a monthly household income between $700 and $875.
[2]Next billion consumers have a monthly household income between $100 and $700.
[3]Subsistence-class consumers have a monthly household income below $100.

A Life of Constraint. As the next billion consumers climb the economic ladder, they will still face scarcity, uncertainty, and compromise. Those conditions affect their purchasing patterns and aspirations. We surveyed more than 1,300 next-billion consumers in Brazil and visited dozens of households throughout the country in order to understand these people's lives. Nearly 60 percent do not have formal jobs, so their incomes fluctuate. When they are paid, 82 percent receive their earnings in cash. In two-thirds of households, individuals pool their income, which means that decisions about large purchases are often made collectively. Nearly 80 percent identified food as their most important monthly purchase.

In a typical family, food purchases account for 39 percent of household spending. As one person told us, "My aspiration is to see my family happy and have food at home—to have a kitchen cabinet full of food." Shelter expenses, meanwhile, consume 23 percent. On average, essential items account for 72 percent of the household budget, leaving 28 percent for discretionary spending. Leisure, for example, constitutes 10 percent of a typical household budget. Contrary to conventional wisdom, therefore, the next billion consumers do have money to spend at the end of most months, and that money represents an opportunity.

For telecommunications to find a place in their budgets, the next billion consumers must start to consider it to be not a frill purchase but a tool that can enhance their lives. Take the example of a painter. (This man happens to be Indian, but a painter in a Brazilian city could easily tell a similar story.) Prior to buying a mobile handset, he struggled to support himself and his family on his monthly income of $100. After purchasing the handset, he was able to manage his schedule more efficiently and serve his customers more effectively. Most important, he could check which stores had the paint he needed before wasting a day shuttling among them. These changes have helped double his monthly income and transform his economic prospects. As his business expands—he now employs two other workers—he is likely to increase his use of the handset and thus increase his economic value to the mobile operator that provided and likely subsidized it.

A Familiarity with Communication Services. In such countries as India and China, the next billion consumers tend to be rural. In Brazil, they are city dwellers and thus more familiar with telephone service than their counterparts in other countries. The challenge for mobile operators and handset makers is to persuade these consumers to increase their use and try new services, such as text messaging.

Twenty-eight percent of the next billion consumers in Brazil already have a fixed line at home, which they find helpful in emergencies and for convenience. One-third of the next billion consumers once had a fixed line but canceled it to save money. Current and former customers alike said that they are confused by their monthly bills. They avoid making long-distance calls—only half of them do so. When they must make such calls, they are more likely to use pay phones than a fixed line at home, probably in order to avoid longer calls and higher costs.

An even greater share of these individuals (48 percent) use mobile handsets than use fixed-line phones in their homes. But they are more likely to receive calls than to make them or use text messaging. In fact, receiving calls is the most-used mobile service among 79 percent of the next billion in Brazil, whereas making calls is the most frequent use for only 18 percent. Sending and receiving text messages is the most common service only for the remaining 3 percent. In interviews, consumers told us that they either had no interest in messaging services or did not know how to use them.

A Willingness to Increase or Start Use—at the Right Price. Price is the key to increased use among the next billion who already use mobile products and services. By price, we do not mean simply the per-minute airtime charge. The price of a handset is a huge barrier to use, as is the minimum price of airtime minutes. Four out of five existing next-billion customers with prepaid plans would spend more if the minimum recharge amount (the charge for buying minutes) was lower. In fact, our research suggests that consumers would likely purchase more airtime each month if the minimum recharge amounts were lower, even if a higher per-minute charge was applied. Of course, lower per-minute charges would also increase use: three out of five of the next billion consumers we interviewed said they would spend more in this case.

Among nonusers, affordability is the primary barrier. Fifty-four percent of them said that they could not afford mobile service, whereas 46 percent said they could not afford a handset. In fact, 44 percent of nonusers said that they would acquire a mobile connection if they were given a free handset, and 50 percent said that they would be willing to finance their handsets.

Although price does drive handset purchases, it is not the only consideration for these individuals, who also see the device as a status symbol in miniature. When we asked consumers a multiple-choice question about their main considerations in purchasing a handset, 92 percent gave price as their top answer, followed by brand at 77 percent and design at 62 percent. As one interviewee told us, "I bought it because I liked it. It can even display a picture of my daughter."

Not all members of the next billion are ready for mobile communications. Four out of ten nonusers said in interviews that they simply did not need a mobile handset. One in five said that nothing would convince them that they needed one. Price reductions and attractive per-minute rates won't bring these individuals into the fold. Unless mobile operators and handset makers are willing to cede this sizable segment of the market, they will need to figure out how to appeal to these consumers on bases other than price.

What Is Broken—and How to Fix It

For mobile operators in Brazil, reaching and serving the next billion is an imperative rather than a social nicety. The fixed-line business has been eroding as existing customers cut the cord and go mobile. Increasingly, younger consumers are making a mobile handset their first and only phone. Often they select prepaid plans to control expenses. To date, operators have benefited from this trend. Even when these young customers do not make many mobile calls, they can be profitable to serve. In Brazil, fixed-to-mobile interconnection fees are higher than in most other countries, representing more than 40 percent of the revenues of mobile operators. However, in the long term, operators cannot build a business around customers' receiving calls. They need to give the next billion a compelling reason to embrace mobile telephone services.

So far, operators have tried to reach the next billion through their existing business models. Not surprisingly, products designed for higher-end consumers and distributed through high-cost, asset-intensive channels are unattractive to the next billion and unprofitable for companies. These companies compound their difficulties in building a business around the next billion by relying on traditional metrics, such as average revenue per user (ARPU). For instance, individual consumers among the next billion might not appear to be attractive on the basis of their ARPU, but the next billion as a group generate lower churn and thus allow operators to avoid big upfront acquisition costs. Only 11 percent of interviewees changed operators in the 12 months prior to being interviewed, compared with 29 percent for other mobile customers. As a result, metrics that estimate customers' lifetime value, such as discounted cash flow, would be more accurate than short-term monthly metrics such as ARPU.

The next billion need to be understood on their own terms. Companies that embrace these consumers stand to reap rich rewards by winning a disproportionate share of a massive revenue and profit pool. The first companies that "discovered" India and China have since moved past their beachheads and are now generating revenues and profits far in excess of early expectations. In fact, the next billion could determine the future winners and losers in many industries and herald the rise of new commercial giants. But seizing the opportunity will be hard work. Operators that follow six design principles will have a head start. (See Exhibit 2.)

Fit-to-Constraint Products. Contrary to popular perception, the next billion do not want products that have been "dumbed down" but those that fit their lifestyles and economic constraints. A farmer in a rural area, for example, may want a rugged handset with a data feed that provides wholesale prices at nearby markets, whereas a day laborer in São Paulo may care about a handset's look and feel and its ability to take pictures. Mobile operators and handset manufacturers need to design products and services that deliver both aspirational and pragmatic value. Our research suggests the following practical guidelines:

- *Offer economical packages.* "Fit the pocket" of consumers by lowering recharge amounts, offering flexible terms, and encouraging free or low-cost trial use.

- *Incorporate lifestyle constraints.* For example, because the next billion consumers tend to share mobile handsets with family members, prepaid family plans would be an attractive option.

- *Appeal to aspirations.* Among other benefits, the mobile handset is a status symbol for the next billion consumers. They enjoy color screens, ring tone downloads, and other features that can be noticed by people around them. They care less about sophisticated software.

- *Strive for quality.* The next billion consumers value durability and sturdiness. Although low prices are important, handset manufacturers also need to take into account the quality of the handset.

Ubiquitous Distribution. Distribution networks wrestle with inherent tradeoffs between cost, coverage, and control. Mobile operators and handset manufacturers will need distribution channels that reach individuals in their neighborhoods and villages, which may be far from traditional telecommunications outlets. These extensive distribution networks will also need to be viable at low volumes and low prices. Finally, operators and handset manufacturers will need to ensure that they have adequate control over pricing, stocking, and service throughout the distribution chain to deliver the high quality these customers demand. The following recommendations should guide the design of distribution networks:

- *Broaden reach.* Operators can create partnerships to leverage existing low-cost and well-established channels. The reach of the postal network, for example, is unparalleled, positioning it as a potential distribution partner.

- *Lower costs.* Reduce breakeven volumes by combining volumes with players that are targeting the next billion—fast-moving consumer-goods companies, for example.

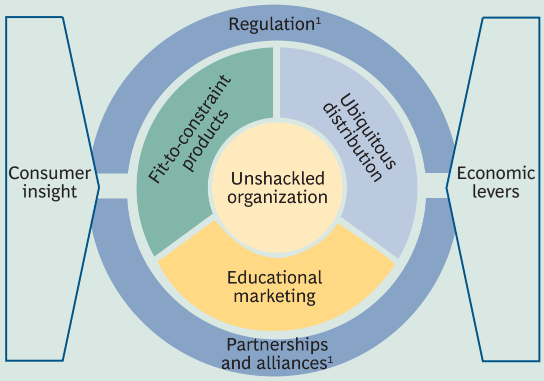
- *Eliminate intimidation.* Operators could, for example, place an attendant at self-service recharge kiosks, as Brazilian banks have done to educate their customers about the services of automated teller machines.

- *Capture discretionary spending.* Operators could establish arrangements with supermarkets that allow consumers to buy prepaid minutes with change from their weekly shopping trip.

- *Work around infrastructure constraints.* In Brazil, banks have offered their products and services through lottery shops and post offices. These outlets have brought financial services to 28 percent of Brazilian municipalities that otherwise would not have them. In part through such arrangements, 98 percent of Brazilian towns now have banking services. Mobile operators should explore similar arrangements.

Educational Marketing. The economic benefits of a mobile handset are not well understood by nonusers. One of the primary challenges for mobile operators and handset manufacturers will be to educate nonusers and convince them that the handset has not just an aspirational value but

Exhibit 2. Companies Must Apply Consumer Insight and Economic Levers to Six Design Principles



Source: BCG analysis.
[1]*Regulation* and *Partnerships and alliances* are outside the circle because they depend heavily on cooperation with third parties.

also a pragmatic one. In other words, operators and manufacturers need to create demand rather than simply serve existing demand. This is a tall order, given that 72 percent of the next billion consumers have not completed high school. Hence, companies should address the peculiarities of the segment by taking the following steps:

- *Offer advice.* Educate consumers about basic functions and features and the economic benefits of mobile handsets.

- *Encourage use.* Design pricing and promotion schemes that offer trial periods and move to traditional plans as users start to enjoy economic benefits.

- *Enlist local advocates.* Leverage advocacy by relying on self-help groups and other referral programs. As an example, Hindustan Unilever enlists poor women in India to sell products in remote regions. This initiative now reaches 80,000 villages in India and accounts for about 15 percent of the company's rural sales.

- *Support first-time users.* Handsets could have a "tip for the day" appear when users turn them on and could come with illustrated manuals.

- *Build trust and identification.* As predominantly new customers, the next billion are not wedded to incumbent brands. They are willing to associate unfamiliar products with familiar brands. This provides an opportunity to extend trusted brands by, for example, establishing a partnership with a trusted consumer company in order to sell service. Alternatively, operators might consider creating an entirely new brand for this segment.

- *Build relationships.* If companies lose the trust of these customers on their first purchase, they may never restore it. Even though these individuals may not be large revenue generators, operators cannot take them for granted.

An Unshackled Organization. When mobile operators and handset manufacturers entered emerging markets, they understandably built organizations focused on serving high-end individuals. It is not surprising, then, that the culture, mindset, and metrics of these organizations are out of step with the next billion. Their centralized, top-down approach to decision making often discourages the initiative required to push the boundaries. To serve the next billion, operators must develop a new organization design with the following cornerstones:

- *Create accountability.* The next billion need a champion within the organization. In many organizations, a standalone business will enable bolder collaboration and partnerships, but a corporate program that orchestrates initiatives across the organization can also work. A respected marketing manager, for instance, could lead programs and processes to capture these consumers.

- *Get help.* Develop external networks to design new offerings, distribution channels, and marketing programs.

- *Embed low costs.* Companies should establish shared-services structures that allow the next-billion business to gain access to corporate capabilities at marginal cost—whenever appropriate. They should also take part only in those activities that they can handle profitably and outsource or collaborate to fill in the gaps.

- *Establish clear governance.* Companies will need to partner with outsiders in order to broaden reach and lower costs. They will need to establish clear decision rights and dispute-resolution mechanisms to manage these partnerships.

Regulation. Historically, regulation has focused on universal access, on the assumption that adoption follows access. This assumption is false for the next billion consumers, who often do not see the need for a mobile handset until they own one. Government and industry bodies need to assume a larger role in promoting the benefits of telecommunications, so that the multiplier effects can pulse through the economy. While the government should continue pushing universal access, it should also be pulling customers onto the mobile network.

Mobile operators and handset makers need to establish working relationships with regulatory authorities in order to convince them of the value of universal adoption. Several regulatory actions would benefit the industry, consumers, and the economy of Brazil:

- *Promote competition.* Operators should encourage regulators to seize opportunities to create greater competition and penetration. In India, for example, the government subsidizes the construction of base stations in rural areas on the condition that the operator shares the tower with competitors. The subsidy encourages the growth of both rural telecommunications and competition.

- *Guarantee universal access through new means.* Although it may seem self-serving for operators to lobby for lower taxes and levies, this move would also lower costs for operators and prices for consumers. Operators should also work with the government to establish credit bureaus in order to reduce nonpayment and delinquencies.

- *Spur adoption.* Handset subsidies routed through operators would help lower the purchase barrier of a mobile handset. The government could also create mobile information networks that provide useful information, such as supermarket promotions and job opportunities, in order to spur adoption.

Partnerships and Alliances. Deconstruction and collaboration are the final pieces of the puzzle required to capture the next billion. A telecommunications player that operates creatively by grafting together the most effective elements across multiple industries could achieve unassailable advantage. The following ideas stand out:

- *Leverage third-party assets.* Mobile operators and handset manufacturers should work with consumer-electronics, consumer-goods, and other companies to create innovative packages of products and services. FM radios bundled into handsets, for example, are proving to be a major draw.

- *Broaden reach and scale.* Operators should consider sharing infrastructure with or outsourcing network operations to equipment vendors, as is being done in India, in order to lower costs.

- *Share complementary capabilities.* To entice reluctant next-billion consumers, operators will need to offer creative services that require partnerships. Mobile banking could become a killer app for the next billion, many of whom are largely excluded from financial services because of poor access. Regulation and practicality may dictate the need for relationships with banks.

Laying the Groundwork

The breadth of actions required to reach the next billion consumers may seem daunting, but mobile operators can take several immediate steps to begin the process of unlocking this opportunity:

- Establish accountability for developing the next-billion opportunity with somebody or some entity within your company. Do not let the opportunity drift.

- Audit existing capabilities that can be leveraged for the next billion.

- Understand the communication needs of the next-billion segment—in particular, the product and service features they value.

- Analyze the economics of the value chain to assess opportunities to reduce costs.

- Educate consumers to increase use and build relationships to reduce churn.

- Design a new organization model that fosters experimentation, focuses on core activities, and encourages collaboration with other industries.

Companies that devise the right offerings, coupled with strategies that radically change the economics of serving the next billion, will uncover a new source of profitable growth. The time to do so is now: in the next three years, the next billion consumers will accelerate their climb up the economic ladder. The players that develop the right business models will capture the lion's share of this market and emerge as the giants of tomorrow. The rest will remain spectators.

About the Authors

Marcos Aguiar is a partner and managing director in the São Paulo office of The Boston Consulting Group. You may contact him by e-mail at aguiar.marcos@bcg.com.

Jörg Funk is a partner and managing director in BCG's São Paulo office. You may contact him by e-mail at funk.joerg@bcg.com.

Michele Pikman is a project leader in BCG's São Paulo office. You may contact her by e-mail at pikman.michele@bcg.com.

Acknowledgments

The authors would like to thank their colleagues James Abraham, Olavo Cunha, David Dean, David Michael, Arvind Subramanian, and Rafael Zapparoli. In addition, the authors acknowledge the contributions of the following members of BCG's editorial and production staff: Katherine Andrews, Gary Callahan, Angela DiBattista, Amy Halliday, and Mark Voorhees.

For Further Contact

BCG's Technology & Communications practice sponsored this report. For inquiries about the Technology & Communications practice, please contact the practice's global leader:

Ron Nicol
Senior Partner and Managing Director
Dallas
E-mail: nicol.ron@bcg.com

For a complete list of BCG publications and information about how to obtain copies, please visit our Web site at www.bcg.com/publications.

To receive future publications in electronic form about this topic or others, please visit our subscription Web site at www.bcg.com/subscribe.

10/07

THE BOSTON CONSULTING GROUP