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# **Understanding and Applying the Stages of Development Model**

By

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## Faculty Comments

(Evaluative comment in which the faculty supervisor should briefly describe the nature of the research project and add an evaluating comment).

*Excellent work*

*James R. Payne*  
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# Understanding Emerging Markets

## Introduction

*The movement toward freer markets in China, Vietnam, the former Soviet Union, Poland, Hungary, the Czech and Slovak Republics, and other [emerging market economies] has led to great interest in the marketing challenges and issues unique to these economies. (Batra 1997)*

Although this section will discuss both multinational corporations (MNC) and local firms in emerging markets (EMs), it will focus on the opportunities presented for local firms and the management challenges faced as EMs migrate to free markets through a similar generalized process. This process is referred to throughout this text as the Stages of Development Model (SDM).

## Overview

In the past, MNCs have viewed emerging markets<sup>1</sup> (Refer to Exhibit 1) as a means to increase volume by entering these new markets with their current mix of products. MNCs have viewed and targeted a very small portion, the 1<sup>st</sup> tier income group (Refer to Exhibit 2), of EM consumers as having similar tastes and preferences to consumers in the MNCs home market. In addition, MNCs believed that these consumers although having smaller incomes than Americans were ripe for any products that they could purchase. By not customizing products that meet local customers needs, many MNCs have been very unsuccessful in marketing their existing products in EMs based on the assumption that all consumers are alike. Thus, MNCs have blatantly neglected to view the unique tastes and preferences of consumers in EMs. Rather than develop new profitable products that meet the needs of the larger consumer segments - the 2<sup>n</sup> , 3<sup>r</sup> , and

<sup>1</sup> Although there are differences between emerging market economies and transitional economies, this text will use emerging market economies synonymously with transitional economies - a movement to freer markets.

4 tiers - within these markets, MNCs have tried to sell products that were marketed for their home markets to a very small portion of the population.

Stating that MNCs have completely mis-marketed products to EMs is only a half-truth. Consumer income levels in EMs can be segmented into four tiers based on purchasing power parity (PPP) (Lieberthal and Prahalad 1998) of the consumer population (Refer to Exhibit 2). For example, the 1<sup>st</sup> tier, where income levels are the highest at \$20,000 and greater, of the PPP accounts for less than 1% of an EM's population. Typically, this has been the target segment that MNCs have decided to market their existing products. In essence, MNCs have tried to skim the cream, a small and atypical market segment, with their existing products. As a result, MNCs have completely neglected the larger consumer populations within the 2<sup>nd</sup>, 3<sup>rd</sup> and 4<sup>th</sup> income tiers comprising 99% of an EM's population and creating a huge opportunity for local firms to service these customers. Interestingly, this is not a new concept. In 1950, Joseph Schumpeter suggested that small entrepreneurial firms would be the sources of most innovation and as a result would be better positioned to meet the needs of these large population segments.

In order for MNCs and local firms to compete in these market segments, they must rethink each factor of their business strategy in order to deliver new products that meet these consumers' needs profitably. As a result of the rapid market evolution changes and tiered income structure in EMs, marketing products based on advanced economy business models will not solve the consumer needs of the 2<sup>nd</sup>, 3<sup>rd</sup> and 4<sup>th</sup> income tier population segments. Therefore, firms should consider using emerging market business models to deal with the rapid market changes and market products to the majority of the population in the larger income tier segments.

## **Business Model Considerations**

Given the increase in management talent in EMs, local firms should be better positioned to develop and deliver differentiated products using emerging market business models for the larger income groups. In order for firms to compete in the 2<sup>nd</sup>, 3<sup>rd</sup>, and 4<sup>th</sup> tier segments, Lieberthal and Prahalad recommend that firms use an emerging market business model that considers and utilizes the following factors:

1. **Price-Performance Equation**: Understanding the implication of global standards on local competitors and vice-versa. An example of this is McDonalds had to localize its menu to meet Indian tastes and preferences while local food chains had to meet McDonalds' global standards for restaurant cleanliness and ambience.
2. **Brand Management**: Understanding the impact of using a localized brand management strategy versus a consistent global brand management approach. As an example, Coca-Cola ineffectively marketed Coke using a global brand strategy while Pepsi successfully tailored its brand strategy to India's market.
3. **Cost of Market Building**: Changing developed tastes and habits can be very costly compared to providing consumers with new products that already meet their current tastes and preferences. For example, Kellogg's spent millions trying to change Indian's breakfast eating habits to eat cereal rather than develop a breakfast product that fit Indian's current habits.
4. **Product Design**: Considering product redesign of existing products that already meet consumers' tastes and preferences in an EM must also consider variations in consumer use, distribution mechanisms and available selling channels.
5. **Packaging**: Experimenting with different packaging concepts that match consumers' tastes and preferences in emerging markets. For example, small one-use sachet served the different buyer behavior in India.
6. **Capital Efficiency**: Reevaluating aspects of production, distribution, and marketing may allow firms to compete profitably for 2<sup>nd</sup> and 3<sup>rd</sup> tier markets by streamlining business practices to operate with less capital.

## **Understanding the Stages of Development Model**

William Davidson Institute (WDI) at the University of Michigan Business School developed the Stages of Development Model (SDM)<sup>2</sup> for EMs to capture the importance and interaction of the external environment and an organization's internal processes. While this model is very data intensive in analysis and implementation, for the purposes of this text the SDM will be discussed

<sup>2</sup> Dr. Arnold Schuh developed a similar three-stage evolutionary framework and presented it in 1995 to the Conference on Marketing Strategies for Central & Eastern Europe.

only in general terms and be illustrated using examples. A more comprehensive understanding of changes in an EM's external environmental should allow organizations to better anticipate future environmental developments and make strategic and tactical decisions when forming its marketing strategy. Specifically, the overall purpose of the SDM is to explain how evolutions within an EM's external environmental might impact an organization's marketing strategies. As a result, understanding an EM's external environment could allow a firm to gain a competitive advantage by properly positioning its firm capabilities for a future stage's environmental situation.

By measuring and analyzing specific environmental changes, a firm essentially has the ability to trend the evolution of an EM's general environment. An EM's development process could span a continuum that stretches from a command economy - as in ex-Communist and Socialist countries as well as in undeveloped countries - to a mature market-based economy. The environmental changes of SDM can be described along a similar continuum of five<sup>3</sup> stages (Refer to Table 1).

**Table 1: Five Stages of SDM**

STAGE	DESCRIPTION
1	Initial Market Development
2	Opportunistic
3	Advanced Opportunistic
4	Strategic
5	Advanced Strategic

The following descriptions of the SDM's five market stages were developed using multiple sources of research conducted in Central Europe. (Azu et al. 1997) In addition to the general economic and political environment descriptions, this section will present the insights by



managers working in EM countries as qualitative evidence and as bases for introducing the stage model. (Taylor 1995) These descriptions should provide the reader with a better understanding of the general patterns of the SDM that EMs exhibit during the evolutionary process. Although these descriptions are highly tied to Central Europe's post-Communist transition from a command to a market economy, the general aspects of them can be applied to the transition of many EMs to a market-based economy.

## **I Initial Market Development Stage**

At a macroeconomic level, during the initial market development stage, the initial shift from a centralized command economy to a market-based economy causes negative GDP growth. Such a drastic change in the economic environment causes inflation to increase rapidly as government price controls are eliminated. In addition, due to the decline in GDP output, unemployment levels will increase.

### **Distribution**

- Low level or lack of any competition and in some cases, central run government distribution.
- Poor central distribution system and no channel differentiation or specialized transportation companies.
- Lack of local products leads to an overload of imports to satisfy unmet consumer demand.
- Consciously attempt to distribute to ALL potential customers.
- Use any channel available to get product to market.
- People with money and contacts get involved with distribution.
- Distribution starts to develop very aggressively via individual distributors, but it is still highly fragmented.
- Corruption is prevalent (e.g. customs, fraud - items paid for but not delivered, "non-existing" firms, etc.).
- Wholesalers do not exist.

<sup>3</sup> The precise number of stages could be fewer or more than five and is less important than understanding the concept that an EM evolves through a series of stages.

### **Pricing**

- Only tight terms are available in the cash dominated system.
- Firms price products to make a return but must be aware of consumer price sensitivity.

### **Promotion**

- Initially only advertising is used to build product awareness and create product "hype".
- No trade-based promotion or very small, quick promotions.

### **Product**

- Firms move very quickly only to establish a market presence and capture initial market share.
- Speed to market is essential in order to fill the void created by large amounts of unmet consumer demand.
- Low brand loyalty except for the residual strength of *Western* products due to import cache and perceived higher quality.
- Basic features only since there is no need for differentiation, due to large unmet demand.
- Low quality products are offered with little or no service and support.

## **II Opportunistic Stage**

The opportunistic stage of development is plagued by political instability as various political groups struggle for government leadership. Short-term hardships are apparent as inflation and unemployment rates continue to rise. Also during this stage, the political leadership's directives reflect the course of reforms taken and the hardships endured by a country. In addition, entrepreneurs drive privatization of small firms in order to satisfy consumer demand neglected by parastatal businesses. As a result of entrepreneurs entering the market, the composition of outputs shift from heavy industry to the consumer retail and services sectors.

### **Distribution**

- Still low level of competition.
- Big distributors start entering the market.
- Government starts to protect major national distributors through regulation.
- Government starts to legislate against corruption and "dirty business" practices.

- As a result, more organized corruption, e.g. Mafia, develops and expands.
- Rapid growth of wholesalers.
- Begin selectivity among wholesalers and retail-based distribution.
- Small retail stores appear, but retail network is still highly fragmented.
- Specialized transport companies appear.
- Begin to rationalize SKU range.
- Continue to increase product availability.

### **Pricing**

- Still tight terms exist and cash on delivery required.
- Establish exchange buffer to stabilize price swings.
- Increased price sensitivity due to competition and availability of substitute products.
- Return on investment is very fast, not more than a year.

### **Promotion**

- Heavy advertising.
- No trade-based promotions.
- Strong product sampling.
- Be aware of product push versus market pull for demand.
- Mass education of price/quality relationship.

### **Product**

- Establish a more carefully positioned product portfolio using customer segmentation.
- Increased services offered are a source of differentiation.
- Imports residual strength continues to dominate local products.

## **III Advanced Opportunistic Stage**

During the advanced opportunistic stage, an EM begins to turn the corner towards increasing development and stability. Specifically during this stage, the government begins to privatize its parastatal assets and invest in infrastructure. As a result of government privatization and investment, the major macroeconomic indicators return to more favorable trends with positive GDP growth and stabilized unemployment and inflation rates. Despite these macroeconomic

improvements, strict adherence to the reform process does not mean that an EM is on the road to recovery. For instance, abrupt political and policy changes to alleviate the hardship resulting from the reforms may repress the positive economic changes. Finally, mass privatization indicates an irreversible transition to a market-based economy and a positive direction toward long-term political and economic stability.

### **Distribution**

- Introduction of legal regulations - targeted at protecting capital - start to stabilize the market.
- Competition develops; big distributors start entering the market.
- Organized corruption continues to grow.
- Foreign distributors aggressively compete with local firms.
- Increased presence of professional distributors.
- Local wholesalers and distributors still protected by local laws.
- Market segmentation - selective client listing.
- Increased specialization of retail trade.
- Decreased importance of wholesalers.
- Increased channel differentiation.
- Entrance of international accounts.
- Increased importance of retail shops.
- Distribution reaches acceptable levels.
- Refocus on more strategically driven channels.
- Concentrate on eliminating competition through legislation and marketing.

### **Pricing**

- Cash on delivery plus seven days based terms start to develop.
- Continue to develop an exchange buffer.
- Market-based pricing occurs.
- Price/quality relationship starts to shift towards quality.

### **Promotion**

- Begin trade-based promotion to increase brand awareness and value.

- Continue to use of aggressive advertising and sampling.

### **Product**

- Increased differentiation of product beginning to evolve towards consumers' local tastes and preferences.
- Consumers rediscover local brands, as domestic producers grow more sophisticated.
- Brand loyalty develops and national context becomes important for purchase.
- Continue to evaluate and rationalize product line to build brand.

### **IV Strategic Stage**

During the strategic stage of development, the government intensifies its presence through increased reform and investment policies. As a result of these policies, the government must balance its efforts to finance continued investment spending and to control budget deficits. Therefore, in order to reduce the burden of the budget deficit, the government focuses on social reform and bank restructuring programs. Even though these reform programs are slow to take effect, this process illustrates the government's change in focus to solve long-term problems in order to support economic stability. By this stage, unemployment and inflation levels have peaked and may even slightly decrease as the labor market becomes more efficient and the labor force migrates to private sector employment.

### **Distribution**

- Small distributors start to disappear due to professional distributors.
- Wholesalers consolidate.
- Small retail stores lose importance and join larger chains.
- Department stores are established.
- Increased importance and number of international accounts.
- New sales channels (e.g. direct marketing) develop.
- Firms target customers who bring the most profits.

**Pricing**

- Price based on competition and product differentiation.

**Promotion**

- Move to a more balanced push and pull approach.

**Product**

- Attempt to create a market for value-added services.
- Foreign versus domestic products become less important as consumers become better educated.

**V Advanced Strategic Stage**

Finally, during the advanced strategic stage of development, the political and economic environments reflect the stability found in most Western countries. Specifically, unemployment and inflation rates are comparable with other stable economies. In addition, GDP continues to grow positively and political turmoil is almost non-existent. Since transformation to a market-based economy is nearly complete through successful mass privatization program, low inflation and unemployment levels, and reformed banking and social systems, enterprises investing in these countries are exposed to minimal levels of risk.

**Distribution**

- Small retail stores disappear.
- Large department stores and multinational accounts.
- More developed mail order, phone, and potentially Internet sales.

**Pricing**

- Price leader (low-cost provider).
- Concentrate on profits.

**Promotion**

- Advertising and promotions are based on well-segmented groups.

## Product

- Service and quality increase in importance.
- Ease of use increases (e.g. standardization, maintenance, compatibility, etc.).
- Product proliferation to meet special niche markets.

## **Underlying SDM Dimensions and Attributes**

Now that we have discussed the five stages within the SDM, we will look at each of these stages across specific environmental dimensions. These dimensions are political, economic, infrastructure, competitive, and consumer. As you will quickly notice, these dimensions look surprisingly similar to the PEST (political, economic, social, technological) analysis tool that is taught in most introductory marketing classes. Specifically, the political and economic dimensions in the SDM match up identically, while the infrastructure and consumer dimensions closely align respectively with the PEST's technological and social components. Although the competitive dimension is not included in the standard PEST analysis, this dimension is a necessary piece in understanding the external market.

Each of the five dimensions can be broken down into measurable attributes that can be described along a similar continuum of planned economy to open, market-based economy. Although these attributes can be measured and weighted relative to each other, this text will only discuss these dimensional attributes in general terms and illustrate them through an example. By understanding changes in these environmental attributes in an EM's, firms will be able to better anticipate future environmental developments and make strategic and tactical decisions when forming its marketing strategy. At this point, we should state that we are assuming a broad time frame for the SDM and that emerging markets evolve at different rates and in a non-linear, iterative fashion through each stage's dimensional attributes. In order to understand how to apply some the SDM's dimensional attributes, an illustration of how a durable goods

manufacturer used the stages of development model to strategically market its products in a sub-Saharan EM country.

### **Political Dimension**

- Political control (e.g. what type of government rules).
- Political system's stability.
- Protectionist trade policies.
- Government/ business relations.

### **Economic Dimension**

- Price levels
- Macroeconomic indicators: GDP growth, consumption and savings levels, inflation rate trends, unemployment rate trends, exchange rate stability, per capita income growth,  $tUi$  trend, % of economy that is private.
- Presence/ "Age" of efficient capital markets.

### **Infrastructure Dimension**

- Physical infrastructure.
- Government investments.
- Complimentary assets: distribution systems, supplier base, transportation & logistics systems, marketing research services.
- Legal infrastructure.
- Communication media, e.g. television, radio, Internet, billboards.

### **Competitive Dimension**

- Overall domestic market growth and market share index.
- Existence and impact of 'gray' market.
- Acquisitions and mergers.
- Market entrance (via import, licensing, JV, or subsidiary) vs. departures.
- Product strategy, availability (e.g. distribution), and awareness (e.g. media).

### **Consumer Dimension**

- Presence of excess consumer demand.
- Population demographics: age, sex, race, income (Purchasing Power Parity) etc.



- Psychographics: social class, education levels, etc.
- Geographic: urban vs. suburban vs. rural.
- Behavioristic: buying and usage patterns, product knowledge, and Brand importance.
- Level and availability of consumer credit.

## **Applying SDM**

Now, we will look at how a consumer durable goods manufacturer used the stages of development model to understand the external environment of a sub-Saharan EM to better market its products there.

This sub-Saharan EM has one political party that is the primary ruling party of its coalition government. Despite the coalition style government, the ruling party controls the majority of government operations. During the 1990s, this country has experienced its first and second fully open and truly democratic political elections at all levels of the government. As a result, the longevity and stability of the government is questionable.

Despite this potential political uncertainty, the government has taken a very proactive role in implementing specific programs that will move the economy to a freer market. Also, the government has committed to privatizing some its key parastatal assets. In addition to this privatization movement, this EM has joined the regional economic community and the WTO to open up its borders to foreign trade and investment. Lastly, in an effort to increase foreign investment, the government has removed all legal limits on capital and management requirements on firms.

Although the sub-Saharan EM's real GDP has experienced positive growth over the past few years, the government's tighter monetary policy coupled with producer and consumer

uncertainty about political stability may negatively affect GDP growth in the near future. As reflected in the tighter monetary supply, interest rates threaten to increase further from its current high level. In addition to tighter monetary policy, the government has planned to reduce its budget deficit one-percentage point from the previous years 5% of GDP. The government believes that these macroeconomic policy changes will cause inflation to drop into single digits over the next year. Although the level of unemployment has remained at about 30%, real wage rates have increased at an average rate of 10% per year. Furthermore, foreign direct investment has increased significantly due to weak currency levels.

Despite the fact that many of the major cities have infrastructure comparable to a fully developed nation, most of the rural areas still lack passable roads, water and electricity, and a well-structured education system. The government has implemented a long-term development program that should provide the masses of the population with access to electricity, telecommunications, water, housing, education, and healthcare.

Despite a growth in consumer spending on durable goods in recent years, consumer spending in this category has softened, as interest rates remain high, household debt continues to increase relative to disposable income, and the availability of consumer credit has been reduced. Furthermore, for more than 60% of the population, average monthly household income remains at less than \$500.

Considering all of these conditions, the consumer durable goods manufacturer can map out where this sub-Saharan EM lies within the continuum of stages in the SDM. As stated previously, an EM will evolve at different rates and in a non-linear, iterative fashion through each of the stage's dimensional attributes. As a result, the example illustrates that an EM's

dimensional attributes may be at different stages within the SDM. The ultimate question then is how can this firm leverage this knowledge to market its products now and in the future. The competitive advantage that this knowledge gives this firm is in the form of insight as to where this EM's external environment will go based on the progressive flow of the SDM. By understanding the flow of these external environment factors, this manufacturer of consumer durable goods can properly position its firm capabilities and products to take advantage of future stage's environmental trends.

## Appendix

Exhibit 1: Economic Growth

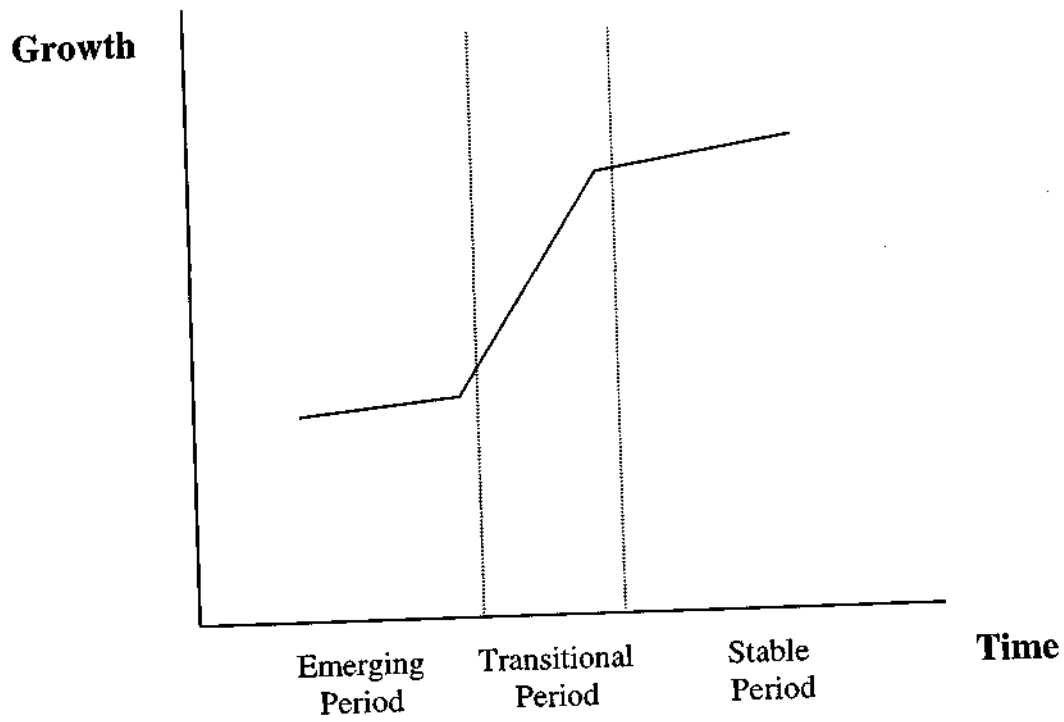
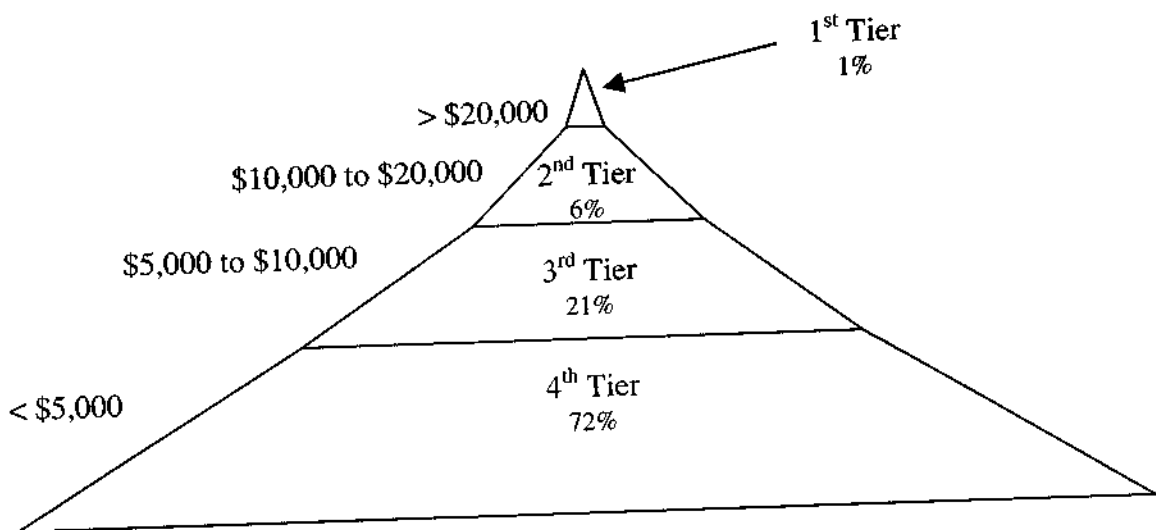


Exhibit 2: EM Purchasing Power Parity (% of Population)



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