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Note on the Global Middle Class

Rapid economic growth in India, China, and other developing nations in the late 20th and early 21st centuries led to the emergence of a new global middle class. These billions of potential consumers captured the imagination of both multinational firms and development economists. Global firms saw more than a billion consumers with evolving tastes. This group could drive revenue and profit growth for decades to come. Development economists hailed the large numbers moving out of poverty and realizing more comfortable lives. Political analysts debated the effect that these newly empowered citizens would have on stability and democracy.

This rapid emergence of the global middle class also raised questions about the definition of the middle class, its consumption habits, and its implications on both domestic politics and international relations. Forecasts of consumption varied, but most foresaw rapid growth, especially in healthcare and education. The consensus was that businesses would be challenged to adapt to this new group.

Defining Global Middle Class Growth

Size and growth estimates of the global middle class varied widely depending on the definition used. The income range used to define the global middle class was influenced by a myriad of factors: a relative or absolute approach, the national poverty line, and whether one was attempting to gauge interest in Western brands or local brands.

There were two main ways to define the global middle class: in relative terms, with the income range differing between countries; and in absolute terms, with the same income range applied in all countries. Nancy Birdsall of the Centre for Global Development and Bill Easterly of New York University proposed the former. Easterly defined the global middle class as the three middle quintiles of income, leaving out the poorest 20% and the richest 20%.[1] Most other analysts have used the absolute approach.

MIT development economists Esther Duflo and Abhijit Banerjee defined the global middle class as earning between $2 and $10 (US) per day. Similarly, Martin Ravallion, economist at the World Bank, defined the *emerging market middle class* as earning $2-13 per day. This population had crossed the World Bank's $2 per day global poverty line, but still lay below the $13 per day poverty line of the United States.[2] Members

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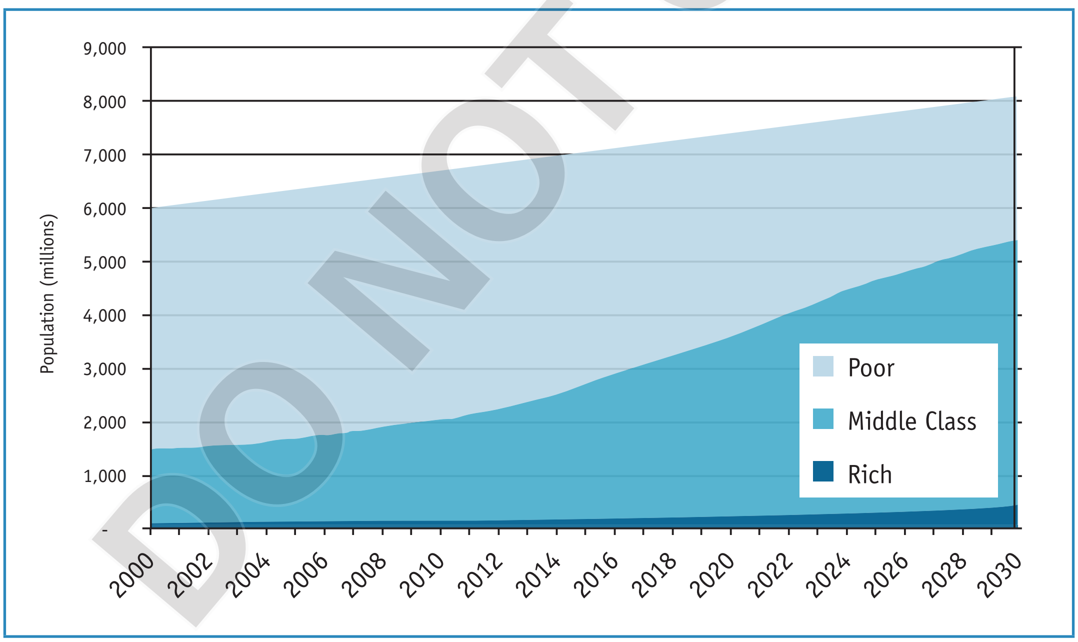
of this group were recognizably middle-class in their respective countries, though not on the global stage; most could not afford Western brands because they spent most of their disposable income on education and healthcare.

Ravallion's global middle class grew from one-third to one-half of the world's population—from 1.4 billion to 2.6 billion—between 1990 and 2005. He attributed much of this growth to India and China; India's middle class grew from 147 million to 264 million in those 15 years, while China's middle class burgeoned from 174 million to 806 million.[3] In the same time period, Latin America and the Caribbean's middle class increased by more than 84 million, and the Middle East and Africa grew their middle-income population by 150 million.[4]

Another estimate was offered by the Brookings Institute, which used a $10-100 per day income bracket to define a smaller, wealthier global middle class that lay between the $10/day average poverty line of Portugal and Italy--"the two European countries with the strictest definition of poverty"—and $100/day, twice the median income of Luxembourg, "the richest advanced country." This group excluded those considered poor in the poorest advanced countries and those considered rich in the richest advanced country. Using this definition, Brookings Institution analysts estimated that the percentage of middle class people in the world almost doubled between 1960 and 2006, and would double again by 2030,[5] expecting the global middle class to grow from about two billion to five billion between 2010 and 2030. Assuming this speed of growth, the middle class would outnumber the poor by 2022 (see **Figure 1**.)[6]

Figure 1

Real and Expected Growth in Global Middle Class, 2000-2030



Source: Brookings Institute, 2010; middle class defined as earning $10-100 per day.

Large corporations created their own estimates, often shifted upward in order to gauge demand for developed-world consumer goods. Goldman Sachs used a $16-80 per day income bracket, expecting the global middle class to expand from 1.5 billion to 3.5 billion between 2008 and 2030.[7] The lower band of this income bracket corresponded to the World Bank's definition of the median income level of upper-middle-income countries (around $3,600, equivalent to around $6,000 in PPP terms). The upper band roughly corresponded to the median incomes of the countries in the OECD group.

McKinsey, a global consulting firm, defined the global middle class as earning somewhere between $6 and $42 per day,[i] depending on the behavioral characteristics of the middle classes of different countries. McKinsey focused on a household's *discretionary income*, the household income left over after spending on food, shelter, and other basic human necessities. Discretionary income generally came from regular, formal employment, or a salaried job. When roughly one-third of a family's income was discretionary, it was considered to have moved out of poverty into the middle class.[8]

McKinsey created middle class profiles for two income brackets in India: a lower-middle class, earning about $6-12 per day, and an upper-middle class living on $12-31 per day (see ***McKinsey's Middle-Income India* sidebar**.)[9] Between 1995 and 2005, the lower-middle class grew from 18% to 41% of the population, while the proportion of upper-middle class increased only from 2% to 4%. The firm also predicted that by 2025, India's middle class would continue to grow, while the number of people earning less than $6 per day would decrease by 32%.[10]

In comparison, McKinsey reported that urban China's lower-middle class in 2005—defined as earning $11-17 per day—was nearly as large as its upper-middle class, earning $17-42 per day. The firm expected the lower-middle class to grow from about 12% to 50% of the urban population by 2015. Of the 77% of urban Chinese that lived on less than $11 per day in 2005, 67% were expected to move into higher income brackets by 2025.[11] See **Table 1** for a compilation of various definitions of the middle class.

McKinsey's Middle-Income India

Lower-middle class ($6-12/day)

People in this group are usually small-time shopkeepers, small-hold farmers, or low-skilled industrial and service workers, all typically spending almost half of their income on basic necessities.

For example, Ramnath (43), a high school graduate, works as an electrician in the Public Works Department and his wife, Lakshmi, is a housewife, bringing up the couple's three children and taking care of her in-laws. They supplement their household income with the takings from a small grocery shop run by Ramnath's father from their one-bedroom home. Food security is not an issue and the family owns an LPG stove, a small TV, an electric rod for heating water, and an iron. The family dreams of the day when they will enjoy the luxury of cold water from their own refrigerator. Although their survival is not in question, they are squeezed constantly by a scarcity of resources.

Upper-middle class ($12-31/day)

These individuals have a diverse range of occupations, from young college graduates to medium-scale businesspeople and government officials. For example, Priti is a nursery school teacher and her husband, Suresh, graduated with a degree in commerce and works as an accountant. The couple spend almost half of their income on food and rent for their two-bedroom apartment. They place a high value on education and, though it weighs on their budget, send their children to a good private school. They own one second-hand car, a 21-inch color TV, a compact music system, a mobile phone, fridge, and some jewelry. The couple hope to someday be able to eat out regularly and own their own apartment.

i Currency conversion done using exchange rates of 44.31 rupees=1 dollar and 6.54 yuan renminbi=1 dollar in April 4, 2011, rounded to the nearest whole number.

Table 1

Absolute Definitions of the Global Middle Class

Authors/Study	Definition (Daily Income)	Historical Estimate	Current Est. Size in billions	Projected Size in billions
Martin Ravallion, World Bank	$2-13	1.4 billion (1990)	2.6 (2005)	
Brookings Institution	$10-100		2.0 (2010)	5.0 (2030)
Goldman Sachs	$16-80		1.5 (2008)	3.5 (2030)
McKinsey-India Estimates	$6-31	20% of population (1995)	45% of population (2005)	
McKinsey-China Estimates	$11-42	7% of population (1995)	22% of population (2005)	80% of population (2025)

Source: Farrell, Gersch, Stephanson. McKinsey Quarterly, June 2006.

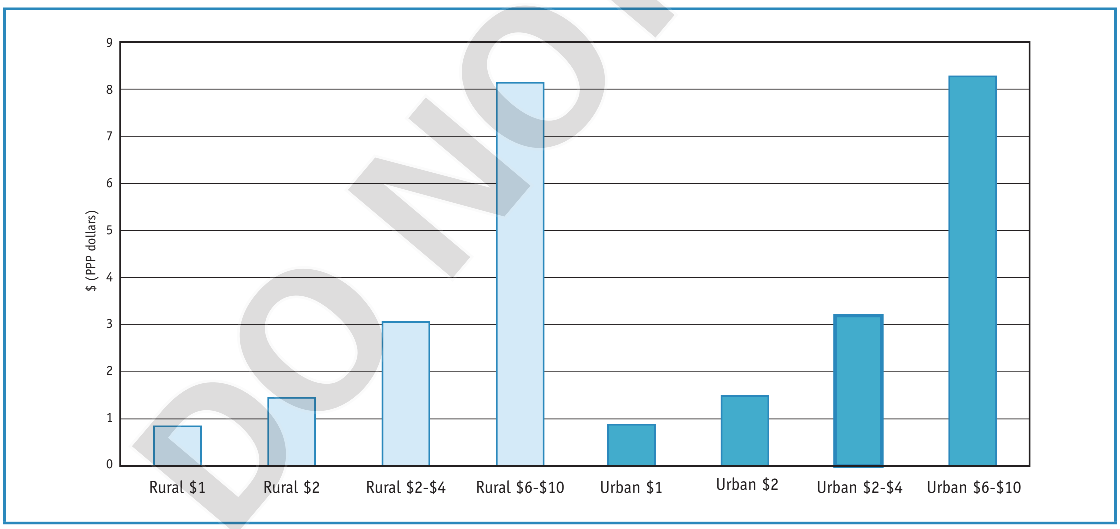
However defined, the global middle class grew quickly at the end of the 20th century and the first decade of the 21st century, and analysts expected its numbers to increase throughout the 21st century. Moreover, the business world began to take notice of how the emerging middle class spent its income.

Global Middle Class Consumption Trends

Average daily household consumption increased with income, spiking when household incomes reached the $6-10/day range across 13 developing countries (see **Figure 2**).

Figure 2

Average Daily Consumption per Capita



Source: Duflo, Esther, and Abhijit Banerjee, "What Is Middle Class about the Middle Classes Around the World?" MIT Department of Economics. December 2007.

This spike corresponded with a change in the composition of household spending. The percentage of household income spent on food decreased when households moved from the $2-4/day income range to the $6-10 income range, across urban and rural areas, and the food purchased was better tasting and more expensive. Similarly, the share of income spent on entertainment increased with income, as did television ownership.

The Tata Nano: Cheap and Cute

The Nano, a $2,500 car produced by Tata Motors company in India, was touted as one of the cheapest and smallest automobiles ever manufactured. Inspired after observing a family of four on a two-wheeler—wife sitting side-saddle—riding through the rain, Ratan Tata set out to produce a car that would, in his words, provide a "safe, affordable, all-weather form of transport" to more than a million families in need of personal mobility. Before it was produced, automobile manufacturers estimated that it was impossible to sell a car at a price lower than $5000. Tata Motors, by eliminating many features and using innovative distribution methods, created a vehicle that was aimed at being affordable to India's middle class.

The standard variant of the Nano had no trunk door, no power steering, no power windows, no air conditioning/heating, and no airbags, and provided only one windshield wiper and one side mirror. There were higher grades of the model, priced correspondingly more for more features. Furthermore, it met all Indian safety and emissions regulations and was fuel efficient, achieving 50 miles to the gallon.

Tata innovated a new car design and distribution method for this vehicle. Independent entrepreneurs were trained to create satellite Nano assembly operations anywhere in India, speeding up the distribution process and bringing the product to customers in remote regions. The Nanos arrived at the hubs in kits with various components; the entrepreneurs assembled the parts and then sold the cars to customers. The same assembly hubs were available to service the vehicles.

Indian consumers were ecstatic over the release. When a middle-class family bought the first Tata Nano to be sold in Mumbai, which was also their first car, wife Shaila commented, "I am very happy, I can't say how happy I am."

A consumption shift in healthcare and education was especially notable. Not only did families earning $6-10 per day spend more on education and healthcare, but they also spent a higher *percentage* of their incomes. The urban middle class spent even more than the rural middle class. Because of this, people in the middle class tended to use private health care services, which led them to buy the medicines that their doctors suggested, undergo recommended procedures, deliver babies in hospitals, and get more medical tests; the poor often relied on home remedies.

Middle class parents may have spent more on education because they were less likely than poor parents to take children out of school to work. Families earning $6-10 per day enrolled twice the number of 7-12-year-olds in school than families living on less than $2 per day, and they were more likely to allow their children to continue through high school. Also, middle class parents were likely to send their children to private schools, which were often better than public schools. Hiring after-school tutors was also common; in India, 20% of primary school boys and 40% of secondary school boys received after-school tutoring.[12]

As the middle class incomes rose, spending on education and healthcare was expected to grow, especially in India. McKinsey forecast that, for the 30 million households which were expected to move from the $6-12/day income range to $12-31/day between 2005 to 2015, spending on education would increase by 13 times and spending on healthcare would increase 10 times.[13]

The global middle class also increased its consumption of other goods and services. India had slightly more mobile phone users than the United States in 2007, while China had more than twice as many. In 2010, China became the world's largest market for television sets and automobiles.[14] In 2008, the year that the Tata Nano was released, more cars were sold in emerging markets than in the US (see ***The Tata Nano: Cheap and Cute*** **sidebar**).[15] India's car sales rose from 800,000 in 2002[16] to 14.8 million cars in 2010,[17] while in China, passenger car sales skyrocketed from 1.1 million to 12.45 million[18] between 2002 and 2005.[19]

Global connectivity was also desirable to the global middle class. In Brazil, 10 million people gained Internet access between 2005 and 2007, and 40 million people, or 29% of the population, had access to the Internet in 2007. Simultaneously, the average amount spent on Internet and TV subscriptions increased by 25% from 2006 to 2007.[20]

The global middle class also had a growing inclination toward financial services. India's ICICI Bank catered to the middle class by lowering transaction costs to levels far beneath those of its competitors. ICICI's cheap mobile phone banking allowed it to reach previously unbanked customers in smaller cities; in 2008 alone, ICICI Bank added 4 million new customers.[21] Similarly, in Brazil, the number of credit cards increased by 91% between 2002 and 2006; by that latter year, one in every 2.3 people had a credit card.[22]

Though the global middle class demonstrated a market opportunity for cheap goods and services, its total spending power was lower than that of the world's rich. In 2000, the global rich – defined as making more money than the average Italian -- accounted for 57.5% of the total world income, while the global middle class accounted for only 14% of the world income. The global middle class was expected to take approximately the same share of total world income by 2030, while the share of world income for the global rich was expected to increase to 69%.[23]

Middle Classes and National Prosperity

In addition to increased consumption, the emergence of a strong middle class was also associated with economic growth and prosperity. A growing middle class correlated with open trade, more investment, and new businesses. This was often because the middle class was not defending a political monopoly and wanted to encourage competition to the nations' elite.[24]

Also, middle class entrepreneurs were generally more successful than poor entrepreneurs. Most businesses owned by the poor were too small to employ anyone beyond family members and earned only a marginal profit. By contrast, many in the middle class were able to access the financial resources needed to cover substantial fixed costs, allowing them to start businesses that were large enough to both employ other people and generate significant profits. For example, Infosys was started in India by seven middle class people with an initial investment of $250. One was the son of a schoolteacher, another was the son of a textile-mill manager, and a third pawned his wife's jewels to help raise money. Infosys eventually became a leading IT and consulting firm with revenues over $4 billion and 91,000 employees worldwide. Growth of the global middle class provided more opportunities for upward mobility in developing countries.

However, there were barriers in the developing world for entrepreneurs, such as corruption, lack of regulation and property ownership, and low availability of secure personal savings accounts and other financial services. For example, nine out of ten Nigerian business owners reported having to make "facilitation payments" to local authorities.[25]

Middle Classes and Political Engagement

As emerging economies and their middle classes grew, the relationship between citizens and the state generally evolved. Ronald Inglehart of the University of Michigan explained the ideological phases that developing world communities passed through as their incomes increased. Poor communities tended to have traditional attitudes, in which members placed the most importance on religious and communal beliefs and understood the world based on the ideas held by people in their immediate vicinities. Often, they had only a superficial connection with their own governments and nations, let alone the rest of the world.

As societies prospered and gained access to opportunity, they evolved toward modernity, more generally described as modern middle-income nations and middle classes in developing nations. In contrast with the poor, middle-income people tended to be more flexible in their thinking, with their values and outlook based not only on friends and family, but also on the media and personal contacts that were far away.[26] As people earned more, they realized their individual stakes in the events taking place around them and began to place importance on judicial systems, social values, and freedom of speech.[27]

For example, a store owner could be aware of a lack of paved roads leading into her town, since this affected her business. Instead of harboring an unmovable acceptance of authority, the middle class entrepreneur would understand the rights and laws governing her quality of life and lobby for change. For example, protests against food prices in nations across Asia, Latin America, and Africa demonstrated a large-scale engagement by the emerging middle classes, as did the 2011 political revolution in Egypt.[28]

Another common characteristic among middle class families across the developing world was the idea of pursuing upward mobility through individual merit, healthy competition, hard work, self-reliance, and thrift. According to Justin Yifu Lin, chief economist at the World Bank, the global middle class' critical asset was its "aspiration, and the means to pursue it."[29]

Implications for Business

Many company executives viewed the emerging global middle class as a massive future market for their products. Muhtar Kent, CEO of Coca-Cola, described the scale of the opportunity as adding a city the size of New York to the world every three months,[30] and predicted a doubling of revenues—from $100 billion to $200 billion—between 2010 and 2020.[31] Kent described:

> We will see a billion people around the world entering the middle class in the next 10 years. This, ladies and gentlemen, will be the greatest economic shift in history. And 60% of this new wealth will come from emerging nations.[32]

Morgan Stanley Asia chair Stephen Roach believed that in the period from 2015 to 2020, the global middle class could compensate for a decrease in American consumerism. However, companies that hoped to take advantage of the emerging global middle class needed unique strategies for the developing world. This meant reducing prices, tailoring products to local cultures, and creating brand awareness for first-time users.

If prices were kept comparable to those in the developed world, companies would only be targeting the upper classes of those nations, since a vast majority of the global middle class still had modest incomes. Companies focused instead on driving down price-points and aiming for high volumes. For example, Coca-Cola sold its beverage in returnable glass bottles in rural China in order to lower the price. Innovations in production and distribution also drove down prices, like the no-frills production techniques used for the Tata Nano.

Companies also had to tailor their products to the distinct cultures of the middle classes of different nations. In India, for example, products had to include high functionality on the features that mattered, while in China there was a high level of brand-consciousness.

A large number of people entering the middle class were experiencing the luxury of consumer choice for the very first time. Companies had the burden of educating these consumers about unfamiliar products and services, creating brand awareness, and providing customized support for these consumers. However, companies were also able to influence tastes and consumption habits, since the consumers had few existing brand loyalties.

Domestic companies faced choices to expand their consumer bases, follow their consumers as they climbed the income pyramid, and/or partner with multinational companies who would be trying to lure away their now top-end consumers. Additionally, multinationals had to work to create distribution and logistics processes that took into account infrastructure challenges, which often created high distribution costs in the developing world.

The many business challenges were complex and varied, but the emerging global middle class provided a new opportunity for companies to grow and establish themselves in emerging markets for years to come.

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Notes

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