

## Want a long-term winner? Back consumption

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August 2010

About 135 million people around the world are estimated to have escaped from poverty between 1999 and 2004. That means that a population greater than Japan's (126 million) was added to the pool of global consumers in just five years.

Over the next few decades, the number of people considered to be in the "global middle class" is projected to jump from 430 million a decade ago to 1.2 billion by 2030, according to the World Bank. Most of the new entrants will come from China and India, where consumption is surging. The World Bank predicts that by 2030, 93% of the global middle class will be from developing countries, up from 56% ten years ago. (The bank defines the global middle class as individuals earning an income between the per capita income of Brazil and Italy.)<sup>1</sup>

These facts explain why so many companies are developing presences in emerging markets; from Asia to Brazil, from sub-Saharan Africa to Russia. They want to capture rates of consumption growth that are unimaginable in mature western economies.

Asia's potential consumption is huge. The outlook, though, is complicated by a preference for saving that is partly due to the lack of a social safety net. China's government, for instance, boosted the incentive to save when it privatised housing and the pension system in 1999 and suggested households should be responsible for their own education and healthcare needs.

As a result of the global credit crunch, however, countries including China have conducted massive stimulus programs and many governments are under pressure to implement social reforms. A combination of income growth and social reform would ignite Asian consumption in coming decades.

While China may be one country everybody is watching to see the consumer revolution take hold, private consumption in India accounts for a higher share of GDP than in China – about 55% versus around 50% in China and about 70% in Australia. In India, rising incomes and readily available retail credit have encouraged consumption growth of 5% to 7% a year over the past decade.<sup>2</sup>

The outlook for further growth is compelling thanks to India's rising proportion of young workers. McKinsey forecasts that India's middle class will grow from 5% of the overall population now to 41% by 2025.

As this occurs, Indian spending habits are likely to change. At present, spending in shopping malls is a tiny percentage of total spending because most money is spent with small traders in public markets. The difficulty for foreign retailers is that India bans foreign investment in multi-brand retailing, so local players such as Reliance, Bata India and Pantaloon Retail are gaining footholds in the expanding formal shopping market.

While consumerism is still to fully grip China and India, it is embedded in some emerging markets such as Brazil, the most western of the BRICs. The South American country, for example, is now the third-biggest market for beauty products after the US and Japan.

### Changing patterns

As incomes grow in emerging markets, the proportion that is spent on necessities shrinks. As the disposable income of emerging consumers grows, so too does the allure of the coolest fashions and the latest gadgets. Consumption patterns in emerging markets are already changing as this trend develops.

While western consumers grow resistant to advertising, forcing companies to be more innovative, multinationals are using time-tested aspirational advertising to build brands in emerging markets.

Guinness, for example, is what the upwardly-mobile Nigerian man ought to be drinking, according to an advertising campaign in the African country. And drinking it he is. Nigeria has recently become the largest market for Guinness in the world.

Another area reliant on advertising that is growing strongly in emerging economies is western-style fast food. Yum! Brands, whose portfolio includes Pizza Hut and KFC, has opened 200 restaurants in India that are achieving revenue growth of 40% a year. In China, the company has around 3,000 KFC outlets and 500 Pizza Huts. Incredibly, it sees the potential for 20,000 restaurants in China.<sup>3</sup>

Tourism and leisure are classic areas of discretionary spending that are set to surge thanks to the growth in the middle class. Companies such as Ctrip.com, which is China's dominant online and telephone travel agency, stand to benefit. Li Ning is the leading player in sports apparel in the mid-end segment, just below the high-end names of Nike and Adidas. It's well placed to capture consumers trading up from the low-end of the sports clothing market.

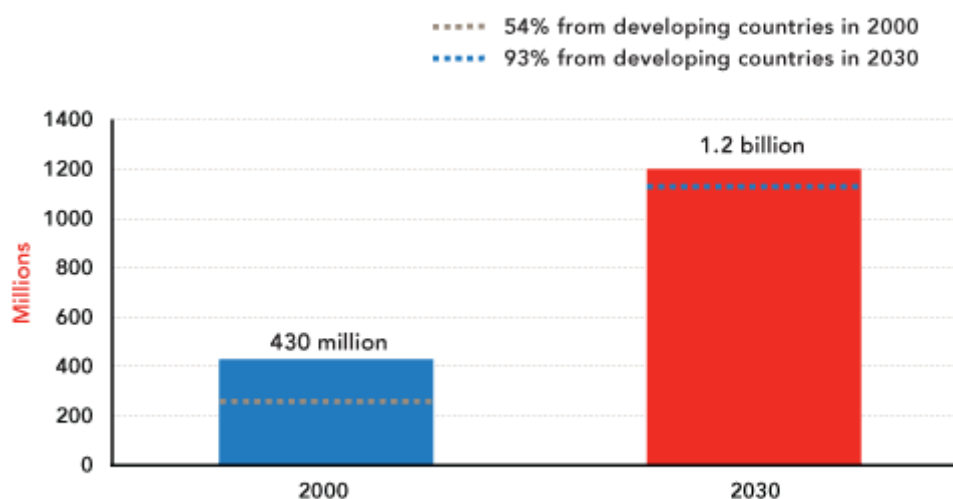
And then there's the potential for the luxury goods market. The elite in emerging markets are happy to indulge in ostentatious purchases to underline their status and reward themselves for their endeavours. This invariably means luxury western brands are in great demand from a relatively small, but high-spending, portion of the population.

The western luxury goods companies have noticed. They have expanded their presence in key financial centres where wealth has accumulated, such as Shanghai and Moscow.

These companies benefit from the fact they have no local competition. In the low- and mid-market areas, there are abundant local competitors who can compete on price. The top end, however, enjoys the exclusivity and allure that comes with high prices. Companies such as Burberry, LVMH and Richemont are poised to benefit as the top strata of the emerging middle class expand.

While industrial investment themes may reward investors only over specific parts of the investment cycle, the steady growth in consumption represents a compelling and enduring theme over the 21st century that deserves long-term inclusion in any equity investor's portfolio. After all, every few years there's another Japan worth of new middle-class consumer to target around the world.

### Massive growth in the global middle class



World Bank. 2009

<sup>1</sup> World Bank. [worldbank.org](http://worldbank.org). As quoted by Citigroup. "Emerging market consumerism". 15 September 2009

<sup>2</sup> DataStream. National statistics. June 2010

<sup>3</sup> Citigroup. "Emerging market consumerism". 15 September 2009

All information comes from Bloomberg and Citigroup unless stated otherwise.

### Important information

References to specific securities should not be taken as recommendations.