

EXECUTIVE BRIEFINGS BUSINESS AND FINANCE: INDIA'S MIDDLE CLASS

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Hard to miss the middle class

The size of India's consumer markets and the definition of its middle class is a subject that is frequently prone to confusion. Recently, *The Economist*, a London-based magazine, published a briefing entitled 'India's Missing Middle Class'. This argued that the constituency so defined is actually smaller than previously believed. The article generated volatile reactions from several commentators, many of which were published in different newspapers. This paper will present our analysis on this subject.

At the outset, it would seem that the correspondent who authored the piece in *The Economist* used partial and selective analysis in arriving at his conclusions. It appeared as if *The Economist* had already made up its mind and then picked instances to support its hypothesis. It relied on observations by Thomas Piketty, the left leaning French economist whose analysis and conclusions in several areas have either been discredited or in the very least disputed.

China is big... doesn't mean India is small

One of the basic themes of the briefing appeared to be a comparison between India's consumer markets with those of China. But such a comparison in isolation is clearly misplaced. India's economy has, for the past 30 years, been a fifth of its neighbour's and this equation continues to hold true. It is logical therefore, that its consumer markets and consumption would be proportionately smaller. If this was to constitute the basis for evaluating India's market attractiveness, then multinational corporations should never have entered this market as they did 2-3 decades ago. In fact, India should never even have been in the reckoning of global business executives and hedge fund managers. As things turned out, most that took the punt have prospered and frequently beyond initial expectations. The reasons are simple enough. Mechanical estimates of size and numbers rarely capture the true potential of an economy. What matters more are the local nuances and preferences of a market and if a business is able to crack these, the payback is often more than what the initial numbers may have suggested.

The Economist's article appeared to have glossed over this principle when, for example, it referred to a measly 100 Starbucks outlets in India compared to 3,000 in China (omitting perhaps opportunely to mention that Starbucks entered China in 1999 and in India, five years ago). But one might justifiably argue that the number of Starbucks outlets can hardly constitute a measure of the middle class. India has tens of thousands of branded food outlets such as those operated by Haldiram, Bikanerwala, Sagar Ratna, etc, which cater to local preferences and constitute a more valid comparison. The opportunity, for both Indian businesses and foreign ones, possibly lies in *dosa* diners and *chaat* shops. The appeal lies in the product.

The size of the middle class? It depends on who is counting

How do you define middle class? Is it based on levels of education, buying patterns, proficiency in foreign languages, income, brand awareness or lifestyles? Or is it simply based on the criterion of an income of USD 10 per day, as *The Economist* suggests? At the very bottom of the consuming pyramid are the under-employed who benefit from the Government's job entitlement programme called NREGA (National Rural Employment Guarantee Act). These beneficiaries receive the equivalent of USD 3 per person per day. As it happens, many of these households have other sources of income, for instance, in construction, farming or as domestic helps. A household maid in metropolitan India earns anywhere between Rs 10,000 and Rs 20,000 a month (USD 5-10 per day). By this definition therefore,

almost everyone except the most impoverished would constitute middle class. How could this possibly add up to only 78 million individuals, which is what The Economist's article claimed? A paper published in the Economic and Political Weekly, a respected journal, by Sandhya Krishnan and Neeraj Hatekar entitled 'Rise Of The New Middle Class In India And Its Changing Structure' contends that the size of this market segment has actually jumped from 304 million in 2004-05 to 604 million in 2011-12. It seems clearly logical that by extension this figure would have grown even more if measured by the same parameters today.

The numbers don't add up

The figure of 78 million individuals is actually based on a dubious model employed by Thomas Piketty. And even a simple back of the envelope calculation shows how far off the mark this figure is. For instance, the current population of vehicles in India is estimated to be 210 million. This includes approximately 154 million two wheelers and 28 million cars, the balance consisting of commercial vehicles, three wheelers, etc. Given that certain households will have more than one vehicle, one could conservatively assume that this translates into approximately 18-20 million car-owning households and perhaps 100 million or so two-wheeler-owning households. Going by The Economist's own example of a two-wheeler buyer representing India's middle class, one arrives at a figure of 120 million *households*. Even if this is toned down on the assumption of statistical discrepancies and estimation errors, one is still left with a market size several times larger than Mr Piketty's estimate. The numbers simply don't add up.

At the end of the day, it's really about the kind and volume of products that are sold in India every year. For instance, 3.5 million passenger vehicles were sold in 2017; 20 million scooters and motorcycles; 250 million mobile phones, almost half of which were smart phones. About 20 million Indians travelled abroad on holiday and over 400 million have at least occasional access to the Internet. These would be construed as sizeable numbers from even the most stringent benchmarks.

Indian aviation: flying high

The Economist's article spoke of Ryanair, a 34-year old budget airline based in Ireland, which services the European market. It compared its size to that of India's aviation market. But the facts are that Indian aviation really began to grow only about a decade ago and even sceptics generally agree that it is probably the second fastest growing market opportunity in the world. Indigo, a 12-year old Indian budget airline has a market capitalisation of USD 7.5 billion against Ryanair's USD 20 billion but aircraft manufacturers such as Boeing and Airbus have no doubt whatsoever in their minds who their more important customer will be in the years ahead: while Ryanair is buying 100 new aircraft over the next few years, India's airlines have placed orders for 900. The Indian aviation market is growing at 20% a year against nearly zero growth in Europe, amply demonstrating the rise of its middle class.

The Indian proposition: a large market and high growth

At the other extreme, the article abruptly switches to comparisons with the West. While it admits that India may be a reasonably large market it likens it to a Switzerland or central Europe – big enough to interest global businesses but not to redefine their fortunes. Such an assertion again misses the point. Switzerland and central Europe are mature economies that have nothing more to offer beyond their current size. India's economy on the other hand, is growing three times faster with many of its consumer markets expanding at double digit rates as in the case of passenger vehicles, two wheelers, aviation, telecom, banking, etc. In fact, there are few countries other than India that offer the combination of a large current market together with high growth potential. Even if China scores higher, it hardly limits the universe for global businesses. The fact is, India's economy will more than double in the next 10-12 years and so will its consumer markets. In the ultimate analysis, this is what invites investment into this market.