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Serving the underserved
tapping the booming middle class market

Every industry is upbeat about the size & the growth of Indian middle class market. With increasing disposable income, the "common man" now has more to spend and more to invest.

Aristotle said that a good society is one where the middle class outnumbers everyone else. In India, various estimates of the middle market vary from 200 million to 300 million. The bigger opportunity is that, if the present growth trend of the last 10 years continues, 40% of India will be in the middle class by 2025.

This throws up significant opportunities for Financial Planners in India; a mass of 550 million to 600 million consumers will be the biggest mass affluent segment globally, apart from China. With an annual income of Rupees 51.5 trillion—11 times what it is today and 58 percent of total Indian income, this will be one of the most significant consumption and investor segment in the world.

The Indian Middle Market

The Indian economic growth has seen the national income increase at a nominal rate of 14 % plus over the last three years, touching Rs 28, 46, 762 crores in 2005-2006. Given a population growth of 1.1%, the per capita income has also grown by 14.3%; rising from Rs 25,716 (2005-6) to Rs 29,382 (2006-7).This clearly indicates the rise of a huge middle market in India. In fact, the Indian middle class is expected to account for over 40% of the total population in the next 20 years.

NCAER data shows that the number of Indian middle class households with annual income between Rs 0.2 million and Rs 2 million has quadrupled in the past 10 years, from 4.7 million households in 1996 to 17.5 million in 2006. Moreover, the number of upper-class households, with annual income greater than Rs 2 million per annum has grown six times from 0.08 million in 1996 to 0.6 million in 2006.

Table 1

Urbanization in India

	1971	1981	1991	2001	2006	2011
Population (mn)	109	159	218	285	325	370
Population Growth (%)	2.7	3.9	3.2	2.7	2.6	2.7
% urban Population	20.0	23.3	25.7	27.8	29.1	31.2
Contribution to national income (%)	35.0	47.0	55.0	60.0	63.0	66.0
Cities–population > 1Mn	8	12	23	35	45	53

Source: Census of India, 2001

The national income growth is simultaneously accompanied with a growth of gross domestic savings to 30% of GDP—Rs 9,60,000 crores per annum. For a nation of savers; the challenge is to translate this huge savings pool into appropriate investments.

A comparison of the Indian households' investment patterns with the US and other countries shows this contrast very starkly (See Table 2). Indians have been saving in fixed return products to the neglect of the capital market products. Even in insurance, which gets 13% of household savings, the population penetration is at 2%, as against an Asian averages of 6% plus. This skewed asset allocation has led to the development of and is perhaps caused by a distribution structure that deeply serves the banking needs of the Indian households well (See Table 3).

Serving the Indian Middle Market

In the May 2007 issue of the Journal of Financial Planning, Sean R. Walters, CAE, Managing Director of the Knowledge and Market Development Group for the Financial Planning Association in Denver, Colorado uses a Cerulli Associates model to explain the approach to various consumer financial segments.

"Researchers at Cerulli Associates have published a model that explains much in the way of how financial advice is provided to the various consumer markets. In their model, technology-based support (high tech) and intermediary-based support (high touch) can be "scaled" to serve different segments of the audience. The less wealth the client has (and presumably, the less complex issues), the more technology can be used to streamline interaction. The more wealth a client has, the more personal interaction they may require. At the high-wealth end of the spectrum, this would translate to a whole multi-disciplinary team of professionals serving highly complex needs. See Chart 1 for an illustration of this model."

The Indian historical experience has been similar. The mass market and the middle market have been offered non customized, one size fits all, products with little Financial Planning assistance. The higher-end affluent to high-wealth segments are served by private banks and high end Financial Planners with customised plans, personalised service and high touch assistance.

The sheer size of the Indian middle-class market has meant that the huge banking and evolving insurance infrastructure has generated large volumes, while the mutual fund industry has been more concentrated. The top 100 mutual fund distributors account for 79% of assets under management. But a welcome trend is that the mutual fund evolution in India is more akin to the US and UK model, where banks have played a smaller role to national distributors and independent financial advisors. With a 50 % market share, national distributors have the scale economies to more effectively address the India middle-class market. Similarly, with localised expertise and low cost models, IFAs can deeply serve this segment.

Table 2

Household Balance Sheets: Indo US Comparison

% of Financial Savings In:	For Indian Households	For US Households
Currency	9	1
Deposits	39	15
MF & Shares	2	33
Claims on Govt.	24	11
Insurance	13	16
Retirement & Pension	13	24

Currency, Deposits & Small savings will lose market share >>> Opportunity

Source: RBI, ICI, USA

Table 3

Distribution: Financial Services providers matrix

	Banks	Insurance Cos	Depositories	Mutual Funds
Branches'000	68.8	3.5	5.0	1.0
Accounts (Mn)	500	200	90	25
Customer Deposits/ Assets Managed (Rs. Bn)	24,657	5,500	35,715	3,533

MF: Under served, Under penetrated >>> Sunrise Industry

Source: RBI, IRDA, NSDL, CDSL, AMFI, LIA MC

Different Strokes for Different Folks

What will be the key Financial Planning models that will succeed in addressing this emerging opportunity? We take a look at some of the existing models

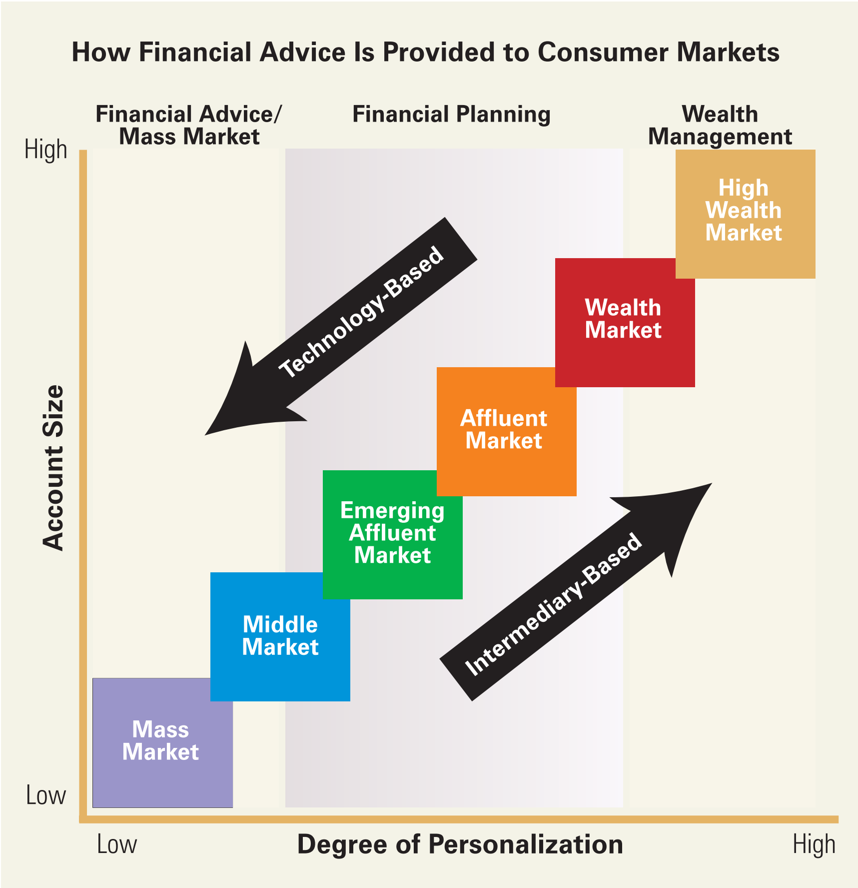
Banks: Banks have a unique advantage in owning the transaction details of investors; have the distribution network, brand name and most importantly multi-product ability advantages. They also have scale economies and ability to offer technology solutions.

So why has the bank's market share been limited? The prime reason is their product orientation, rather than a customer orientation. Most banks don't have a customer profitability model, though they have product revenue models. Hence instead of making genuinely customer friendly Financial Plans, most banks are pushing high revenue products, especially ULIPs to customers. With employee revenue sharing models, this leads to a lot of mis-selling and aggressive pitching of products to customers. The other bane of banking models has been the high employee turnover. Customers like the high-touch promise of banks, but research has shown that less than 20% customers are happy with the amount of communication and continuity provided by their bank's relationship manager. And the short term focus of target driven bank branches, leads to constant churning of customer portfolios from one product to another, to maximise the banks commissions, not necessarily the customer's profits.

So, what can banks do to address the Middle Market? The critical need is to make genuine Financial Planning the centre-point of customer relationship management. Banks can also use technology to offer web-based, telephone-based, ATM-based services and encourage transaction solutions to customers to reduce costs and enhance efficiencies.

National Distributors: National distributors have had the most success in

Chart 1



Source: Cerulli Associates

terms of evolving with the changing market place realities. What can the national distributors do? Scalability of the

A SUCCESSFUL IFA STRATEGY in serving the middle-class market is to organise the client base around a common target or niche client base.

Financial Planning process is the key challenge. Cerulli researcher, William Waldert advises on the concept behind achieving scalability: "Success in this market depends on the ability of firms and advisors to develop a system to serve a large group of diverse investors in an efficient, repeatable manner—to make it as scalable as possible."

Aggregation and having a single window '*customer view*' is the first essential step. Tagging, identifying and offering profitability based services are keys to their success built on the high touch culture.

They should invest in technology. Successful companies in this space need to develop a system that involves a significant use of technology, and streamline back-office plan production approach that allows their front end employees and sub brokers to serve clients. Training and accreditation is the key, as the brands are still nascent and evolving.

Independent Financial Advisors: With a market share of 25%, equal to the formidable banking segment, the IFA segment is a truly resilient one. However, to succeed in the future, IFAs will need to reinvent themselves. They have thrived on individual service, localized presence, accessibility and anytime, doorstep service as well as continuity and accountability.

What can the IFA segment do to address the Middle Market? A successful IFA strategy in serving the middle-class market is to organise the client base around a common target or niche client base. This strategy can be difficult to execute, but highly successful both from a client and advisor experience. Cerulli Associates', William Waldert says, "The advantage of specialisation is that the advisor works with similar clients. They enjoy being around their clients and communicate with them more effectively. In addition, there is a ready-made referral network. Advisors must find a narrowly focused, but widely available, group of potential clients with whom they can develop a special relationship."

Crystal Ball Gazing

In conclusion, the managed funds level in India is forecasted to reach USD 1 trillion by 2015. Pension reforms will unleash a fresh wave of money and customer requirements into the Financial Planning profession. Success will be achieved by those market intermediaries who make a genuine Financial Planning framework the centrepiece of their customer relationship management process.

India's success has been built on its human capital. This dynamic middle market deserves a customized, friendly and comprehensive Financial Plan offering to translate their huge savings into satisfying investments. The Indian Financial Planners are certain to deliver this over the next twenty years. The future of the Financial Planning profession in India is decidedly bright.