Business Standard

Subir Gokarn: Mystery of the missing FMCGs

Consumer spending is spread over a wide range of goods and services

Subir Gokarn | New Delhi May 10, 2004 Last Updated at 00:00 IST

For some time now, people have been trying to make sense of the relatively slow growth of the FMCG sector. Two sets of explanations are commonly advanced. One is based on price.

Branded products made by the corporate sector are at a price disadvantage because they carry the full burden of central, state and local indirect taxes.

Competition from the informal sector, which is able to avoid at least some of this burden, is increasing. For a lot of consumers who are just beginning to use these products on a regular basis, price is clearly a dominant consideration.

The second is based on emerging rigidities in household spending decisions. More and more households are availing of financing to be able to buy an increasing range of products and services, from housing to automobiles to consumer durables to vacations.

Higher education is also easily financed through loans. The result is that an increasing proportion of household expenditure is committed to servicing debt, leaving that much less for discretionary spending. FMCGs bear some of the impact of this, with consumers looking for cheaper products and/or making do with less.

While both explanations place the burden on "environmental" factors, they do have significant implications for marketing strategy. Price reduction to match the low-priced offerings is clearly one such response, and we have seen plenty of that in the last few weeks and months.

Of course, cutting prices to increase revenues will only work if a specific technical condition is satisfied, viz, the price elasticity of demand must be lower than -1. If this is not the case, then the increase in volumes will not offset the reduction in prices, and total revenues will not increase.

The point is that the translation of "explanations" into "strategies" can perhaps be made a little less risky by thinking through the various links in the chain and the conditions that must be satisfied for a particular strategy to have a favourable impact.

To the extent that these conditions can be quantified, as in the case of the price elasticity of demand, quantifying them through the use of appropriate data and techniques is essential to the translation process.

Explanation No 2 "" structural change in consumption baskets "" implies a simple proposition that can be easily tested at the macro level. If the argument that households are cutting back on higher-priced FMCGs produced by the organised sector in order to service their monthly commitments on borrowings for housing, vehicles, durable goods and so on, there should be a negative correlation between the growth rates of the two categories.

The Index of Industrial Production (IIP), in its use-based classification, classifies consumer goods as durables (including two-wheelers, household appliances and so on) and non-durables (basically, FMCGs).

The simple correlation coefficient of the growth rates of these two categories over a 10-year period from 1995 to 2004 is -0.11. It is negative, but its magnitude is not large enough to be persuasive about the validity of the explanation.

However, we should recognise that retail financing has been a significant factor in consumer decisions only for the last few years. Truncating the period of analysis to 2000-04, which should roughly coincide with the explosive growth in financing for things other than housing, the picture is strikingly different.

The correlation coefficient changes to -0.65, which is highly significant in statistical terms, and much more supportive of the explanation.

While the simple correlation analysis has some value, it leaves several questions unanswered. One set relates to the kinds of things that are not included in the IIP "" education and health services, entertainment and so on, which are clearly accounting for increasing shares of household budgets.

If the monthly committed expenditure explanation is valid, its impact should be felt on all expenditures that are not in this category.

The table presents some macro-level numbers on the shares of various groups of consumer goods and services in total private final consumption expenditure (PFCE) as reported by the National Accounts Statistics.

2001-02 is the latest year for which this particular decomposition is available. The assumption is that the bigger trends visible in this eight-year timeframe are persistent. Aggregate consumption grew at around 5.3 per cent per year in real terms, marginally below the rate of growth of GDP over the period.

This difference, small though it may be, indicates that the share of consumption in GDP is declining, which in turn implies that anybody exclusively serving consumption needs will see growth slip in relation to GDP. But, that is at the aggregate level; once we itemise consumption, there is a clear divergence in patterns.

Five categories grew faster than the aggregate, thereby increasing their shares. Two of these "" furniture, appliances, etc and transport and communication "" are likely to have been significantly impacted by growth in retail finance.

The first of these two still accounts for a relatively small share, which suggests that committed expenditures are small. The second had a relatively high share of around 11 per cent in 1993-94, which grew to about 14 per cent in 2002; the impact on committed expenditures perhaps grew more than proportionately.

The other three categories that grew relatively fast are intriguing. Medical care and health services and recreation, educational and cultural services showed relatively rapid growth, even though their shares are not particularly high at the end of the period. There is both a discretionary and a non-discretionary component in these categories.

While people appear to be spending more on entertainment and travel, it is quite likely that the costs of medical care and education have gone up. The public sector is deteriorating rapidly and people at all income levels are perforce moving to private providers. In their scheme of priorities, does this mean that food, FMCGs and clothing are the categories to take the hit?

The residual miscellaneous category also grew relatively fast. This also includes some FMCGs, but there are too many undefined goods to draw any firm inferences from its growth. The most one can say is that consumer spending is being spread more thinly over a wider variety of both goods and services.

The first cut evidence seems to broadly suggest two drivers of slow FMCG growth: one, a decline, although mild, of the share of aggregate private consumption in GDP; and two, a re-allocation of spending not just to things that can be financed, but also essential health and educational services, which are becoming increasingly more expensive. Apart from the strategic implications of these shifts, there also appears to be a public policy dimension to the mystery.

(The writer is chief economist, Crisil. The views expressed are personal)