McKinsey&Company

Consumer Packaged Goods

Global Growth Compass

Locating consumer-industry growth opportunities in emerging markets

November 2011

Claudia Benshimol Severin
Rogerio Hirose
Udo Kopka
Subho Moulik
Taro Nordheider
Fábio Stul

Contents

Global Growth Compass: Locating consumer-industry growth opportunities in emerging markets

Introduction 1

Growth in consumer spending will be driven by emerging markets 2

Emerging city focus 3

How the Global Growth Compass approach works 4

Implications for business leaders 5

The Global Growth Compass database and model 6

Global Growth Compass: Locating consumer-industry growth opportunities in emerging markets

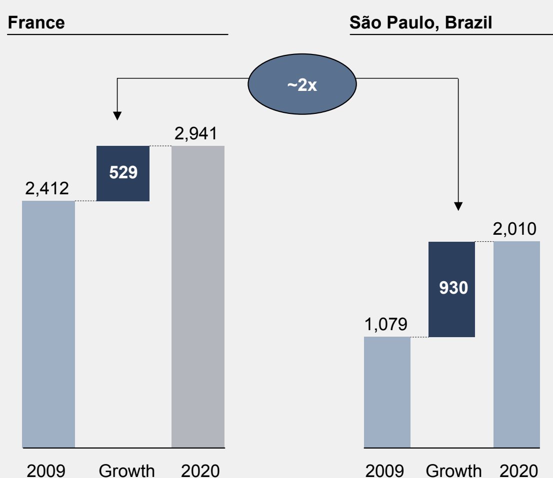
Introduction

Today some 5 billion people live in 37 countries where nominal GDP per capita is in most cases less than $1,000 a year. Despite representing roughly 70 percent of the world's population, these emerging-market consumers account for only 35 percent of the world's GDP. This is changing; by 2020 the collective GDP of the emerging markets[1] will overtake that of the developed economies[2] for the first time. And over the next 10 years, consumer spending in emerging markets is expected to grow three times faster than consumer spending in developed nations, reaching a total of $6 trillion by 2020.

Fast-growing cities will account for the lion's share of growth in emerging-market consumer spending. For example, sales in hair-care products in São Paulo are expected to grow by approximately $1 billion over the next decade, double the $0.5 billion growth in hair-care sales expected from the whole of France (Exhibit 1).

Exhibit 1 In hair-care products, the city of São Paulo is expected to see nearly twice the growth as France.

Expected growth in consumer spending on hair care
$ million, 2009–20



Source: Global Growth Compass database, McKinsey analysis

Growth is a critical source of shareholder value for consumer goods companies. Today, one-third of the combined market value of global consumer goods players is linked to growth. Dynamic emerging markets therefore deserve particular attention from global players, although few are extensively active in these arenas yet: only 30 percent of the top 15 fast-moving consumer goods (FMCG) companies' revenues came from emerging markets in 2009.[3]

Decision makers in FMCG multinationals must understand and address changing patterns of growth in consumer goods consumption, in both geography and category. But deciding how best to allocate resources among a large number of rapidly growing potential consumer goods markets is difficult. Sound decisions depend on understanding which areas will offer the highest prospective returns in particular categories and when. Focusing simply on the BRIC countries—Brazil, Russia, India, and China—cannot be the right answer for all categories. Even when it is, which BRIC cities will be the most important?

We have developed the Global Growth Compass to help decision makers at multinational companies analyze the proliferating opportunities in emerging markets quickly and rigorously. This tool combines historical data on category growth, macroeconomic indicators, statistical growth modeling, and knowledge of local markets to enable consumer goods companies to understand differences in market potential and choose investment strategies for particular geography and category combinations. The Global Growth Compass database covers 50 consumer categories, 60 countries (both emerging and developed), and more than 2,000 cities around the world. The countries represented in the database together account for 96 percent of 2010 global GDP.

This paper explains the overall emerging-market opportunity for FMCG companies and then details different levels of growth opportunities in emerging country and city markets. It outlines the analysis underpinning these findings and finally describes how the Global Growth Compass can help business leaders plan and prioritize their investments in future growth.

1 Asia (excluding Japan and Singapore), Eastern Europe, Latin America, Middle East (excluding Israel), and Africa.
2 North America, Western Europe, Australia, Japan, Israel, New Zealand, and Singapore.
3 A simple average of the top 15 companies' 2009 revenues in beauty and personal care, home care, packaged foods, and soft drinks.

Growth in consumer spending will be driven by emerging markets

Consumer spending worldwide across the 50 FMCG categories covered by the Global Growth Compass grew by about 5 percent a year over the past decade to reach $7 trillion in 2010. Eighty-three percent of that spending was concentrated in three segments: food and beverages, apparel and accessories, and alcoholic drinks. Over the next 10 years, we expect consumer spending worldwide to grow by $5 trillion, almost double the growth seen in the previous decade and the equivalent of 60 P&Gs.

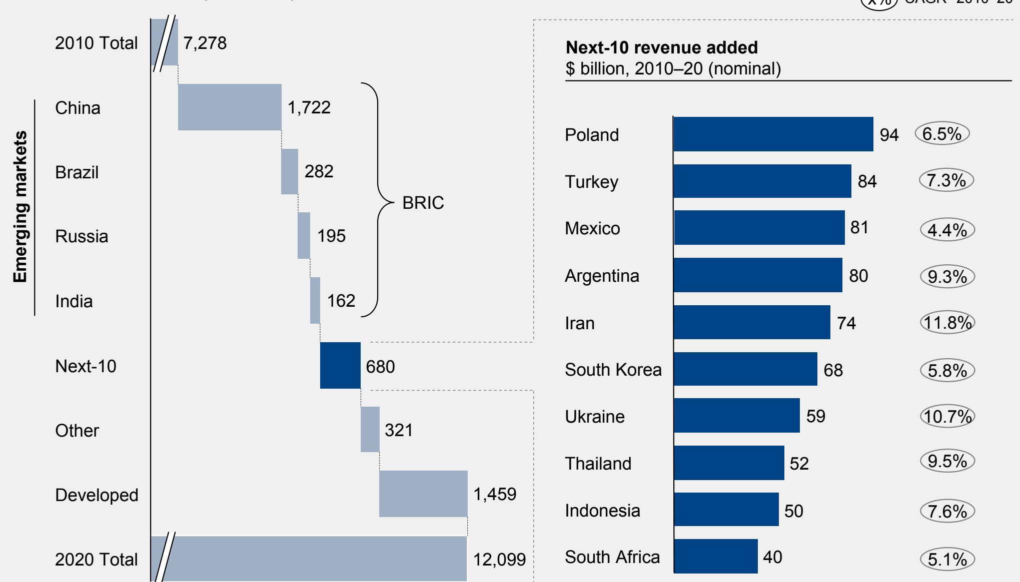
The rate of global consumer spending growth will vary across categories and markets. For instance, worldwide spending on categories like juices, skin care, and noodles and pasta will double over the next decade, whereas spending on confectionery and carbonated beverages will increase only by about one-third over the same period. Even similar categories may vary considerably in their rates of growth. For example, in Italy, spending on snack bars is expected to grow at an average of 10 percent a year until 2020, while the adjacent category of savory snacks is expected to grow by only 2 percent.

Across the board, however, increased spending in emerging markets will drive the expected increase in consumer spending worldwide. By 2020, emerging markets will represent close to 50 percent of total consumer spending and about 70 percent of the overall growth in consumer spending from 2010 to 2020. For example, in the skin-care category we expect spending growth over the next decade of about $84 billion, up from $44 billion in the previous decade: emerging markets are expected to contribute $60 billion or close to 70 percent of that total growth. In carbonates, we expect growth in the next decade of $129 billion, 1.5 times the growth in the previous 10 years, and emerging markets to contribute $100 billion or nearly 75 percent of the total.

Among emerging markets, BRIC will continue to dominate, contributing about 50 percent of expected growth in consumer spending on FMCG categories. But the BRIC countries do not tell the whole growth story: about 15 percent of total growth in emerging-market consumer spending will come from the next 10 largest emerging countries: Argentina, Indonesia, Iran, Mexico, Poland, South Africa, South Korea, Thailand, Turkey, and Ukraine (Exhibit 2). These account for almost twice as much growth as all the remaining 23 emerging markets put together.

Exhibit 2

Within emerging markets, the next 10 countries after BRIC[1] will also drive significant growth.



Historically, there has been a correlation between the collective exposure of FMCG multinationals to emerging markets and their overall revenue growth. Those with the highest exposure grew at the fastest rate. We believe this relationship can only get stronger. Although many FMCG multinationals have already begun to address the opportunities arising in emerging markets at a country level, we believe that all could benefit from taking a more granular view of the emerging consumer goods markets: a city perspective.

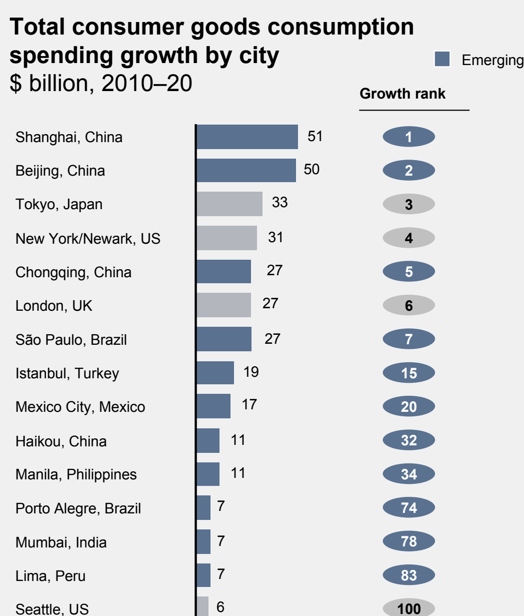
Emerging city focus

The top 300 cities across the world will contribute about 40 percent of all growth in global consumer spending between 2010 and 2020. But the "Emerging 300" cities, that is, the top 300 cities in emerging markets with populations larger than 200,000, will contribute about one-third of all consumer spending growth. In some categories and geographies, therefore, targeting the emerging 300 cities selected for their growth dynamics might lead to better results than focusing on countries. For example, the market for confectionery in Beijing and Istanbul will display higher growth than Singapore and Greece.

FMCG multinationals need to know which cities offer the most promising prospects for each of their businesses and how they can best position themselves to capture these market opportunities. But many of the emerging urban economic dynamos are not yet household names. Cities among the emerging top 300 that will experience the highest growth in the consumer goods categories over the next 10 years, such as Chongqing and Haikou in China (growth ranks 5 and 32) and Porto Alegre in Brazil (growth rank 74), may not feature on the radar screen of FMCG company headquarters (Exhibit 3).

FMCG decision makers need to understand how particular cities and clusters of cities are set to grow. Scrutinizing the world's economic geography at this level of detail will

Exhibit 3 Some cities that expect to see high growth in consumer spending may not be very familiar—or important—to some multinational companies.



Source: Global Growth Compass database; McKinsey analysis

be a critical element of any consumer industry player's emerging-markets strategy. The Global Growth Compass can drill down to measuring S-curves for consumer goods consumption at the national level as well as for cities. The shape of these S-curves may vary. Taking an example from Brazil, where forecasts are available for approximately 5,000 Brazilian cities, we can cluster cities according to different geographic and consumption patterns to identify pockets of growth on a more granular level. McKinsey has a number of city analytics tools, including the Global Growth Compass, that can help companies analyze growth in cities across most critical emerging markets.

How the Global Growth Compass approach works

The Global Growth Compass approach can help companies analyze market prospects in developed and emerging markets and cities quickly and rigorously. In particular, it can help decision makers understand the timing of critical inflection points in particular markets and rapidly forecast how sales will develop across different markets for different categories. It offers consumer goods companies a better fact base than they have today on which to build developing-market entry strategies and make portfolio and investment decisions.

GDP per capita is the most important driver of consumer goods consumption in emerging markets. Growth in consumption of any category typically follows its own version of the classic S-curve growth model. For any consumer product in an emerging market, the growth multiplier—that is, the increase in the category's sales per capita associated with a one percent increase in real income per capita—is linked to the shape of the emerging-market S-curve. When the multiplier is low the curve is relatively flat; when the multiplier is higher the curve is steeper. The opportunity to grow sales in a category is greatest when the curve is steep. Investing at or a little ahead of the moment when the curve turns up is likely to create the most value.

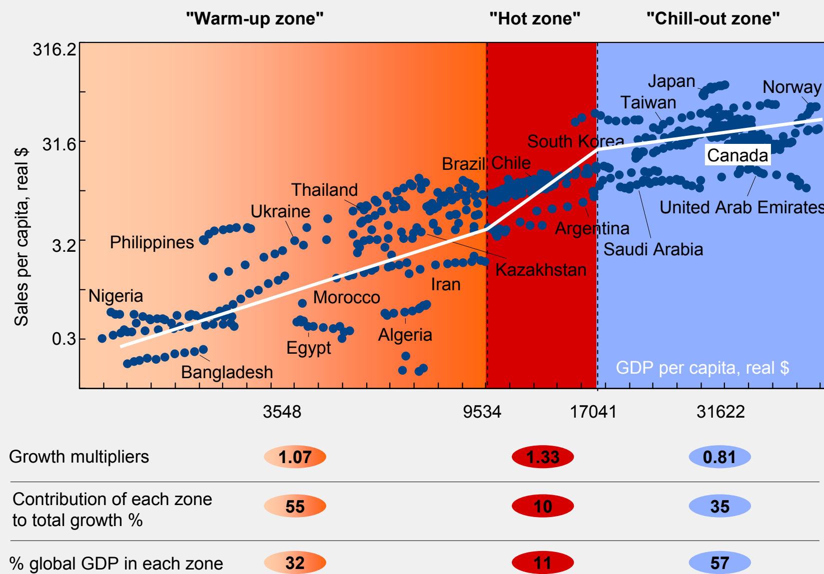
The Global Growth Compass can compile S-curves at a country or city level for individual categories. Exhibit 4 illustrates the global S-curve for the skin-care category. The initial flat part of the curve shows the levels of GDP per capita at which skin-care products are too expensive for most potential consumers. As a result, at this stage—the "warm-up zone"—sales grow slower than GDP per capita. But as GDP per capita continues to grow, eventually people will be able to afford skin-care products and the category will reach its takeoff point. This will vary by product category, depending on factors such as pricing, consumer preferences, and so on. For example, the skin-care category reaches takeoff point at a GDP per capita of around $9,500 real (2005 base), later than most food and several other personal-care categories.

After takeoff, market penetration accelerates significantly and begins to match growth in GDP per capita. This is the "hot zone," where the greatest opportunities lie. As GDP per capita rises further, eventually the appetite for the newly affordable category is saturated. This is the category's "chill-out zone," where market penetration generally remains flat despite continuing growth in GDP per capita. Consumers start to direct their incremental income and wealth to other categories.

Exhibit 4

The Global Growth Compass can compile S-curves at the country or city level for individual categories, such as skin care.

Category penetration for skin care relative to GDP per capita across countries



Source: Global Growth Compass database; McKinsey analysis

Implications for business leaders

Currently, most consumer goods companies fail to reallocate investments to growth markets; on average companies tend to reallocate only three to five percent of their funds year-on-year, despite elaborate recurring strategic review and budgeting processes. However, McKinsey research has shown that companies that more aggressively reallocate budgets toward opportunities tend to consistently outperform their more conservative peers.

By understanding a category's S-curve across cities or countries and the factors that influence it, companies can make more accurate forecasts of the category's potential and select the appropriate investment strategy for each geographical market. It is also important to complement a revenue-growth perspective with a profit perspective for key markets being considered. In our experience, it is possible to do this by examining pricing across markets and assessing value-chain economics.

From a revenue-growth perspective, companies should shape their investment strategy according to the growth zone—warm-up, hot, or chill-out—in which the market lies.

For markets in the warm-up zone, companies should "plant the seeds" for entry. Companies that move early into such markets can potentially establish a strong advantage and capture significant market share.

As a market moves closer to the hot zone, companies must get ready for takeoff. Typical activities will be the same as those appropriate in the warm-up zone, but on a broader scale and faster. Companies already present in the market will want to scale up their operations quickly.

In markets well within the hot zone, companies need to "surf the curve." Companies can take advantage of a category's momentum by moving in or scaling up quickly, even faster than for markets that are just beginning to take off. However, entering at this later point is likely to be more expensive because of the higher costs of developing a brand and acquiring customers once other companies have already established credible brands and have robust product and value propositions.

Even as they ride the growth wave, companies should prepare for the wave to break. When it flattens, companies will be relying on market-share gains or acquisitions for further growth in that particular market. But when a market enters the chill-out zone, there are likely to be more attractive growth opportunities elsewhere to sustain the company's growth momentum.

We believe business leaders should reflect on some key questions:

- What percent of my portfolio growth in the next five years is coming from the warm-up, hot, and chill-out zones?
- Which countries should we focus on for investment and human resources allocation?
- What are our top 200 cities—the cities we have to enter to realize our growth ambitions?
- What are the country-city combinations that we should "own" to live up to our growth aspirations?
- Do we have standardized route-to-market and commercial models for our prioritized city-country combinations?
- How can we get away from the "stickiness " of resource allocation? And how can we avoid being anchored by past budgets or investment allocations?
- Are some of the business models that we observe in the emerging markets truly leap-frogging so that they should be applied in developed market?

The Global Growth Compass database and model

The Global Growth Compass comprises a proprietary database and forecasting model that provide market sales and volume data for approximately 50 product categories across 60 markets, including 37 emerging markets, and more than 2,000 cities.

The Global Growth Compass can help companies determine where selected markets fall on a category's S-curve and explore growth opportunities at a more granular city level as well. For purposes of benchmarking and completeness, the database also covers these categories for developed markets.

The data are updated regularly and can be analyzed by category, city, and market. The Global Growth Compass also has the ability to generate subcategory-level forecasts and incorporate custom data sets.

To address the burgeoning but complex opportunities in emerging markets, FMCG companies should begin by examining their current product portfolio and their current presence and relationships in emerging markets. Given the consumer spending growth these markets will generate over the next decade, companies should focus on sizing and seizing these opportunities immediately or risk losing future market leadership to those companies that do.

Claudia Benshimol Severin is a senior knowledge expert in the New Jersey office. **Rogerio Hirose** is an associate principal in the São Paulo office, where **Fábio Stul** is a director. **Udo Kopka** is a director in the Hamburg office. **Subho Moulik** is an associate principal in the Chicago office. **Taro Nordheider** is a principal in the Munich office.

Contact for distribution: Subho Moulik
Phone: +1 312 551 7971
E-mail: subho_moulik@mckinsey.com

Consumer Packaged Goods
Designed by Knowledge Services design team
November 2011
Copyright © McKinsey & Company