

## Unlocking the potential of emerging-market cities

**Richard Dobbs, Jaana Remes, and Fabian Schaer**

**Most companies still take a national or regional view when allocating resources for global growth. They should shift their focus to fast-growing cities.**

**A massive wave of urbanization** is propelling growth across the emerging world. This urbanization wave is shifting the world's economic balance toward the east and south at unprecedented speed and scale. It will create an over-four-billion-strong global "consumer class" by 2025, up from around one billion in 1990. And nearly two billion will be in emerging-market cities. These cities will inject nearly \$25 trillion into the global economy through a combination of consumption and investment in physical capital. This is a very significant shot in the arm for a global economy that continues to suffer from pockets of acute fragility.

Yet few business leaders focus on the importance of cities when establishing growth priorities. In a recent survey, we found that fewer than one in five executives makes location decisions at the city (rather than country) level. Few executives expected this approach to change over the next five years, and more than 60 percent regarded cities as "an irrelevant unit of strategic planning."<sup>1</sup> As these new

<sup>1</sup>"McKinsey Global Survey results: Relocating for growth" was conducted in February 2012. The survey received responses from 2,962 executives, representing the full range of regions, industries, and company sizes. To adjust for differences in response rates, we weighted the data by the contribution of each respondent's nation to global GDP.

## Exhibit 1

## Approximately 440 emerging-market cities are poised to deliver close to half of global GDP growth.

Cities' contribution to global GDP and GDP growth<sup>1</sup>

### Emerging-market cities

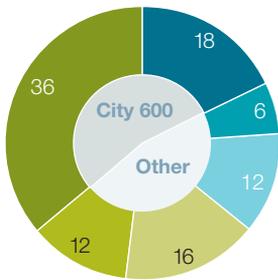
■ 443 cities in the City 600<sup>2</sup> ■ Other large cities ■ Small cities and rural areas

### Developed-market cities

■ 157 cities in the City 600<sup>2</sup> ■ Other large cities ■ Small cities and rural areas

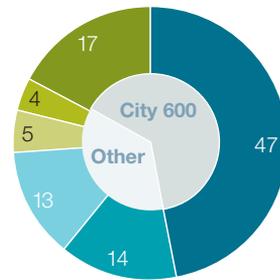
### Global GDP, 2010, %

100% = \$63 trillion (real exchange rate<sup>3</sup>)



### Global GDP growth, 2010–25, %

100% = \$50 trillion (real exchange rate<sup>4</sup>)



<sup>1</sup>2,600+ cities, including large cities as well as smaller cities and rural areas.

<sup>2</sup>The top 600 cities by their contribution to global GDP growth 2010–25.

<sup>3</sup>Reflects market exchange rate.

<sup>4</sup>Prediction based on differences in per capita GDP growth rates of countries relative to the growth of US per capita GDP.

Source: McKinsey Global Institute Cityscope 2.0

urban-growth zones flourish, there's a cost to companies that lack a clear view of the emerging landscape—chiefly in the potential for resource misallocation.

Shifting investment away from established markets to more promising areas can be difficult, as our colleagues have shown in separate research.<sup>2</sup> Budgets are often “sticky” because companies lock into current rather than future opportunities. And many middle-tier emerging-market cities, however attractive, may be unfamiliar. Take Foshan, Porto Alegre, and Surat—cities that are unlikely to be high on the priority lists of global executives, though each has more than four million inhabitants, fast growth, and a vibrant base of consumers. Indeed, each of these cities will contribute more to global growth than Madrid, Milan, or Zurich.

And they are far from isolated examples. Our research indicates that 440 emerging-market cities, very few of them “megacities,” will

<sup>2</sup>See Stephen Hall, Dan Lovallo, and Reinier Musters, “How to put your money where your strategy is,” [mckinseyquarterly.com](http://mckinseyquarterly.com), March 2012.

## Exhibit 2

### A city-specific lens can reveal urban areas with the highest growth potential in a given market.

Top cities by growth in given market, 2010–25

Rank	Elderly higher-income consumers <sup>1</sup> (aged 65+)	Young entry-level consumers <sup>2</sup> (aged 14 or under)	Consumer spending on laundry care products <sup>3</sup>	Demand for commercial floor space <sup>4</sup>	Municipal water demand
1	Shanghai	Lagos	São Paulo	New York	Mumbai
2	Beijing	Dar es Salaam	Beijing	Beijing	Delhi
3	Tokyo	Dhaka	Rio de Janeiro	Shanghai	Shanghai
4	Tianjin	Ouagadougou	Shanghai	Los Angeles	Guangzhou
5	Mumbai	Khartoum	Mexico City	Tokyo	Beijing
6	São Paulo	Ghaziabad	Moscow	Washington, DC	Buenos Aires
7	Osaka	Sanaa	Bangkok	Dallas	Kolkata
8	Chongqing	Nairobi	Istanbul	São Paulo	Khartoum
9	Delhi	Luanda	Manila	Guangzhou	Dhaka
10	Nanjing	Baghdad	Johannesburg	Chicago	Istanbul

<sup>1</sup>With household income >\$20,000 at purchasing-power parity.

<sup>2</sup>With household income of \$7,500–\$20,000 at purchasing-power parity.

<sup>3</sup>Based on city-level market-demand-growth model.

<sup>4</sup>Includes replacement floor space.

Source: McKinsey Global Institute analysis

account for close to half of expected global GDP growth between 2010 and 2025 (Exhibit 1). Crafting and implementing strategies that emphasize such cities will require new attention from senior leaders, new organizational structures that take account of urban rather than just regional or national markets, and potentially difficult choices about which activities to scale back elsewhere to free up resources for new thrusts.

Companies that adopt such a strategic approach may gain early-mover benefits. For some, developing better insights into demographic and income trends—such as an understanding of the urban areas where the population of older, wealthier consumers is growing most rapidly—will be sufficient. Others may need to dig deeper, learning the market dynamics of specific products in target cities. To illustrate the different panoramas of opportunity that appear when companies use a city-specific lens, we looked at five business sectors, each with different demand profiles. We then ranked cities with the highest growth potential for each of the sectors (Exhibit 2). Among the takeaways:

- Companies marketing health care products to seniors would find Shanghai and Beijing topping the list of cities with growing populations of older consumers whose incomes are sufficiently high (above \$20,000 on a purchasing-power-parity basis) to afford these products. Tokyo and Osaka are the only developed-world cities among the top ten—a sign that well-off, aging consumers no longer are found exclusively in developed markets.
- Baby food is at the other end of the age spectrum. Combining income and demographic data—in particular, the numbers of households with young children—we found that cities in Africa offer great potential. More than half of the top ten cities enjoying rapid growth in the number of children<sup>3</sup> who live in households with incomes from \$7,500 to \$20,000 (on a purchasing-power-parity basis) are in Africa.
- São Paulo, Beijing, Rio de Janeiro, and Shanghai rank highest in a targeted analysis of market growth for laundry products. In fact, over the next decade, São Paulo will experience more growth in the sale of detergents and related cleaning products than the national markets of France or Malaysia will. That’s just a small shard in the global-consumption mosaic for emerging cities. We project that urban consumers in developing countries will spend an additional \$14 trillion annually by 2025.
- By 2025, cities worldwide will need to spend at least \$10 trillion more per year on physical capital—everything from office towers to new port facilities—than they do today. In building construction, the new floor space required will be equivalent to 85 percent of today’s entire residential and commercial building stock; 40 percent of that growth will be in Chinese cities.
- Urban water-related infrastructure, another pressing need, will require \$480 billion in global investment by 2025, with 80 percent of that flowing to emerging-market cities. Mumbai and Delhi will be the leaders in that spending.

In addition to supporting geographic priority-setting, a city-level view can help companies sharpen their marketing strategies. Product adoption rates often are tied to local preferences that can vary across different cities within the same country—preferences that marketers

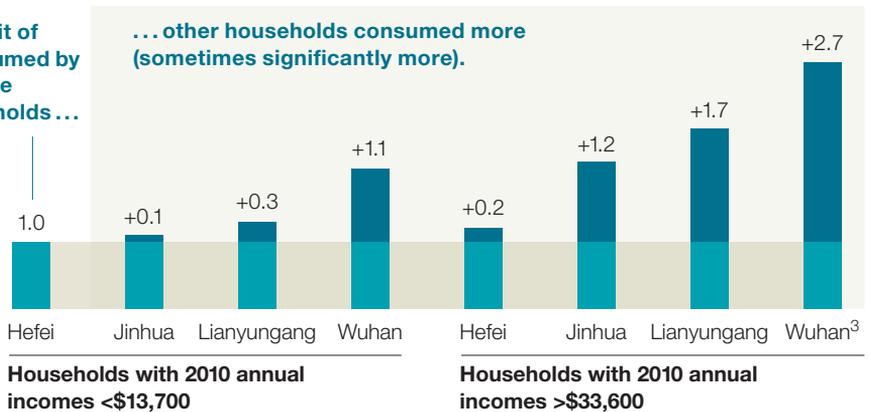
<sup>3</sup>Individuals aged 14 and under qualify as children for the purposes of this analysis.

## Exhibit 3

### Awareness of cities' different spending patterns across products can sharpen a company's marketing focus.

Example: average yogurt consumption per household in 2010, by cities in China<sup>1</sup>;  
index: consumption in Hefei households with incomes <\$13,700 = 1.0<sup>2</sup>

For every unit of yogurt consumed by lower-income Hefei households ...



<sup>1</sup>With 2010 populations between 1.1 million (Lianyungang) and 9.7 million (Wuhan).

<sup>2</sup>Income levels adjusted for purchasing-power parity (PPP); \$1 at PPP = 3.9 renminbi.

<sup>3</sup>For households earning >\$51,900, since data for households earning \$33,600–\$51,900 not available.

Source: 2010 McKinsey survey of 15,000 Chinese consumers; McKinsey Global Institute analysis

may miss when they follow the time-honored approach of plotting adoption curves that trace purchases by levels of household income and by product types within categories. Yogurt consumption shows the types of variations that a national view might not pick up: we found, even after adjusting for income levels, that typical households in Wuhan spent significantly more on yogurt than their counterparts in three comparable Chinese cities did (Exhibit 3). Awareness of different spending patterns by city across products should give companies a better basis for allocating marketing and distribution resources.



As the locus of global economic activity shifts to developing nations, companies should be aware of the growth dynamic that's playing out in cities. Leaders who give their strategies an urban dimension could find themselves positioned to allocate investments more effectively and to seize more readily the many opportunities at hand. ○

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