McKinsey&Company

APRIL 2011

McKinsey Quarterly

STRATEGY PRACTICE

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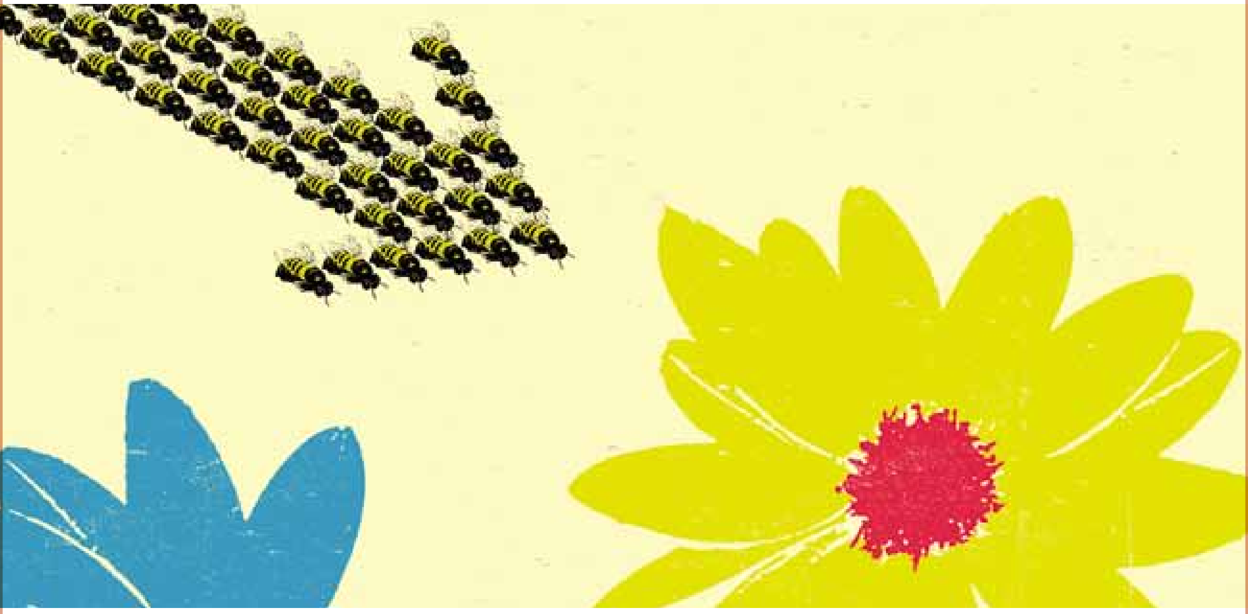

Is your emerging-market strategy local enough?

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The diversity and dynamism of China, India, and Brazil defy any one-size-fits-all approach. But by targeting city clusters within them, companies can seize growth opportunities.

Creating a powerful emerging-market strategy has moved to the top of the growth agendas of many multinational companies, and for good reason: in 15 years' time, 57 percent of the nearly one billion households with earnings greater than $20,000[1] a year will live in the developing world. Seven emerging economies—China, India, Brazil, Mexico, Russia, Turkey, and Indonesia—are expected to contribute about 45 percent of global GDP growth in the coming decade. Emerging markets will represent an even larger share of the growth in product categories, such as automobiles, that are highly mature in developed economies.

Figures like these create a real sense of urgency among many multinationals, which recognize that they aren't currently tapping into those growth opportunities with sufficient speed or scale. Even China, forecast to create over half of all GDP growth in those seven developing economies, remains a relatively small market for most multinational corporations—5 to 10 percent of global sales; often less in profits.

To accelerate growth in China, India, Brazil, and other large emerging markets, it isn't enough, as many multinationals do, to develop a country-level strategy. Opportunities in these markets are also rapidly moving beyond the largest cities, often the focus of many of these

[1] In terms of purchasing-power parity (PPP).

companies. For sure, the top cities are important: by 2030, Mumbai's economy, for example, is expected to be larger than Malaysia's is today. Even so, Mumbai would in that year represent only 5 percent of India's economy and the country's 14 largest cities, 24 percent. China has roughly 150 cities with at least one million inhabitants. Their population and income characteristics are so different and changing so rapidly that our forecasts for their consumption of a given product category, over the next five to ten years, can range from a drop in sales to growth five times the national average.

Understanding such variability can help companies invest more shrewdly and ahead of the competition rather than following others into the fiercest battlefields. Consider Brazil's São Paulo state, where the economy is larger than all of Argentina's, competitive intensity is high, and retail prices are lower than elsewhere in the country. By contrast, in Brazil's northeast—the populous but historically poorest part of the country—the economy is growing much faster, competition is lighter, and prices are higher. Multinationals short on granular insights and capabilities tended to flock to São Paulo and to miss the opportunities in the northeast. It's only recently that they've started investing heavily there—trying to catch up with regional companies in what is often described as Brazil's "new growth frontier."

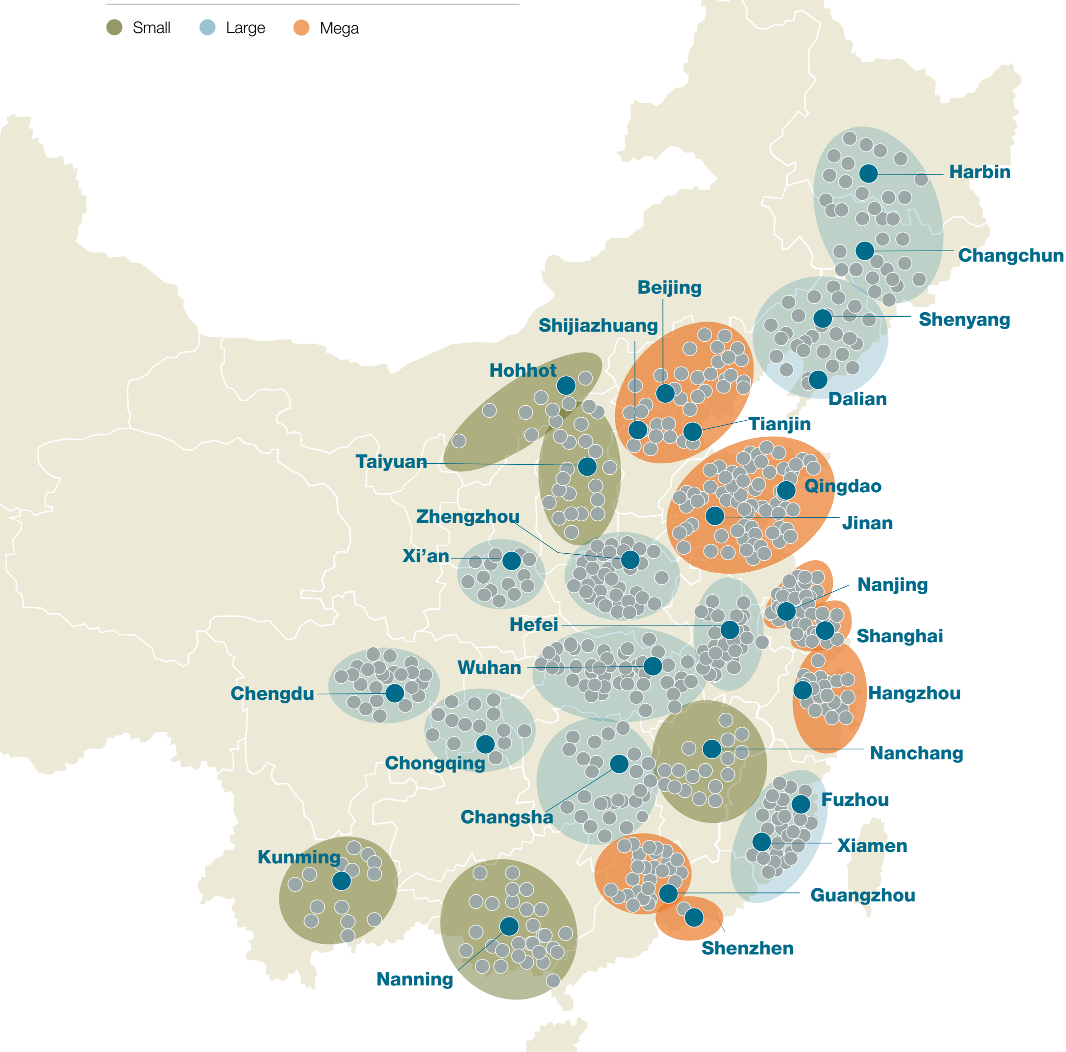
As developing economies become increasingly diverse and competitive, multinationals will need strategic approaches to understand such variance within countries and to concentrate resources on the most promising submarkets—perhaps 20, 30, or 40 different ones within a country. Of course, most leading corporations have learned to address different markets in Europe and the United States. But in the emerging world, there is a compelling case for learning the ropes much faster than most companies feel comfortable doing.

The appropriate strategic approach will depend on the characteristics of a national market (including its stage of urbanization), as well as a company's size, position, and aspirations in it. In this article, we explore in detail a "city cluster" approach, which targets groups of relatively homogenous, fast-growing cities in China. In India, where widespread urbanization is still gaining steam, we briefly look at similar ways of gaining substantial market coverage in a cost-effective way. Finally, in Brazil we quickly describe how growth is becoming more geographically dispersed and what that means for growth strategies.

A recent analysis of China revealed 22 distinct urban clusters.

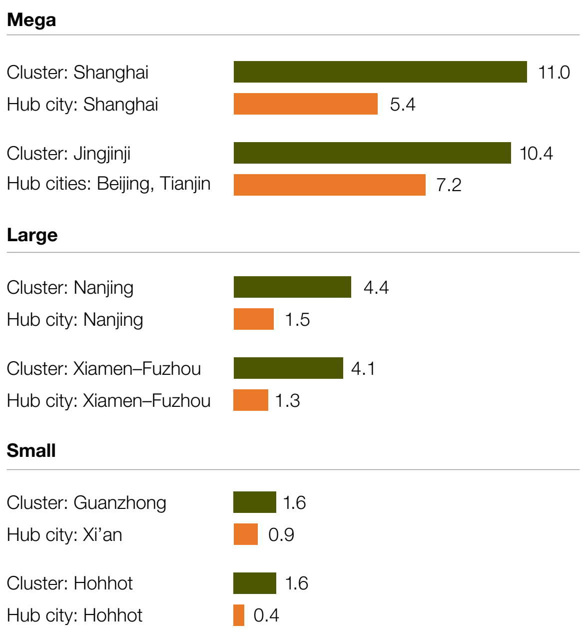
Urban clusters and their hub cities

Clusters are grouped by size, based on average 2015 urban GDP as % of national urban GDP (in 2005 renminbi)



Clusters vary considerably in their share of urban GDP and in the relative importance of their hub cities.

Top two clusters in each size category, projected 2015 urban GDP as % of national urban GDP (in 2005 renminbi)



Targeting the right city clusters in China

By segmenting Chinese cities according to such factors as industry structure, demographics, scale, geographic proximity, and consumer characteristics, we identified 22 city clusters, each homogenous enough to be considered one market for strategic decision making. Prioritizing several clusters or sequencing the order in which they are targeted can help a company boost the effectiveness of its distribution networks, supply chains, sales forces, and media and marketing strategies.

More specifically, this approach can help companies to address opportunities in attractive smaller cities cost effectively and to spot opportunities for, among other things, expanding within rather than across clusters—a strategy that requires a less complex supply chain and fewer partners. Companies that nonetheless want to expand across clusters may find it easier to target 50 to 100 similar cities within four or five big clusters than cities that theoretically offer the same market opportunity but are dispersed widely across the country.

Another major benefit of concentrating resources on certain clusters is the opportunity to exploit scale and network effects that stimulate faster, more profitable growth. Because most brands still have a relatively short history in China, for example, word of mouth plays a much greater role there than it does in developed economies. By focusing on attaining substantial market share in a cluster, a brand can unleash a virtuous cycle: once it reaches a tipping point there—usually at least a 10 to 15 percent market share—its reputation is quickly boosted by word of mouth from additional users, helping it to win yet more market share without necessarily spending more on marketing.

Here are four important tips to keep in mind when designing a city cluster strategy for China.

Focus on cluster size, not city size

It's easy to be dazzled by the size of the biggest cities, but trying to cover all of them is less effective for the simple reason that they can be very far from one another. Although Chengdu, Xi'an, and Wuhan, for example, are among the ten largest cities in China, each of them is about 1,000 kilometers away from any of the others. In Shandong province, the biggest city is Jinan, which is barely in the top 20. Yet Shandong has 21 cities among China's 150 largest, which makes the area one of the five most attractive city clusters. Its GDP is about four times bigger than that of the cluster of cities around and including Xi'an, as well as three times bigger than the cluster of cities surrounding Chengdu.

Look beyond historical growth rates

The growth of incomes and product categories is another variable that must be treated in granular fashion. Extrapolating future trends from historical patterns is particularly suspect—however detailed that history may be—because consumer spending habits change so rapidly once wealth rises.

In some clusters, many people are starting to buy their first low-end domestic cars; in others, they are upgrading to imports or even to luxury brands. We expect sales of SUVs to increase at a 20 percent compound annual growth rate nationwide in the next four years, for example, but to grow as quickly as 50 percent in several cities and, potentially, even to decline in some where penetration is already deep. Similar or even sharper variance held true in almost every service or product category we analyzed, from face moisturizers to chicken burgers to flat-screen TVs. Yogurt sales in some cities are growing eight times faster than the national average.

The Shenzhen cluster has the highest share (90 percent) of middle-class households—those earning over $9,000 a year. In other clusters, such as Nanchang and Changchun–Harbin, more than half of all households are still poor. As a result, people in the Shenzhen cluster are already active consumers of many categories, and the potential for growth is fairly limited. In the poorer clusters, many categories are just emerging, as larger numbers of people pass the threshold at which more goods become affordable. From a strategic viewpoint, the richer cluster could still be a major growth market for premium goods but not for most mass-market ones.

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Don't be fooled by generalities

Talking about Chinese consumers and how they shop is a bit like talking about European consumers. While some generalizations may be fair, certain very strong differences, even within regions, go well beyond the already significant economic variance. Guangzhou and Shenzhen, for example, are both tier-one cities, located in the same province and just two hours apart. But Guangzhou's people mainly speak Cantonese, are mostly locally born, and like to spend time at home with family and friends. In contrast, more than 80 percent of Shenzhen's residents are young migrants, from all across the country, who mainly speak Mandarin and spend most of their time away from their homes. To be effective, marketers will probably have to differentiate their campaigns and emphasize different channels when reaching out to the people in these two cities. That's why we suggest managing them in different clusters, despite their proximity.

The need to localize marketing activities also results from the limited reach of national media. China has over 3,000 TV channels, but just a few are available across the country. In some areas, only around 5 percent of consumers watch national television. Other media, such as newspapers and radio (and of course billboards), are even more local.

Very few companies can craft their entire strategy at the level of a cluster—those that do are usually its regional champions. But with differences such as the following common, some tailoring is critical:

- Every second consumer in Shandong believes that well-known brands are always of higher quality, and 30 percent are willing to stretch their budgets to pay a premium for the better product. In south Jiangsu, only a quarter of consumers preferred the well-known brands, and only 16 percent were willing to pay a premium for them.

- In the Shenzhen cluster, 38 percent of food and beverage shoppers found suggestions from in-store promoters to be a credible source of information, compared with only 12 percent in Nanjing.

- In Shanghai, 58 percent of residents shop for apparel in department stores, compared with only 27 percent of Beijing residents.

With such diversity common, even merely fine-tuning the marketing mix and channel focus by cluster can pay enormous dividends.

Allow your clusters to be flexible

Some companies may want to merge or divide clusters for strategic-management purposes. A company could, for instance, merge geographically nearby clusters, such as Guangzhou and Shenzhen or Chengdu and Chongqing, if its supply chain was well positioned to manage these proximate clusters as one. Other companies, highly driven by the media market, would find it sensible to split the Shanghai cluster into subclusters, because some markets within it are still quite different in their TV habits and other choices. By contrast, people in certain clusters, such as Chengdu or Guangzhou, watch similar TV shows across the entire cluster, so intracluster expansion allows companies to make more effective use of the media spending needed to attract consumers in the big cities.

The actual number of submarkets a company opts for will depend in practice on its needs. That number should be manageable—most likely, 20 to 40. Fewer wouldn't be likely to produce the required degree of granularity, though a company might have logistical reasons for taking this approach. More would probably be too many to run effectively.

Cost-effective market coverage in India

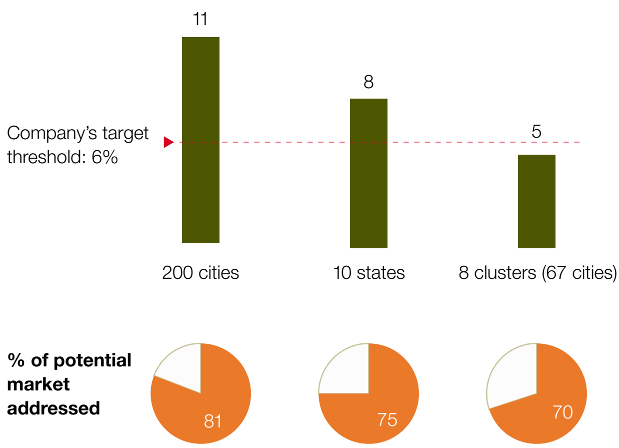
Often, the challenges of accessing consumption growth cost effectively are even greater in India than in China because India is less urbanized and at an earlier stage of its economic development. Companies would need to reach up to 3,500 towns and 334,000 villages, for example, to pursue opportunities in the 10 (of 28) Indian states that by 2030 will account for 73 percent of the country's GDP and 62 percent of the urban population.

To allocate financial and human resources smartly and make things more manageable, companies need to walk away from averages and adopt more granular approaches. Some companies will be well served by focusing on 12 clusters around India's 14 largest cities. Those clusters will provide access to as much as 60 percent of the country's urban GDP by 2030, when the 14 largest cities are likely to account for 24 percent of GDP.

True, India's major clusters won't cover as much of the economy as those in China, where they will encompass 92 percent of urban GDP by

In India, focusing on city clusters helped one technology company reduce its customer service costs dramatically.

Cost to serve as % of sales



2015. Yet a hub-and-spoke approach in India should provide similar opportunities to optimize supply chains, as well as sales and marketing networks. An established technology player formerly operated in 120 cities all over India, for example. Recently, it shifted to focusing on eight clusters with a total of 67 cities, which still gave it access to 70 percent of its potential market. One benefit: customer service costs fell from a rapidly growing 9 to 10 percent of sales to a more acceptable 5 percent.

Alternatively, a company might improve the economics of its Indian business by focusing on a handful of states, an approach recently adopted by a retailer that had previously been pursuing a national footprint. Another company, this one in the consumer goods sector, recently decided to pursue opportunities in eight cities where consumers earn over $2,500 a year—more than twice the average for India—and the retail infrastructure suits its products nicely. Without this more granular analysis, the multinational would have stayed on the sidelines in the mistaken belief that Indian consumers weren't ready for its products. It would therefore have missed the opportunity to challenge a competitor rapidly gaining the lead in those markets.

Seizing new regional opportunities in Brazil

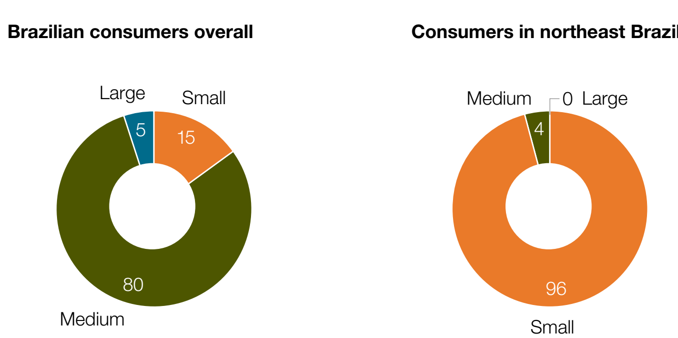
In contrast to China and India, Brazil has been open to multinationals for decades. But during much of that time, most large companies in sectors such as consumer packaged goods focused on the southern (and most affluent) parts of the country. With just over half of the national population, this region includes São Paulo city and state, Brazil's financial and industrial center.

As economic growth accelerated in recent years, many consumers started upgrading to more sophisticated products. But growth has also been moving beyond the south and a few large cities, becoming more geographically dispersed. In the populous northeast, for example, income per capita is only half of its level in São Paulo, but the economy is growing faster than it is elsewhere in Brazil. Succeeding in new regions like the northeast requires a fresh approach for many companies. Consider the following:

- Many global companies still make the mistake of doing their consumer research in São Paulo when they are designing new products or national marketing campaigns for Brazil. They don't realize that cosmopolitan São Paulo probably has more in common culturally with New York than with any other city in Brazil.

In Brazil, consumer preferences can vary dramatically across regions.

Example: consumer preference for name-brand detergent's pack sizes,[1] pack size as % of total sales



[1] Small = < 500 grams, medium = 1,000 grams, large = >1,000 grams.
Source: LatinPanel

There is no one-size-fits-all strategy for capturing consumer growth in emerging markets.

- Modern-format stores account for 70 percent of retailing in Brazil overall, but for only 55 percent in the northeast. To reach thousands of small (and often capital-constrained) outlets spread all over the region, packaged-goods companies must develop third-party networks specializing in frequent deliveries of goods and small drop sizes. What's more, in Brazil as a whole, many consumer goods companies found that they had focused too much on hypermarkets when designing assortments and promotions. One company, for example, discovered that Brazil's expanding drugstore chains were the fastest-growing channel for personal-care and beauty products. Some leading consumer goods companies have now created specialized organizations that execute distinct channel strategies in different regions and categories, with tailored product portfolios and displays.

- Many packaged-goods companies see detergent powders as a developed category in Brazil. But relatively affluent consumers there are upgrading to larger and more sophisticated washing machines, and many consumers in the northeast are buying their first fully automated machines. New detergent formulas therefore have enormous potential—annual consumption in the northeast is less than half of what it is in the south. Seizing this opportunity requires an understanding of the regional consumer, however, particularly pack size preferences. Consumers in the northeast also want a strong perfume and great quantities of foam but care less about whitening power.

Brazil is distinct from China and India in many respects. But as these examples suggest, there too identifying growth opportunities increasingly requires a detailed understanding of vast regional variations in competition levels, income, product growth rates, consumer preferences, and retail channels.

There is no one-size-fits-all strategy for capturing consumer growth in emerging markets. What's clear, though, is that traditional country strategies and other aggregated approaches will miss the mark because they can't account for the variability and rapid change in these markets. As the battle for the wallet of the emerging-market consumer shifts into higher gear, companies that think about growth opportunities at a more granular level have a better chance of winning.

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