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Three myths about growth in consumer packaged goods

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We expect the sector to grow strongly. The key for companies is to sell the right products in the right markets at the right times.

Imagine, if you will, that over the next decade the world will gain an additional 81 Procter & Gambles or 458 equivalents of Kellogg's. This is the sort of growth that will happen in the global consumer-packaged-goods (CPG) sector, which will nearly double in size—to \$14 trillion—by 2025, from \$8 trillion in 2014.

It's natural that for much of the past 20 years, the discourse on growth has highlighted the BRIC countries: Brazil, Russia, India, and China. But with competition in these markets intensifying, some companies have shifted their focus to other regions of the world, such as Africa and non-BRIC Asia and Latin America. Everywhere, however, competition and high capital requirements are making it increasingly difficult to achieve growth and create value through geographic expansion, so it's crucial for companies to take the guesswork out of their plans.

The three myths

We used McKinsey's Cityscope Navigator tool to take a fine-grained look at the markets of more than 2,600 of the world's largest cities. Our analysis revealed some surprising truths about where the most promising opportunities lie—and cleared up three widespread myths about CPG growth.

Myth 1: The United States isn't a growth market

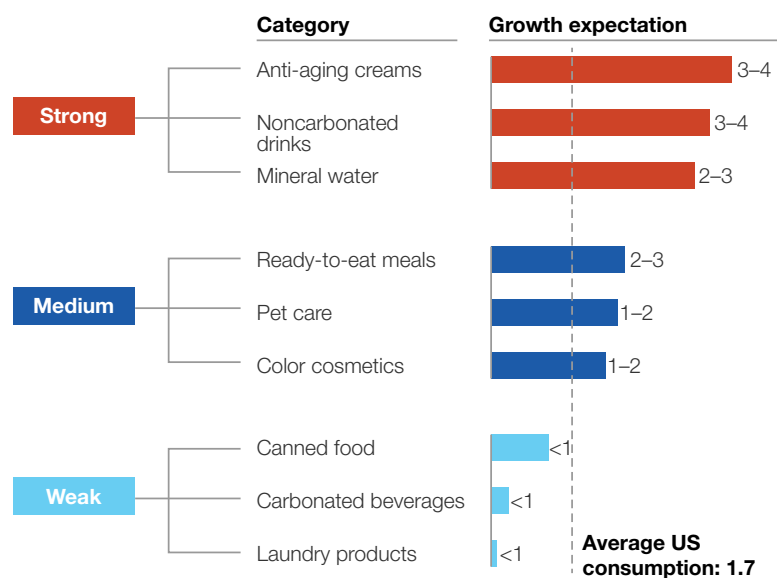
Most CPG companies have had very low expectations for growth in the US market. They've long seen it as the scene of a battle for distribution, where they must secure placement for their products in the fastest-growing retail channels just to maintain their share of a pie that's not getting bigger.

But this no-growth (or, at best, low-growth) picture isn't entirely accurate. Somewhat surprisingly, a number of cities in developed markets, including the United States and Western Europe, are growing as rapidly as those in emerging markets. Companies that ignore these cities

could be missing out on opportunities very close to home. Our analysis forecasts that between 2014 and 2025, certain product categories—including anti-aging cream, still drinks, and mineral water—will grow at almost twice the rate of overall US consumer spending (Exhibit 1). Companies can thus generate above-average growth in the United States by not only taking market share from competitors but also making targeted investments in high-growth categories.

Exhibit 1 Certain categories show strong growth in the United States.

Real growth, CAGR,¹ 2014–25, %



¹Compound annual growth rate.

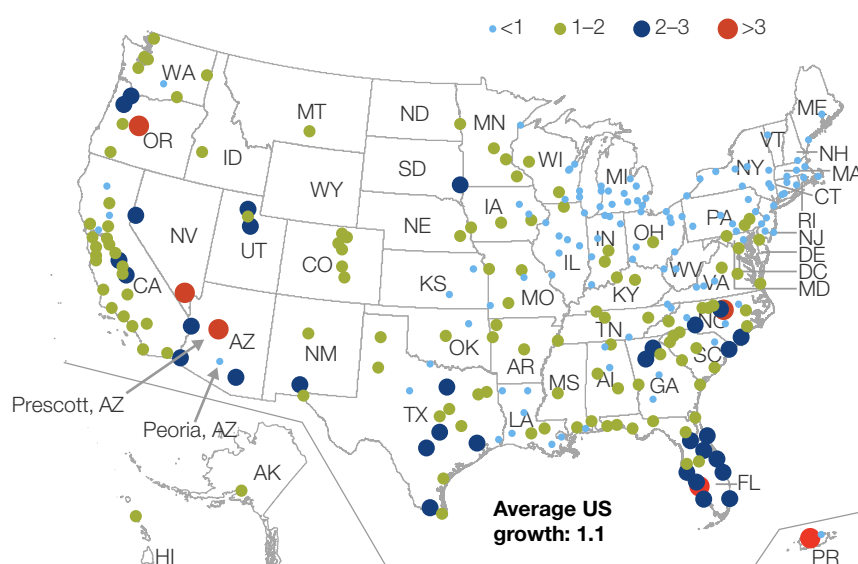
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In addition, demand within developed markets varies by geography. The beer category illustrates this point: average US consumption growth from 2014 to 2025 is estimated at 1.1 percent—but in some cities, the projected growth rate exceeds 3 percent (Exhibit 2). In Arizona, the city of Prescott is less than 100 miles from Peoria, but is predicted to grow at least three times faster.

Western Europe also has pockets of rapid expansion, with some categories increasing at two to three times the national average in certain metropolitan areas. Beer consumption is growing three times as quickly in Belfast, for instance, as in all of Germany.

Exhibit 2 Certain US cities are experiencing above-average growth—for example, in beer consumption.

Real growth, CAGR,¹ 2014–25, %



¹Compound annual growth rate.

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Myth 2: It's too late to enter China or India

Some companies have written off China and India as unrealistic expansion opportunities; they feel their capital base isn't sufficient for a credible entry or that the competitive environment is already too tough for new entrants. But companies shouldn't dismiss these markets outright. Instead, they should ascertain whether building a presence in only a few selected cities is feasible.

For product categories with low minimum scale requirements, even a limited entry in China or India can yield returns equivalent to countrywide coverage in other emerging economies—or higher. The juice market, for instance, will grow more than three times as fast in Shanghai alone as in all of Malaysia. Furthermore, many cities in China and India are continually modernizing their retail and distribution infrastructures, making market entry less complex than it would be in rural areas.

Myth 3: Emerging-market consumers don't buy premium products

As international CPG companies venture into the emerging world, many of them choose to sell only simple products that meet basic needs. And with good reason: fast-moving categories, such as soft drinks and laundry detergent, offer the greatest reach and the highest market potential.

Yet some large cities in emerging markets have per-capita income levels comparable to those of large North American and European cities. Demand structures in these emerging locales and their developed-market counterparts are increasingly similar. Discretionary products, such as premium cosmetics, disposable diapers, and pet food, therefore have higher sales potential.

Companies that meet this nascent consumer demand early will be well positioned to become market leaders. Forward-thinking companies can even play a part in stoking demand, as Procter & Gamble did with disposable diapers in China (until about a decade ago babies there wore only cloth diapers—or none at all). In 2006, P&G developed a cheaper but still absorbent Pampers diaper for the Chinese market. Working with the Sleep Research Center at the Beijing Children's Hospital, the company conducted two studies showing that babies fall asleep faster and stay asleep longer when they wear Pampers. These messages were extensively marketed to Chinese consumers.¹ Today, Pampers is the top-selling brand in the \$6.7 billion Chinese diaper market.

Developing strategies for micromarkets

Taking a fact-based, granular approach can change the entire outlook for particular markets. For instance, we analyzed 58 product categories in 550 microregions and more than 5,500 cities in Brazil² and found that it is poised for speedy economic growth in this decade. One region in particular—the Northeast—will grow fastest, with consumer expenditures increasing almost threefold by 2025.

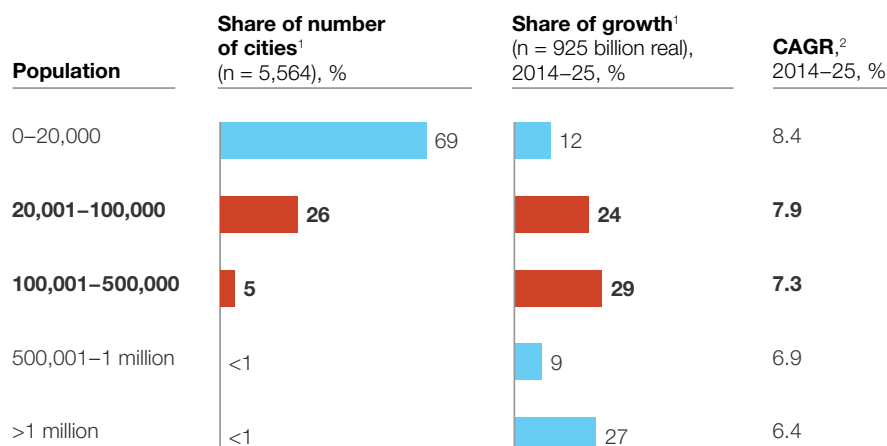
Notably, we found that some of Brazil's fastest-growing cities aren't sprawling metropolises or state capitals but medium-size places with populations ranging from just over 20,000 to 500,000. These cities aren't even on the radar screens of many CPG companies, yet their annual growth rate—about 7.5 percent—is comparable to China's. Collectively, they are projected to contribute approximately half of Brazil's total growth in consumer spending (Exhibit 3).

With the increasing affluence of Brazilians, a number of products will experience explosive sales growth. One is sunscreen: sales volumes of this previously low-penetration category are expected to double by 2025. Others will grow at a more measured but still impressive rate—50 percent for baked goods, for instance. But to date, the leading retailers in Brazil aren't capturing much of this growth. Many large ones, including Walmart, Carrefour, and Companhia Brasileira de Distribuição, either are underrepresented in some of the country's fastest-growing cities or don't have even a single store.

¹ Mya Frazier, "How P&G brought the diaper revolution to China," January 7, 2010, cbsnews.com.

² Brazil is divided into more than 500 microregions, which are legally defined administrative areas comprising groups of municipalities. Our Brazil Cityscope Navigator database contains information on these microregions as well as on more than 5,500 cities in Brazil.

Exhibit 3 Medium-size cities generate half of Brazil's consumption growth.



¹Figures may not sum to 100%, because of rounding.

²Compound annual growth rate.

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In contrast, our work in India shows that most of its growth will come from a small number of urban areas. For example, the country's 70 most populous cities, which account for only one-seventh of the population, are expected to contribute one-fourth of the growth in the food and beverage market from 2014 to 2025. Fortunately for CPG companies, accessing these cities is significantly cheaper than reaching smaller ones and rural areas.

Questions CPG companies should ask


As we already know, companies that rapidly and aggressively shift resources into growth areas tend to outperform their more conservative competitors.³ We believe that consumer-packaged-goods players should make bold moves, but only after answering these questions:

1. **Hot-spot analysis.** What are our top 100 cities—those where we should build a presence to achieve our growth ambitions?
2. **Category selection.** Which categories and subcategories have the greatest growth potential in those cities?
3. **Market check.** What specific market conditions can we expect?
4. **Resource allocation.** Which geographic regions should get additional resources to ensure our future growth?

³Stephen Hall, Dan Lovullo, and Reinier Musters, "How to put your money where your strategy is," *McKinsey Quarterly*, March 2012, mckinsey.com.

In the developed world's cities, which generally are more mature and thus have lower growth potential, a separate set of questions is critical:

1. *Granular analysis.* Which cities or micromarkets offer the best growth opportunities for our products?
2. *Presence check.* How strong are we on the ground in high-growth regions?
3. *Market positioning.* In which high-growth areas is our market share below average?
4. *Resource reallocation.* Have we reallocated our investments and best talent to the highest-growth regions and categories?

The answers to these questions can also inform decisions about product portfolios, marketing expenditures, labor (such as the size and deployment of the sales force), and even the location of manufacturing facilities and distribution centers. Companies that venture, ahead of the competition, into high-growth regions and categories armed with granular data will be better able to take—and hold—market-leading positions for years to come. 

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