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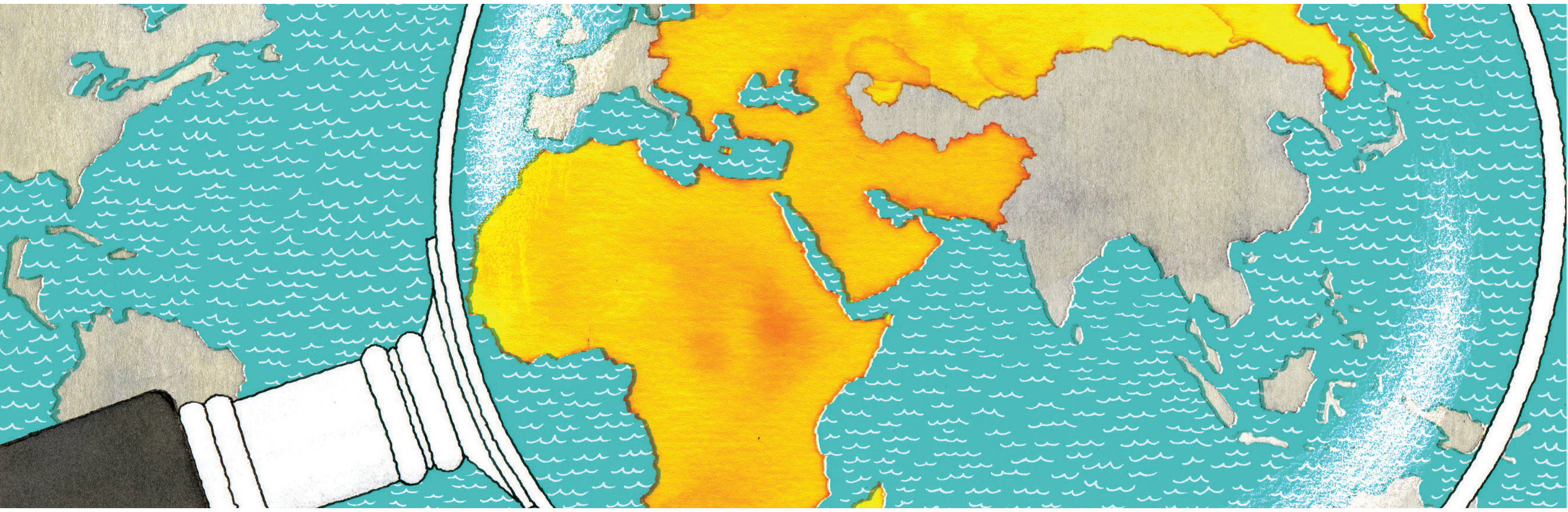

Consumer Packaged Goods/Retail

Doubling your company's growth in a volatile region

Eastern Europe, the Middle East, and Africa hold tremendous growth potential for consumer-centric, digitally savvy companies that take a long-term view.

Peter Breuer and Pål Erik Sjåtil

Home to more than two billion people—almost 30 percent of the global population—the region comprising Eastern Europe, the Middle East, and Africa (EEMA) is large and diverse. Its fundamentals are promising: approximately half of global population growth will come from the region, and in many EEMA countries, rapid urbanization is bringing about a rise in consumer spending. Growth in consumer spending in Eastern Europe, for instance, is expected to be 1.5 times that in Western Europe. Consumers are enthusiastically embracing both global and local brands as well as new retail formats. Millennials are gravitating toward digital channels; both e-commerce and m-commerce are growing.

Given the geopolitical and economic volatility in parts of EEMA, however, some might see the market as high risk and low reward. But more discerning observers see high-growth investment opportunities in specific sectors of the EEMA economy. We believe retailers and consumer-goods manufacturers can double their growth in the region in five years through careful strategic and organizational choices and disciplined planning.

Challenges and opportunities

There are vast differences in consumer behavior and the level of economic development among countries in the region. We think of EEMA as five distinct subregions, each with a unique consumer landscape and unique growth opportunities:

- **Africa** is the second fastest-growing consumer region worldwide. Urbanization is happening faster on the African continent than anywhere else in the world: 45 percent of the African population will be urbanized by 2025. Africa will have a larger workforce than China or India by 2034.

- In **Central Europe**, the outlook for the consumer sector is improving after a period of slowed GDP growth. Consumers have become more discerning and are looking for value for their money.

- Countries in the **Middle East**, particularly those in the Gulf Cooperation Council, enjoy abundant natural and human resources. The drop in oil prices has had a major economic impact, yet in many Middle Eastern countries, the average standards of living and disposable income remain relatively high.

- In **Russia** and the **Commonwealth of Independent States**, the economy has struggled due in part to lower oil prices and currency deflation. But there have been signs of recovery, and modest growth is expected in 2017.

- With a population of more than 80 million, **Turkey** is the world's 17th-largest economy by GDP. Despite recent political upheaval, GDP grew 2.9 percent in 2016.

The economic and geopolitical developments of recent years have yielded unprecedented uncertainty and massive change in EEMA. The decline in oil prices, stock-market gyrations, and dramatic currency depreciation have had severe knock-on effects. Leadership changes and political unrest have roiled some governments. Indeed, 65 percent of the world's "fragile states" are in EEMA, according to the 2017 Fragile States Index; Aon's Political Risks Map shows that more than 80 percent of countries with the highest level of political risk are in EEMA.

Still, over the next five years, EEMA's GDP is projected to grow at 5 to 6 percent per year at current prices. Political instability could delay a return to stronger growth, but we believe that local and multinational companies alike can double their growth in the region in the next five years. It's an ambitious but certainly achievable goal, as Dubai-based Majid Al Futtaim has shown: the conglomerate has doubled its revenue every five years since 1995 (see "Reshaping 'retail-tainment' in the Middle East and beyond," on page 8).

Imperatives for growth

By now, it's widely known that a company's success in emerging markets depends partly on how well it tailors its products and marketing messages to local tastes. The successes of online fashion retailer ASOS in Russia and of Domino's Pizza in Nigeria, for example, are due in large part to these companies' localized offerings. Another oft-cited success factor, exemplified by companies such as Coca-Cola and P&G, is the ability to adapt the supply chain to serve thousands of mom-and-pop stores and other small independent retailers.

Those capabilities remain important and necessary, but they're not enough. For sustained growth in EEMA, companies must also take a long-term view; make granular, data-driven choices about where to play; get their channels and formats right; and become digital innovators.

Take a long-term view

Companies that make decisions based on quarterly results and daily share prices probably won't last long in EEMA, but those that take a long-term view can be richly rewarded. An investment horizon of one or two decades, rather than the typical two to five years, can help companies prepare—both mentally and organizationally—for the economic ups and downs in this volatile region.

One way a company can take a long-term view would be to explore EEMA as a location for sourcing and manufacturing. With a youthful workforce and ample natural resources, the region has the potential to become a manufacturing hub. Russia, for instance, has attracted a number of multinationals: IKEA opened its fifth factory there in 2016, and Mars has expanded its chewing-gum and pet-food manufacturing activities in Russia. Meanwhile, in South Africa, Unilever has seven manufacturing locations, including new factories that make ice cream, home-care products, and savory dry foods. Nestlé has had a presence in Egypt since 1870 and has continued to invest in the country. The company locally manufactures 70 percent of the products it sells in Egypt, and it opened a new chocolate factory there in mid-2014.

Use granular data to decide where to play

Recent McKinsey research on the consumer-packaged-goods (CPG) industry shows that winning CPG companies make big bets on emerging markets, which are still contributing the bulk of revenue growth despite increased competition.[1] But that growth isn't evenly spread out. In Africa, for instance, half of consumption growth is expected to come from only three geographic areas: East Africa, Egypt, and Nigeria.

That means companies must be highly selective about where to invest their resources and talent. To double growth, they must be able to identify—and pivot quickly to—the highest-growth product categories in the highest-growth markets. And it isn't enough to have a general knowledge of which categories and which countries are growing fastest. Instead, leading companies must use granular data, drilling down to specific subcategories and cities—thereby optimizing their portfolios at the business-cell level.

For instance, between 2015 and 2025, absolute growth in the personal-deodorants category in Warsaw alone is expected to be 1.4 times that in the entire country of Hungary. Similarly, three Turkish cities—Istanbul, Ankara, and Izmir—together are projected to contribute more than 40 percent of Turkey's absolute growth in the sauces and condiments category.

Make consumer-centric choices with regard to formats and channels

Retailers that can best configure their formats to local consumer needs will capture most of the growth. For example, a few Russian retailers saw an untapped customer base: people living in residential communities with poor infrastructure and transportation networks. These retailers opened small convenience stores in such neighborhoods, with each store located within walking distance of houses and apartment buildings. As a result, some of these retailers achieved double-digit revenue growth between 2015 and 2016.

In some cases, a brick-and-mortar store format may not make sense at all, because of infrastructure challenges or a lack of desirable real estate. The solution? E-commerce. Since its 2012 launch, Jumia in Nigeria has kept consumer needs front and center—and has grown to become Africa's largest e-commerce platform. For example, Jumia attracts consumers who don't have bank accounts or credit cards, because it accepts a number of payment options, including mobile payments and cash on delivery. To make sure customers receive their orders in a timely manner (which can be particularly challenging in Nigeria due to heavy traffic and poor road networks), Jumia owns a fleet of delivery trucks in addition to using third-party logistics providers. Customers can also pick up their orders at Jumia's convenient pickup stations, which it operates in partnership with other businesses such as security-systems providers and shipping companies.

Among CPG manufacturers, too, making consumer-centric channel decisions is crucial. McKinsey benchmarking studies have shown that winning CPG players prioritize the highest-growth channels—namely, convenience stores, discounters, and, in certain markets, e-commerce—and systematically reallocate resources to those channels.

Invest in digital solutions and advanced analytics

Digital success stories in EEMA include South

African apparel, home, and sporting-goods retailer Mr Price, which has built an omnichannel presence in eight African countries and Australia. In 2016, its online sales grew by more than 60 percent. The retailer's digital initiatives have included equipping store personnel with tablets and administering in-store digital training; the company also uses digital technology and analytics to reduce its vehicles' fuel consumption and make deliveries more efficient. In Poland, clothing retailer LPP is continuing to invest in new digital technology, plans to double its workforce in the e-commerce channel, and has expanded its network of online stores abroad. Its online sales more than doubled in the first half of 2017, and overall sales grew 16 percent.

CPG players are investing in digital solutions as well, not just to improve consumer engagement but also to address pain points along the value chain. For example, beverage companies are equipping sales reps with mobile devices for taking orders and managing inventory. Other CPG manufacturers are using digital sales technology to ensure that wholesalers are meeting performance targets.

Company leaders must ensure that the entire organization embraces digital technology and advanced analytics. Employees at every level should receive training and coaching on new digital tools and approaches. In addition, to become digital innovators, companies need to attract digital and analytics talent, such as software developers, data scientists, and user-experience designers. EEMA boasts many highly educated and entrepreneurial youth, making for a deep talent pool and the potential to become a hub for technological innovation. Ukraine and Russia have strong education systems that produce graduates with valuable computer-science and math skills. Dubai is at the forefront of several new technologies; for example, it is expected to be the first city in the world to launch autonomous air taxis.

CEOs can work with governments to develop ecosystems to attract tech talent to the consumer industry. Particularly in start-up hubs that are emerging across Eastern Europe—such as the Estonian capital of Tallinn, where Skype originated—local governments are lending support by building infrastructure, introducing business-friendly laws and tax policies, and even investing in start-ups themselves.

Retailers and CPG companies can also boost their digital and analytical capabilities through partnerships with best-in-class organizations. A "build, operate, transfer" model—whereby an external vendor builds a solution, operates it side by side with a retailer or CPG manufacturer, and then transfers capabilities to end users—is one potential partnership approach.

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Like other emerging markets, EEMA presents both daunting challenges and exciting opportunities. Success in the region requires long-term thinking, data-driven decision making, a keen understanding of local consumers, and technological know-how. In time, companies that cultivate these attributes could reap outsize rewards. ■

[1] Rogerio Hirose, Davinder Sodhi, and Alexander Thiel, "How do winning consumer-goods companies capture growth?" April 2017, McKinsey.com.

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