SEPTEMBER 2014

The glittering power of cities for luxury growth

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The global economy is experiencing an unprecedented shift toward emerging-market cities. Here's a road map of where luxury-goods companies should compete in the next decade.

An economic rebalancing of great scale and speed is occurring from the West to the East and South. In fact, we are observing one of the most significant economic transformations the world has seen: 21st-century China is urbanizing on a scale 100 times that seen in 19th-century Britain and at ten times the speed. This means that the shift currently making Asia—once again—the world's economic center of gravity is 1,000 times larger than was witnessed during the Industrial Revolution.

One of the most dramatic aspects of this emerging-market economic revolution is the growing power of cities and the extreme growth concentration in a limited number of megacities. The world's top 600 cities (measured by absolute GDP) are expected to drive nearly two-thirds of global economic growth by 2025. Massive urbanization will continue across emerging markets, which will envelope three-quarters of these large cities. It is projected that by 2025, there will be 60 megacities—more than double the current number of urban behemoths—where GDP will exceed $250 billion, accounting for a full one-quarter of global GDP.

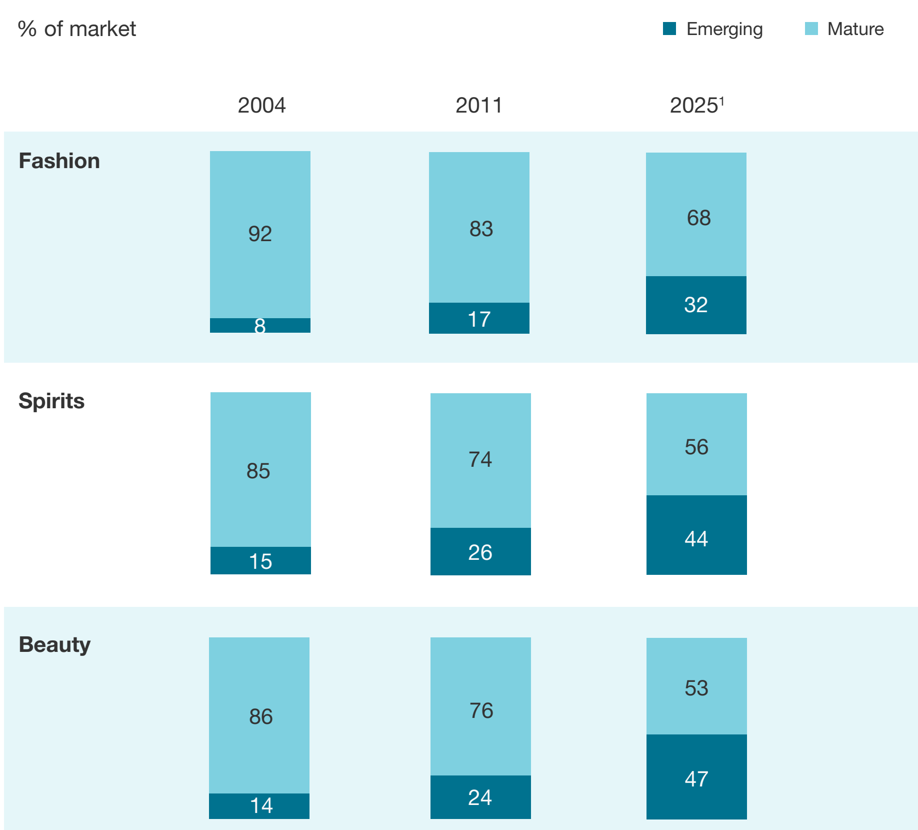
Out of the 25 largest growth-contributing cities, 21 are located in emerging markets, with a significant number of them in China. This represents a great leap from today's status quo, in which only 4 of the 25 wealthiest cities are found in the developing world. Yet economic growth does not automatically mean consumption development—or luxury-market growth. Market growth in these cities is indeed conditioned by specific factors that differ from city to city. Variables such as birth rate, wealth distribution, and share of working women correspondingly affect growth in categories such as baby food, beauty products, luxury goods, and women's fashion. To prioritize their efforts, companies will need to identify the biggest and fastest-growing cities with regard to their particular products and services.

Where luxury growth will come from

Using the McKinsey Global Institute's Cityscope—which draws upon broad sets of economic and sociodemographic data for more than 2,600 cities around the world and combines these with deep market understanding to forecast growth at the level of individual cities—we have developed a unique road map for how luxury companies should understand and approach global-growth opportunities. Our LuxuryScope "city guide" of luxury markets organizes granular data and statistical forecasting across luxury categories. For example, several critical, market-level insights emerged from our analysis:

- *Growth is increasingly shifting toward emerging markets across all luxury categories.* In luxury women's ready-to-wear, the weight of emerging countries will grow from less than 10 percent a decade ago to 32 percent in 2025. In luxury spirits and high-end cosmetics, the share of emerging markets will nearly double in the next decade, reaching 44 and 47 percent, respectively (Exhibit 1). Within this time frame, these markets will have grown three times faster than mature markets. However, the rebalancing toward emerging economies is less advanced for luxury items than for mass-market ones—in midmarket apparel, for instance, emerging countries will account for more

Exhibit 1 Growth is shifting to emerging markets across luxury categories.



[1]Forecast.

than 55 percent of the total in 2025. And it is worth noting that for countries such as Brazil, China, and Russia, the local number may not truly reflect the importance of Brazilian, Chinese, and Russian consumers, since much of their shopping is done while traveling abroad.

- *Luxury growth is highly concentrated in cities.* The world's top 600 cities will account for 85 percent of growth in the luxury-apparel market in 2025 versus 66 percent for luxury beauty products and only around 40 percent for consumer packaged goods. In fact, the more upscale and less "basic" products that consumers desire, the more growth will be concentrated in cities.

- *Mature cities remain critical given their absolute size.* There will be changes during the next decade, with seven new cities landing on the list of top luxury cities: Beijing, Chongqing, Guangzhou, Hong Kong, Rio de Janeiro, Shenzhen, and Tianjin. Yet the fast growth of emerging cities does not mean that mature markets are becoming irrelevant—far from it, in fact. When we take a closer look at the 20 largest markets for luxury women's ready to wear in 2025, they are mostly mature-market cities, with not one Chinese city on the list and no emerging-market cities in the top five. For many luxury players, increasing market share in large Western megalopolises should be at least as important as riding the wave of growth in emerging countries.

- *Growth is granular and varies by category, price point, and style.* Driven by cultural fit with a brand's value proposition and underlying growth factors by category and price point, the attractiveness of particular cities can differ significantly among luxury players. For instance, luxury women's apparel is dominated by the traditional fashion capitals, such as Milan, New York, and Paris; spirits are strong in the Americas, while skin-care growth is concentrated in Asia. Mexico City, for instance, ranks 18th in fashion, 8th in spirits, and does not even appear in the top 20 for beauty (Exhibit 2). But within each of these categories, the attractiveness of any single brand will also vary depending upon its fit with local taste.

- *Emerging countries will drive growth, with China taking the lead.* Of the top 20 cities for luxury-apparel growth, 7 are found in the "Next 15" countries (that is, the 15 fastest-growing emerging countries), which will account for 90 percent of global luxury growth across beauty and women's ready to wear. Not surprisingly, China alone will drive half of this growth, while the remaining countries in the Next 15 will account for one-fifth of the potential luxury consumers in the world by 2025, nearly four times as many as in the United Kingdom.

This extreme growth concentration is great news for luxury brands and retailers. It will allow companies to more easily and completely focus their efforts on higher-growth areas. Analyses conducted on growth concentration by city reveal that extensive growth opportunities still exist in Europe and the United States, even in cities as large as London, Los Angeles, and Paris. The city approach to growth can also serve as a compass for companies seeking to navigate the vast sea of emerging markets, helping players to prioritize cities and focus their resources on targeted market-entry plans, whether in Belo Horizonte, Brazil, or Wuhan, China.

Exhibit 2 These cities will be the world's luxury capitals in 2025.

Top 20 cities based on forecast 2025 market size

Fashion	Spirits	Beauty
Paris	New York	Hong Kong
Tokyo	Los Angeles	Tokyo
Milan	Chicago	London
London	Washington, DC	New York
New York	Houston	Moscow
Moscow	Dallas	Shanghai
Osaka	London	Beijing
Los Angeles	Mexico City	Paris
Rome	Shanghai	Los Angeles
Seoul	Beijing	Taipei
Singapore	Moscow	Singapore
Dallas	Philadelphia	Osaka
Chicago	San Francisco	Seoul
Madrid	Miami	Chicago
Nagoya, Japan	Boston	Shenzhen
Miami	Atlanta	Madrid
Sydney	Seattle	Dallas
Mexico City	Phoenix	Milan
Washington, DC	Tokyo	Dubai
Saint Petersburg	San Diego	Rhein-Ruhr, Germany

What companies must do

Taking the city-by-city approach can help luxury companies revamp their growth strategies and gain new insights that can be used to adjust their business-development models, resource allocations, and organizational structures. How can these new business insights into potential on the city level be used to accelerate companies' growth?

The right plan

It is well understood that having the right strategic plan is the essential starting point for any growth journey. Building this plan requires clear answers about where to go and when. Luxury-goods companies must identify growth opportunities at the city level, generating insights on where to concentrate resources to achieve the greatest impact. In addition, this approach also encourages the development of forward-looking market intelligence, a key enabler for ensuring that strategic decisions will allow companies to stay one step ahead of the competition. The city "attack plan" might look quite different from the traditional market-expansion road map. For instance, rather than discussing Asia or Europe as alternative locations—or even Spain versus France—decision makers may ask, "In what ten key cities should we establish a stronger presence?"

Outstanding execution to achieve impact

When companies begin looking at fast-growing emerging-market cities, five key issues need to be tackled to help ensure success:

1. *Identifying the right go-to-market model for each location.* In their efforts to go international, luxury brands and retailers should decide on an expansion model that best suits their needs and the realities of their new footprint. In a world without constraints, most would prefer a wholly owned retail-store expansion. However, in new geographies, an optimally balanced model needs to be developed, accounting for all pertinent legal, financial, and operational constraints, while balancing short-term speed with long-term strategic interests. Winning companies may find it most beneficial to put down stakes right away with a local partner in order to benefit from the partner's market knowledge, reduce risk, and relieve short-term financial constraints—and they will design a buyback option that's included from the start to secure long-term brand control.

2. *Determining if there is a need for local-offer customization.* Deciding whether or not to adapt the offering to local tastes and customs is something that most luxury companies seeking international growth opportunities will need to address. The question is, how do you ensure global brand consistency while satisfying the needs of customers in Paris, Shanghai, and, maybe tomorrow, Lagos? Key topics to address include how to convey a consistent brand experience globally, at each point of sale, and what it will take to operationally deliver new fits and sizes, designs, or even in-store service offerings. Many companies are challenged by rapidly increasing complexity and the risk of brand dilution, so it is vital that any customization effort is backed by a lean and responsive back-office organization, as well as a robust brand strategy.

3. *Ensuring global customer service.* While being home to a vast number of potential luxury consumers, many Next 15 countries are not yet served by most luxury brands with a local retail presence. How should companies start interacting with this new group of consumers, who hail from countries as diverse as Bangladesh, Mexico, and Nigeria? The positive news is that these new luxury prospects travel: they are exposed to luxury brands when entering retail shops abroad or when ending up in a Milan or New York flagship store. This offers opportunities for luxury companies to connect with such shoppers, gather consumer insights, and better understand their needs and affinity with luxury goods, so that when they are faced with having to decide whether to enter a new country, they can make well-informed decisions.

4. *Gauging a need for organizational changes in the longer term.* Organization is another critical area in which the rise of megacities in emerging countries is causing new challenges. Historically, most luxury brands have structured their teams around zones, then countries, and then areas within countries where relevant. But if Shanghai will eventually be three times the size of Switzerland, would it not require the same management focus—and the manager of Shanghai

being at the same level in the organization as the country manager of Switzerland? Moreover, talent scarcity and difficulty in finding the right fit locally will reinforce the need to rethink historical organizational models.

5. *Choosing how to deploy or redeploy resources.* Resource misallocation is probably the biggest growth bottleneck for companies seeking to expand their footprint. Allocation of financial resources is critical, and capital needs to be invested in places where the strategy can unfold. Unfortunately, there is often a strong tendency to cling to existing strategies in Western organizations, with only marginal year-on-year reallocation. The challenge is even greater for companies attempting to focus on cities without city-level budgeting, as resources usually tend to get diffused. But resources are not only financial: the allocation of human resources is also critical to ensuring impact, and it is important that the best talent is deployed where it will make the most difference. One question to consider here: Are you prepared to reassign one of your top leaders, who may currently be the head of an entire country, to become a district manager in Shanghai or São Paulo? This is the kind of resource-allocation thinking that will make companies win in the new game of city-level-focused growth.

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The global paradigm shift driven by emerging-market cities is posing similar questions for Western companies for many different industries. For luxury players, cities probably matter more than for any other product category, and as retailers, most have the "luxury" of choosing, at a very granular level, where and when to open or expand a store. In this context, luxury players are uniquely positioned to pioneer this new approach to accelerate their growth.

The authors wish to thank Benjamin Durand-Servoingt for his contributions to this article.

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