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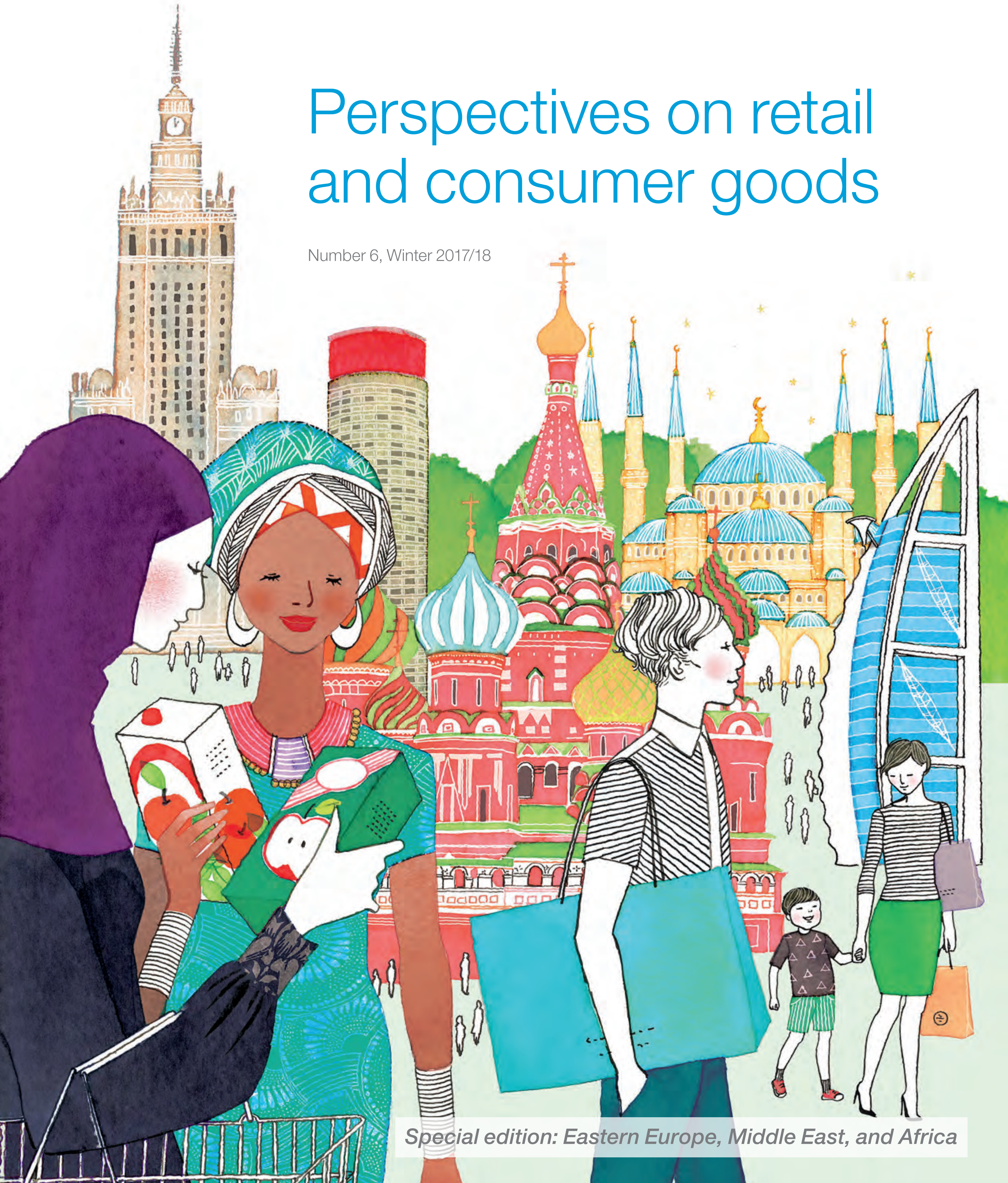

Special edition: Eastern Europe, Middle East, and Africa

Perspectives on retail and consumer goods is written by experts and practitioners in McKinsey & Company's Retail and Consumer Packaged Goods practices, along with other McKinsey colleagues.

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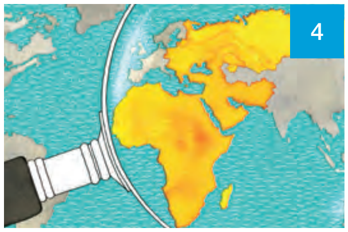

Foreword

The year 2017 has been an interesting and eventful one. Everywhere in the world, companies have had to grapple with economic and political uncertainties—but smart companies have nevertheless been able to thrive. This is certainly true in Eastern Europe, the Middle East, and Africa (EEMA), a region that has experienced its share of volatility but also its share of growth.

The articles in this special edition of *Perspectives on retail and consumer goods* give an overview of the consumer landscape in each of EEMA's subregions, as well as market-specific recommendations for companies doing business there. One common theme that emerges is the increasingly important role of data and analytics. Across EEMA, retailers and consumer-packaged-goods (CPG) manufacturers are harnessing the power of big data and advanced analytics to better understand and meet the needs of consumers. Whether it's by enabling mobile payments in Africa or deploying cutting-edge analytical techniques to refine pricing and assortment in Russia, companies are benefiting from new technologies—and, in so doing, are rising above the competition.

A highlight of this edition is our interview with Alain Bejjani, the CEO of Middle Eastern conglomerate Majid Al Futtaim. One of us (Peter) had the pleasure of interviewing Alain in Dubai and came away impressed with his relentless focus on customer experience, his commitment to talent development, and his long-term thinking.

We hope that you find this journal to be a source of new and useful insights and that it sparks important discussions in your organization about how best to capture opportunities in the EEMA market. We've seen firsthand that consumer and retail companies that commit to the region can achieve robust, profitable growth—and we firmly believe the region holds vast long-term potential and untapped possibilities, both for local family-owned businesses and multinational corporations. We wish you all the best in your EEMA journey.

Peter Breuer
Leader,
EEMA Consumer & Retail

Pål Erik Sjåtil
Managing Partner,
EEMA

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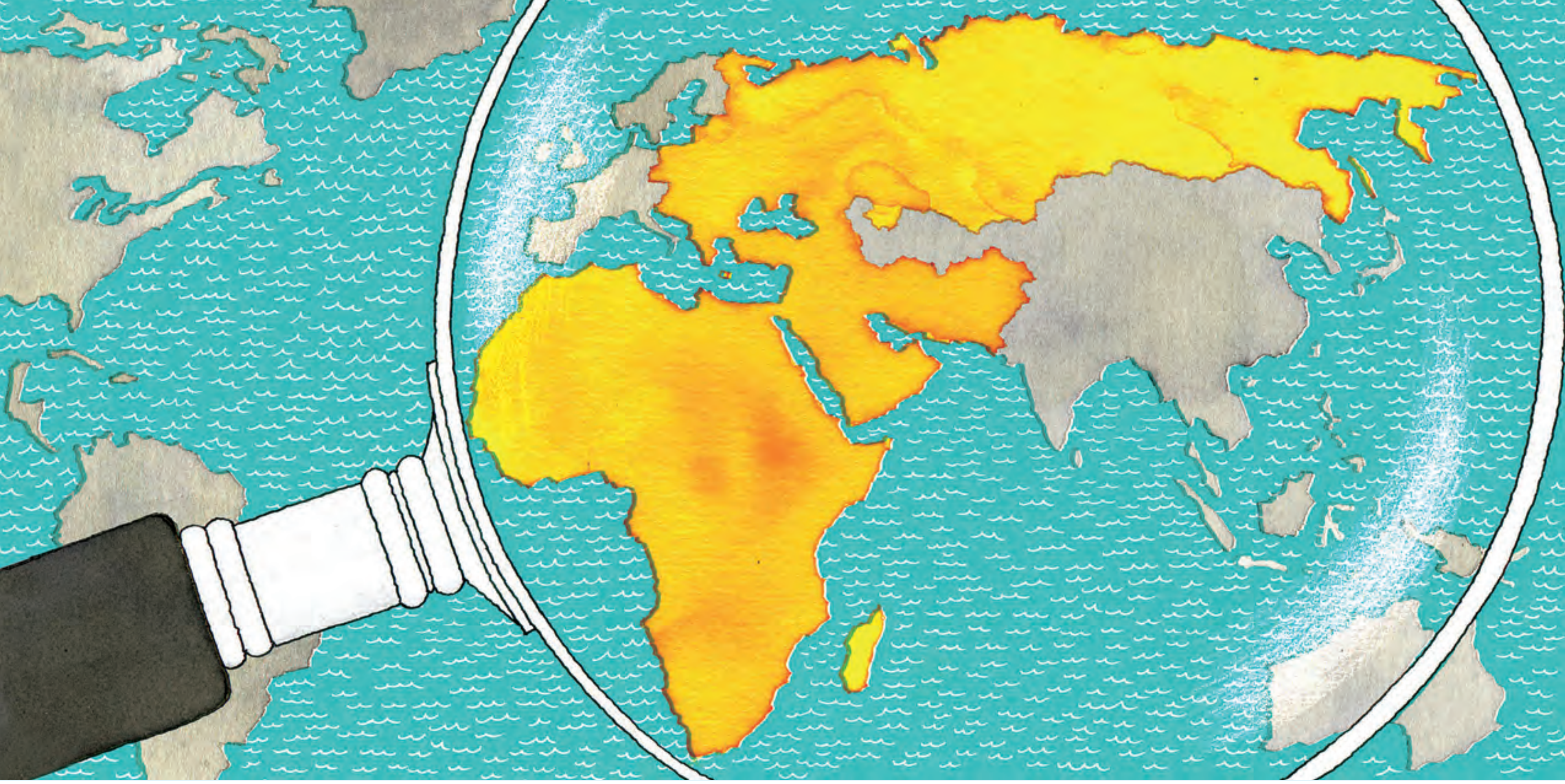

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Doubling your company's growth in a volatile region

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 Risk 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.

■ ■ ■

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. ■

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

Peter Breuer is a senior partner in McKinsey's Cologne office, and **Pål Erik Sjåtil** is a senior partner in the Moscow office.

The authors wish to thank Yvonne Fahy for her contributions to this article.

Reshaping 'retail-tainment' in the Middle East and beyond

Alain Bejjani, CEO of conglomerate Majid Al Futtaim, shares his perspectives on retail's future and on his own leadership journey.

Peter Breuer and Gemma D'Auria

In the summertime, temperatures in Dubai can exceed 40°C (104°F). No surprise, then, that people flock to the air-conditioned Mall of the Emirates to shop, dine, see movies, play arcade games, or ... ski. Yes, this mall—located in the desert—houses Ski Dubai, the world's largest indoor ski slope and snow park.

The Mall of the Emirates is owned and operated by Majid Al Futtaim Group, a conglomerate with a presence across the Middle East, Africa, and Central Asia. The leading developer and operator of shopping malls in the region, Majid Al Futtaim also owns VOX Cinemas, the Middle East's largest movie-theater chain; several leisure and entertainment centers; and the Carrefour franchise in 38 countries. Since opening its first mall in 1995, the conglomerate has doubled its revenues every five years, reaching approximately $8.2 billion in 2016.

For the past two years, Majid Al Futtaim has been led by Alain Bejjani, a lawyer by training, with a career spanning more than ten years within the organization. Bejjani recently spoke with McKinsey's Peter Breuer and Gemma D'Auria in Dubai. Excerpts of the conversation follow.

McKinsey: *Your businesses serve thousands of consumers every day. What are the biggest consumer trends you're seeing?*

Alain Bejjani: The most exciting global trend affecting all of our businesses is the shift in consumer focus from product to experience. Majid Al Futtaim has long been a pioneer in customer experience—partly because it's extremely hot in the Middle East during the summer months, and it's not unusual for people to spend the whole day at the mall. But they don't want to just shop all day long, so we have turned our malls into social hubs and true "retail-tainment" destinations that address our customers' wants, in line with our vision of "creating great moments for everyone, every day." As our Mall of the Emirates tagline testifies, "Shopping is just the beginning." And we are reinventing our assets all the time. Our ThEATre by Rhodes, for example, is a partnership between our VOX Cinemas and a celebrity chef. We've married movie viewing with gourmet food to create a completely novel experience.

In line with this trend of valuing experience over product, customers are even starting to define luxury differently. It is about truly enjoying the "great moments," the experience, irrespective of the price point. ThEATre by Rhodes isn't an exorbitant expense—just a premium on a regular movie ticket—but people see it as a luxury experience, and they love it because it is unique. People don't want to just pay for luxury; they want to *live* it.

Another trend we see is that more consumers want technology to be seamlessly embedded into their experience. This is particularly true in the Middle East, which has some of the fastest growth rates in smartphone adoption, Internet penetration, online shopping, and social-media usage in the world. So we are embedding a technology dimension into everything we do. We've integrated our IT platforms and created a central repository for our customer data. We're using technology to take our offering to a new level, and analytics to learn more about ourselves, our people, and our customers and make decisions that help us create great moments for them. We see technology as the currency of the future. And we're working on establishing an online presence for our brands that will be as prominent as our offline presence, in particular, for our grocery retail business.

Another big trend is that disruption is no longer coming merely from our traditional competition but often from outside the boundaries of our specific industries. We need to make sure we not only look at the experience and technology of today but also constantly imagine and stay ahead of customer wants for the technology-enabled experience of tomorrow. This is where learning from other industries is tremendously helpful. We are learning from the world's leading technology companies—Google, Facebook, Amazon, as well as great start-ups that are applying new approaches to solve real challenges.

McKinsey: *Does that mean Majid Al Futtaim is starting to see itself as a technology company?*

Alain Bejjani: Somewhat. Our overarching strategic thrust is to continue to be fit for purpose. That means we need to transform ourselves from a largely brick-and-mortar business into a technology-fueled enterprise, and do it in a way that keeps the customer at the heart of everything we do.

I believe retail has moved away from understanding our customers deeply, as clients, not just as a collective mass of consumers. We need to go "back to the future" and nurture an individual, personalized relationship with the customer, just like retailers used to do in the old days. But to do that today, we need data-driven insights and technology, as well as the right mind-sets in our people. These are, essentially, the pillars of our long-term strategic direction: unforgettable customer experience and globally competitive human capital, fueled by technology.

McKinsey: *You defined your 25-year strategic direction just last year. Why was that an important exercise? Does it make sense to have a long-term plan in such a fast-changing retail environment?*

Alain Bejjani: Like much of the corporate world, our horizon has always been defined in five-year rolling priorities. Yet I believe we are at a point where our decisions—about what we do, where we play, and how we earn the right to win—will be life-defining for our company. We simply cannot make such critical choices without a long-term strategic direction, a "North Star." You have to be grounded in your

Alain Bejjani

Vital statistics
Born in 1973, in Beirut, Lebanon

Married, with 2 daughters

Education
Holds a bachelor's degree in civil law and a master's degree in civil and corporate law from Université Paris-Est Créteil

Career highlights
Majid Al Futtaim Holding
CEO (2015–present)

Chief corporate-development and brand officer, Majid Al Futtaim Properties (2014–15)

Various positions, including head of business development, Majid Al Futtaim Properties (2006–14)

Investment Development Authority of Lebanon (2001–05)
Executive vice chairman

Melkane, Rached, Bejjani & Associates (1999–2006)
Founding partner

fundamentals to sustain growth, particularly when you are a diversified and growing conglomerate, with 12 businesses at different stages in their life cycle. Otherwise, it is extremely easy, even tempting, to be derailed. As Lewis Carroll once wrote, "If you don't know where you are going, any road will take you there."

I have often said to our leaders that outperforming the competition should not be our endgame. The endgame is to fulfill our potential as an organization. Our 25-year strategic direction helps us to stay focused on that endgame.

McKinsey: *One of your goals is for Majid Al Futtaim to have a stellar global reputation. What would you like to be known for?*

Alain Bejjani: I'd like us to be known for leading by example and creating great moments. We don't always do a good job in promoting our commitments and achievements. We are world-class in some aspects of our business and deserve to be a global benchmark in those. Take sustainability, for example. We recently launched a net-positive strategy: we will reduce our water consumption and carbon emissions so that we put more back into the environment than we take out, resulting in a positive corporate footprint by 2040. We are extremely proud to be the first company in the Middle East to commit to such a target; we're proud to be part of a small group of corporates globally to "walk the talk" and have this strong commitment to sustainability.

So we have become much more deliberate in communicating our impact. I think this is increasingly important in a world that is much more instantaneous. We are also focused on establishing our thought leadership in specific topics that are core to our future and where we aspire to lead the way, such as customer experience and innovation.

McKinsey: *You've now been CEO for about two years. Do you feel you've made any mistakes?*

Alain Bejjani: By and large, I believe we've made the right strategic choices. But I think we could have done much better on two fronts: human capital and technology. In both of these areas, we are playing catch-up to globally competitive standards.

We were busy building a business but did not make our people center stage. Only recently have we started focusing on human capital as much as on financial capital. We cannot predict what capabilities we will need in the future; hence, we need to be globally relevant in order to attract top talent. Some of the most critical roles in the future have not even been created yet. So the only way forward is to instill an open and learning mind-set in our organization. We need to continuously reinforce ourselves as an organization where talented, ambitious people can thrive. This is very difficult to get right and to sustain. [Author and motivational speaker] Simon Sinek eloquently describes this in his book *Start with Why*. He explains that people don't join an organization any more. Rather, they join a cause. Majid Al Futtaim's cause is our vision of "creating great moments for everyone, every day."

Similarly, technology in our company was always perceived as an enabler yet was never fully integrated into everything we do. We've now established our School of Analytics & Technology, with a curriculum that spans everyone in the company—from CEOs to frontline workers. I believe we are one of the few companies globally to have invested in analytical and digital capability building to such an extent.

So yes, we've made mistakes, but what is most critical is the ability to auto-correct, which is very hard without an open and learning mind-set. Instilling this mind-set in all of our people is a major challenge and the main reason we work so hard on our organizational culture. Our Leadership Institute is a milestone in our road map to become a learning organization.

McKinsey: *Say more about the Leadership Institute. What is it, and how exactly is it helping you build capabilities?*

Alain Bejjani: We established it two years ago, based on a leadership model that details the specific leadership behaviors we expect from our people, no matter their level of seniority (exhibit). We have dedicated significant time and effort to defining these behaviors and describing in detail what it means to meet, exceed, or fall short of expectations. We discuss our leadership model in each and every one of our town-hall meetings, and we encourage everybody in the organization to use it when providing feedback. Since its launch, more than 9,000 employees have attended one or more of our programs in the Leadership Institute.

We take our top talent very seriously. We assess people rigorously on performance and potential, using a 360-degree tool, and we provide them with opportunities to lead. But we go beyond that—we proactively support our team members in their leadership and professional-development journey through an ongoing performance-management dialogue, designed to empower them to thrive in an ever-changing world. We invest in our people, and we're willing to take risks on them. I am a great example of how the organization takes a risk on people. This is my first CEO role, and I feel tremendously privileged to have been given this opportunity.

In summary, we are striking a partnership with our team members to reflect our shifting philosophy—from financial capital being our most critical asset to human capital. Everything starts and ends there. I believe the "new normal"—this context of exponential change in which we live and work—is placing much higher demands on leadership. The implication is that financial capital will no longer be the limiting factor to growth or the catalyst to superior performance; the quality of human capital

Exhibit

The Majid Al Futtaim leadership model comprises six themes, with the company's values at the core.

Source: Majid Al Futtaim

will be. I believe we have shifted from an era of capitalism to one of "talentism," in which whoever attracts, develops, and retains the best talent wins. And what do I mean by "best talent"? It is quite simple—people with a growing and learning mind-set.

McKinsey: *As CEO, how do you yourself learn?*

Alain Bejjani: I enjoy learning through conversations, whether they are spontaneous or structured—meetings, lunches, coffee breaks. People who know me would tell you that I often evolve my thinking while brainstorming and discussing a particular issue. It is when I'm in stimulating conversations that I'm most able to generate new ideas, assess strategic choices, and push the boundaries of what's possible.

Of course, I also measure myself against our leadership model. It's tough to "hold up the mirror" and read through your own 360-degree feedback and acknowledge your own gaps and deficiencies.

But this is precisely what is required if we are to embed a learning mind-set in the entire organization and a healthy approach to dealing with failure.

I actually decided to be bold and role-model transparency by sharing my 360-degree feedback with my team. One thing I need to work on, for example, is spending more time coaching people. I think this is a fair observation and a piece of feedback I am working on.

McKinsey: *What's the best leadership advice you've received since becoming CEO?*

Alain Bejjani: I can think of three things that have resonated the most with me. The first is a French saying, "Give time to time." It doesn't translate well into English, but what it means is that there are just some things you cannot rush. In our company's transformation, for example, I have found that you should communicate the case for change, then build evidence of impact to sustain the change, but also give time for people to absorb, internalize, and practice the change. We do that by promoting an open and trusting environment where people can voice their concerns and where no issue is allowed to fester.

But this doesn't mean "leave it to time" or "go slow"—in fact, I see it as one of the main responsibilities of my role to keep a sense of urgency and a fast pace in the organization. Change is more an art than a science. You need to use your judgment as a leader to figure out which parts of the organization can move faster than others and which ones need different types of intervention, and adjust accordingly. It is not a one size fits all.

Another quote I like is from Winston Churchill: "If you are going through hell, keep going." It speaks to a quality I have a renewed appreciation for, which is grit—sticking with your long-term goals and persevering when things don't work out exactly as you wish.

A third saying that I've taken to heart is, "It may not be your fault, but it is your problem." You have to take full responsibility for your actions as well as for the actions of those you lead. I believe leaders need to overmanage, but not micromanage.

McKinsey: *One final question: What are your sources of inspiration?*

Alain Bejjani: I grew up in Beirut during the civil war. When I look back, I find that one of the many lessons from that experience is that one can achieve anything against all odds, if one really sets his heart and mind on it. In this regard, I am inspired by Mr. Majid Al Futtaim's vision, his ambition to be world class, and his perseverance in keeping the long-term view.

Dubai is another great source of inspiration. The city that we call home was built in such a short time yet has defied the rules of economics and established itself as a true global destination. It is humbling to see how Dubai, which was endowed with very limited natural resources and could have easily remained a trading outpost at the edge of a vast desert, is trying to lead globally in transport, commerce, tourism, technology, responsive government, and even happiness. Majid Al Futtaim would not be the organization it is today if it had not been headquartered in Dubai. ■

This interview was conducted by **Peter Breuer**, a senior partner in McKinsey's Cologne office, and **Gemma D'Auria**, a partner in the Dubai office.

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Lions (still) on the move:
Growth in Africa's consumer sector

Africa remains a high-potential region, but growth is concentrated in a few markets and income segments. To win, companies need a tailored, data-driven approach.

Damian Hattingh, Acha Leke, and Bill Russo

Just a few years ago, consumer spending in Africa passed the $1 trillion mark. The continent's impressive growth trajectory at that time—in particular, the robust growth in Africa's 30 largest economies—caught the attention of consumer businesses worldwide. Indeed, the consumer-facing sector has been pivotal in Africa's growth story, accounting for almost half of the continent's GDP growth between 2010 and 2014.

But because of the recent slowdown, some executives have begun to question whether Africa's once-roaring economy and burgeoning consumer sector still hold promise. Is Africa truly worth investing in? Can multinational companies succeed in the region? Is the African consumer opportunity still as attractive as it once seemed? Our unequivocal answer is yes—but companies will need to adopt increasingly sophisticated approaches to compete effectively.[1] In this article, we share our latest perspectives on Africa's outlook to 2025 and what it will take for consumer-goods companies to thrive in the region.

A temporary slowdown

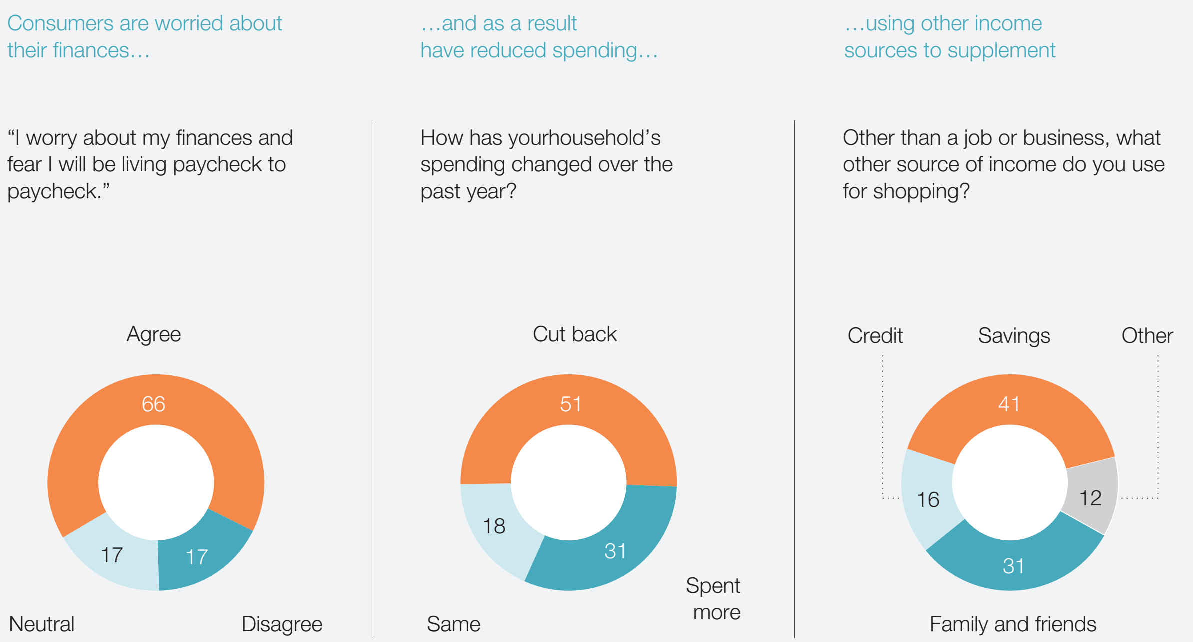
Consumer spending across the continent amounted to $1.4 trillion in 2015, with three countries—South Africa, Nigeria, and Egypt—contributing more than half of that total. Food and beverages still constitute the largest consumption category, accounting for as much as one-third of Africa's household spending in 2015 (and close to 40 percent of household spending in lower-income countries such as Ghana, Kenya, and Nigeria), but discretionary categories already make up a substantial share of consumption. Spending on nonfood consumer goods—including clothing, motor vehicles, and household goods—accounts for a further 15 percent of consumption.

However, due in part to currency devaluations and a sharp downturn in oil-exporting economies, spending growth has slowed. Out of the 15 largest consumption markets in Africa, which constitute 90 percent of the continent's total consumption, 12 experienced a slowdown in consumption growth between 2014 and 2015—the exceptions being Ethiopia, the Democratic Republic of Congo, and Tanzania.

Clearly, the African consumer is under financial pressure. In a 2016 McKinsey survey of consumers in six African countries, two-thirds of respondents said they were worried about their finances and more than half said they've reduced their spending (Exhibit 1).

Exhibit 1 **Consumers in six African countries surveyed are finding it harder to maintain their living standards.**

Results from countries surveyed,[1]
% of respondents, weighted average



[1] The countries surveyed were Ethiopia, Ghana, Kenya, Morocco, Nigeria, and South Africa; 4,600 people sampled.
Source: McKinsey African Consumer Survey, September 2016

The outlook to 2025

Consumer spending in Africa is projected to reach $2.1 trillion by 2025.[2] The following strong structural fundamentals are in place to drive the consumer opportunity:

A young and growing population. The continent's population is projected to grow by 20 percent over the next eight years, with Africa's youth making up 40 percent of the total. By 2025, almost one-fifth of the world's people will be living in Africa. This population growth is accompanied by falling dependency ratios and an expanding workforce: the size of Africa's working-age population is expected to surpass both India's and China's by 2034.

Rapid urbanization. By 2025, an additional 190 million people in Africa are expected to be living in urban areas, which means that about 45 percent of the population will be urbanized by then. City dwellers are voracious consumers: per capita consumption spending in large cities in Africa is on average 79 percent higher at the city level than at the national level. Cities in Kenya and Nigeria, for instance, have per capita consumption rates that are more than double the country rates. The top three cities in Ghana and Angola will account for more than 65 percent of national consumption spending in each of these countries.

Rising incomes. Since 2005, increases in spending per household have been responsible for about 40 percent of consumption growth in Africa. By 2025, 65 percent of African households will be in the "discretionary spending" income bracket (earning more than $5,000). Consequently, the profile of goods and services that Africans purchase will shift, from basic necessities toward more discretionary products.

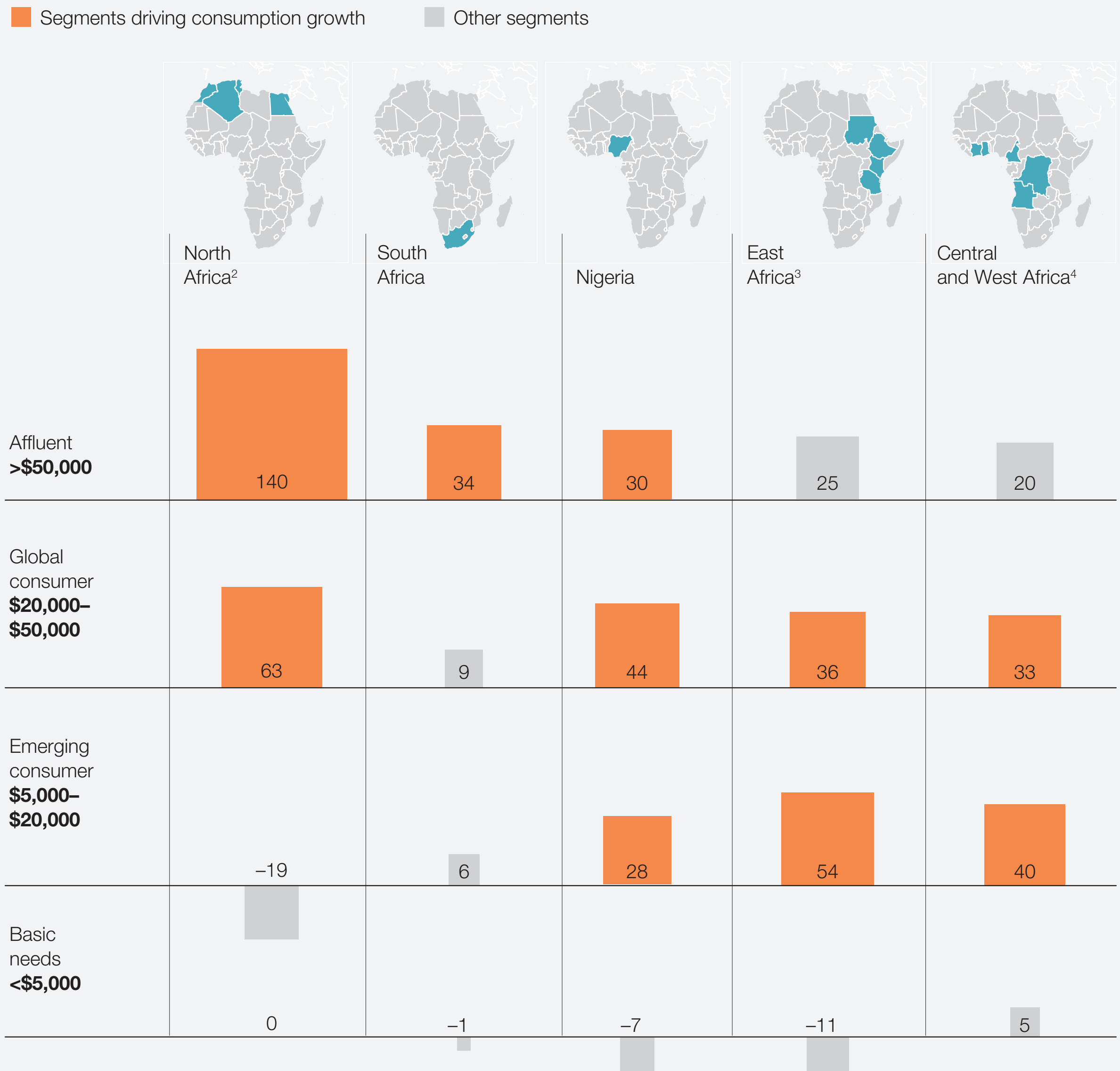
Widespread technology adoption. Technology is opening many new doors for consumers. Mobile money, for instance, is growing five times faster in Africa than in any other region. By 2020, half of Africans—up from 18 percent in 2015—are expected to own a smartphone, which they can use to buy and sell products and services, pay bills, and make remittances. A study in Kenya found that families with M-Pesa mobile money were able to withstand financial shocks (such as illness) without reducing their consumption, because they could borrow money electronically from friends and family. The success of e-commerce company Jumia—colloquially referred to as "the African Amazon.com"—is partly due to the fact that it accepts mobile payments, allowing even Africans who don't have bank accounts to make purchases. E-commerce and m-commerce offerings are partially leapfrogging formal retail, and McKinsey analysis suggests that e-commerce could account for 10 percent of retail sales in Africa's largest economies by 2025.

These factors bode well for the continued growth of Africa's consumer sector. However, growth will be uneven across countries and income classes, and the geographic spread of consumption will change. Our colleagues at the McKinsey Global Institute have identified four groups of consumers that will drive much of Africa's consumption growth between now and 2025: those earning more than $50,000 a year in North Africa and South Africa, Nigerian consumers, middle-income consumers in East Africa, and middle-income consumers in Central and West Africa (Exhibit 2).

East Africa's share of consumption is projected to rise from 12 percent in 2005 to 15 percent in 2025; Francophone Africa's, from 9 percent to 11 percent. Meanwhile, South Africa's share is projected to decline from 15 percent to 12 percent over the same period, and Nigeria's from 26 percent to 22 percent. But given that Nigeria will still account for more than a fifth of African consumption, consumer companies can't afford to ignore that market, even amid challenges in the business environment.

Exhibit 2 **Much of Africa's consumption growth is coming from only a few consumer segments.**

Consumption growth by household income segment, 2015–25,[1] $ billion (2015 prices)



[1] These 15 African markets generated 89% of 2015 demand and will be responsible for 82% of consumption growth between 2015 and 2025.
[2] North Africa comprises Algeria, Egypt, Morocco, and Tunisia. Egypt will account for 62% of the region's growth in consumption.
[3] East Africa comprises Ethiopia, Kenya, Sudan, and Tanzania.
[4] Central and West Africa comprises Angola, Cameroon, Côte d'Ivoire, Democratic Republic of Congo, and Ghana.

Source: African Development Bank; Canback Global Income Distribution Database (C-GIDD); IHS; Oxford Economics; McKinsey Global Institute analysis

Serving the African consumer

In previous articles, we've discussed some of the imperatives for consumer companies to succeed in Africa.[3] These imperatives—such as taking a city-based view of growth, getting credit for value, tailoring the offer to the local market, and creating bespoke route-to-market models—are as relevant as ever. But the changing consumer and retail landscape has highlighted the importance of several other focus areas: making smart use of advanced analytics across the value chain, adopting sophisticated pricing and assortment strategies, and being selective about distributor relationships.

Understand customers through advanced analytics

Formal retail in Africa is expected to grow by about 5 percent each year over the next few years, bolstered by the aggressive expansion of international retailers such as apparel players Cotton On, H&M, and Zara. However, informal retail channels are likely to continue to dominate the market in sub-Saharan Africa for the foreseeable future.

Because of the highly fragmented nature of informal retail in much of Africa, many consumer-goods companies rely on a passive wholesale model and lack a direct relationship with the retailer, limiting their visibility into retail-outlet performance. But leading companies are now exploiting big data and advanced analytics to take their understanding of their customers to a new level. A consumer-packaged-goods (CPG) manufacturer, to serve hundreds of thousands of small outlets in Africa, equips its sales reps with handheld devices that they use for collecting detailed information about, for instance, an outlet's product range, pricing, in-store execution, and storage space. This information, combined with internal data (such as SKU-level sales and profitability) and external data (such as weather forecasts), helps the company make outlet-specific decisions about which products should be in the assortment, how much stock the outlet should have, what types of promotions will be most effective, and so on. Sales reps then receive specific recommendations based on the analytics. Early results suggest that using advanced analytics in this way can drive a 10 to 15 percent sales improvement within months.

Adopt a more sophisticated approach to pricing and assortment

In the past, companies could offer just a small range of products with a basic pricing structure, all targeting the "average" African consumer. Today, in light of rising income disparities across the continent, the most successful CPG companies are using tiered-pricing strategies to capture price premiums from high-income consumers or special consumption occasions (for example, meals at restaurants or bars) while continuing to provide affordable price points for lower-income consumers or value-oriented occasions (such as family meals at home).

Beer companies have long had tiered brand offerings in Africa. Heineken's brand portfolio in Nigeria, for example, includes Goldberg, a value brand; Star, a

mainstream brand; and Heineken, a premium brand. Soft-drinks players take a slightly different tack: they vary their products' pack formats and sizes. The Coca-Cola Company sells soft drinks in low-cost returnable glass bottles, nonreturnable polyethylene terephthalate (PET) bottles at slightly higher price points, and, at even higher price points, sleek cans or sleeved PET bottles. It sells each of these formats in a variety of pack sizes tailored to specific occasions; it also adjusts pack sizes from time to time to ensure that they remain affordable to the target consumer segments while still being profitable for the company.

Still other companies differentiate their pricing and assortment by region. One CPG manufacturer studies competitor dynamics, cost-to-serve economics, and consumer incomes within microgeographies so that it can develop region-specific product portfolios and highly localized discounting tactics.

Choose, segment, and manage distributors strategically

Many CPG companies' distributor networks in Africa are the result of long-standing and often unexamined relationships. It's therefore not uncommon for CPG manufacturers to find themselves making big investments (for example, through discounts and other kinds of trade spending) in distributors with poor outlet coverage, shoddy execution, or suboptimal capabilities.

Companies should instead be deliberate about designing their distribution network. They should select distribution partners who can help them achieve strategic objectives such as maximizing outlet coverage or optimizing cost to serve. They should then segment distributors based on criteria such as size and quality of relationship, and then differentiate their treatment of each segment—deploying levers such as trade terms, account planning, capability building, and territory allocation in line with segment needs or challenges. Finally, CPG companies should closely track distributor performance on clearly defined metrics (such as volume, outlet coverage, SKU coverage, and price compliance), establish pay-for-performance parameters, and conduct regular performance dialogues with distributors. A handful of large manufacturers, including Diageo and Unilever, excel at these practices. Other companies would do well to follow their lead.

■ ■ ■

Africa's economic lions may not be roaring as loudly as they were a decade ago, but they are still undoubtedly on the move. Consumer companies seeking long-term growth would be unwise to ignore the region's potential. ■

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[1] See *Lions on the move II: Realizing the potential of Africa's economies*, McKinsey Global Institute, September 2016, on McKinsey.com.

[2] In real 2015 prices.

[3] Damian Hattingh, Karl-Hendrik Magnus, and Sidhika Ramlakan, "South Africa's cautious consumer," July 2016, McKinsey.com; and Yaw Agyenim-Boateng, Richard Benson-Armer, and Bill Russo, "Winning in Africa's consumer market," July 2015, McKinsey.com.

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Central Europe's consumers: Looking for value

To attract the region's value-oriented consumers, retailers and manufacturers in Central Europe must expand their assortments, both in stores and online.

Wojtek Bogdan and Jurica Novak

Consumers across Central Europe are worried about their finances. But that doesn't mean they're buying the cheapest products. This is a value-oriented market, where smart shoppers are finding ways to stretch their budgets without sacrificing quality. And they're looking for deals at traditional retail stores as well as in digital channels.

To win with Central European consumers, companies can't simply offer products of mediocre quality at entry-level prices. The most successful retailers and consumer-packaged-goods (CPG) manufacturers in the region have found ways to provide added value while keeping prices low, whether it's by improving product quality, offering a larger assortment, or providing a seamless and satisfying customer experience.

The Central European shopper: Strapped yet selective

On average, Central Europeans are feeling less financially secure than their Western European neighbors. Take Poland as an example: almost a third of the country's consumers (compared with only 16 percent of German consumers) said they were either "moderately" or "very" fearful of losing their jobs.[1] The average monthly wage in Poland is less than half that in the European Union as a whole.[2] In a recent McKinsey consumer-sentiment survey, 30 percent of Polish respondents said they live paycheck to paycheck, compared with 20 percent across Western Europe. Only 14 percent said they felt optimistic that their financial situation would soon improve.[3]

Despite this sense of financial insecurity, consumers in Central Europe aren't necessarily purchasing the least expensive products when they shop. Instead, they look for the best value for their money—products and experiences that offer additional benefits or better quality, but at affordable prices.

One might assume that Central European consumers would gravitate toward private-label (PL) products, but that hasn't been the case. They're willing to trade down from their preferred brands to cheaper options, but they haven't been switching to PL products as enthusiastically as consumers in other countries. And when they do decide to give PL products a try, many aren't satisfied with the experience—which may not be surprising, since the PL products available in Central Europe today tend to be of relatively low quality. The share of PL grocery products is therefore lower in Central Europe (22 to 25 percent across countries) than in Western Europe (36 percent on average). In 2016, PL accounted for only 3 to 10 percent of Central European sales in apparel and footwear and for only 5 to 8 percent in beauty products.[4]

Digital and omnichannel growth

Convenience stores, the region's fastest-growing modern format, are expected to sustain annual growth rates of 6 to 10 percent in some Central European markets (including Poland, Romania, and Slovakia) over the next few years. In Poland, modern retail formats have become dominant. But across Central Europe, traditional (or "fragmented") trade still accounts for a considerable fraction of retail sales, ranging from 11 percent in Slovakia to 46 percent in Romania.[5]

Some modern retailers are tapping into the Central Europeans' affinity for traditional trade. A few large retailers, for instance, have opened outdoor and indoor seasonal stores that prominently display ultrafresh dairy products, meats, fruits, and vegetables. These seasonal stores recreate the feel of old-style farmers' markets. By selling their wares in this format, modern retailers aim to strengthen their credibility in fresh, ultrafresh, artisanal, and regional products.

But in the search for the best value-for-money deals, consumers across the region aren't shopping only in physical stores—more and more of them are turning to digital channels. Depending on the country, 60 to 80 percent of households in Central Europe already have Internet access; those figures are expected to reach 80 to 90 percent by 2020. Young people in particular are digitally connected: Internet usage among Polish consumers under 35 years of age is on par with US figures.

Online grocery still accounts for less than 1 percent of total grocery sales in Central Europe, but other categories have made considerably more headway online. In the current digital battlegrounds—health and beauty products, as well as apparel—the online share ranges from 7 to 9 percent. Across all categories, growth in online sales, projected at 16 percent a year for the next five years, will far outpace growth in the offline CPG retail market, estimated at only 3 percent a year over the same period.

Excluding grocery, online retailing accounts for 11 percent of total sales in Poland, with sales volumes comparable to those in Spain and Italy. The percentage is slightly lower in other countries in the region: 10 percent in the Czech Republic, 6 percent in Slovakia, and 5 percent in Hungary. Small as the numbers may seem, e-commerce is here to stay, and we fully expect these figures to rise steadily in the coming years. Across all of Central Europe, mobile commerce is expected to grow as well, at a rate of 25 to 30 percent between now and 2021.

How to win the Central European consumer

As consumers in Central Europe become omnichannel shoppers, they are educating themselves more on price and on product features. Retailers and CPG manufacturers must therefore ensure a consistent, value-oriented presence across channels. In addition, they must act on the following priorities:

Invest in—and advertise—value-for-money brands

Retailers and CPG players are now offering higher-quality and premium products and brands, even at mainstream price points. In many retail sectors—including apparel, beauty, and grocery—retailers are launching midtier and premium PL products and advertising them heavily. Some are of considerably better quality than the PL goods that soured Central European consumers on PL brands. In a few cases, these retailers' PL investments have paid off handsomely, with PL products taking significant share away from branded CPG products.

In Central Europe and elsewhere, the discounter Lidl, for instance, offers high-quality, affordable products under its Deluxe brand. Aimed at strengthening Lidl's food credentials, the advertising for Deluxe engages the emotions, helping to establish the company as a retailer for everyday products as well as special-occasion ones. Other retailers, too, are communicating emotional cues in their advertising—whether through TV commercials that tell sentimental or humorous stories about family, romance, and special occasions, or print ads that show PL products as indispensable parts of daily life.

Broaden the assortment, especially in fresh food and prepared meals

The most successful retailers are providing a broader assortment. Grocers, for instance, are expanding their selections of vegetarian, vegan, and organic products. They're also selling more ready-made meals—a category pioneered in Poland by Biedronka, which now carries a large assortment of frozen dinners.

Biedronka has transformed itself from a no-frills discounter that carries only the basics into a retailer that gives consumers access to more exotic and higher-end fare: its seafood selection, for instance, includes lobster and octopus, and it now sells soup made in a new company-owned factory. Similarly, Lidl operates in-store bakeries that are burnishing its reputation as a credible—even high-quality—retailer in categories that haven't traditionally been discounter strongholds. The food distributor and retailer Eurocash, too, has sought to differentiate itself by investing in factories that make sushi and other prepared foods.

Convenience stores are upping their game in fresh food as well: they've introduced new store formats with larger offerings in fresh produce, ready-to-eat meals, and grab-and-go snacks. Żabka, a chain of convenience stores in Poland, is expanding its ready-to-eat assortment while also venturing into food service with simple items such as coffee and hot dogs. The chain is working on a new format, primarily for shopping malls, with an even stronger emphasis on food service.

Leverage digital technology to improve the customer experience

Retailers and CPG manufacturers alike are investing in technology and building an omnichannel presence. Hypermarkets, for example, are incorporating more digital technology into their stores. One of Carrefour's newest hypermarkets in the Polish city of Poznan offers digital solutions to help shoppers explore broader online assortments in bakery, dairy, and alcoholic beverages. In the wine section, shoppers can consult a "virtual sommelier"—a digital kiosk that suggests specific wines, depending on the occasion, food pairings, or customer preferences.

Central European retailers in other sectors have also introduced in-store technologies. The bookstore and lifestyle retailer Empik, for example, offers "virtual bookseller's assistants" and other interactive features in its new Future Store concept. Certain restaurant chains, including McDonald's, are accepting orders through digital terminals. Some are taking this approach a step further, providing for personalization and customization through digital channels. KFC is piloting a mobile order-and-pickup service at about 170 locations in Poland. Customers can use a mobile app to access exclusive offers, personalize their purchases (for example, by specifying how many drumsticks or wings they would like in a bucket of fried chicken), pay for their orders, and select pickup times. Delivery is also available at more than a dozen KFC locations.

CPG companies, for their part, are starting to experiment with selling some of their products—particularly basic and value-oriented assortments—through e-marketplaces. They are also making their higher-end and premium brands available exclusively through their own e-commerce sites or specialty e-tailers, such as online health-and-beauty stores. The most sophisticated CPG players have developed a detailed omnichannel strategy that helps them to benefit from the growth of e-commerce and, at the same time, to maintain strong relationships with retail partners.

The Central European consumer now has much higher expectations for retailers and CPG companies, both offline and online. That means companies in the region have little choice but to innovate constantly across channels. Several have risen to the challenge; the rest should take action soon or risk losing out to faster-moving competitors.

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[1] Labour Market Monitor survey, Randstad Research Institute, December 2016.
[2] Based on Eurostat data, 2015.
[3] McKinsey Global Consumer Sentiment Survey, September 2016. For highlights from it, see Max Magni, Anne Martinez, Rukhshana Motiwala, and Alex Rodriguez, "Consumer sentiment around the world: Trending upward," May 2017, McKinsey.com.
[4] According to the Private Label Manufacturers Association.
[5] In this article, data and projections for retail formats and digital channels come from Euromonitor unless otherwise noted.

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Retailing in the Middle East: How to recapture profitable growth

Major structural shifts in the region will compel retailers to transform their businesses both commercially and operationally.

Peter Breuer, Gemma D'Auria, Abdellah Iftahy, and Tarek Mansour

For much of the past 15 years, retailers in the Middle East—particularly those in the Gulf Cooperation Council (GCC) countries—have benefited from a favorable macroeconomic environment. Grocery, apparel, electronics, and other retail segments have achieved profits and returns above the global industry average.

But a confluence of structural shifts is challenging these retailers' revenue and profitability. The decline in oil prices, geopolitical instability, and the rapid evolution of digital technology have all had a profound effect on Middle Eastern governments, consumers, and businesses. Retailers are no exception: in every segment, growth has slowed significantly even as margins are being squeezed.

To adjust to these structural shifts—the Middle East's "new normal"—retailers must undertake both a commercial and an operational transformation. The good news is that GCC retailers haven't yet pulled a number of levers that have proved effective for retailers in other parts of the world. In this article, we discuss three of the levers that can most rapidly boost a retailer's financial performance. The potential impact: an increase of 15 to 20 percent in sales and of 5 to 10 percent in profits.

Years of above-average growth

Between 2011 and 2015, GCC retailers captured above-average revenue growth, margins, and returns (Exhibit 1). One driver of this high performance was the ability to charge higher prices than are typical in other markets. Consumers in the region were willing to spend their fast-growing disposable incomes, which were rising at two to three times the global average. Certain GCC countries had outsize proportions of millionaire

Exhibit 1 **In the past five years, retailers in the Middle East have outperformed their global peers.**

[1] Compound annual growth rate.
[2] Earnings before interest, taxes, depreciation, and amortization.
[3] Return on invested capital. Gulf Cooperation Council benchmarks based on publicly listed players.
[4] Based on mass apparel segment only (average of franchises and own brands).
[5] Based on franchise players.
[6] Based on average of 2013–15.

Source: Broker reports; Euromonitor; expert interviews; Thomson Reuters Eikon; McKinsey Corporate Performance Analysis Tool

households. Elevated spending levels in Qatar, the Kingdom of Saudi Arabia (KSA), and the United Arab Emirates (UAE) drove the strongest period of growth that the Middle East had ever seen.

Another boon for the region's retailers was limited competition. Import tariffs and local-ownership laws discouraged foreign competitors from entering the market. Additionally, cheap inputs—including low-cost expatriate labor and heavily subsidized utilities—kept costs down for retailers. Foreign workers, who typically earned less than 50 percent of local workers' wages, constituted more than half of the workforce in the KSA and more than

The Middle East's new normal will challenge retailers' top and bottom lines.

70 percent in Qatar and the UAE. Fixed prices for electricity and petroleum were as much as 95 percent lower than prices in the rest of the world.

During this period, GCC retailers innovated. They opened vast shopping malls that have become consumer destinations. They introduced new retail concepts—examples include the luxury children's store Level Kids (which combines designer clothing with specialized services such as a spa and concierge) and Café Bateel, a gourmet-food store and restaurant. They built franchises of renowned global brands. Some invested heavily in capabilities like talent management and leadership development.

How times have changed

But today, with oil prices only slightly recovered from a 13-year low and geopolitical risks abounding, retailers find themselves in a vastly different business environment. The region's governments, which rely heavily on hydrocarbon-related revenues, are in belt-tightening mode and making major changes in fiscal policy—such as introducing a new 5 percent value-added tax and new "sin" taxes (100 percent on tobacco products and energy drinks, as well as 50 percent on soft drinks); reducing energy and utility subsidies, thereby pushing up prices by more than 20 percent across the Middle East; and slashing capital expenditures. The KSA, for instance, cut $65 billion from its budget by canceling, limiting, or postponing planned projects.

At the same time, retailers' costs are rising, partly as a result of new labor-localization laws, market-priced utility costs, and new tax measures. The KSA is charging higher visa fees for expats and introducing new laws requiring retailers to hire Saudi nationals for approximately 1.5 million retail jobs. Labor costs are therefore expected to rise by as much as 15 percent. Subsidy cuts are expected to increase the cost of utilities, such as power, electricity, fuel, and water, by as much as 15 to 20 percent.

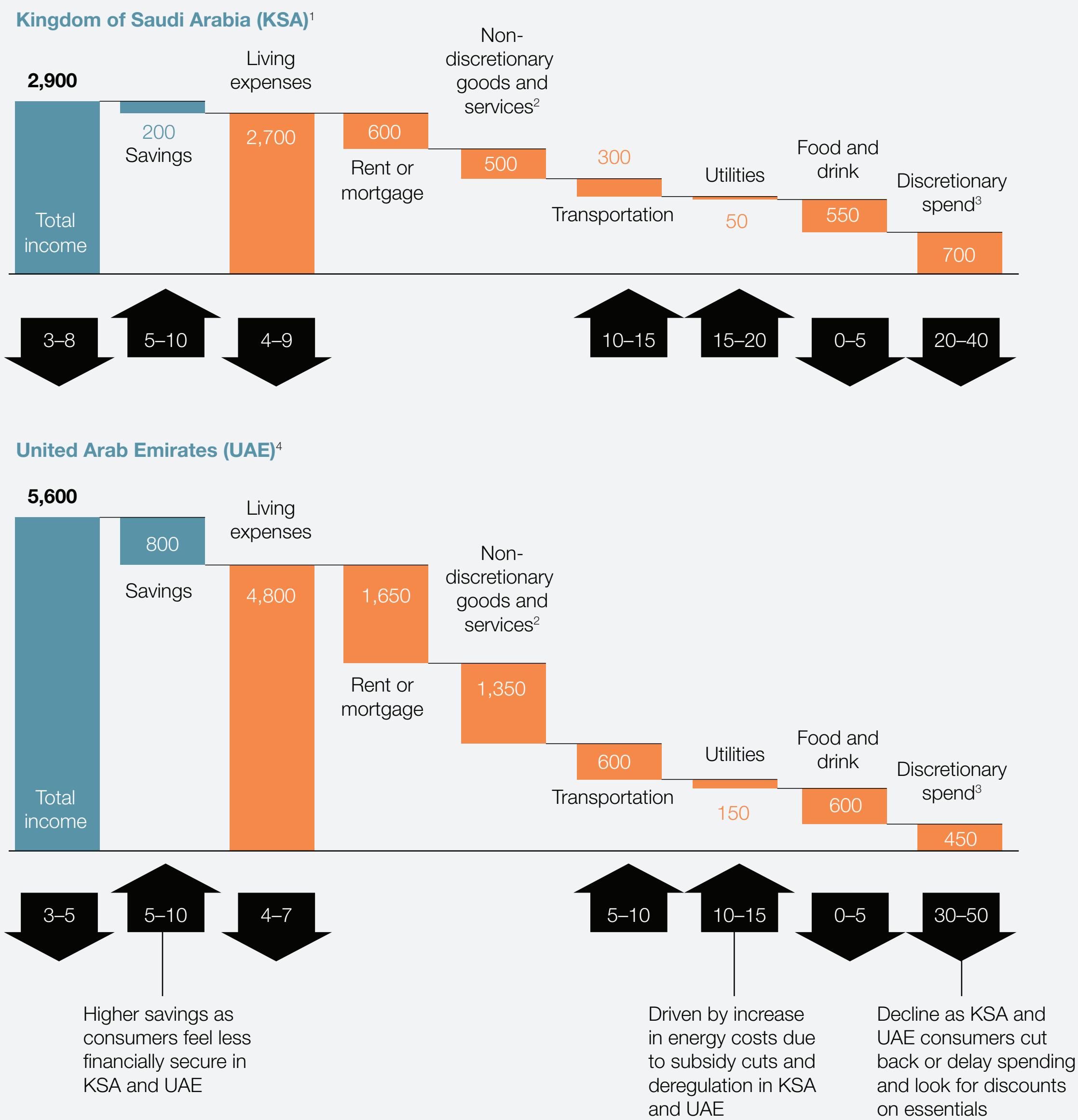
Consumers, seeing stagnation in their real disposable incomes, are increasingly cutting back on spending and looking for ways to save money (Exhibit 2). The latest McKinsey consumer-sentiment survey reveals that in both the KSA and the UAE, three out of four consumers are worried about job losses. Almost half of consumers said they are delaying purchases, and more than a third said they are living paycheck to paycheck.

Furthermore, competition is intensifying, both offline and online. Per capita retail square footage has increased, and real-estate productivity has declined. The impact of online platforms such as Amazon and Alibaba is being felt in the Middle East—for instance, Amazon recently acquired Souq.com, the region's leading e-commerce player.

This new normal will challenge retailers' top and bottom lines. We expect the slowdown to continue at least through 2018. For example, grocery sales are projected to grow between 2 and 5 percent in 2018, well below the 8 percent growth that the sector achieved in 2015. We expect lower growth in apparel and electronics as well, throughout the region. As for profitability, grocery and electronics retailers could see a 3 to 5 percent decline in EBITDA margins, while apparel retailers could witness a drop of 7 to 10 percent.

Exhibit 2 **Consumers, under financial pressure, are cutting back on their retail spending.**

Household monthly income and consumer expenditure, $, % impact under new normal

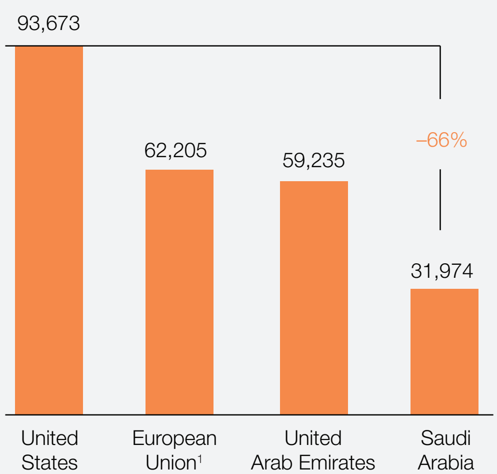


1 Based on income and expenditure distribution in 2013 for Saudi and non-Saudi households.
2 Includes healthcare, telecom, education, and other personal goods and services.
3 Includes clothing, footwear, home furnishings and appliances, recreation, hotels, and restaurants.
4 Emirati and non-Emirati households, 2014 data.

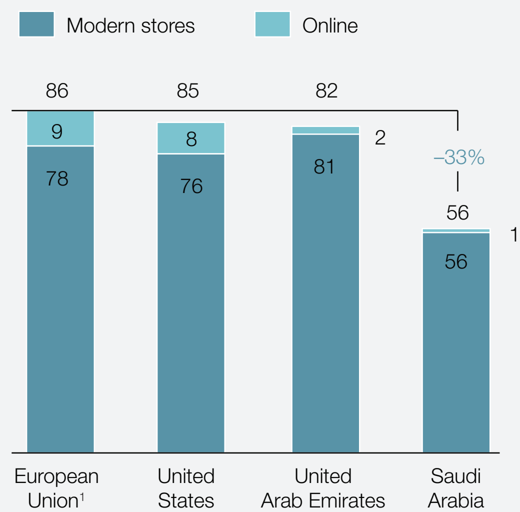
Source: Dubai Statistics Center; Euromonitor; General Authority of Statistics, Kingdom of Saudi Arabia; GCC Statistical Center; Statistics Centre Abu Dhabi; McKinsey analysis

Exhibit 3 **Gulf Cooperation Council retailers lag behind international peers in productivity and modernization.**

Labor productivity retail and wholesale, 2013, Value per worker, $ (market-exchange rates at 2013 prices)



Modern-trade penetration in grocery, 2014, % share of total trade



Note: Figures may not sum because of rounding.

[1] Average of France, Germany, and United Kingdom.

Source: Central Department of Statistics and Information, Saudi Ministry of Economy and Planning; Central Intelligence Agency; EU KLEMS; IHS Global Insight; International Monetary Fund; World Bank; UAE National Bureau of Statistics; *Retail and wholesale: Key sectors for the European economy*, Institute of Retail Management, Saïd Business School, University of Oxford, April 2014; McKinsey Global Institute analysis

What's needed now: A commercial and operational transformation

These structural shifts call for decisive action on both the commercial and operational fronts. Fortunately, there remains much untapped potential: GCC retailers lag far behind their international peers in labor productivity and modernization levels (Exhibit 3). The gap between the United States and the KSA, for instance, is 66 percent in retail and wholesale labor productivity. Modern trade accounts for more than 80 percent of grocery sales in the UAE, but for less than 60 percent in the KSA and the region as a whole.

That means retailers in the Middle East have room to pull a wide-ranging set of commercial and operational levers. In our experience, levers that address one or more of three transformation imperatives—namely, developing a distinctive value proposition, pursuing strategic advantage in a functional area, and zeroing in on immediate sources of value—can be particularly powerful.

Develop a distinctive value proposition for customers

In light of fiercer competition and shifts in consumer sentiment, retailers in the Middle East must develop customer-centric offerings that make them stand out from the pack. Deep knowledge of the customer is a prerequisite for creating a customer-focused assortment, a finely targeted pricing and promotions model, and seamless omnichannel services.

Example lever: Assortment optimization

A consumer-centric assortment is one major component of a distinctive customer value proposition. Too often, retailers make supplier-centric assortment decisions—they stock the products and brands that their favored suppliers offer or that are sold at the best prices by their suppliers. Instead, retailers need to understand how consumers decide what to buy: which products they view as substitutes for other items, and what factors matter to them most when they buy specific products. Such consumer insights can be generated through market research, loyalty-card data mining, and the use of predictive-analytics tools. These insights should then inform the assortment at each store to ensure that the breadth of local customers' needs are covered.

A leading grocery retailer undertook an end-to-end assortment optimization, removing underperforming or redundant SKUs in each category and adding new high-potential SKUs to meet unaddressed customer needs. The retailer embedded an innovative big data solution—which regularly generated insights about consumer behavior—as part of its new processes. The impact was an 11 percent increase in sales from space reallocation and improved SKU lists, as well as a 2 percent margin improvement.

Create strategic advantage by excelling in one or more functions

Another avenue for recapturing profitable growth in the Middle East is to outperform competitors in one or more functional areas. The choice will depend largely on the competitive landscape. Which functions do competitors typically neglect or underinvest in? Which carry the most potential and will truly set the company apart? For instance, Middle Eastern retailers might decide to make bold moves in the recruitment and retention of top talent, in building digital and analytics capabilities, or in strategic sourcing.

Example lever: Supplier negotiations

If a company decides to focus on strategic sourcing, one high-impact capability is supplier negotiations. Data-driven negotiations could reduce cost of

goods sold and yield margin improvements of 3 to 5 percent, which can then be reinvested in innovation and growth initiatives. Best-practice retailers develop comprehensive vendor and category playbooks containing detailed vendor profiles, sales and margin data, discounts, and analytics on vendor performance, allowing them to build a wide range of performance-based "asks" and arguments. The playbooks also create transparency on promotions and pricing performance and associated vendor funding. Leading retailers invest in consumer data and advanced analytics so that they're equipped to challenge suppliers' claims about the importance and role of brands. Just as important, they make sure to build the negotiation skills of buyers and category managers through certification processes, thorough training, and frequent coaching.

Home in on immediate sources of value

To create momentum and rapidly reset their business for the Middle East's new normal, retailers must capture quick wins—they must launch initiatives that can make a meaningful difference to the top and bottom lines within a mere three to six months. Working-capital management; the optimization of selling, general, and administrative (SG&A) costs; and lean store operations are some operational initiatives that can yield quick wins.

Example lever: Marketing-spend effectiveness

We've seen retailers in the region reduce SG&A costs by as much as 20 to 30 percent. Some retailers have found that improving marketing-spend effectiveness is an immediate source of value, not only for reducing SG&A spending but also for increasing sales and deepening customer relationships. To improve marketing-spend effectiveness, leading retailers do the following:

Reallocate spend to strategically important brands and channels. Retailers tend to dedicate the bulk of their marketing dollars to older, established brands or channels that they have invested in historically rather than to newer, high-growth brands and new digital channels. Instead, retailers should regularly review their spending and reallocate marketing dollars to align them with the strategic importance of each brand and channel.

Emphasize "working spend." All marketing dollars used for purchasing media time or space, including above-the-line and below-the-line advertising, constitute working spend. Nonworking spend encompasses marketing expenses, such as creative fees, used to create the advertisement itself. Best-in-class companies ensure that their nonworking spend doesn't exceed 20 percent of total marketing spend. Retailers should reevaluate their marketing mix and shift more of their budgets toward working spend, which has a direct impact on reach.

Optimize procurement spend. Finally, leading companies monitor and refine their procurement of marketing services. They renegotiate agency contracts and consolidate dispersed accounts with agencies that offer similar services, thereby reducing their spending while increasing their bargaining power.

A multibillion-dollar electronics retailer had been allocating most of its media spend to newspaper inserts and television. The company was seeing declining traffic, even with an above-average ad–sales ratio. With the help of a granular media-mix model, the retailer cut back on underperforming legacy spend and increased digital spend—in particular, paid search. The return on investment of its media spending increased by more than 20 percent, and sales grew by over $40 million, even as the company reduced its overall marketing budget by 15 percent.

The pace of implementation

Depending on the urgency of change, retailers can adopt different implementation models and proceed at different speeds. Retailers netting above-average performance might consider pursuing a set of targeted actions in carefully sequenced phases, each lasting three to six months, starting with quick wins. They should leverage and improve existing structures and systems rather than starting from scratch. They should also focus on building capabilities during implementation, to ensure lasting change.

For retailers with highly challenged bottom lines, the need for action is obviously more urgent. A full-scale organizational transformation taking place over 12 to 18 months, when multiple levers are pulled simultaneously, may be needed. A transformation office would oversee the program, with each initiative having a distinct owner.

In the Middle East's new normal, retailers that take a business-as-usual approach will see tempered growth and lower profitability. To win, companies will need to make both commercial and operational changes. The time to act is now.

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A new reality for the Russian consumer industry

The country's economy is showing signs of recovery, but many consumers are still hesitant to spend. Here's how companies can win in this evolving market.

Dmitry Bogod and Alex Sukharevsky

In the past three years, declining oil prices and international sanctions have taken their toll on the Russian economy, plunging the country into financial crisis. Between 2014 and 2016, GDP fell by 1.5 percent per year on average, and private consumption by 7.1 percent. Recently, there have been glimmers of recovery—driven in part by a modest rebound in oil prices, a growing agricultural sector, and increased trade with China—and growth is expected to be as high as 1.5 percent in 2017. Still, consumer spending remains substantially below pre-crisis levels, and purchasing power has weakened due to the devaluation of the ruble.

Russian consumers have been adjusting to this new economic reality. They've become more selective and discerning in their purchases. In a recent consumer survey, a majority of respondents—57 percent—said they more often shop around to get the best deals. But they still buy their preferred brands, albeit in smaller quantities; only about 17 percent of Russian consumers said they have traded down to cheaper options. More than one-third said they have changed where they shop in order to buy their preferred brands at lower prices.[1]

Russia's changing retail and consumer landscape brings new challenges but also new opportunities. The most successful companies will be those that can best make data-driven decisions, manage their customer relationships, and keep costs under control.

Changes and challenges

The financial crisis in Russia has been tough on consumer-goods companies' margins for a number of reasons. For one, a weaker ruble buys fewer raw materials, causing the cost of goods sold to rise. Retailers have substantially stepped up their promotional activity. Companies have been unable to pass on higher costs to consumers, and any price increases are outpaced by inflation.

For manufacturers, profitability has been further squeezed by the growth of modern trade, a lower-margin business for them. Modern retail now constitutes 68 percent of the Russian grocery market and is poised for more growth. Consolidation among modern grocers continues, with the top five grocery retailers accounting for a combined market share of about 27 percent, gaining approximately 6 percent between 2014 and 2016. The soft-discounter format, which already has a 22 percent share of modern trade, is the fastest-growing and most profitable modern format in the country: Russia has 112 soft-discount stores for every one million people—the third-highest density among European countries. “Alcomarkets,” modern convenience stores that specialize in selling alcohol and tobacco products, grew 50 percent in 2015 alone. The online channel is also gaining popularity, growing by 19 percent a year in Russia, compared with only 7 percent a year across Europe, since 2013.

Further complicating matters for manufacturers, a newly introduced trade law puts restrictions on the producer–retailer commercial relationship. The law places a 5 percent cap on the volume discounts that manufacturers can give retailers, thus limiting manufacturers’ flexibility in offering pay-for-performance trade terms.

In addition, international sanctions have negatively affected certain parts of the Russian economy. That said, the Russian government’s countermeasures have provided a stimulus for local suppliers: across multiple categories, particularly those affected by sanctions, local sourcing is becoming more pervasive. From coffee to furniture, companies are finding Russian suppliers to meet local demand. The Russian agricultural sector has stepped up production, and in many categories, locally grown food has completely substituted for imports. In poultry and pork, for instance, Russia is expected to become almost entirely self-sufficient by 2019.

How to win

The strategies that consumer-packaged-goods (CPG) companies can employ to win in Russia are similar to those in other emerging markets: active management of pricing and promotions, cultivation of the traditional trade, and careful attention to costs. But the specific tactics they should use are somewhat different due to the particular context of the Russian economy.

Differentiate pricing and promotions across regions and channels

Many Russian companies (and Russian subsidiaries of multinationals) have traditionally charged the same prices in every region of the country. Of course, pricing is a tricky matter, particularly in a market where consumer sentiment has yet to recover—but companies operating in Russia must acknowledge and capitalize on the heterogeneity of the country’s regions. Income levels, macroeconomic indicators, consumer preferences, competitive dynamics, and price sensitivities vary widely from one region to the next.

Data-driven differentiation of pricing, at both the SKU and region/area level, could lead to 2 to 3 percent growth in revenue and profit. Some executives might believe there’s not enough data in the Russian market to enable active pricing management, but we’ve found the opposite to be true: companies can in fact access vast amounts of data—including data on consumer price sensitivity and product-switching behavior—to inform the development of advanced pricing mechanics. The data are available from retailers and market-data aggregators; there are also official government statistics. Some gasoline stations already adjust prices based on factors such as traffic and weather conditions.

Active management of promotions can be a powerful lever as well. Because discounts and promotions tend to be quite effective in enticing Russian consumers to make purchases, retailers engage in promotion wars and squeeze their suppliers for additional funding—typically resulting in margin losses for both parties. Companies should use advanced analytics and big data to understand the historical performance of their promotions and estimate the impact of future promotions. When companies make data-driven choices as to which items to promote, the mechanics and timing of promotions, and the depth of discounts, they can realize margin improvements of 1 to 3 percent.

With analytics, companies can model the net effect of promotions (incremental net sales and incremental margin). They can also make fact-based estimates with regard to a variety of critical factors, such as pull-forward effects (when shoppers stock up on a promoted product, "pulling forward" purchases that they would otherwise have made at a later date); cannibalization (when customers opt for a promoted product instead of a full-priced product, resulting in lost margin for the retailer); and the halo effect (when shoppers buy additional products at the same time as a product on promotion—for instance, shoppers buying ice-cream cones when ice cream is on sale).

Carefully define trade terms and retailer incentives

The buying power of large modern retailers typically allows them to purchase products from CPG manufacturers at prices 3 to 7 percent lower than what traditional retailers pay. In addition, the promotional funding that modern retailers receive from manufacturers is about 20 to 30 percent more than what traditional retailers get. These disparities give large national retailers an incentive to "leak" volumes to traditional trade—that is, they resell products purchased in bulk to smaller independent retailers, thus gaining additional profit for themselves while eroding profitability for CPG manufacturers.

CPG companies can take steps to prevent such leakage. For one, they can craft tighter trade terms that make it unprofitable for retailers to leak products. They can closely monitor sales volumes by benchmarking both regular and promotional sales across key accounts, taking into consideration seasonality and price elasticity. They can track their own sales activity as well as competitors' by acquiring transaction-level data from retailers and by having their merchandisers conduct regular checks of sales in and sales out. They can also strengthen their relationships with the traditional trade—perhaps by offering nonmonetary incentives (such as retail equipment) and loyalty programs—to stimulate direct purchasing.

Traditional trade is still, and will continue to be in the coming years, an important component of Russian retail. Many "B brands" (lower-priced, locally produced goods and services that are not well known globally) become best sellers in modern trade but aren't available at all at independent retailers, suggesting that there is pent-up consumer demand for these lesser-known brands. Manufacturers of B brands should build a presence in the traditional trade, whether by finding distribution partners, developing their own distribution capabilities, or a combination of the two.

Drive cost efficiency

Best practices for achieving greater cost efficiency include using zero-based budgeting,[2] cutting nonstrategic expenses and funneling the savings into marketing efforts, and driving down third-party costs through improved procurement, using techniques such as design to value.[3]

Many CPG companies also look at their route-to-market model as an area in which they can easily cut costs, whether through outsourcing the sales

force, sharing coverage with exclusive distributors, or migrating to lower-cost service models for lower-priority customers. For example, a large CPG manufacturer in Russia has improved its route-to-market decisions and refined its service model by conducting large-scale surveys among the outlets it serves. Depending on the outlet characteristics, the company tailors every store visit—from the type of representative who visits to the frequency and duration of the visits.

Several companies have gained efficiencies—simultaneously securing their supply chain—through vertical integration. A few of the top retailers in Russia are exploring options for acquiring and integrating manufacturing capabilities into their organizations; one major national retailer has announced a $10 million investment in production development in 2017. Some manufacturers are integrating downstream and opening their own retail chains.

■ ■ ■

The Russian market is undergoing tremendous change. Companies that take a disciplined and analytical approach will not only be able to withstand economic volatility—they will also be well positioned to thrive when the market recovers. ■

[1] The McKinsey Russia Consumer Sentiment Survey was conducted online in September 2016 and had 1,000 respondents.

[2] Kyle Hawke, Matt Jochim, Carey Mignerey, and Allison Watson, "The truth about zero-based budgeting: ZBB for consumer-goods players," April 2017, McKinsey.com.

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How Turkish companies can become global successes

The country's demographics and business climate have made it fertile ground for local companies with global aspirations.

Ilke Bigan, Semih Decan, and Bengi Korkmaz

With a GDP of $857 billion and a population of approximately 80 million, Turkey is the 17th-largest economy in the world. It is home to a number of major players in the consumer sector: for example, the world's third-largest biscuit producer and seventh-largest home-appliances manufacturer are Turkish companies. More than 60 percent of the world's hazelnuts come from Turkey, as does 10 percent of the world's pasta. Turkey is also among the top ten textile and jewelry exporters globally.

The country has a young and increasingly urban population: the average age in Turkey is 31, compared with 42 in the European Union, and approximately 75 percent of its people live in urban areas. In the coming decade, the working-age population will increase, potentially driving growth in both domestic consumption and production (provided that Turkey can continue to increase labor productivity). Over the past ten years, annual GDP growth has averaged 5 percent; in the first half of 2017, GDP growth exceeded 5 percent, making Turkey one of the fastest-growing large economies in the G-20.

Its dynamic population and a low cost base for businesses have helped Turkey become competitive in consumer industries, including food and beverages, home- and personal-care products, durable goods, and apparel. And more Turkish companies are venturing outside their home market. Having honed their business skills and expertise in the volatile yet growing Turkish economy, several Turkish companies have built a presence in multiple countries—and have become multinational success stories. Within the past decade in particular, Turkish companies have had a steep upward trajectory in the globalization journey. But to sustain their global success, they'll need to strengthen their culture and capabilities, particularly in performance management, digitization, innovation, and design thinking.

What it takes to make it abroad

To thrive in emerging markets, consumer-goods manufacturers and retailers must excel in certain areas, such as tailoring their offer to local needs and preferences, or developing a route-to-market model to serve the fragmented trade (which still accounts for slightly more than half of Turkey's $165 billion retail sector). We have found that, in addition to these capabilities, three other attributes have helped leading Turkish consumer companies win not only in Turkey but also elsewhere.

1. An entrepreneurial spirit and an ownership mind-set

Among Turkey's corporate success stories, many feature a family business led by an ambitious founder or leader. This person's entrepreneurial drive, along with his or her ability to build a leadership team and nurture strong business relationships, are key to the operating company's growth. The founder ensures that this expansive vision and passion for the business are passed on from generation to generation. Indeed, a majority of Turkey's conglomerates carry the names of the founding families. Every single one of the 13 largest Turkey-based consumer companies operating internationally is either fully or partially owned by a family (exhibit).

In successful Turkish companies, shareholders with an ownership mind-set (whether they are family members or professionals who have an entrepreneurial spirit) formulate the company's vision, define the growth ambition, and establish the agenda—either by directly leading the management teams and being deeply involved in day-to-day operations, or by being active and outspoken board members.

2. Rapid decision making to capture expansion opportunities

In emerging markets, the success of a new business often depends on how quickly it can reach critical mass and achieve profitability through economies of scale. Companies that grow up in emerging markets thus tend to expand more rapidly and have a higher risk tolerance than their developed-market counterparts do. Instead of taking small, cautious steps, Turkish companies take a running start. They learn to be resilient and persistent against early obstacles.

For instance, Doğuş Restaurant Entertainment and Management—also known as d.ream—was founded a mere five years ago but has already expanded to Europe, Asia, the Middle East, the Far East, and the United States. It has created or acquired 51 restaurant brands, with 180 outlets. Its model is to combine the corporate structure and financial resources of its parent company, Doğuş Group, with top culinary and executive entrepreneurs and talent in the otherwise fragmented and underdeveloped restaurant industry.

BIM, Turkey's largest retailer, also expanded its international operations quickly. In 2009, BIM opened its first stores in densely populated cities in Morocco. Instead of bringing Turkish-made goods to Morocco, BIM strove to understand the particularities of Morocco's local culture, tastes, and consumer behavior, then developed relationships with local suppliers to manufacture its private-label products—a somewhat risky proposition, since BIM had no preexisting relationships with suppliers in Morocco. Today BIM operates more than 300 stores in Morocco. In 2013, it expanded into Egypt as well and now has more than 200 stores in that country.

Exhibit

The largest multinational consumer companies based in Turkey are all family-owned businesses.

Company	Revenue, $ billion	Industry	Countries of operation (excluding Turkey)
BIM	6.65	Retail	2
Arçelik	5.33	Electronics	32
Migros	4.44	Retail	2
Vestel	4.16	Electronics	10
Anadolu Efes	3.45	FMCG[1]	16
LC Waikiki	3.16	Retail	36
Hayat Kimya	1.40	FMCG	6
Ülker Bisküvi	1.30	FMCG	19
Eti	0.91	FMCG	3
Koton	0.80	Retail	28
Sütas	0.71	FMCG	3
d.ream	0.70	F&B[2]	12
DeFacto	0.67	Retail	19

[1] Fast-moving consumer goods.
[2] Food and beverages.

Source: "*Capital* 500: The largest 500 companies in Turkey," *Capital* magazine, 2016; company annual reports; press searches

3. The ability to manage market-specific complexity

A third success factor for Turkish companies is the ability to react immediately to market signals and to manage complexity in the market. Turkey has had an open economy for a long time, so Turkish products have long had to compete with imported goods. Fast adaptation, innovative problem solving, lean decision making, and a nimble organization are important factors that enable local companies to hold their own against competitors.

Excellence in complexity management is one of several qualities that helped Arçelik become Turkey's leader in home appliances (its market share is 50 percent) and one of Europe's largest durable-goods manufacturers. The company has been able to rapidly enter new markets and localize its offering. Today, it generates about 60 percent of its revenues abroad. Arçelik's ability to manage complexity stems in part from its relentless focus on consumer needs, an infusion of global talent, and its investments in advanced technology. The company's 14 R&D and design centers are constantly generating market-specific insights and developing market-specific products and solutions. In addition, the company has set up "garages" that bring together cross-functional talent and ecosystem players in a start-up-like environment. These garages use innovative approaches and tools to quickly scale up promising ideas in each market.

How can global Turkish companies continue to improve?

These attributes together constitute a recipe for transforming a homegrown Turkish entity into a thriving international business. To accelerate growth and sustain performance in highly competitive foreign markets, Turkish companies must continually build capabilities in the following areas:

Fostering a performance-driven culture. Most multinational Turkish companies already embrace and celebrate cultural diversity and strive to create an inclusive environment for employees, suppliers, and stakeholders. But to become world-class in talent attraction, engagement, and retention, they still need to better articulate the essential elements of their desired global culture and strengthen performance management. In addition to creating accountability through traditional performance-management processes and formal people reviews, companies need to establish rigorous, unbiased consequence management.[1] Long-term global aspirations also require a company to pay close attention to its organizational health, not just its current financial performance—in part by setting stretch targets for employees, sharpening managerial skills, and increasing the organization's external orientation.[2] Establishing globally

> Turkish companies should invest in building advanced digital and analytical capabilities, especially in areas where digitization can help them leapfrog their developed-market counterparts.

consistent ways of working is critical as well. Also, companies should provide incentives for mobility, both to increase expertise across regions and to build cross-country bonds.

Leapfrogging through digitization. As new technologies—including digital solutions, artificial intelligence, 3-D printing, and the Internet of Things—continue to transform all aspects of the global consumer industry, companies should develop a clear understanding of the threats and opportunities that digitization brings. Turkish companies should invest in building advanced digital and analytical capabilities, especially in areas where digitization can help them leapfrog their developed-market counterparts. They should consider accelerating their digital transformations through capability-building investments such as partnerships with digital experts and recruitment of new kinds of digital talent.[3]

Setting up an innovation engine. Only a handful of Turkish companies have been able to build strong brands that are recognized and respected in many countries around the world; examples include Turkish Airlines and Arçelik's appliance brand Beko. Building global brands and staying competitive in the global arena takes constant innovation—both incremental, "close to the core" innovation as well as breakthrough innovation in the form of disruptive flagship projects.[4] Turkish companies tend to do well at incremental innovation but need to develop a medium- and long-term innovation ambition, as well as systems and resources to continuously generate, prioritize, and cultivate the best ideas.

Establishing a 'design thinking' mind-set. Design—not just of products and services, but of the entire customer experience—is increasingly becoming a core capability that can drive growth and competitive advantage. Companies that adopt design thinking strive to truly understand customer needs, instill a customer-centric empathy in the organization, engage in cross-functional ideation processes, and act quickly to bring a product to market and adjust it based on customer feedback.[5] Through design thinking, companies can boost customer satisfaction and brand loyalty, ultimately yielding higher sales and profits

■ ■ ■

As Turkish companies look to expand outside the country's borders, they can learn from other companies that are farther along in the internationalization journey. An entrepreneurial vision, quick decision making, and excellence in complexity management have been—and will continue to be—crucial to success, both in Turkey and beyond. But these are only the first steps. To sustain success as multinationals, Turkish companies must then take big strides in strengthening their culture and capabilities. ■

[1] For more on performance management, see Raffaele Carpi, John Douglas, and Frédéric Gascon, “Performance management: Why keeping score is so important, and so hard,” October 2017, McKinsey.com; and Boris Ewenstein, Bryan Hancock, and Asmus Komm, “Ahead of the curve: The future of performance management,” *McKinsey Quarterly*, May 2016, McKinsey.com.

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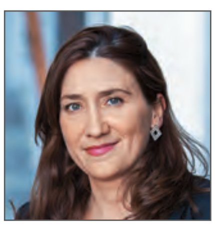

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