

# REPORT

## Winning in Emerging-Market Cities

A Guide to the World's Largest Growth Opportunity



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# Contents

<b>Introduction</b>	4
<b>Emerging-Market Cities: The New Business Imperative</b>	5
Reaching Mr. Yang (and a Billion Other New Urban Residents)	6
The Rise of the Cities	8
Emerging-Market-City Segments	8
Creating a Portfolio of Target Cities in Emerging Markets	12
<b>Capturing the Consumer Opportunity</b>	13
Categories of Opportunity	14
Five Imperatives for Consumer Businesses	15
<b>Capturing the Infrastructure Opportunity</b>	18
Housing	18
Water and Sanitation	19
Transportation	19
Electricity	20
How to Tap In to the Infrastructure Opportunity	20
<b>Incubators of Dynamic Local Competition</b>	21
<b>The New Agenda for Emerging-Market Growth</b>	22
<b>For Further Reading</b>	23
<b>Note to the Reader</b>	24



# Introduction

**T**he single largest commercial growth opportunity globally in the decade ahead is the rise of cities in emerging markets. And the most pivotal decisions that many companies will make in the near future are those regarding their commitment to winning in these cities and their strategies for doing so.

Yet most global companies are failing to recognize this opportunity, its magnitude, and the high-stakes nature of the choices confronting them. When they approach the emerging markets, most companies think of countries, not cities. And those cities that do spring to mind are a few “megacities,” rather than the large number of other, smaller cities that present the real opportunity. Most crucially, some companies tend to view business decisions related to cities tactically rather than strategically—if, indeed, they recognize the need for such decisions at all. These companies are making a huge mistake.

Is your company among them? Ask yourself just a few simple questions:

- ◇ How many emerging-market cities does your company serve currently, and how many does it plan to serve by 2020? There are 717 such cities with populations of more than 500,000, and most are growing at rates far above the global average.
- ◇ Does your executive team understand the growth opportunity? Emerging-market cities will account for 30 percent of global private consumption by 2015, and private consumption is growing at a rate of 11 percent per year. The infrastructure investment in these cities is forecast at \$30 trillion to \$40 trillion cumulatively over the next 20 years.

- ◇ Does your executive team know which current and up-and-coming competitors are taking these markets seriously and winning? Global scale in many industries will be determined by those that play these cities well.
- ◇ How many emerging-market cities has your executive team visited? Most executives know about the megacities, but those are yesterday’s growth story. Do you know the needs and habits of customers in the cities that will matter in the future? Understanding and winning in the new paradigm of the “many cities”—which means determining which and how many of the hundreds of smaller cities to enter and when—has become the new imperative.

This report is one result of a year-long global research effort spanning key urban centers of the developing world, led by our business strategists in each location. It is not an academic treatise on urbanization policy or a primer for governments. Instead, it is a commercially focused wake-up call for companies under pressure to grow.

As best we can tell, it is the first handbook that frames the emerging-market growth opportunity as one built upon cities, and that quantifies what is at stake while outlining a set of practical steps for embarking on a path to success. Its insights and recommendations represent a fundamentally new way of defining and approaching the world’s largest growth opportunity. We hope that it stirs debate, reflection, and accelerated action within your organization. We look forward to your feedback and to engaging with you directly on this vitally important growth driver.

# Emerging-Market Cities

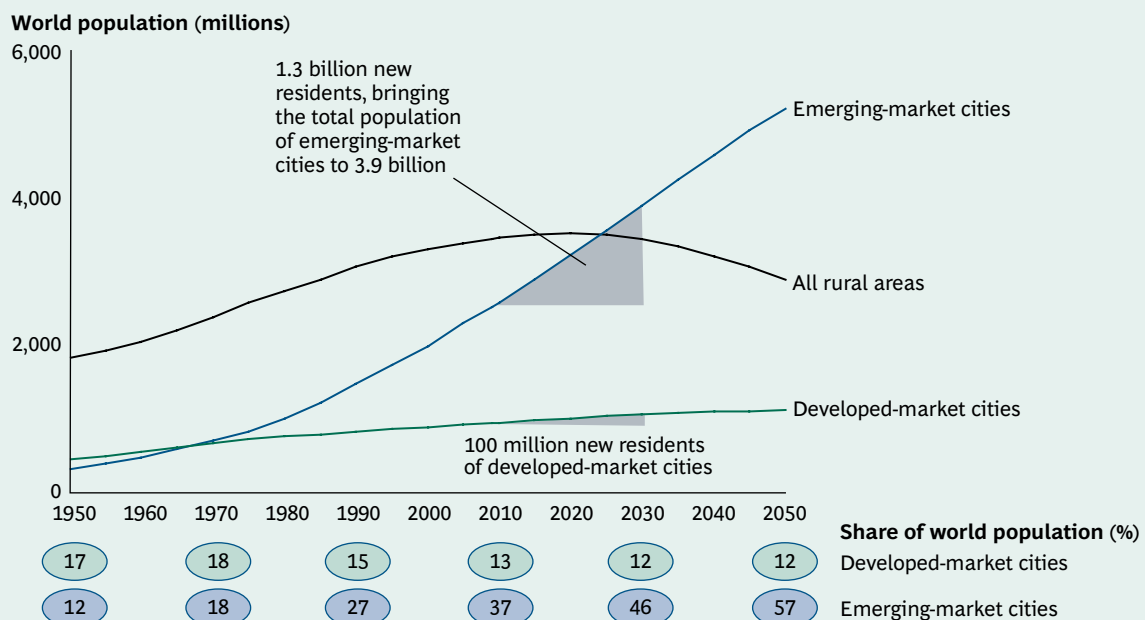
## The New Business Imperative

One-third of the world's population—2.6 billion people—live in cities that are located in the emerging markets. By 2030, the number of emerging-market urban dwellers will increase by another 1.3 billion. (See Exhibit 1.) In contrast, cities in developed markets will add only 100 million new residents in the next 20 years.

This massive growth will fundamentally change the competitive landscape in many ways. Consumer demand will rapidly increase as the middle class in these markets expands, new infrastructure will be required as cities grow, and those companies that are best positioned to capture the opportunity will tap into larger profit pools, grow faster, and use emerging-market cities as a catalyst for innovation.

### Exhibit 1. Rapid Growth Will Further Boost the Population of Emerging-Market Cities

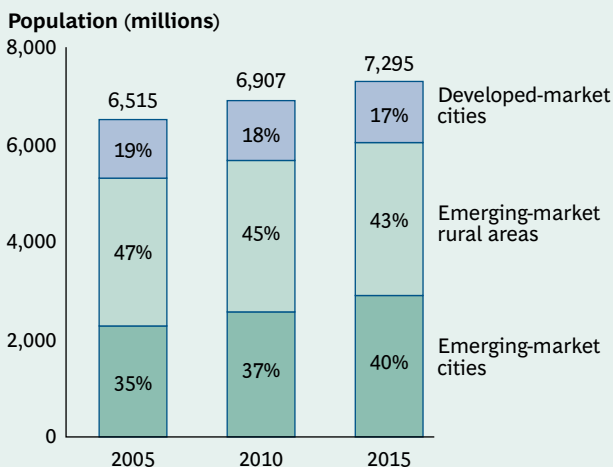
By 2030, another 1.3 billion people will live in emerging-market cities, more than the total population of today's developed-market cities



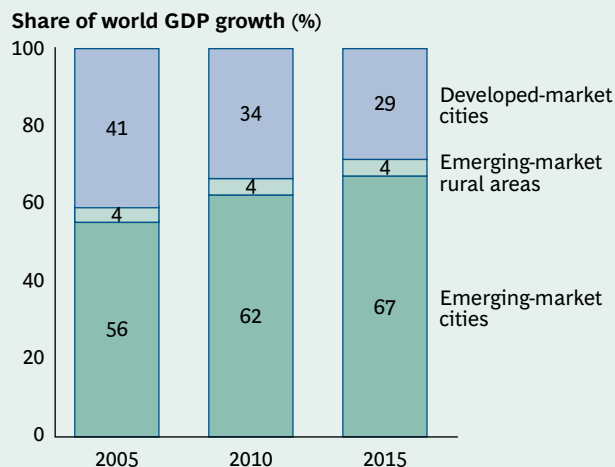
Sources: United Nations, *World Urbanization Prospects: The 2009 Revision*; Economist Intelligence Unit; Chan, K.W., "Fundamentals of China's Urbanization and Policy," *China Review* 10:1, 2010; Mitra, Arup and Mayumi Murayama, "Rural to Urban Migration: A District Level Analysis for India," IDE Discussion Paper No. 137, 2008; BCG analysis.

## Exhibit 2. Emerging-Market Cities Will Play an Increasingly Large Role in the Global Economy

More than one-third of today's world population resides in emerging-market cities...



...driving more than 60 percent of world GDP growth



Sources: United Nations, *World Urbanization Prospects: The 2009 Revision*; Economist Intelligence Unit; BCG analysis.

Note: Rural GDP is the agricultural portion of GDP; city GDP is nonagricultural GDP. Some figures do not add up to 100 because of rounding.

Just consider: already in 2010, emerging-market cities drive more than 60 percent of world GDP growth. By 2015, they will account for 67 percent of this growth. (See Exhibit 2.) There are already 717 emerging-market cities with populations of more than 500,000, and another 371 such cities will reach this size by 2030. There are only 240 cities of equal size in the developed world today.

Income levels in emerging-market cities are reaching an inflection point, with the middle-class population expected to rise 70 percent between 2010 and 2015. The leap in the number and size of emerging-market cities, alongside the burgeoning number of middle-class households and the infrastructure required to support them, is creating unprecedented new growth opportunities for companies—and significant new complexities. Companies wishing to grow in emerging markets must rapidly increase the number of cities served, and they must improve their ability to win in a range of urban market segments. This will require that they develop new business models and channels in order to serve these markets profitably. Dramatic organizational change may be required. A “cities strategy” is key to growth in emerging markets, and successful companies will be those that embrace this challenge.

### Reaching Mr. Yang (and a Billion Other New Urban Residents)

Beneath the headline figure of 1.3 billion new residents of emerging-market cities are countless individual stories of change and mobility. Companies that are serious about pursuing growth in emerging markets must develop greater insights into these new urban residents. Mr. Yang exemplifies the unique situations in which such consumers find themselves. (See the sidebar, “The Pulse of the City,” for similar stories from other cities.)

A few years ago, Mr. Yang moved from the Chinese countryside to the nearby “big city,” where he started his own restaurant. Having saved their earnings from working at a small advertising company, he and his wife took out a mortgage on a sparsely furnished one-room restaurant next to a hospital, with sleeping quarters in the back. Since then, Mr. Yang has used his earnings from the restaurant to buy a range of “middle class” goods, including two TV sets, a mobile phone, a refrigerator, a washing machine, an air conditioner, a DVD player, a computer, and a small minivan that he uses to drive his daughter to the city’s best private kindergarten.



## The Pulse of the City

### Emerging-Market Consumers

The rise of emerging-market cities is affecting the lives of their residents in profound ways, as changes in the urban environment shape new habits, needs, and ambitions.

#### Ahmedabad, India

Take Hitesh, for example. Ten years ago, he moved from a village in the Indian state of Gujarat to Ahmedabad, a city of 4.5 million, where he now lives with his mother, wife, and two daughters in a three-story house in the old part of town.

Hitesh, who is 31, works as a stockbroker in a firm that he opened with a friend several years ago. He brings in an annual income of \$5,280, placing his family squarely in the middle of Ahmedabad's middle class. His household spending habits are typical of a middle-class family in Ahmedabad. Almost half their income goes to food and housing, although Hitesh and his family also spend a lot on transportation and entertainment. In the last few years, his wife, Komal, has begun buying groceries at a new supermarket instead of from local *kiranas*, as mom-and-pop convenience stores are called, and the family buys electronics from a local showroom or from a friend's electronics shop. They now have \$700 in household assets, including a washing machine, a refrigerator, a television, a DVD player, and two mobile phones—all of which, with the exception of the refrigerator, are international brands. Hitesh also owns a motorcycle, which he bought for \$850. For fun, the family likes to go to the nearest shopping mall.

Hitesh and his family have seen a dramatic upgrade in the quality of their lives in the last few years, and they have high hopes for continued improvement. Hitesh expects his income to double within the next five years, and he and Komal are already planning how their lives will change. Their first focus is housing. The family currently live in an old neighborhood with narrow streets and dilapidated buildings, and they would prefer a more developed area. In fact, at the time we interviewed them, they were closing on a house that had greater investment value and more living and outdoor space, including a garden and a parking spot. Hitesh and Komal have decided to buy an air-conditioning unit for their new home, are aiming to set up an Internet connection, and are budgeting \$4,000 to \$5,000 for new furniture. After they spruce up their house, they plan to invest in a small car and, eventually, new office space for Hitesh's firm, ideally in one of the commercial developments that have recently sprouted up in Ahmedabad. However, the family also expect to

spend more on health care and, as their daughters grow up, education.

#### Curitiba, Brazil

In the Brazilian city of Curitiba, a family described experiences and aspirations similar to those of Hitesh's family. The husband, 38, works as a mechanic, and his wife stays at home; their total household income is around \$8,000 a year, placing them in the lower ranks of Curitiba's middle class. They moved from the smaller nearby city of Parana-gua a few years ago in search of better health care, which is particularly important because the couple has a child with special needs, as well as two other children.

Their neighborhood, which is nine kilometers from the city center, offers an example of the urgent need for infrastructure improvements in emerging-market cities. The roads around the family's home are unpaved and the sewers often leak. Curitiba is much more sprawling than many such cities, and the family leases a foreign car to get around, even though it consumes around one-third of the household income. Much of the rest of their income is spent on food and on medical care for their son. They own a mix of foreign and local branded electronics and appliances, including two TVs, a refrigerator, a freezer, a stove, a washing machine, and a stereo. For entertainment and relaxation, they watch TV and talk with friends on the phone. The family use the Internet only when they visit the father's mother, in order to save on the cost of installing it in their own home.

The family's means have increased significantly in the last few years. Three years ago, the husband brought home only around half of what he now earns, and he expects his income to double again within the next five years. After the car lease is paid off, in about three years, the couple plan to begin saving for retirement, as well as for a house in an area with paved roads and better infrastructure. The wife is looking forward to upgrading their home appliances and hopes to buy a stainless-steel refrigerator, a flat-screen TV, and a new stove.

#### Jakarta, Indonesia

Born and raised in Jakarta, Widodo still lives there with his wife and two daughters. He makes \$6,000 per year running a construction supply company, a gemstone business, and a watch repair shop; his wife does not work outside the home. The family live in a house south of the city center that they purchased in 1996 for \$50,000 and are still paying off.

## The Pulse of the City (continued)

Widodo's household assets total \$15,000. The family's inventory of electronics, appliances, and vehicles is large: three cell phones, a TV, a washing machine, a refrigerator, a desktop PC, a DVD player, a car, and a motorcycle, all international brands. When Widodo and his family want to buy electronics, they compare prices and shop at Giant or Carrefour; for groceries, however, Widodo's wife prefers the traditional markets. Their home does not have an Internet connection, but Widodo's wife uses her mobile phone to access Facebook, which is extremely popular in Indonesia.

Widodo's life has changed a great deal in the last few years. As his businesses have thrived, his total expenditures have doubled, allowing him to purchase a car along with other, more expensive items, such as the PC his daughters use for school.

In the past, Widodo had three credit cards, but he closed the accounts to control his costs, and when he travels—the family likes to vacation in Semarang or Hong Kong—he carries traveler's checks or cash. Even though he saves nearly one-quarter of his income each year, he uses the bank only for cash deposits and withdrawals, and he does not invest in stocks. As for the family's consumption habits, housing, education, and transportation currently dominate their expenditures. In the future, Widodo plans to spend even more on health care and on his daughters' education. He will also upgrade the household's electronics and appliances in the next five years, including the mobile phones, PC, and washing machine—but his first priority is an air-conditioning unit. Widodo's openness to technology is changing as well—he is considering getting his own e-mail account and creating a website for his business.

Mr. Yang's concerns have changed considerably since opening his restaurant. He now worries about the rising cost of his child's education, whether to buy a new car and a separate apartment, the poor quality of local health care, and what rapid housing and infrastructure construction in the area mean for his business. Mr. Yang has never used a credit card, and although he has Internet access, he has never shopped online because of security concerns. He expects his income and spending to rise over the next few years.

One might assume that Mr. Yang lives in a major urban center such as Shanghai or Beijing. But, in fact, he relocated to Xiaochang, a fast-growing city of around 160,000 people in landlocked Hubei province approximately 700 kilometers west of Shanghai. (See Exhibit 3.)

Few executives are likely even aware of this city's existence. Indeed, the consumers we spoke with in Xiaochang owned only Chinese branded goods—with the exception of foreign mobile phones and a few counterfeit foreign products. But given that fast-growing smaller cities like Xiaochang are at the forefront of emerging-market-city growth, companies without a strategy for determining in which and in how many of these cities to compete risk overlooking a huge opportunity. Similarly, the business models and go-to-market approaches that companies use in other markets may need to be adapted to profitably reach consumers like Mr. Yang.

## The Rise of the Cities

The same phenomena that created Xiaochang have built up scores of cities like it in China—and hundreds more in other emerging markets—creating wealth beyond such megacities as Mexico City, Mumbai, and Shanghai. The development process itself is familiar, being driven by both rural migration and urban population growth. But what is different in the emerging markets is the scale and speed at which it is occurring.

The megacities often highlighted in the media account for just a fraction of the opportunity. In fact, a disproportionate amount of the growth is occurring in cities with a much lower profile on the global stage. Cities with fewer than 5 million inhabitants already represent 83 percent of the urban residents in emerging markets and are growing more rapidly than the megacities. (See Exhibit 4.) Since many of these cities have characteristics quite different from the larger cities, the strategies companies use when they enter these markets must be refined accordingly.

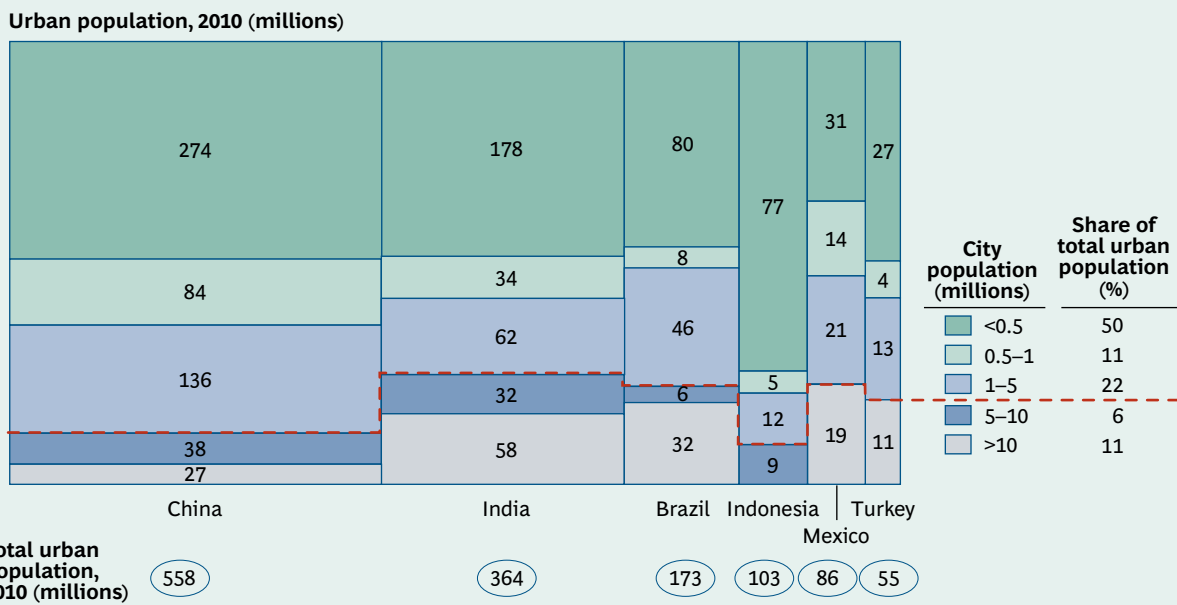
## Emerging-Market-City Segments

One of the first steps in making the decision about whether or not to become active in an emerging-market city and in developing an appropriate strategy is to understand the nature of the various cities involved by segmenting them

### Exhibit 3. Emerging-Market Cities Are Changing Beyond Recognition



### Exhibit 4. Most Urban Residents in Emerging Markets Live Outside the Largest Cities



Source: United Nations, *World Urbanization Prospects: The 2009 Revision*.  
 Note: Some figures do not add up to the totals shown because of rounding.

into distinct groups. This can provide a lens for prioritization as well as highlight the need for different go-to-market approaches to address different types of cities. While no segmentation of emerging-market cities can be universally applicable, there are four major groups that are relevant for nearly all businesses. (See Exhibit 5.)

**Megacities.** Megacities are defined here as those with populations of 10 million or more. They are critical markets now and will remain important for decades to come. Their role as financial and trade capitals allows them to act as international gateways for their countries or regions. They are characterized by high population density, which lowers the barrier to reaching consumers, and they

are key markets for higher-end offerings such as complex financial products and luxury goods. The megacities have a second important role for consumer-oriented businesses. Because they often represent the leading edge for consumption habits and high-end brands within a country, they can be important stepping stones for companies to reach deeper into national markets. Perhaps most important, megacities tend to attract pools of top talent in their regions owing to the influx of young, highly motivated individuals who flock to these cities in the hope of a better education and a better future.

Yet these markets are almost always challenging. As the first entry point for many multinational companies and

## Exhibit 5. Emerging-Market Cities Can Be Grouped into Four Major Segments

Selected Sample

Megacities	Cluster capitals		Specialist hubs		Horizon towns	
<b>Argentina</b> ◇ Buenos Aires	<b>China</b> ◇ Changsha ◇ Daqing ◇ Dongguan ◇ Fuzhou ◇ Guiyang ◇ Handan ◇ Lanzhou ◇ Liuzhou ◇ Luoyang ◇ Nanning ◇ Shantou ◇ Shijiazhuang ◇ Suzhou ◇ Tianjin ◇ Zhengzhou	<b>Brazil</b> ◇ Aracaju ◇ Belém ◇ Brasília ◇ Campo Grande ◇ Cuiabá ◇ Joinville ◇ Londrina ◇ Ribeirão Preto ◇ Salvador ◇ São Luís ◇ Teresina	<b>China</b> ◇ Anyang ◇ Bozhou ◇ Changde ◇ Chengdu ◇ Huaibei ◇ Huainan ◇ Huizhou ◇ Lu'an ◇ Shangqiu ◇ Suizhou ◇ Suqian ◇ Wenling ◇ Wuhu ◇ Xinxiang ◇ Yancheng ◇ Yongzhou	◇ Nagpur ◇ Pune ◇ Surat  <b>Brazil</b> ◇ Belo Horizonte ◇ Campinas ◇ Curitiba ◇ Fortaleza ◇ Goiânia ◇ Manaus ◇ Porto Alegre ◇ Recife  <b>Mexico</b> ◇ Aguascalientes ◇ Campeche ◇ Cancún ◇ Los Cabos ◇ Monterrey ◇ Querétaro  <b>Russia</b> ◇ Kazan ◇ Sochi ◇ Kaluga	<b>China</b> ◇ Baiyu ◇ Daocheng ◇ Ganzi ◇ Hengshan ◇ Huili ◇ Jinchuan ◇ Leibo ◇ Muchuan ◇ Puge ◇ Xiaochang ◇ Xinjin ◇ Yajiang ◇ Yinchuan ◇ Yuexi ◇ Zhaojue ◇ Zhongjiang	<b>Brazil</b> ◇ Açailândia ◇ Araguaína ◇ Caxias ◇ Codó ◇ Imperatriz ◇ Macapá ◇ Paço do Lumiar ◇ Palmas ◇ Parauapebas ◇ Parnaíba ◇ Santarém ◇ São Jose de Ribamar ◇ Timon  <b>Mexico</b> ◇ Abasolo ◇ Allende ◇ Calakmul ◇ Calkiní ◇ Candela ◇ Candelaria ◇ Cuatro Ciénegas ◇ Escobedo ◇ Hecelchakán ◇ Hopelchén ◇ Palizada ◇ Tenabo
<b>Brazil</b> ◇ Rio de Janeiro ◇ São Paulo	<b>India</b> ◇ Bhavnagar ◇ Kochi ◇ Kozhikode ◇ Madurai ◇ Mangalore ◇ Mysore ◇ Pondicherry ◇ Raipur ◇ Rajkot ◇ Vadodara ◇ Vijayawada ◇ Visakhapatnam ◇ Warangal	<b>Mexico</b> ◇ Culiacán ◇ Guadalajara ◇ Hermosillo ◇ León ◇ Mérida ◇ San Luis Potosí ◇ Tijuana ◇ Tuxtla Gutiérrez ◇ Veracruz	<b>India</b> ◇ Ahmedabad ◇ Amritsar ◇ Bangalore ◇ Bhopal ◇ Coimbatore ◇ Faridabad ◇ Hyderabad ◇ Indore ◇ Jaipur ◇ Jalandhar ◇ Kanpur ◇ Kolkata		<b>India</b> ◇ Bari ◇ Chhibramau ◇ Chomu ◇ Kandi ◇ Konch ◇ Kuchaman City ◇ Lumding ◇ Moradabad ◇ Narwana ◇ Nuzvid ◇ Pitapuram ◇ Rampurhat ◇ Tuni	

Source: BCG research.

the prize hunting ground for the strongest local players, megacities are intensely competitive, making success there no easy task.

Take Jakarta. It is the largest city in Indonesia by a huge margin. Surabaya, the next largest, has only around one-third of Jakarta's 10 million residents. Jakarta is by far the most competitive city in Indonesia, and—although other cities are growing extremely fast—it is still the country's key market.

Establishing a presence in Jakarta is important because of its size but also because other Indonesian cities lack entertainment and shopping options. As a result, middle-class and wealthier residents of smaller cities often head to Jakarta on weekends. For example, we spoke with a resident of Medan, a mid-size city in North Sumatra, who runs a snacks and provisions shop and makes around \$10,000 a year; he regularly takes his wife and son to Jakarta for shopping and entertainment.

Many companies choose to enter the megacities before expanding beyond. This strategy has merit in terms of establishing a presence and brand recognition, and it can yield the quickest returns. But companies should not be lulled into a false sense of security from double-digit growth in these cities. They represent only a fraction of the opportunity—and a shrinking one at that, as smaller cities continue to experience higher growth rates.

**Cluster Capitals (and Satellite Cities).** Cluster capitals are trade hubs that are surrounded by smaller satellite cities. There are nearly 150 cluster capitals (with populations of 5 to 10 million), including Changsha (China), Joinville (Brazil), and Veracruz (Mexico). Cluster capitals are large, of course, but another reason for their strategic importance is their proximity to a significant number of nearby satellite cities (of which there are 500 to 1,000). As a result, cluster cities can function as regional hubs within a country, and their strategic importance should not be underestimated.

Many multinational companies have established a presence in cluster capitals, but many have not used these cities as platforms to branch out into the satellites—a potential source of additional growth. In some cases, this is because they have applied the same go-to-market model

that has worked in the megacities, failing to recognize the unique advantages that cluster cities present.

Given the large number of cluster capitals in the emerging markets, a uniform expansion strategy is likely unwise. Analysis is required to identify the most attractive clusters and to prioritize footprint expansion into these cities.

Megacities represent a shrinking opportunity as smaller cities continue to experience higher growth rates.

**Specialist Hubs.** There are already more than 100 specialist hubs—midsize cities (with populations of 1 to 5 million) whose growth is often closely linked to the development of local natural resources or industrial hubs. These cities are experiencing higher growth rates than others in the emerging markets, with real GDP growth

of more than 3 percent. Examples include Aguascalientes (Mexico), Ahmedabad (India), Hyderabad (India), Recife (Brazil), and Wenling (China).

Specialist hubs are overlooked by many multinational competitors because they are smaller and more geographically isolated than megacities or even cluster capitals, and they have a lower GDP per capita than their larger peers. However, the middle-class and affluent populations in these cities are rapidly expanding and driving significant changes in the consumption mix.

Companies seeking to move into the specialist hubs will need to carefully evaluate their coverage models and go-to-market approaches, especially given the geographic dispersion of many of these cities and the resulting high costs of reaching them.

**Horizon Towns.** There are hundreds of small, geographically dispersed emerging-market cities that we call horizon towns. These cities are often characterized by less-developed infrastructure and lower GDP-per-capita growth than other emerging-market cities. Examples include Calkiní (Mexico), Macapá (Brazil), Moradabad (India), and Yinchuan (China).

Horizon towns tend to be the most challenging cities to address in a comprehensive way because of their small size and geographic dispersion. However, business models capable of reaching deep into these cities will find many ripe market opportunities. Although consumers there usually have more basic needs than those of their counterparts in other emerging-market cities,

they also have a strong willingness to selectively trade up.

Most multinational companies have not invested heavily in covering horizon towns, which are consequently dominated by local competitors. Our research has shown that counterfeit goods occupy a significant share in these markets owing to the absence of many of the prestigious foreign brands. As a result, companies that venture into these cities will be confronted by a vastly different set of consumer needs and competitive behaviors, and they will need to adapt accordingly.

## Creating a Portfolio of Target Cities in Emerging Markets

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Companies that decide to enter the emerging markets often start by targeting the megacities. These large cities are an obvious first choice, but they are quickly becoming saturated. The quest for growth and scale now compels companies to move beyond the megacities to the “many cities.”

These smaller emerging-market cities are characterized by fragmented distribution channels, great local variation in consumer habits and income levels, and complex logistics, all of which will require companies to seriously consider which and how many of these cities to serve, when to enter them, and what go-to-market models to use. Long-term profitable growth will require a portfolio of target cities and business models. In addition, it will require significant innovation in how companies approach these various markets.

We have found that the companies that have been most successful in serving emerging-market cities typically adopt no more than three or four distinct go-to-market models to serve different city types. The following approach can guide companies in developing their target portfolios within key emerging markets.

First, assess how market demand will unfold across the cities of the target country, setting expansion priorities from a proper fact base. This requires an understanding of the shape of demand within and across cities—that is, how many and which cities account for a given percentage of the overall addressable market, now and in the future. (This is not a trivial exercise, and it requires

the support of true local experts—there are no off-the-shelf insights for many of these markets.) On the basis of the assessment results, segment and prioritize your target cities, and evaluate your overall growth plans in order to understand how much market share is required in how many of them.

Second, develop and test a small number of go-to-market models to serve different types of cities. These models could address your approach to sales forces, distribution relationships, local partner management, logistics, customer service, local marketing, and the organization of these activities. Developing the models will involve tailoring the tradeoffs among cost, coverage, and control in order to economically serve different city environments. The models will differ according to city size, spending levels, proximity to other markets, fragmentation of the local retail environment, and other factors. Thinking in terms of clusters of cities, rather than individual cities, is an essential part of the design process.

Third, implement and refine these models, while exploring how to push the boundaries. Emerging-market cities are changing so fast that it’s essential for companies to regularly refine their approach. For example, as income levels rise, more and more marginal cities may become attractive targets.

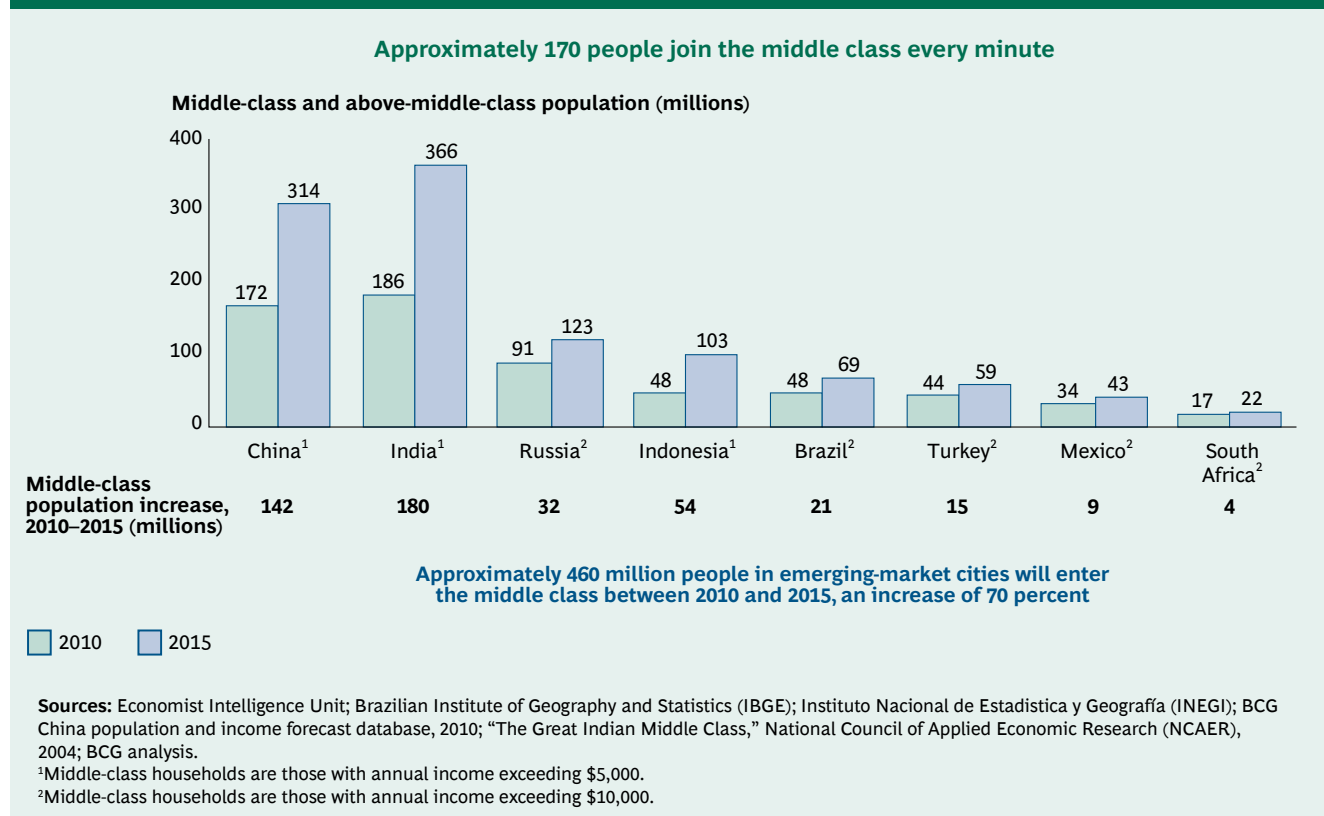
Companies that pursue such an approach to developing and implementing a city portfolio strategy will undoubtedly identify new opportunities for growth and hidden risks to be addressed; for some, it can spark a fundamental rethinking of their approach to the emerging markets. Companies that fail to seriously tackle the portfolio approach will likely see many first-mover opportunities in the most attractive city clusters be taken up by the competition.

# Capturing the Consumer Opportunity

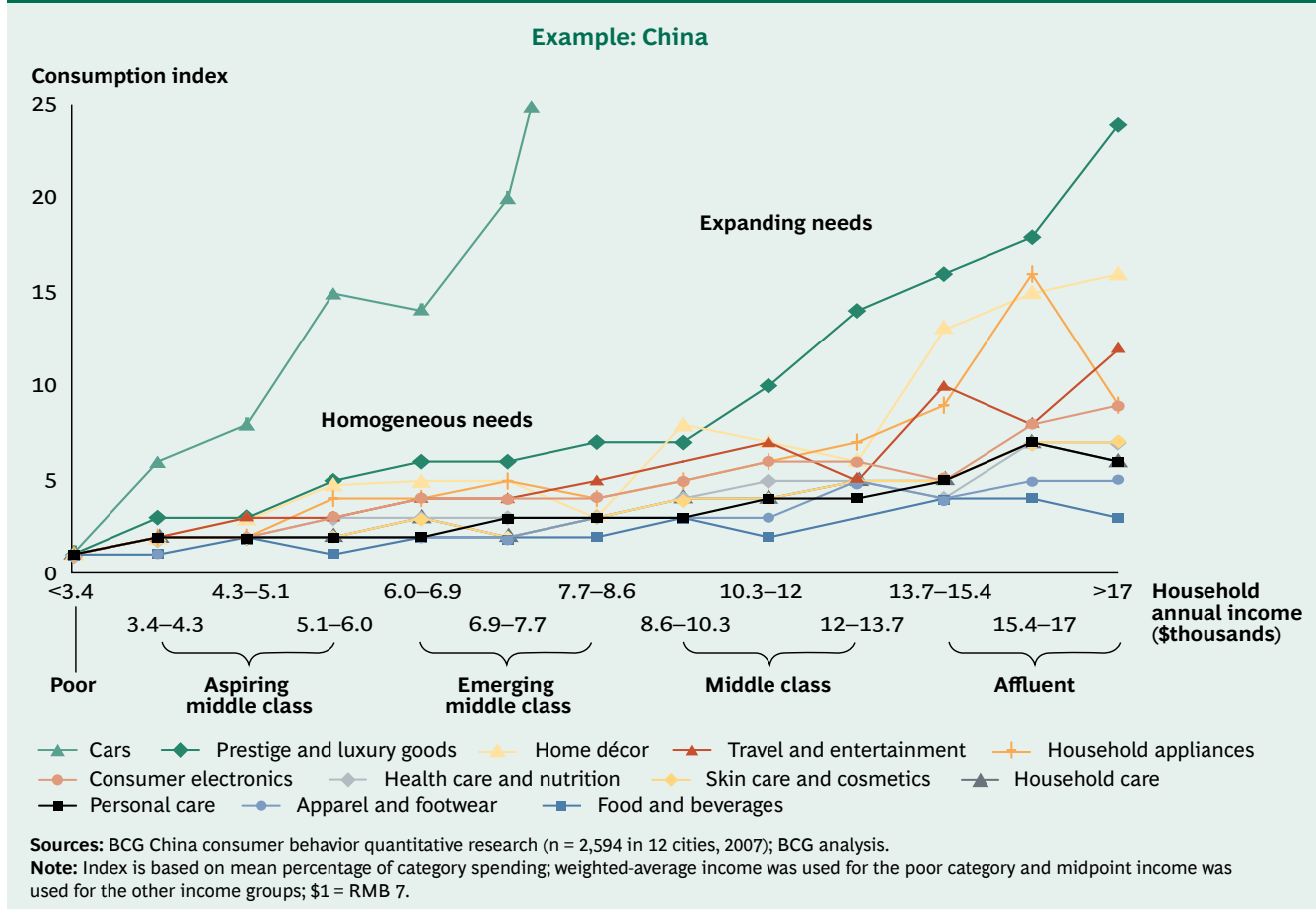
Not only is the population of emerging-market cities increasing, but growing numbers of residents are seeing their incomes rise markedly. By 2015, 130 million households representing 460 million residents of cities in Brazil, China, India, Indonesia, Mexico, Russia, South Africa, and Turkey will have graduated to the middle class. (See Exhibit 6.)

This change in income levels is currently reaching an inflection point, with many products previously unattainable by average residents starting to become necessities. Once households enter the middle class, consumption of categories such as luxury goods and home décor increases rapidly. (See Exhibit 7.) The car market provides a preview of what will occur in many other categories. In 2000, emerging-market cities accounted for 8 percent of total

**Exhibit 6. The Middle-Class Population of Emerging-Market Cities Is Burgeoning**



## Exhibit 7. Consumption Patterns Change Radically as the Middle-Class Population Grows



car sales. Today, more than 37 percent of the world's cars are purchased in these markets, including a significant share of luxury cars. In the first half of 2010, BMW sold more cars in China than in the United Kingdom, and Mercedes-Benz reported a 120 percent sales increase in China over the same period.

### Categories of Opportunity

Basic consumer products may be experiencing this increased demand ahead of other goods and services, but rapid growth will undoubtedly be seen in other categories as well.

◇ *Consumer Products.* By 2015, emerging-market cities will account for around 30 percent—or \$2.6 trillion—of the total global consumption of clothing and house-

hold items. And these cities are already some of the fastest-growing markets for luxury goods in the world.

◇ *Education.* Education is a high priority—in some cases, even the single largest expenditure—for many emerging-market city dwellers. Some residents we interviewed said they had opted for more expensive private schools, and the view that education is an investment in their children's future was a recurring theme. For instance, a middle-class couple we spoke with in Indore, India, spend half of their annual income of \$8,200 on education for their two children. What's more, the bulk of their savings is earmarked for future educational needs.

◇ *Health Care.* Many of the emerging-market urban residents we spoke with identified improved health care



as a priority for future expenditures. Several already subscribe to private health services or health insurance systems because they are dissatisfied with publicly available options in their area. A chef we spoke with in Wenling, China, commented on the poor quality of health care coverage for migrant workers in his city, and many others had similar concerns. It is likely that in the near future, as sedentary work becomes increasingly available in the cities, along with low-cost high-fat and high-sugar-content foods, a rise in health problems such as diabetes, heart disease, stroke, and obesity will spur increased demand not only for medical care but also for goods and services such as organic foods and health clubs.

- ◇ *Consumer Financial Services.* Although their average income levels are much lower than those of their counterparts in developed markets, most of the residents of emerging-market cities we interviewed were saving a very significant portion of their incomes for the future. In some cities, however, residents expressed frustration regarding a lack of consumer financial services. The business owner in Medan, Indonesia, referred to earlier, complained about the difficulty of getting a loan to expand his business. And a migrant worker we spoke with said that he would like to open a savings account, but the nearest bank branch was too far away from where he lived. Nonetheless, consumer finance in emerging-market cities is expected to reach \$10 trillion by 2030. Cities with populations of less than 5 million will account for a significant share of this growth, including the majority of mortgage and auto loans and slightly less than half of personal loans.

## Five Imperatives for Consumer Businesses

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The rise of the emerging-market cities has many parallels with the rise of cities in the developed economies. But five key differences—and the unique imperatives that they imply—are of critical importance for companies seeking to serve consumers in these markets.

**The scale and speed of the rise of these cities is unprecedented.** Through 2030, the growth in new city residents in the developed economies will be outpaced by

that of new residents in emerging-market cities by a factor of ten.

By 2030, there will be more than 1,000 cities in emerging markets with populations in excess of 500,000.

*Imperative: To serve these consumers, companies will need to move quickly.* Many consumers in emerging-market cities are at the early stage of forming brand preferences as they move up the income ladder, and those companies with the strongest presence and the most attractive product offerings will be well positioned to win in these markets. The sheer volume of growth potential that these cities represent could tip the scale in favor of nimble competitors capable of taking advantage of this unprecedented opportunity.

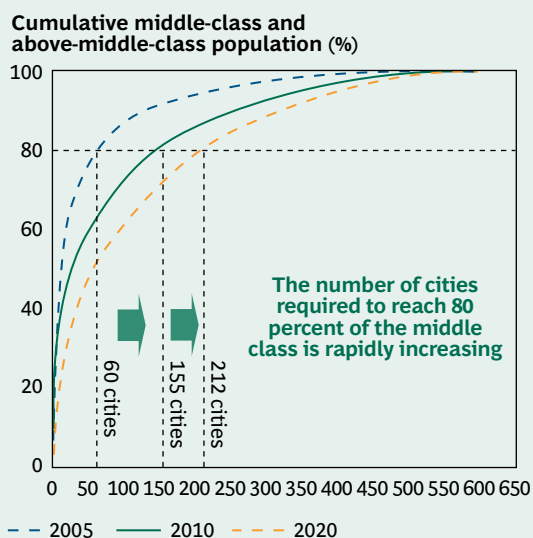
**Capturing consumer demand in these markets will necessitate dealing with an extremely large number of individual cities.** By 2030, there will be more than four times the number of cities with populations in excess of 500,000 in the emerging markets than in the developed economies—more than 1,000 such cities.

*Imperative: Companies will need to align their city coverage with the most attractive opportunities and adapt their business models to reach further and deeper into these markets.* In 2005, a company had to be in 60 cities in China in order to reach 80 percent of that country's middle class. In 2020, a company wishing to reach the same share of the middle class will have to be in 212 Chinese cities. (See Exhibit 8.) Clearly, many companies need to be asking some difficult questions about their coverage levels and go-to-market approaches in emerging-market cities. Chief among them: How many cities do we need to be covering? And how can we serve these markets profitably?

**The local living environment—such as the type of housing typical of a particular area—shapes lifestyles and therefore influences purchasing behavior and consumption patterns.** While some factors, such as dense populations, are characteristic of many emerging-market cities, others vary significantly from place to place, including crime, pollution, food safety, and the quality and availability of local housing, schools, and health-care facilities.

## Exhibit 8. Rapid Expansion in City Coverage Will Be Required to Keep Up with Middle-Class Growth

### Example: China



Sources: BCG China population and income forecast database, 2010; BCG analysis.

*Imperative: Products and services for emerging-market cities need to be driven by deep insights into how city living shapes the needs of targeted consumers. Local characteristics must be taken into account when tailoring products and services for these markets, which requires the development of comprehensive consumer insights in a company's target cities. Many multinational companies have underinvested in this effort, regarding it as too difficult or time-consuming. However, given the diverse needs of the many emerging-market cities and the speed at which consumer preferences are changing, a deep understanding of consumers is vital for success in these markets.*

Take today's high-end urban kitchen in China, for example. In such a kitchen, there probably will not be a cappuccino maker, but an expensive soymilk machine is likely—or will at least be aspired to. There probably will not be a food processor, but a high-end rice cooker is likely. And there will probably be neither an oven nor an automatic dishwasher, but a modern gas range with a sophisticated ventilation hood—and possibly a

built-in drinking-water filtration system—is likely. These elements of the modern Chinese kitchen reflect a combination of local cuisine (rice, soymilk, and fried rather than baked foods), local economics (a low-cost maid is likely to be more affordable than the space needed for a dishwasher), and local environmental concerns (water purification is a must). Companies wanting to win consumers in these markets must go to market with solutions based on these very specific types of insights.

### Mobility differences will affect shopping behavior.

Narrow or poorly paved roads in large cities cause traffic congestion that severely limits mobility—and shopping. “I often go to the nearby *kirana* to buy basic items because I hate waiting in traffic to get to the supermarket,” said a resident of Ahmedabad, India, with an annual household income of \$12,000. Such constraints have a strong influence on the daily routines and shopping behaviors of households in many cities.

*Imperative: Companies must shape their go-to-market approaches in light of the local retail mix. The retail landscape is changing rapidly in emerging-market cities, but it differs significantly depending on city size and local culture. Smaller cities tend to have a mix of traditional trade—such as mom-and-pop stores—and modern trade, including chain stores or franchises.*

In general, people in dense cities prefer neighborhood stores and more frequent shopping trips. “We usually do grocery shopping at the nearby grocery store,” said an Istanbul resident who lives with his family in the downtown area. “Most daily trips are local and done by public transport.” In emerging-market cities characterized by urban sprawl, however, residents prefer hypermarkets and tend to make weekly shopping trips. “We go shopping once a week at Carrefour or Wal-Mart,” a São Paulo father and husband told us. Cars, not surprisingly, are a crucial part of suburban living. “We can't live without our car here in the suburbs,” said Mrs. Gonzalez, an upper-middle-class housewife in Mexico City. “My husband spends hours commuting by car to work, and [the car is necessary] for getting our weekly groceries from the hypermarket.”

**The residents of emerging-market cities are getting “wired” far more rapidly than many executives imagine.** Already, 610 million residents of Brazil, China, India, Indonesia, and Russia use the Internet regularly, and this number will rise to 1.2 billion by 2015. Increasing connectivity is occurring in parallel with the rise of emerging-market cities, and the confluence of these two trends has the potential to fundamentally alter consumer behavior.

*Imperative: Companies must understand the effect of digital shopping channels on consumers in emerging-market cities.* Internet access is leading to increased consumer sophistication in these markets. An entrepreneur in Medan, Indonesia, researches products on the Internet because he distrusts salespeople. A middle-school teacher in Wenling, China, shops for his children online because he can find

better deals there. Consumers in most megacities and cluster capitals are already open to shopping online, and their willingness is growing with improving technology. For example, online shopping is popular in China’s large coastal cities, and more than half the residents of Shanghai and Beijing make purchases online. In smaller cities such as Chengdu and Luoyang, however, consumers still tend to be less open to online shopping.

Digital shopping presents both opportunities and challenges. On the one hand, the use of online channels may allow some companies to participate in emerging-market cities where a physical presence is not economically viable. On the other hand, it raises the risk of value chain disruption by pure online players in industries traditionally dominated by brick-and-mortar chains.

# Capturing the Infrastructure Opportunity

**E**merging-market cities will need better housing and infrastructure—including transportation, water, sanitation, and electricity. Meeting these needs will require an estimated cumulative expenditure of \$30 trillion to \$40 trillion by 2030—the equivalent of 60 to 70 percent of the total global investment in infrastructure. (See Exhibit 9.) The strongest driver of infrastructure demand will be population growth. Thus, the majority of housing and infrastructure investment will be in smaller cities rather than in the megacities. In Mexico, for example, cities with populations of less than 500,000 are consuming nearly half the country’s cement output. As to China, the satellite images in Exhibit 10 show the massive infrastructure development that has taken place in Tianjin, a cluster capital not far from Beijing, since 2000.

## Housing

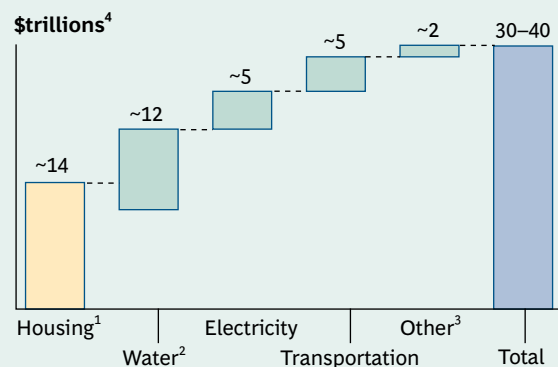
Emerging markets will require an estimated \$13.8 trillion in housing investment from 2010 to 2030, with a huge portion of the demand coming from Brazil, China, India, and Mexico. These investments will result in the addition of some 10.7 trillion square meters of housing in China, while India will add 5.2 trillion square meters. At the same time, urban dwellers in China and India will increase by 270 million and 230 million, respectively.

The acute demand for housing in emerging-market cities means that already-high population densities will increase further, particularly in China and India. The need to overcome space limitations is likely to drive up demand for multifamily residential housing. Shanghai may be something of a leading indicator on this front—the number of stories and the floor area of high-rise buildings

there have increased threefold since 2000 along with population density. The housing construction boom means that virtually all construction-related industries are being driven and transformed by the emerging markets. Take elevators, for example. Nearly 70 percent of new elevator demand globally now comes from the emerging markets—China alone accounts for nearly 50 percent of global demand. In this environment, new companies based in emerging markets are becoming formidable fast. China-based Ningbo Shenling Elevator Accessories Company is now the world’s second-largest maker of elevator doors

**Exhibit 9. Emerging-Market Cities Will Require More Than \$30 Trillion in Infrastructure and Housing Investment**

Cumulative investment requirement, 2010–2030



Infrastructure (blue) Housing (orange)

Sources: OECD, *Infrastructure to 2030*, 2006; Morgan Stanley; CLSA; National Bureau of Statistics of China; BCG analysis.

<sup>1</sup>Includes demand only from increased urban population and expanding average living space per capita, calculated on a yearly basis; does not take into account excess inventory.

<sup>2</sup>Includes water supply, wastewater, and sanitation services.

<sup>3</sup>Includes airports/seaports (\$600 billion) and telecommunications (\$1.1 trillion).

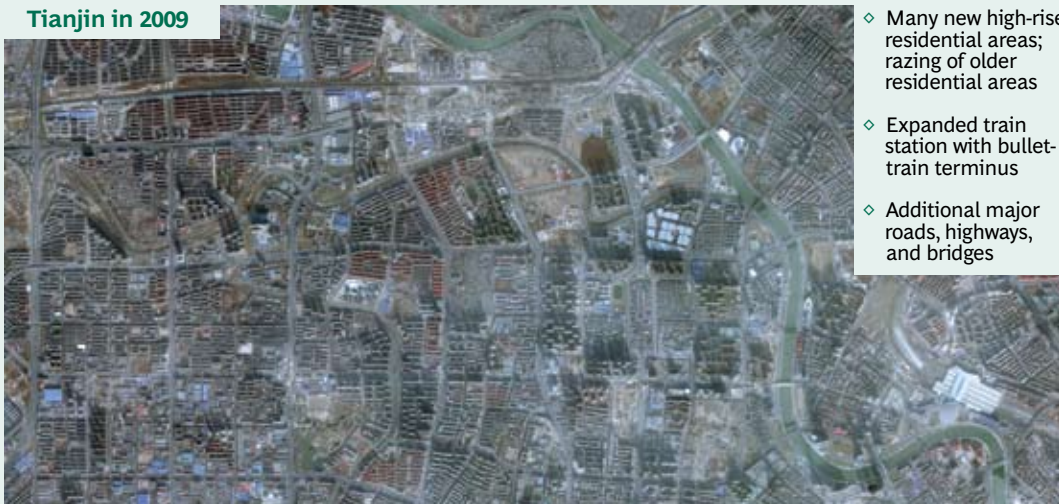
<sup>4</sup>Constant 2010 prices.

## Exhibit 10. Infrastructure Development in Tianjin, China, Has Soared in the Past Ten Years

Tianjin in 2000



Tianjin in 2009



- ◇ Many new high-rise residential areas; razing of older residential areas
- ◇ Expanded train station with bullet-train terminus
- ◇ Additional major roads, highways, and bridges

Sources: GeoEye; DigitalGlobe.

and is growing rapidly. Other businesses involved in housing construction (makers of building control systems, air conditioners, lighting, and window glass, for example) are similarly undergoing dramatic transformation.

### Water and Sanitation

Perhaps the most serious infrastructure deficits in many emerging-market cities are in water and basic sanitation. Access to safe drinking water is inadequate in many cities in the emerging markets—even in some megacities—and growing water scarcity will only exacerbate the problem.

Water therefore promises to be one of the biggest investment targets in emerging-market cities. In some areas, water shortages are already driving the adoption of desalination and advanced water-reuse and recycling schemes. The winning technologies stand to gain from significant demand in other cities facing acute shortages, especially in China and India.

### Transportation

The need for better links among emerging-market cities will intensify the demand for improved transportation.

Traffic is currently a major bottleneck, both within and between cities. In addition to investments in roads and highways, investments in public transportation are gaining momentum. For example, Delhi opened its first subway line, with 21 stations, in 2002. Now, a mere eight years later, a total of five lines with more than 100 stations are in operation. In China, 110,000 kilometers of rail lines will be built by 2012—nearly 50 percent more track than the length of the entire U.S. Interstate Highway System. This will include 13,000 kilometers of high-speed rail—more than anywhere else in the world.

Transportation infrastructure will continue to present companies with significant commercial opportunities. Demand growth in cities with populations of less than 5 million will be particularly notable as these cities upgrade their infrastructure in order to develop the local economy.

## Electricity

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We anticipate that emerging markets will need \$5.3 trillion worth of investment in electricity infrastructure from 2010 to 2030. Approximately 60 percent of the global generating capacity added through 2030 will be built in emerging markets.

Electricity consumption per capita in emerging-market cities is significantly lower than in developed markets but is likely to increase rapidly in tandem with rising income levels. This trend underscores the need for investments in energy efficiency in these markets.

## How to Tap In to the Infrastructure Opportunity

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There are many ways for companies to play a role in meeting the infrastructure needs of emerging-market cities: through city planning, financing and investment, the construction and management of new infrastructure, the operation and maintenance of existing infrastructure, or the supply of raw materials, components, and innovative technologies.

In addition, environmental challenges arising from rapid economic development will spur demand for innovative

Realizing the potential of the infrastructure opportunity will require new or adapted business models.

“cleaning and greening” solutions. Emerging-market cities suffer from severe air pollution: the 30 most polluted cities in the world are all in emerging markets. Renewable energy, zero-emission vehicles, and urban greening are just a few examples of the technologies and practices that emerging-market cities will need to integrate into their infrastructure-planning processes in the coming decades, as increasing numbers of affluent and middle-class residents demand a better living environment. In addition, expanded waste-treatment capacity will be needed to handle higher population levels in these cities.

The shortfall between needed infrastructure in emerging-market cities and available public funds is estimated to be in the neighborhood of \$11 trillion to \$14 trillion through 2030. This creates an opportunity for private investors to help governments raise funds to bridge the financing gap or for private construction firms and asset managers to take a financial stake in their contracts. Although the emerging markets have different financing capabilities and different degrees of openness to privatization, the sheer size of this gap has encouraged many governments to embrace private financing in the form of public-private partnerships (PPPs). The amount invested in greenfield projects involving private participation was \$62 billion in 2007 for the six largest emerging-market countries, compared with \$25 billion in 2003.

Several PPP models have been successful in emerging-market cities, including one in Indore, where India’s first Bus Rapid Transit System was deployed in 2006. An innovative arrangement allowed the city to build a modern transit system with dedicated busways, a computerized ticket-vending system, and continuous GPS monitoring. The company created for this PPP has been profitable since its first year in operation.

Many capabilities will need to be fostered in order to win in the infrastructure markets of emerging-market cities, and companies that realize the tremendous potential of these markets will need to act fast. New or adapted business models will be required to realize the full potential of the opportunity, and new challenges and complexities around issues such as organization, talent management, risk management, and city portfolio strategy will certainly need to be addressed.



# Incubators of Dynamic Local Competition

**T**he same vibrant environment that is shaping consumption in emerging-market cities is giving rise to innovative local competitors that are tailoring their products and services to the unique opportunities these cities afford. Companies that operate in emerging-market cities are likely to encounter new competitive challenges, and the ability to understand and adapt to them is crucial.

One example of local innovation is Mumbai's *dabbawalas*, as the city's box-lunch caterers are called. Mumbai is India's most densely populated city, and traffic congestion there is rampant. As a result, it is excruciatingly time-consuming for office workers, many of whom live outside the city center, to return home for lunch. The *dabbawalas* provide these workers with hot meals at low cost. Their supply chain is carefully designed to prevent delays and disruptions in delivery.

Some local competitors have succeeded in disrupting value chains in their industries. The emergence of Yonghui as a leading supermarket chain in Chongqing is a good example. The company buys produce directly from individual farmers rather than from traditional intermediar-

ies. This supply-chain model allows Yonghui to stock produce as fresh as that found in farmers' markets and to sell it at lower prices than those of its multinational competitors. In Chongqing alone, Yonghui's success has allowed it to expand from 9 supermarkets in 2007 to 44 in 2009—far exceeding the growth of international hypermarkets during the same period. At the same time, the company has managed to maintain a relatively flat management structure, keeping overhead low and enabling rapid decision-making.

It is just a matter of time before local competitors such as these set their sights on global expansion and challenge incumbents for leadership in their home markets. This is already occurring in the infrastructure market, where Chinese state-owned construction companies, such as China Communications Construction Company and China State Construction Engineering Corporation, have racked up billions in international revenue. The winners in the emerging-market cities will be poised to emerge as formidable competitors on the global stage. This is a risk that often receives little notice from established multinational companies and deserves additional strategic consideration.



# The New Agenda for Emerging-Market Growth

**C**apturing the tremendous growth opportunity presented by the emerging-market cities will require a new management agenda for the emerging markets, with cities as its focal point. Pursuing this agenda will ensure that companies focus on the right strategic issues in order to build a successful position in these markets. It requires executives to tackle the following imperatives:

- ◇ *Define growth plans on the basis of specific target cities—the portfolio of emerging-market cities to be served now and in the future.* It is no longer sufficient to plan on the basis of countries or loosely defined regions within countries. Planning must include an explicit evaluation of the costs and benefits of serving different cities. Most companies will find that they are serving far fewer cities than they should be, and that they need to be much more ambitious and specific.
- ◇ *Specify the necessary go-to-market models to enable profitable expansion into more and smaller cities.* Multiple go-to-market models are imperative. The models required for smaller cities will be fundamentally different from those required for megacities. And the right model's payoff can be huge—a model that enables smaller cities to be served profitably can open up vast new markets. Most companies will find that they have not devoted sufficient effort to developing such models.
- ◇ *Develop true expertise and insight regarding consumer needs across a range of city environments in emerging markets.* Consumers in emerging-market cities have a great variety of unique needs and behaviors. Most companies fail to invest properly in gaining direct insights into these consumers and translating those insights into products and services.
- ◇ *Forge a game plan to profit from the infrastructure boom.* Infrastructure-related companies need to grasp the magnitude and speed of the infrastructure growth taking place in emerging-market cities. While new local champions are rising up on the crest of this wave, many companies in developed markets are missing out.
- ◇ *Develop talent and organization plans at a city-by-city level over a five-to-ten-year time frame.* As the number of commercially important cities skyrockets, the need for companies to have talent based in all these locations also grows. But most companies are still developing their plans for talent and organization only at the national level. They have failed to clearly define where their future talent needs will arise, and they are overlooking important local talent pools. Taking cities seriously requires a fundamental shift in talent planning.
- ◇ *Upgrade capabilities for managing complexity and risk.* As demand unfolds across a massive number of emerging-market cities, every company that takes this growth challenge seriously will experience a higher level of complexity and risk. Companies must begin planning for this now.

The rise of emerging-market cities represents the world's single largest commercial growth opportunity for decades to come. While the promise is vast, the complexities are also daunting. Never before in history have companies been faced with the challenge of doing business simultaneously in thousands of cities around the globe. Growth for many companies requires taking up this challenge. Those that do so and succeed will become true global winners.





# For Further Reading

The Boston Consulting Group publishes other reports and articles that may be of interest to readers of this report. Recent examples include the following:

**The Global Infrastructure Challenge: Top Priorities for the Public and Private Sectors**  
A White Paper by The Boston Consulting Group, July 2010

**The Keys to the Kingdom: Unlocking China's Consumer Power**  
A report by The Boston Consulting Group, March 2010

**China's Luxury Market in a Post-Land-Rush Era**  
A White Paper by The Boston Consulting Group, September 2009

**From Crisis to Opportunity: How Global Challenger Companies Are Seeking Industry Leadership in the Postcrisis World**  
A White Paper by The Boston Consulting Group, September 2009

**Lucky 8: Understanding and Capturing China's New Growth**  
A White Paper by The Boston Consulting Group, July 2009

**The 2009 BCG 100 New Global Challengers: How Companies from Rapidly Developing Economies Are Contending for Global Leadership**  
A report by The Boston Consulting Group, January 2009

**Wealth Markets in China: The Beginning of the Race for China's Rich**  
A Focus by The Boston Consulting Group, October 2008



# Note to the Reader

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