# Reaching middle class consumers in emerging markets: Unlocking market potential through urban-based analysis

Ilke Kardes

*Institute of International Business, Center for International Business Education and Research, J. Mack Robinson College of Business, Georgia State University, 35 Broad Street, Suite 1423, Atlanta, GA 30303, United States*

| ARTICLE INFO | ABSTRACT |
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| | The international business landscape has transformed in dramatic ways over the past three decades. In particular, the importance of middle class households, concentrated especially in urban areas in emerging markets, is now well-recognized. We propose and demonstrate a systematic approach to urban-based market potential analysis. Based on international market segmentation literature, our key argument is that a more focused market potential analysis, based on middle class households, is superior to an aggregate, country-level market potential analysis. The proposed method highlights specific market potential indicators, especially suitable for middle class analysis. Further, we demonstrate this new approach through a case study. Finally, this manuscript positions itself as a managerial tool.<br>© 2016 Published by Elsevier Ltd. |

## 1. Introduction

The rise of the middle class has accentuated the attractiveness of emerging markets for western business. Middle class consumers in emerging markets are now exposed to western lifestyle and brands thanks to global media and communications. These consumers now hold high aspirations for upgrading their stand-ards of living and lifestyles. Thanks to rapid economic growth and rising disposable income, they can now afford a wide variety of products and services. As such, middle class households in emerging markets now represent viable and significant target market segments for western businesses—only if they can be clearly identified, quantified, and targeted.

Scholars and practitioners have offered numerous techniques to delineate foreign market potential. These include: the three-step approach (screening, identification, and selecting) (Cavusgil, 1985; Koch, 2001; Kumar, Stam, & Joachimsthaler, 1994); indexing and ranking (Armstrong, 1970; Cavusgil, 1997; Conners, 1960; Liander, Terpstra, Yoshino, & Sherbini, 1967; Lindberg, 1982; Mullen & Sheng, 2006; Samli, 1977); and clustering (Cavusgil, Kiyak, & Yeniyurt, 2004; Liander et al., 1967; Sethi, 1971). They are carried out with such estimation models such as cluster analysis, portfolio analysis, conjoint analysis, multiple factor analysis, regression analysis, shift-share analysis, and multiple criteria methods (Ozturk, Joiner, & Cavusgil, 2015). These techniques are useful to assess the overall potential of a country and the ranking top prospective markets. For example, in a study of African markets, Deloitte (2012) ranks Morocco as a highly attractive market due to a substantial middle class, whereas Tanzania represents a market with a relatively small middle class. Based on those results of the study, one can expect that Morocco provides more opportunity for companies than Tanzania does. However, the results do not provide accurate information as to which part of a national market offers the greatest potential regarding middle class. In support of our assumption, some studies of the Global Cities Initiative, developed by Brookings Institute and JPMorgan Chase, acknowledge that investors may take the advantage of being early movers if only they identify opportunities in urban areas (Finch, 2014). As a result, country-level analyses are not quite adequate for delineating the specific market potential of middle class households. On the other hand, a finer analysis based on urban locations within a country can better represent the market opportunity for the middle class in emerging markets.

A more focused, granular approach that examines finer subsets of a large country can pinpoint the attractive middle class consumer segment. In the present study, we propose a more focused approach where emerging market potential can be assessed by not just considering the entire country as a whole, but one that delineates different regions or cities within a country. Such a granular approach is especially suitable for large and diverse emerging markets like China, Indonesia, Mexico, and India.

The primary rationale for forming urban-based clusters is the diversity within a country fostered by ethnic groups,

*E-mail address:* ikardes@gsu.edu (I. Kardes).

socioeconomic classes, languages, infrastructure, geography, and consumption patterns. For example, China has 56 different ethnic groups (Atsmon, Child, Dobbs, & Narasimhan, 2012), and the number of languages spoken in India is about 438 (Economist, 2012). The complex composition of many emerging markets causes an uneven distribution of middle class within a country. Therefore, the consideration of an emerging market as a whole may lead to misleading conclusions about the consumption behavior of emerging market consumers. In an urban-based approach, managers focus on regions or cities with high potential to access neglected middle class consumers (Agrawal, Choudhury, Pokardas, Rastogi, & Srivastava, 2014; Lane, St. Maurice, & Wu, 2006).

There is some evidence in the academic literature, but especially in management consulting circles, that a more focused, urban-based market potential analysis is superior to traditional approaches. From an academic perspective, Schlager and Maas (2013) recommend a micro level analysis for segmentation, given the highly diverse institutional context in emerging markets. In this regard, "within-country heterogeneity" requires "a finer grained level of aggregation in EMs." Likewise, Desarbo, Jedidi, and Sinha (2001) advocate that an aggregate analysis cause inconsistent parameter estimates in the existence of a heterogeneous cluster.

From the perspective of practitioners, consulting companies[1] and governmental organizations[2] advocate the use of a city- or urban-based approach to identify the real potential within large and diverse markets. For example, WEF (2014a) extends the leading *Global Competitiveness Index* for countries to the city level. One of the factors to be considered for city competitiveness is the emerging middle class and urbanization.

Moreover, studies by both PwC (2014a) and United Nations (2014) point out emerging markets cities as the solution for the aging population in advanced economies. These cities host a growing number of young generations who are the source of talent and consumption for companies.

Furthermore, in another study, PwC (2014b) refers to urban areas in growth economies, especially in Asia-Pacific, as target markets for infrastructure sectors like water, power, mining, transportation, telecommunication and construction by 2025.

In addition to companies operating in the B-to-B sector mentioned above, cities also provide big opportunities for consumer goods firms. For example, a McKinsey study authored by Kim, Remy, Schmidt, & Durand-Servoingt (2014) argue that multinationals operating in luxury-goods sector ought to develop a strategy at the city level. Rather than considering a country as a whole, managers may identify top cities in emerging markets to target.

As a particular best practice, in referring to a well-known technology company operating in India, McKinsey suggests that the company has reduced customer service cost from 11 to five percent of sales by targeting 67 cities, instead of 200 cities previously considered (Atsmon, Kertesz, & Vittal 2011). Similarly, Haier, a leading Chinese white goods manufacturer, organized its sales management teams by provinces as well as cities (Kleiner, 2014).

An important rationale for an urban-based market potential analysis is that consumption patterns vary among different cities within a country, especially in large emerging markets. For example, the preference for yogurt in Wuhan is significantly higher than it in other cities in China. Thus, a city-based approach may facilitate to pinpoint marketing strategies like product adaptation, pricing, the type of the products and others based on local needs and preferences (Dobbs, Remes, & Schaer, 2012).

If different perspectives of practitioners are simultaneously considered, we may draw the following specific conclusions for B-to-B and B-to-C sectors regarding the rationale of an urban-based market potential analysis.

## 1.1. Rationale of an urban-based market potential analysis for B-to-B sector

Firstly, companies operating in the business-to-business sector may benefit from an urban-based market potential approach. Governments in many emerging markets invest in the public-private collaboration to build new cities and enhance the modernity in existing urban areas. Such efforts aim to build a good infrastructure equipped with modern technologies and thus, to boost the economic activity in a country.

Infrastructure projects are usually implemented through collaboration between government and the private sector. Thus, they provide significant opportunities for construction, transportation, mining and engineering firms.

## 1.2. Rationale of an urban-based market potential analysis for B-to-C sector

Secondly, because urban areas with developed infrastructure provide a better life, they attract people from rural areas resulting a growing immigration from rural into the urban locations. Thus, the population growth mainly concentrates in mega and mid-sized cities in both emerging and frontier markets. Growing population means an increase in the number of potential end consumers that results in higher profit margins for companies operating in the consumer goods sector.

Although a focused analysis of a country should provide more precise details about market potential noted above, well known consulting companies contend that many international managers still prepare strategic business plans at the country level (Atsmon et al., 2012). A possible reason for neglecting an urban-based market potential analysis may be the lack of knowledge about how to conduct such a granular analysis and also the uncertainty as to what relevant data and metrics should be employed. Moreover, the academic literature has not yet acknowledged the need for granular approaches based on the potential of middle class consumers in urban areas. Consequently, the purpose of this manuscript is to propose and demonstrate a systematic approach to urban-based market potential analysis, especially suitable for middle class studies. This approach introduces specific metrics to assess market potential. Moreover, it also takes into account the high potential of the rising middle class in emerging markets. Key features of this proposed granular approach are the focus on middle class and the consideration of urban areas.

We aim to contribute to knowledge in international business in four distinct ways. First, this research provides a new perspective to market potential analysis. A refined market potential analysis is offered as an alternative measurement to the aggregate, country level market potential analysis. A country-level approach is replaced with the urban-based perspective regarding the unit of analysis. Second, the urban-based perspective enriches the literature on global market segmentation. Although some scholars refer to the importance of identifying finer customer segments within a country for developing international market entry strategies (e.g., Schlager & Maas, 2013; Douglas & Craig, 2011; Palumbo & Teich, 2004; Lenartowicz & Roth, 2001), they have not offered alternative approaches. Additionally, business practitioners emphasize *"the need for a systematic approach to evaluating cities and their metropolitan areas as distinct markets"* (Finch, 2014).

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[1] For example, McKinsey, Boston Consulting Group (BCG), Ernst & Young (EY), and PricewaterhouseCoopers (PwC).

[2] For example, United Nations (UN) and World Economic Forum (WEF).