Creating Value for
EMERGING CONSUMERS
In Retailing

PROJECT 1 May 2003
A study conducted for
THE COCA-COLA
RETAILING
RESEARCH COUNCIL
LATIN AMERICA
By Booz-Allen Hamilton

Creating Value in Retailing for Emerging Consumers

Breaking Myths about Emerging Consumers -- Learning from Small Scale Retailers

An Exploratory Study conducted for the Coca-Cola Retail Research Center - Latin America by
Booz Allen Hamilton

June 20, 2003

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About the authors

▸ The Coca-Cola Retailing Research Council – Latin America (CCRRC - LA) is dedicated to develop a better understanding of the food retailing and allied merchandise distribution business in Latin America. It concentrates in identifying and then studying selected relevant issues, and present its findings to the manufacturing and retailing communities, in order to assist in the development and enhancement of the food retailing business in the region

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  – Alejandro Frenkel

This project set out to build an actionable agenda for retailers to create greater value for emerging consumers

Consumer / Market Understanding

▶ Understand the mindset of the small retail sector's customer base [1]
  – Brand and store format needs
  – Purchasing behavior and its drivers

▶ Profile key segments/formats for organized and small retailing
  – Business models and value drivers
  – Sources of competitive advantage, opportunities, and threats
  – Impact of market environment, competition and regulation

▶ Understand the supply chain of small retailers and the role intermediaries play

▶ Identify performance and value proposition gaps between large scale and small retail trade in serving emerging consumers

Actionable Agenda

▶ Identify areas that can be influenced and controlled by the retail trade—and those which cannot

▶ Define guidelines for building an actionable agenda

▶ Articulate, at a high level, key focus/priority areas for:

  – Retailers
  – Manufacturers
  – Other stakeholders

(1): *Across key FMCG's categories—food/beverages, toiletries and personal/home care—for relevant Latin American markets*

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We focused our efforts on six key countries, small and traditional formats and a significant share of emerging consumer spend
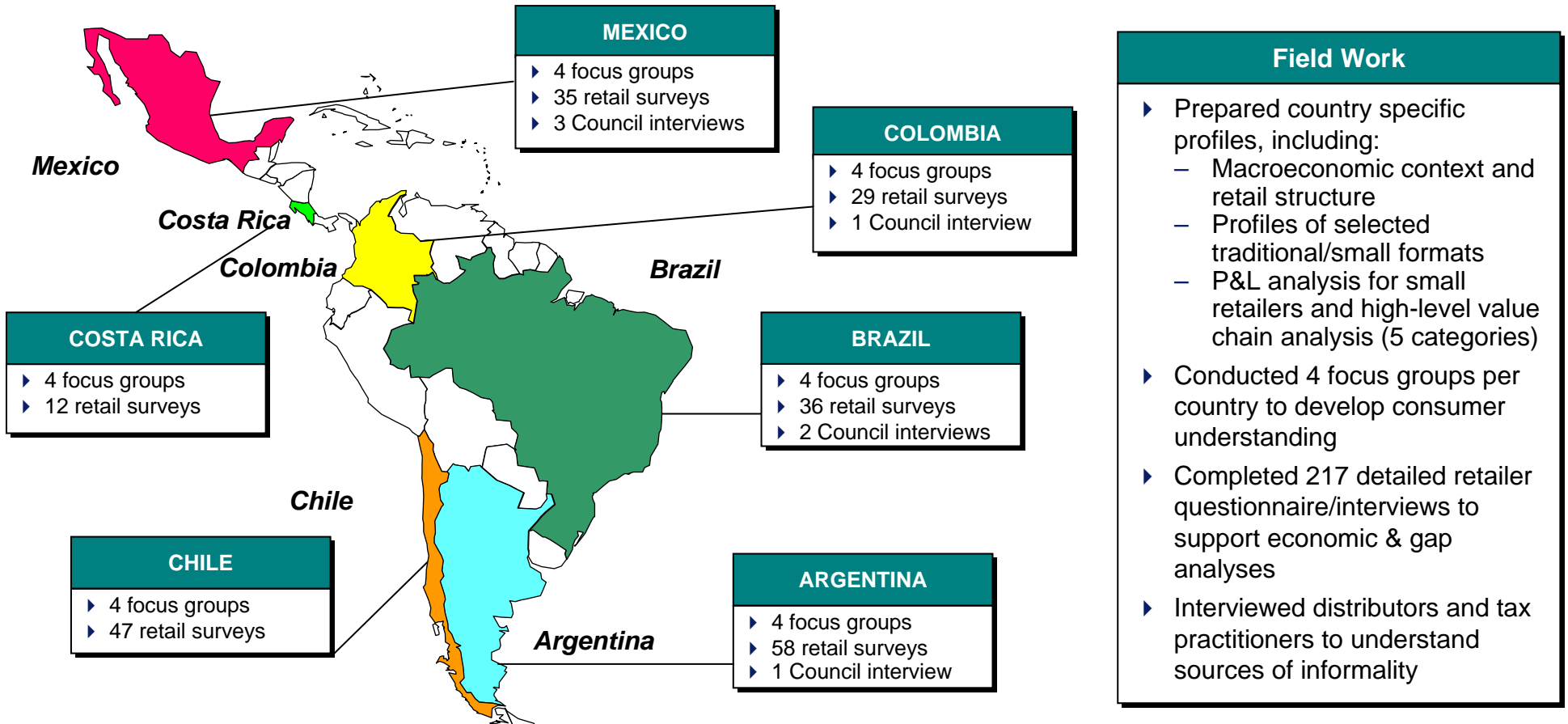
Overview of Project Scope

Mexico

Costa Rica

Colombia

Chile

Argentina

Brazil

▸ Six Latin American countries: Argentina, Brazil, Chile, Colombia, Costa Rica, and Mexico

▸ "Emerging" consumers:

– Primary focus on consumers who make up the low to middle socioeconomic strata (SES) in each country

– Less emphasis on the marginal and affluent socioeconomic segments

▸ Goods that represent the bulk of these consumers' expenditures: off-premise food & beverage, household products, and personal care

▸ Small / traditional retail formats that are the most relevant competition for the modern trade (small self service, traditional, street and open air vendors)

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We conducted a structured market research effort covering those dimensions

Overview of Market Research Activities

MEXICO
- 4 focus groups
- 35 retail surveys
- 3 Council interviews

COLOMBIA
- 4 focus groups
- 29 retail surveys
- 1 Council interview

COSTA RICA
- 4 focus groups
- 12 retail surveys

BRAZIL
- 4 focus groups
- 36 retail surveys
- 2 Council interviews

CHILE
- 4 focus groups
- 47 retail surveys

ARGENTINA
- 4 focus groups
- 58 retail surveys
- 1 Council interview

Mexico

Costa Rica

Colombia

Brazil

Chile

Argentina

Field Work

- Prepared country specific profiles, including:
  - Macroeconomic context and retail structure
  - Profiles of selected traditional/small formats
  - P&L analysis for small retailers and high-level value chain analysis (5 categories)
- Conducted 4 focus groups per country to develop consumer understanding
- Completed 217 detailed retailer questionnaire/interviews to support economic & gap analyses
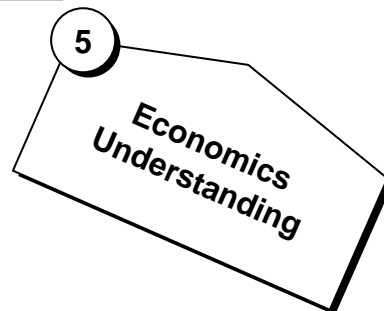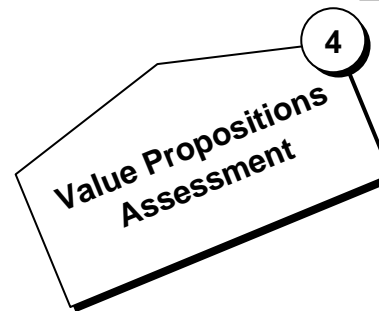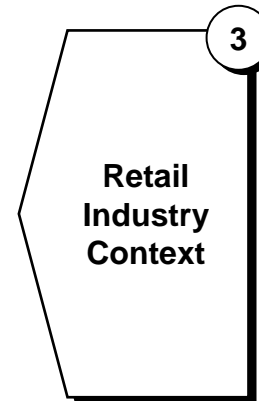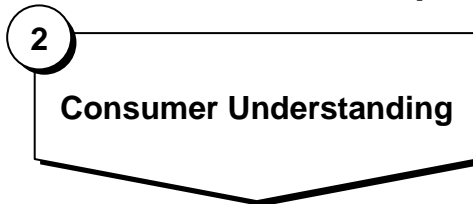- Interviewed distributors and tax practitioners to understand sources of informality

This document is organized around five dimensions to address challenges and opportunities for Retail Chains

Document Roadmap

- Product/ Brand needs
- Buying process
- Format/ outlet needs

2 Consumer Understanding

- Dualistic social structures
- Macroeconomic performance and outlook

1 Macro-Economic Context

Challenges & Opportunities for Retail Chains 6

3 Retail Industry Context

- Key trends
- Structure
- Emerging formats

5 Economics Understanding

- Economic & key performance levels
- Supply chain
- Informality

4 Value Proposition Assessment

- Place
- Price / Value
- Assortment
- People
- Services / Other

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Document Roadmap

2

Consumer Understanding

1

▶ Dualistic social structures

▶ Macroeconomic performance and outlook

Macro-Economic Context

Challenges & Opportunities for Retail Chains

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Retail Industry Context

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Economics Understanding

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Value Propositions Assessment

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Latin America designates a region inhabited by people with similar cultural heritage and traits – but present striking socio-economic differences
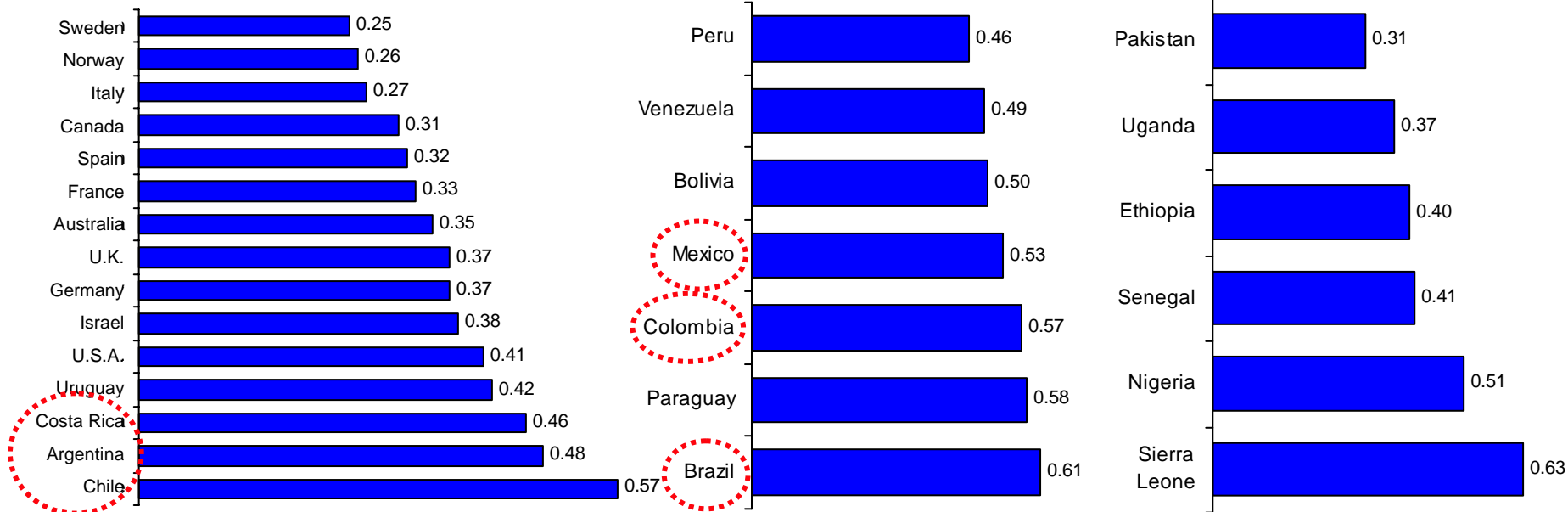
Complete Equality ← ······················· GINI Coefficient ······················· → **Maximum Inequality**

0   1

All individuals have exactly the same income

100% of income concentrated in 1 individual

"High Human Development"

Country	GINI
Sweden	0.25
Norway	0.26
Italy	0.27
Canada	0.31
Spain	0.32
France	0.33
Australia	0.35
U.K.	0.37
Germany	0.37
Israel	0.38
U.S.A.	0.41
Uruguay	0.42
Costa Rica	0.46
Argentina	0.48
Chile	0.57

"Medium Human Development"

Country	GINI
Peru	0.46
Venezuela	0.49
Bolivia	0.50
Mexico	0.53
Colombia	0.57
Paraguay	0.58
Brazil	0.61

"Low Human Development"

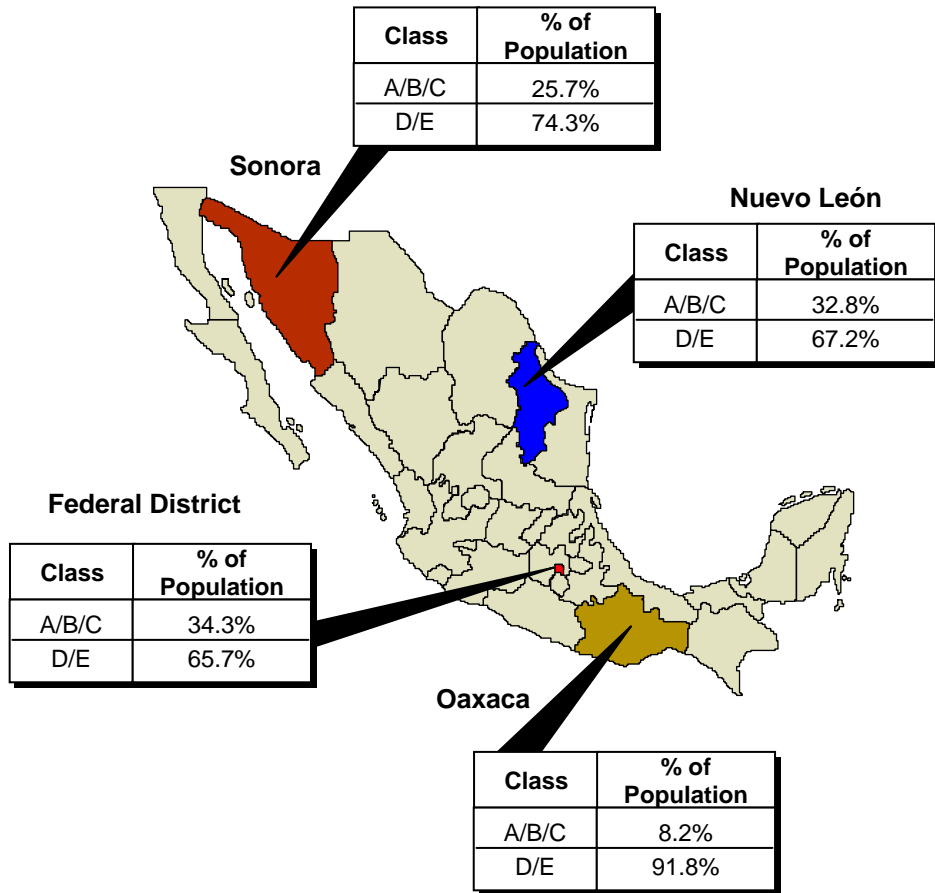| Country	GINI
Pakistan	0.31
Uganda	0.37
Ethiopia	0.40
Senegal	0.41
Nigeria	0.51
Sierra Leone	0.63

Source: BID 2002 Report on Human Development

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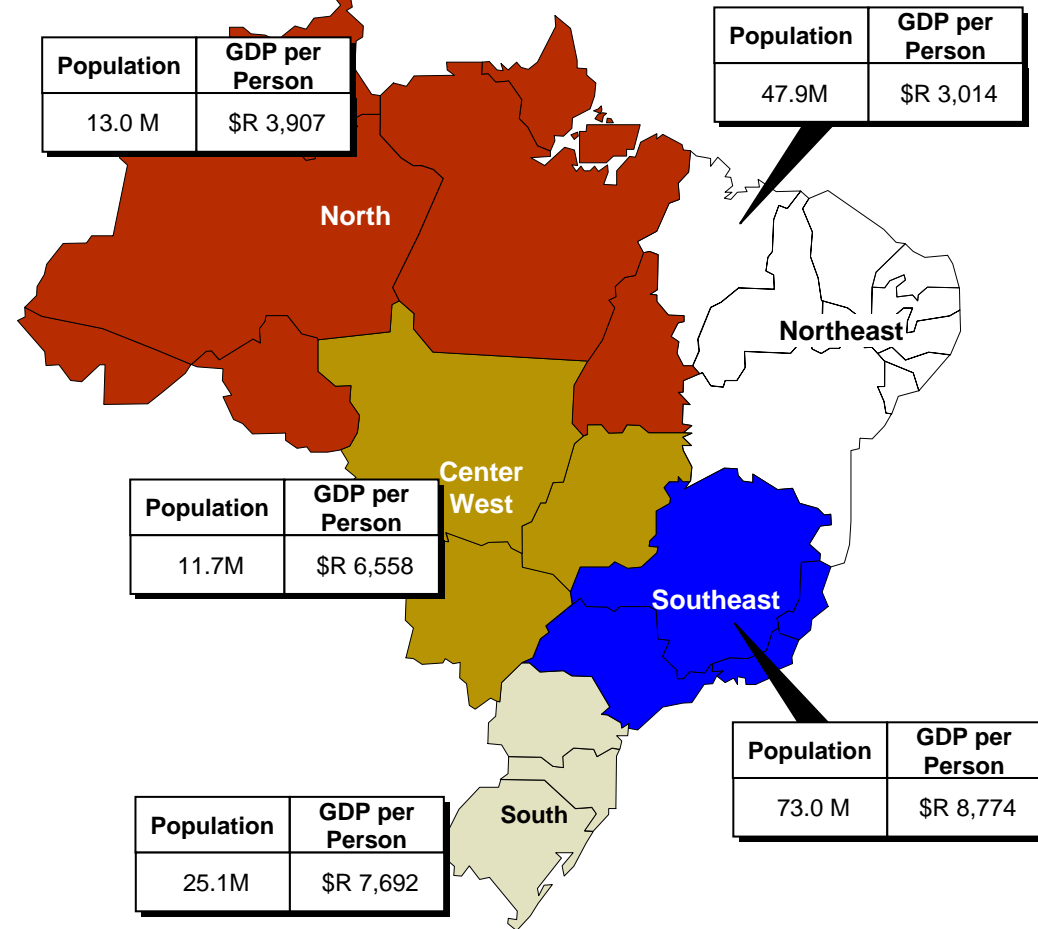# These differences can be very significant even within countries of the region ...

Mexico
(Population = ~104M, Avg. GDP per Capita = US$6,164)

Sonora

Class	% of Population
A/B/C	25.7%
D/E	74.3%

Nuevo León

Class	% of Population
A/B/C	32.8%
D/E	67.2%

Federal District

Class	% of Population
A/B/C	34.3%
D/E	65.7%

Oaxaca

Class	% of Population
A/B/C	8.2%
D/E	91.8%

Brazil
(Population = ~170M, Avg. GDP per Capita = $R 6,473)

North

Population	GDP per Person
13.0 M	$R 3,907

Northeast

Population	GDP per Person
47.9M	$R 3,014

Center West

Population	GDP per Person
11.7M	$R 6,558

Southeast

Population	GDP per Person
73.0 M	$R 8,774

South

Population	GDP per Person
25.1M	$R 7,692

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After a decade of reform and moderate growth, Latin America is still showing highly dualistic social structures …

Socio Economic Segments In Latin America
(% of Total Population vs. % of Total Purchasing Power [2])
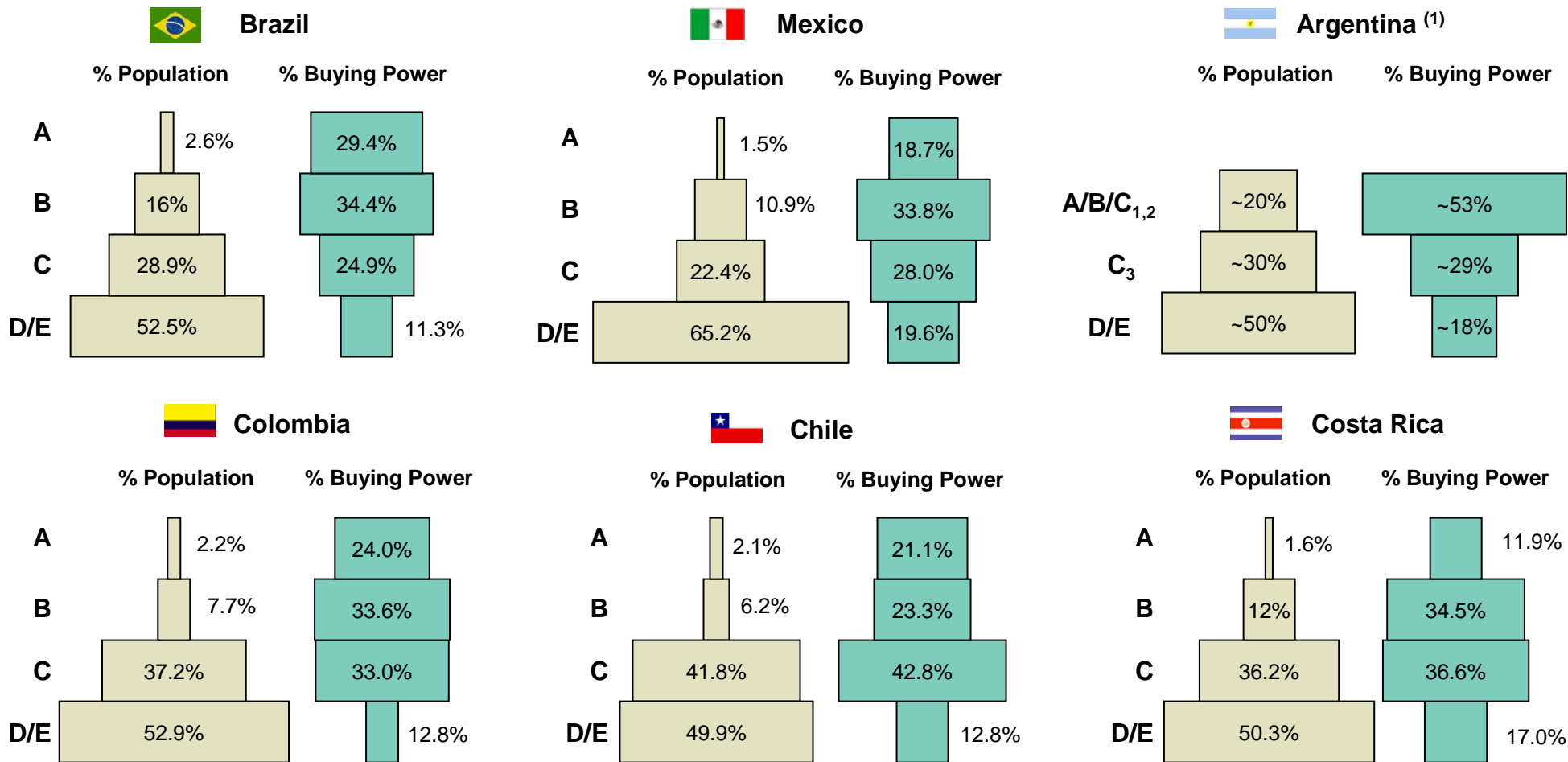
Brazil

	% Population	% Buying Power
A	2.6%	29.4%
B	16%	34.4%
C	28.9%	24.9%
D/E	52.5%	11.3%

Mexico

	% Population	% Buying Power
A	1.5%	18.7%
B	10.9%	33.8%
C	22.4%	28.0%
D/E	65.2%	19.6%

Argentina [1]

	% Population	% Buying Power
A/B/C$_{1,2}$	~20%	~53%
C$_3$	~30%	~29%
D/E	~50%	~18%

Colombia

	% Population	% Buying Power
A	2.2%	24.0%
B	7.7%	33.6%
C	37.2%	33.0%
D/E	52.9%	12.8%

Chile

	% Population	% Buying Power
A	2.1%	21.1%
B	6.2%	23.3%
C	41.8%	42.8%
D/E	49.9%	12.8%

Costa Rica

	% Population	% Buying Power
A	1.6%	11.9%
B	12%	34.5%
C	36.2%	36.6%
D/E	50.3%	17.0%

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Recently, macroeconomic conditions have worsened, making emerging consumers even more important to retailers

Latin America Real GDP @ PPP [1]

US$2.9T

1%	C. Rica
7%	Chile
9%	Colombia
12%	Argentina
28% Mexico	
42% Brazil	

GDP (2001)
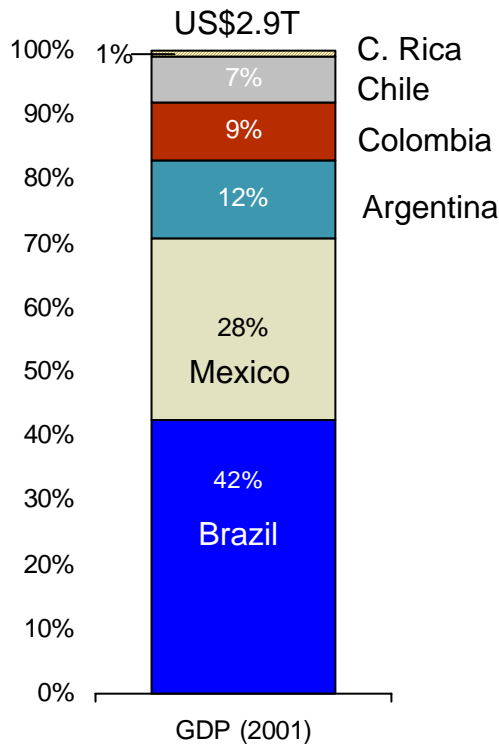
Macroeconomic Outlook

Brazil
- GDP up 2.4% versus year ago
- Consumer price inflation was ~14% in 2002 but expected to stabilize in low single digits for '03

Mexico
- GDP grew 0.9% in 2002, below 1.7% target
- Oil prices expected to help drive 2.9% GDP growth for 2003

Argentina
- 10.2 % decline in GDP vs. 2002
- Consumer prices up nearly 40%
- Showing some signs of recovery; industrial production surged 11.4%

Colombia
- GDP up 1.9% versus year ago
- Consumer prices rose by 7.4%
- Flat to mild growth expected

Chile
- GDP up 1.8% versus year ago
- Consumer prices rising mildly at 3%
- 3% GDP growth expected for 1H'03, driven by consumer spending and exports

Rule of thumb: a developing economy has to increase per capita output by at least 3% per year in order to make progress in reducing poverty [2]

Low / Lower Middle Class [3] (% of Population)
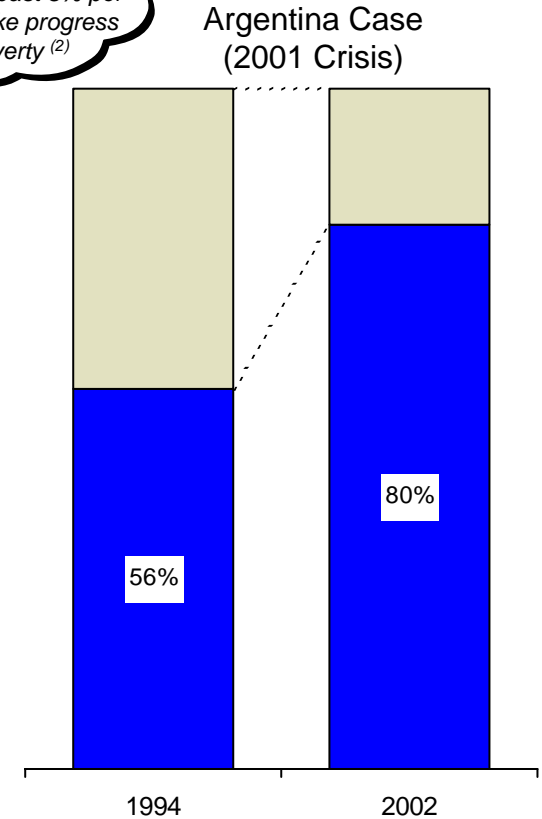
Argentina Case (2001 Crisis)

- 1994: 56%
- 2002: 80%

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Growth and rising per capita incomes helped fuel the penetration of chain/large supermarkets, which supply a large portion of the FMCG market

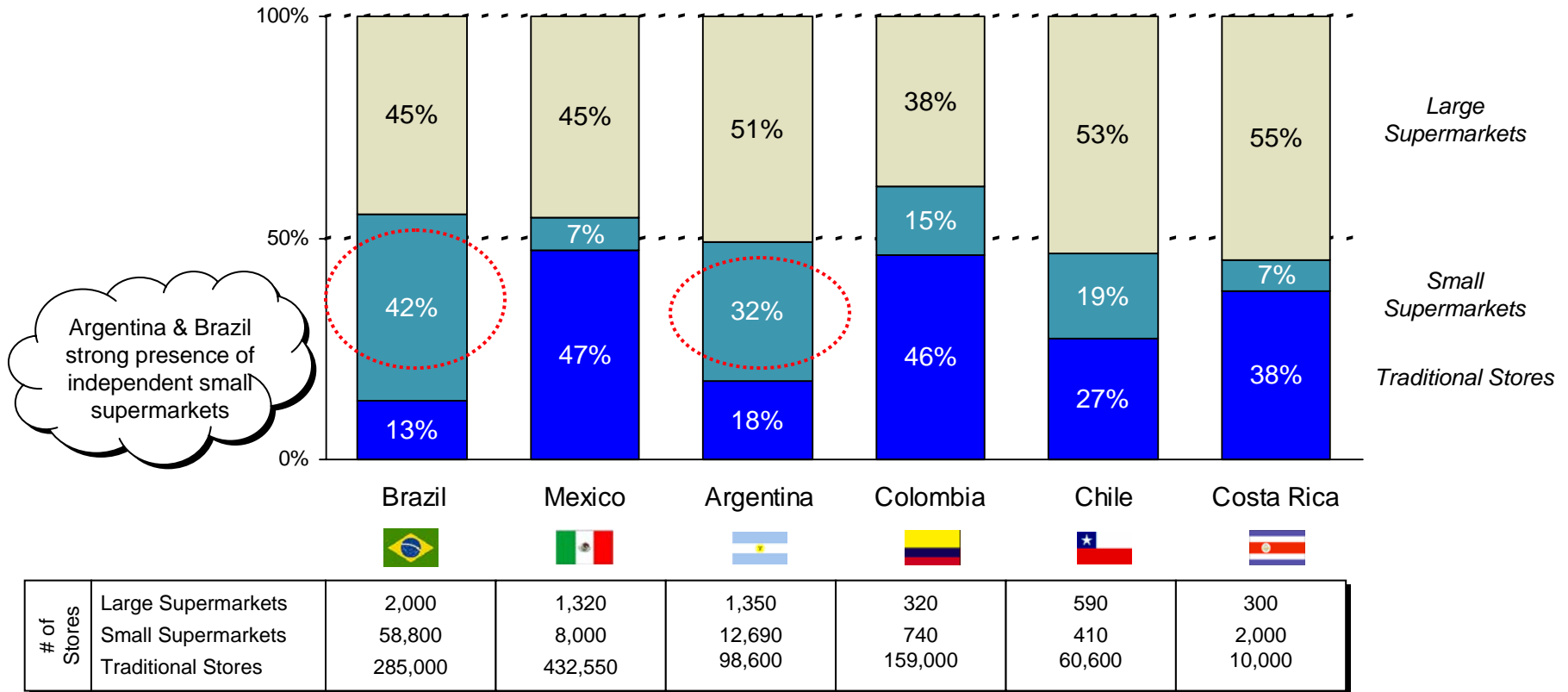**Large Supermarket penetration vs. GDP per Capita 2001**

Countries with similar income/capita show wide differences in large supermarket penetration - differences partly explained by % of urban population

The most "Latin" countries in Europe show significant penetration of traditionals

$R^2 = 0.5879$

Y-axis: Large Supermarket penetration in Consumer Goods Market
X-axis: GDP/Capita in USD (2001)

Data points: United States, Belgium, United Kingdom, Sweden, Germany, Denmark, Switzerland, Finland, Norway, Portugal, Austria, Chile, Spain, Costa Rica, Argentina, Greece, Italy, Brazil, Colombia, Mexico

Drivers / Factors

▸ Rising per capital incomes and more working women

▸ Urban population growth

▸ Consumer preference for self-service (tempered by cultural differences)

▸ Increased penetration of cars, and refrigerators

▸ Inflation (incentives to convert cash immediately into goods)

▸ Aggressive retail investments — MNC, local chains

▸ Conversion of traditional stores into self-service as small retailers' capabilities improve

▸ Regulation playing an offsetting role in some countries—e.g., limitations on store openings or size

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Yet small and traditional formats are holding their ground in Latin America, comprising 40%-50% of retail food sales in each country

Retail Consumer Packaged Goods Industry Structure by Country

Large Supermarkets	Brazil	Mexico	Argentina	Colombia	Chile	Costa Rica
Large Supermarkets	45%	45%	51%	38%	53%	55%
Small Supermarkets	42%	7%	32%	15%	19%	7%
Traditional Stores	13%	47%	18%	46%	27%	38%

Argentina & Brazil strong presence of independent small supermarkets

# of Stores	Brazil	Mexico	Argentina	Colombia	Chile	Costa Rica
Large Supermarkets	2,000	1,320	1,350	320	590	300
Small Supermarkets	58,800	8,000	12,690	740	410	2,000
Traditional Stores	285,000	432,550	98,600	159,000	60,600	10,000

Note: Large Chain Supermarkets defined as follows: Brazil - 10 checkouts or more; Argentina - 5 checkouts or more; Colombia – store size of 1000 m² or more; Chile – any chain supermarket. Figures exclude on-premise sales (e.g., bars, restaurants) and selected categories.

Source: AC Nielsen 2002, Booz Allen Analysis

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The market presence that small retailers are able to maintain is often attributed to market dysfunction

▸ Large scale retail chains may be surprised by the position that small retailers seem to enjoy, e.g.

- Significant presence with emerging consumers

- Success at serving customers from upper levels

- Increased attention from suppliers who are developing small retail channel strategies

▸ It is tempting to succumb to conventional wisdom and attribute the continued success of small retailers to market inefficiencies

- On the demand side: "poor, unsophisticated consumers who shop in dirty, unpleasant stores – sometimes trapped by credit relationships or the lack of a car"

- On the supply side: "a fundamentally inferior value proposition and unproductive business model that is artificially propped up by informality"

This study will reveal findings about emerging consumer needs, small retailers, and how these retailers sustain their business

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- ▸ Product/ Brand needs
- ▸ Buying process
- ▸ Format/ outlet needs

1 **Macro-Economic Context**

Challenges & Opportunities for Retail Chains **6**

3 **Retail Industry Context**

5 **Economics Understanding**

4 **Value Propositions Assessment**

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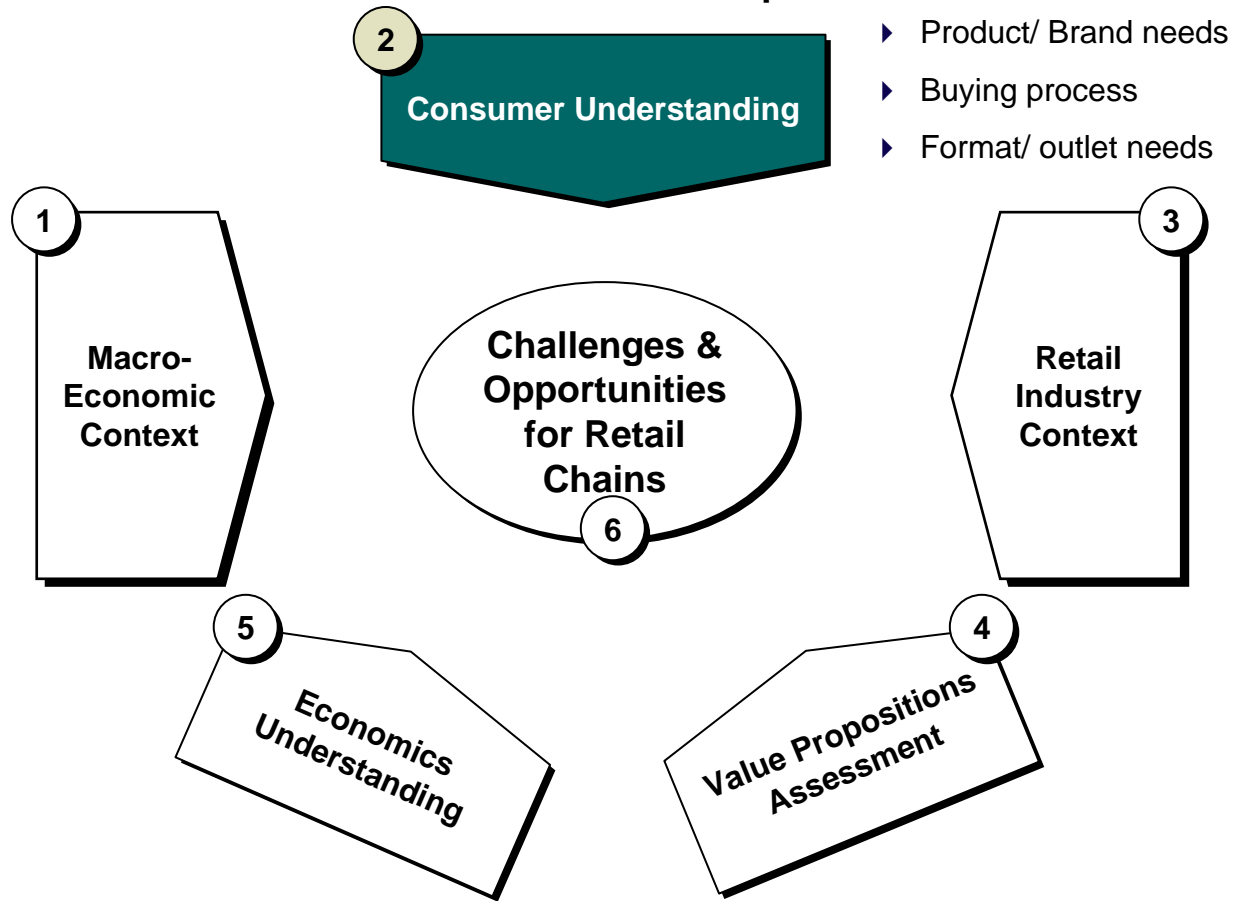
Quote

"You can cater to rich people and I'll take the rest. The good Lord made more of them."

Charles Kemmons Wilson

(Founder, Holiday Inn Hotels)

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Summary findings – the 'myths' about emerging consumers:

"Myths" About Emerging Consumers

▸ Poor consumers have little money to spend

▸ At the "Bottom of the Pyramid," needs are simple and the lowest cost prevails (value brands, discount formats) …

▸ …making low shelf prices overwhelming attractive to emerging consumers

▸ Emerging consumers are often looked at as junior versions of their higher income compatriots, who should naturally prefer large supermarkets (The "Modern" or "Organized" Trade) …

▸ … but although they cannot act on their natural preferences (e.g., need for credit, lack of car), "it's just a matter of money & time" until emerging consumers flock to large supermarkets

▸ Finally, Latin America's lower income consumers are often collectively referred to as the "popular class" implying that they can be addressed as a single group

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The "truth" about emerging consumers:

▸ Although their incomes are lower, emerging segments spend a disproportionately bigger share of income on consumer products—the net effect is that emerging class household purchases amount to substantial sums over time

▸ Emerging consumers are certainly price sensitive – as observed by behavior during shopping process – however, they are more focused on minimizing "total purchase cost" [1]

▸ As a result, proximity and price are the first order determinants of store choice

▸ These consumers do have other needs (e.g., product assortment and personal relationships) – and criteria varies for "stocking" trips and "daily needs" purchases

▸ These segments see some advantages to large supermarkets but there are also many disadvantages that translate into very real barriers to shopping at large self-service stores

▸ Recent changes in behavior due to economic crisis may exacerbate these attitudes

▸ Logically, these consumers do not all behave alike, and there may be meaningful differences based on amount/stability of income and attitudes about brand loyalty, store loyalty, and innovation

Note: (1) see Glossary of Terms at the end of this chapter

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Our focus is understanding *what* and *where* emerging consumers buy—and *why* they make these choices

Framework for Consumer Understanding

(1) Emerging Consumer Characteristics
- Demographics
- Socioeconomic variables

(2) Product / Brand Needs

(3) The Buying Process

(4) Format / Outlet Needs

- What do emerging consumers buy?
  - Food and beverage
  - Household and personal care

- How does the purchasing process take place?
- How do consumers decide?

- Where do emerging consumers shop and why?
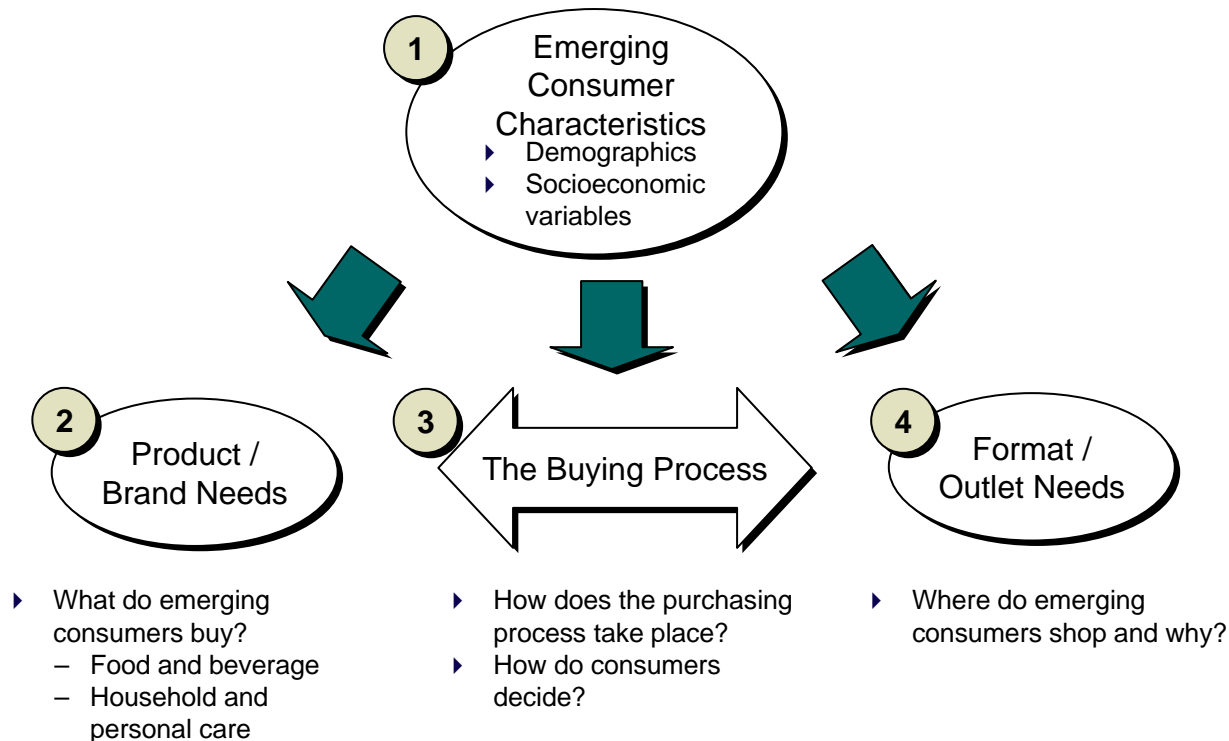
Methodology & Sources

- Qualitative study, using focus groups as methodology
  - Contracted local agencies to ensure cultural alignment
  - Executed four groups per country
  - Targeted women belonging to low/middle and low SES
- Syndicated data sources/ studies
  - Consumer characteristics (Economist, local institutes)
  - Shopping habits (Nielsen, CCR Latin Panel, others)
- Other sources
  - On-site consumer interviews
  - Literature and article search
  - Local retail associations (e.g., ANTAD in Mexico)

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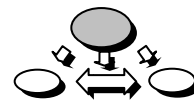
Definition: the "Emerging Consumer" belongs to the lower to lower-middle income SES

Socio Economic Segments & Target Sample
(% of Total Population)

	Brazil	Mexico	Argentina	Colombia	Chile	Costa Rica
Upper Class Upper Middle Class	A, B 18.6%	A/B, C+ 14%	AB, C1 11%	AB or 6,5 5%	A, B, C_1 8.9%	A, B 15.3%
Middle Class Lower Middle Class	C 28.9%	C+,C_m, C- or C+, C 26%	C_2 ~9% C_3 ~30%	4 or C_1 8.0% 3 or C_2 33.0%	C_2 19.4% C_3 24.8%	C+/C ~34% C- ~15.7%
Lower Class	D 42.5%	D+,D_m,D- or D+, D 50%	D_1, D_2 46%	2 or C_3 35% 1 or D 14%	D 34.5%	D 32%
Indigent	E 10%	E 10%	E 4%	1 5%	E 12.4%	E 3%
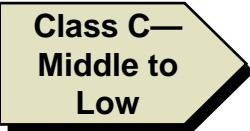
Focus Group Target Sample

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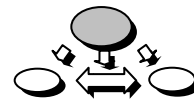
Occupation is a key differentiator of emerging segments, driving income and asset ownership

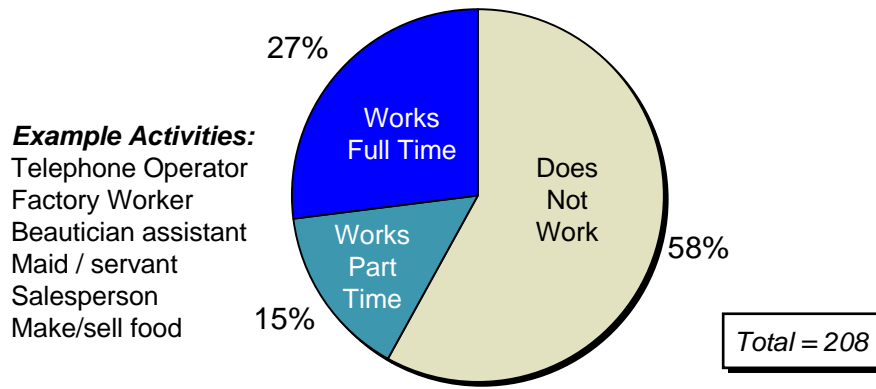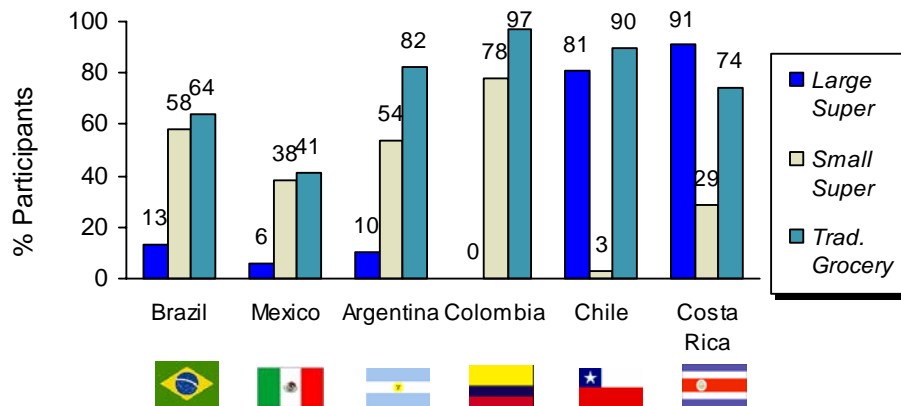|	Typical Occupation for Main Income Earner (MIE)	Avg. Family Size [2]	Typical Asset Ownership
Class C— Middle to Low	▸ Technician ▸ Qualified Operator ▸ Taxi driver ▸ Salesperson ▸ State employees ▸ Transportation workers	4.1	▸ Telephone ▸ Refrigerator ▸ Stove, radio, TV ▸ Low levels of ownership: vehicle, microwave
Class D	▸ Operator, factory worker ▸ Construction workers ▸ "Peón" / "Changarín" ▸ Street seller, vendors ▸ Janitor ▸ Security guard	4.2	▸ Refrigerator ▸ Stove, radio, TV ▸ Moderate levels of ownership for washing machine, telephone (except Brazil & Colombia)
Class E	▸ Domestic Service ▸ Day Laborer ▸ Delivery person	4.1	▸ Low levels of ownership: TV, stove, radio

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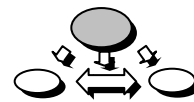
Emerging consumer segments surveyed present lower income levels but are not "destitute"

Focus Group Participants–Occupational Status

27%
Works Full Time

Does Not Work
58%

Works Part Time
15%

Example Activities:
Telephone Operator
Factory Worker
Beautician assistant
Maid / servant
Salesperson
Make/sell food

Total = 208

Percent Participants Who "Always" Buy at:
Large Super/Hyper, Small Super, Traditional Grocery

% Participants

|	Brazil	Mexico	Argentina	Colombia	Chile	Costa Rica
Large Super	13	6	10	0	81	91
Small Super	58	38	54	78	3	29
Trad. Grocery	64	41	82	97	90	74

Large Super
Small Super
Trad. Grocery

- ▶ Groups conducted in São Paulo, Recife, Mexico City, Monterrey, Buenos Aires, Santiago, Bogotá, and San José for women in "C" and "D" segments

- ▶ Almost all (91%) have completed primary school education and all are functionally literate

- ▶ Nearly all households own a stove, T.V., radio, and refrigerator (less penetration in Colombia)—in Mexico and Costa Rica there is relatively high penetration of VCRs, washing machines, and access to cars

- ▶ A majority of households have "stay-at-home" housewives / mothers
  - 83% married, 12% divorced/widowed, 5% single
  - 58% do not work at all (see left), typically depending on spouse as family provider
  - 97% of participants have children (average of 2.8 children each)

- ▶ These women are responsible for making the bulk of household purchases (food, beverage, etc.)

- ▶ Participants shop at several different formats, but state they "always" buy more at small retailers (exception: CR)
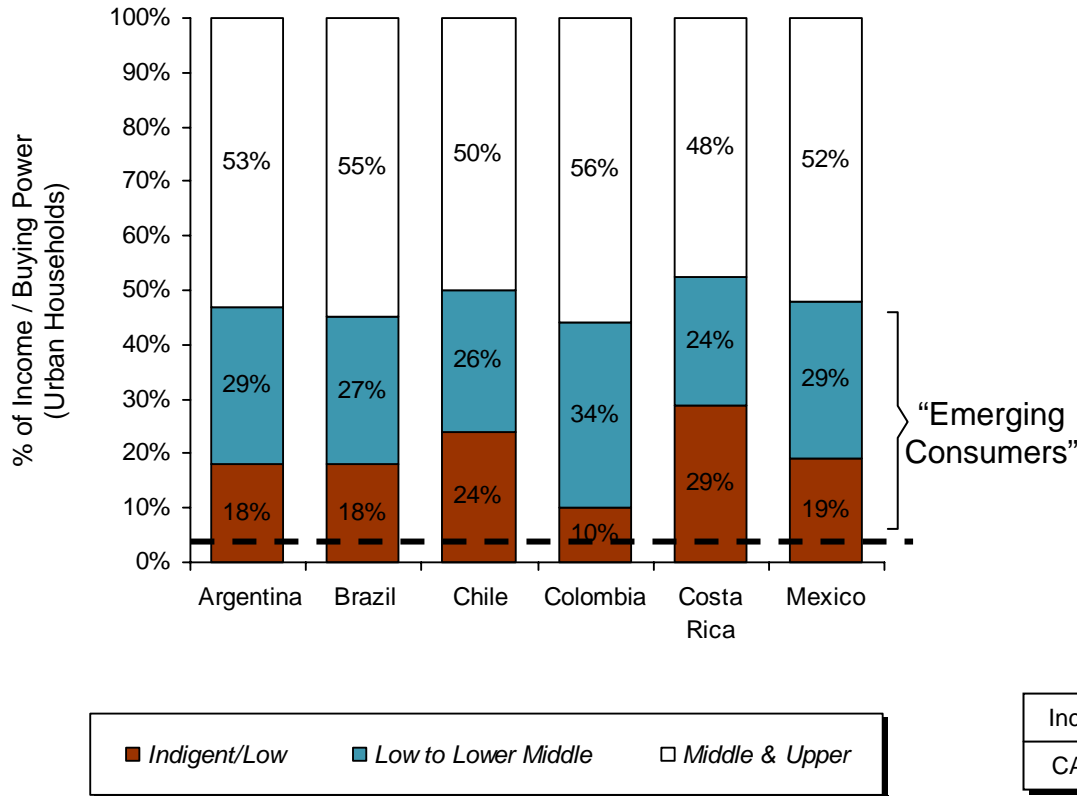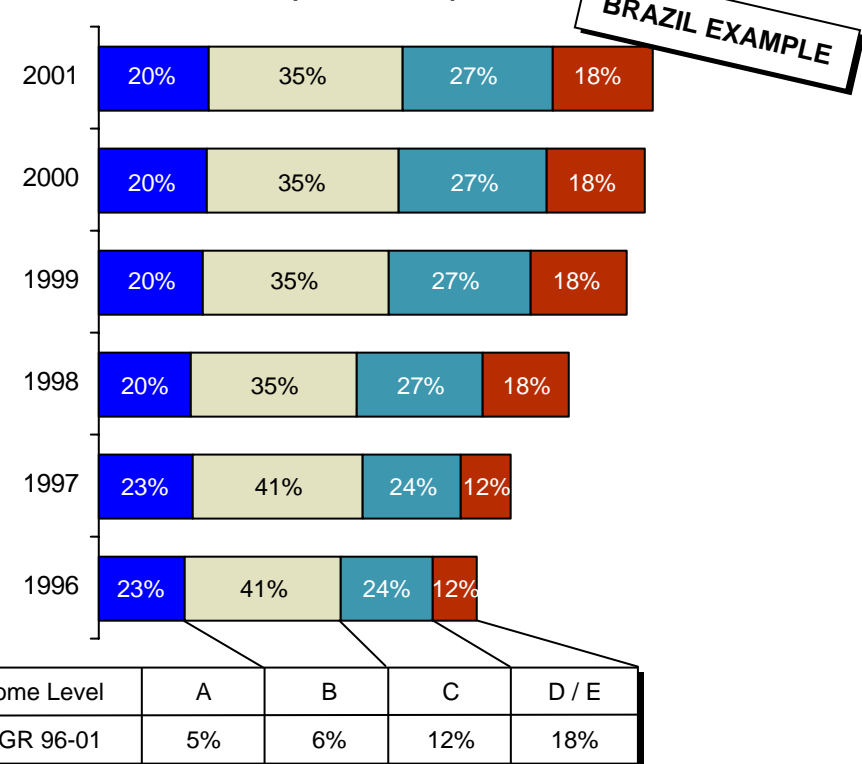
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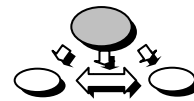
Collectively, emerging consumers have significant buying power

Emerging Consumer Segments Have Buying Power and are Growing

Share of Income/Buying Power by Socio-Economic Status

% of Income / Buying Power (Urban Households)

|	Indigent/Low	Low to Lower Middle	Middle & Upper
Argentina	18%	29%	53%
Brazil	18%	27%	55%
Chile	24%	26%	50%
Colombia	10%	34%	56%
Costa Rica	29%	24%	48%
Mexico	19%	29%	52%

"Emerging Consumers"

Notes: All data from 2000 except Argentina (2003) and Brazil (2001)
Analysis based on urban incomes/consumption
Source: CCR/Latin Panel, Unimer, ICOOM Ltda.,Strategy Research Corporation

Urban Consumption by Income Level (1996-2001)

BRAZIL EXAMPLE

Year	A	B	C	D/E
2001	20%	35%	27%	18%
2000	20%	35%	27%	18%
1999	20%	35%	27%	18%
1998	20%	35%	27%	18%
1997	23%	41%	24%	12%
1996	23%	41%	24%	12%

Income Level	A	B	C	D / E
CAGR 96-01	5%	6%	12%	18%

Note: Real Growth -- constant values of 2001
Source: Target 2000, Booz Allen analysis
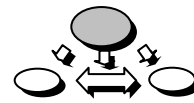
Individually, these consumers buy less …

Weekly Consumer Products Purchases by SES
(1993-2000; Across all Formats)

D Class Spends 50-60%
of what Upper Classes Spend

Mexican Pesos
(Constant Values of 2000)

1000
900
800
700
600
500
400
300
200
100
0

1993   1995   1996   1998   2000

Year

— A & B Classes   - - C Class   · · · D Class

Average Ticket by SES
(2Q'01-4Q'02;Supermarkets Only)

Colombian Pesos
(Nominal Values)

35000
30000
25000
20000
15000
10000
5000
0

2Q'01   3Q'01   4Q'01   1Q'02   2Q'02   3Q'02   4Q'02

Quarter

Lower Class Spends 40-50%
of what Upper Class Spends

— Upper Class   — Upper Middle Class
- - Middle Class   · · · Low/Indigent Class

Note: Study Publication Schedule Changed in 1996
Source: ANTAD Supermarket Trends Study, 2000
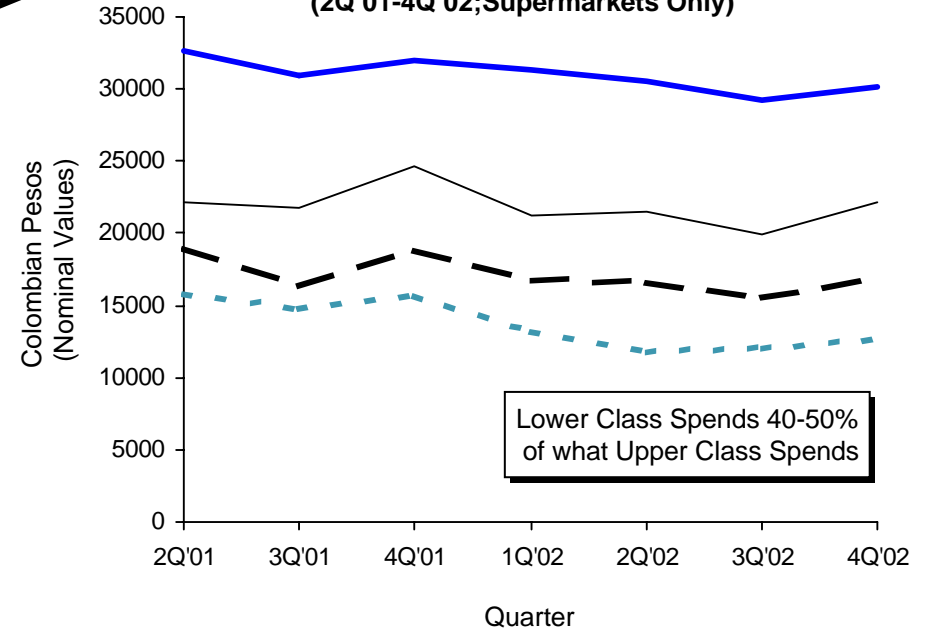
Source: AC Nielsen

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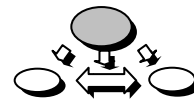
... but spend a greater portion of income on food and consumer products

▸ Consumer products are the #1 consumption category across all countries

▸ Housing / rent and transportation / communication typically absorb a large part of the remainder

▸ Emerging consumers spend a disproportionately larger share on consumer products, with the lowest SES claiming to spend nearly all income on these purchases

The "Average" Consumer

Country	% Consumption on Consumer Products
Argentina	42% [1]
Brazil	37%
Chile	32%
Colombia	34%
Costa Rica	39%
Mexico	33%

Source: Strategy Research Corporation

Note: CCR Latin Panel study suggests that percentage in Argentina has risen to 47% in the wake of economic crisis

The "Emerging" Consumer

Country	% Consumption on Consumer Products
Argentina	60–70% (C_3 /C_2) to 70–80% (D_1/ D_2)
Brazil	50–70% (C) to "almost all" (D)
Chile	>50% (C_3) to "nearly all" (D)
Colombia	"More than half"
Costa Rica	50 – 75%
Mexico	50 – 60%

Source: Market research

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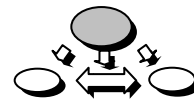
The net effect is that emerging class household purchases of consumer products amount to substantial sums

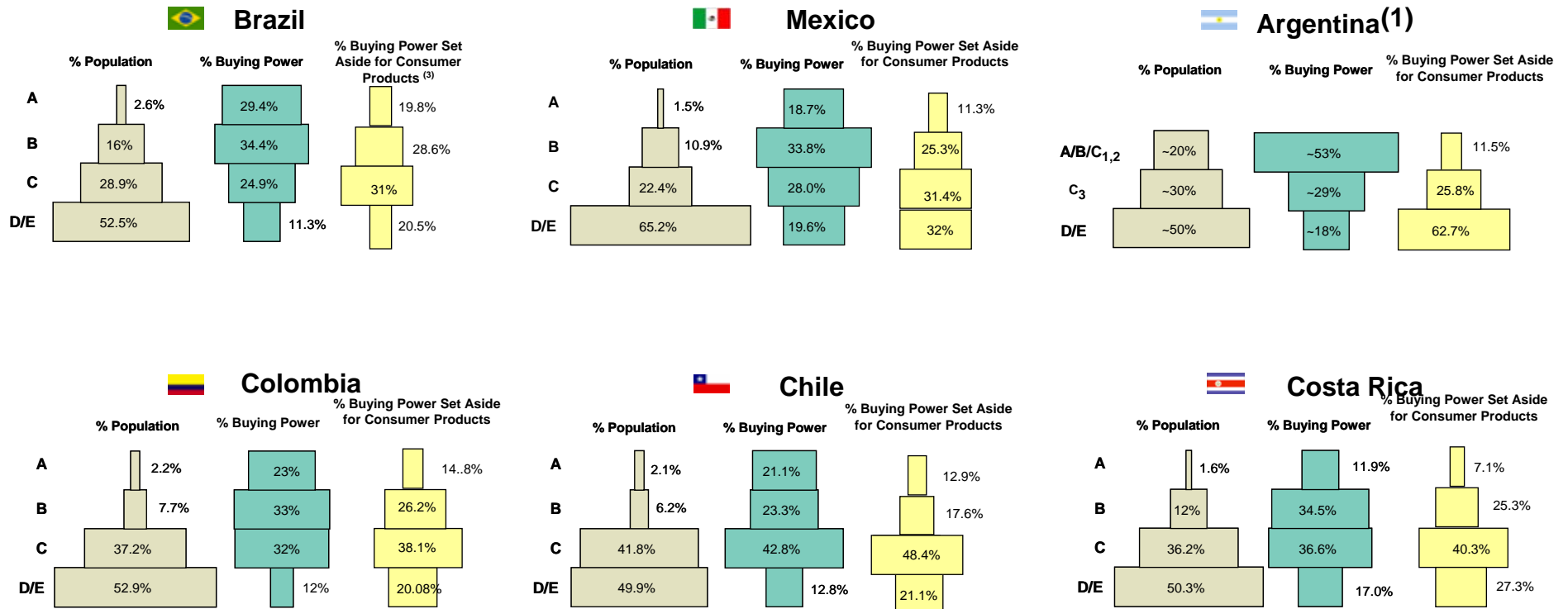## Socio Economic Segments In Latin America
(% of Total Population vs. % Buying Power for Consumer Products[3])

Brazil

	% Population	% Buying Power	% Buying Power Set Aside for Consumer Products [3]
A	2.6%	29.4%	19.8%
B	16%	34.4%	28.6%
C	28.9%	24.9%	31%
D/E	52.5%	11.3%	20.5%

Mexico

	% Population	% Buying Power	% Buying Power Set Aside for Consumer Products
A	1.5%	18.7%	11.3%
B	10.9%	33.8%	25.3%
C	22.4%	28.0%	31.4%
D/E	65.2%	19.6%	32%

Argentina[1]

	% Population	% Buying Power	% Buying Power Set Aside for Consumer Products
A/B/C$_{1,2}$	~20%	~53%	11.5%
C$_3$	~30%	~29%	25.8%
D/E	~50%	~18%	62.7%

Colombia

	% Population	% Buying Power	% Buying Power Set Aside for Consumer Products
A	2.2%	23%	14..8%
B	7.7%	33%	26.2%
C	37.2%	32%	38.1%
D/E	52.9%	12%	20.08%

Chile

	% Population	% Buying Power	% Buying Power Set Aside for Consumer Products
A	2.1%	21.1%	12.9%
B	6.2%	23.3%	17.6%
C	41.8%	42.8%	48.4%
D/E	49.9%	12.8%	21.1%

Costa Rica

	% Population	% Buying Power	% Buying Power Set Aside for Consumer Products
A	1.6%	11.9%	7.1%
B	12%	34.5%	25.3%
C	36.2%	36.6%	40.3%
D/E	50.3%	17.0%	27.3%

*Note: (1) % of household income; A/B/C$_1$ & C$_2$ percentages reported together for 11/2002*

(2) For 1999 in 1999 US$

(3) % Buying power set aside for Consumer Products: amount of buying power associated with Consumer Products

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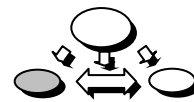
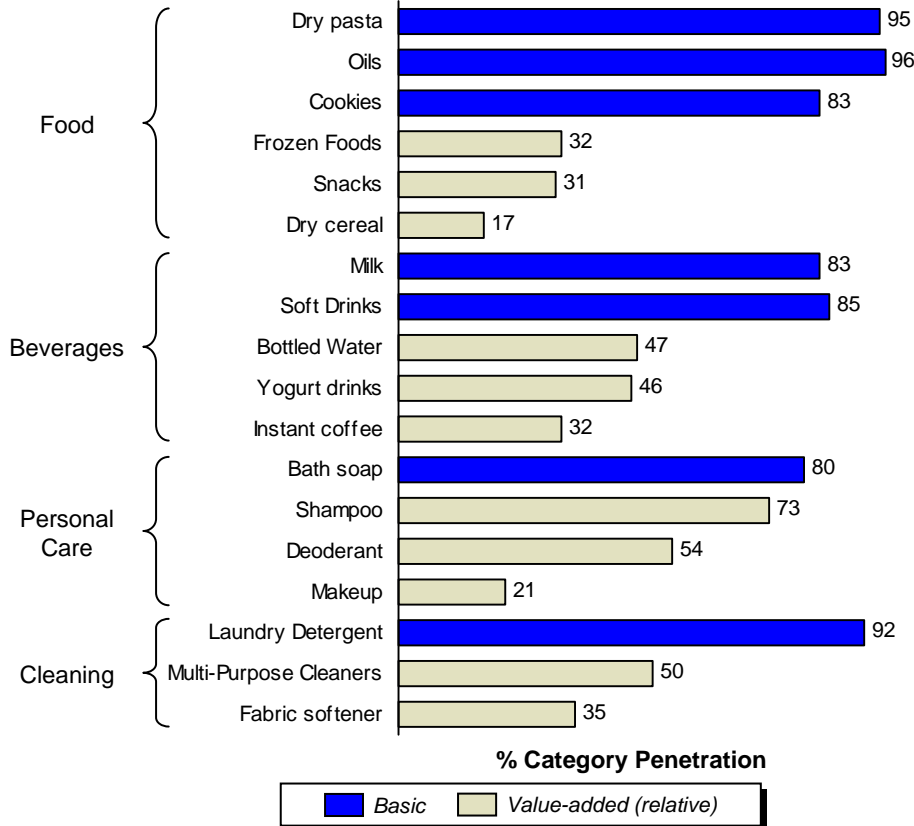# Emerging consumer spend is weighted towards more basic, "staple" products in Food, HPC and Household care

	"Staples"	**"Secondary"**	**"Luxuries"**
PACKAGED FOODS	Rice, beans, dry pasta, oil, salt sugar, tomato sauce, cookies & snacks for kids (value brands) Br: flours (wheat, manioc, corn), canned fish (Class C) Col: lentils	Sweet and salty snacks, some canned food Mex: cereal, snacks Arg: salty snacks, sweets, candy Ch: dressings, mayonnaise	Canned foods, chocolate candy, cookies (leading brands), cereal Arg: tuna, olives, "alfajores" Br: condensed milk, cake mix Ch: heat of palm Col: Salty snacks (adults)
PERISHABLE FOODS	Fruits and vegetables, eggs, bread, margarine/butter Arg: jelly, cold cuts	Cold cuts, meats Arg/Ch: Sausages Br: yogurt, cheese, chicken Mex: ground hamburger meat Ch/Col: margarine, chicken	Frozen foods, ice cream Br: frozen lasagna, fried potatoes, hamburger patties Br/Mex: ready-to-eat pizza Mex/Col: seafood
BEVERAGES	Coffee, Juice concentrate Col: chocolate bars Br: value brand sodas Mex: powdered drink mix Arg/Ch: tea	Value brand sodas (Arg, Col), Br: powdered drink mix Arg/Br: beer	Coca-Cola Arg/Col: wine Mex: tequila, rum CR: Gatorade sports drinks Ar/CR: Tang powdered drink
CLEANING PRODUCTS	Powdered laundry detergent, bleach, disinfectant Br/Col: bar laundry soap Mex: softener, steel wool Arg: floor cleaner	Softener Arg: multi-purpose cleaners, air freshener Col: liquid dish detergent	Leading brands in detergent and softener Br: furniture polish
PERSONAL CARE	Toilet paper, soap, toothpaste, sanitary napkins, deodorant, family shampoo, sanitary napkins Mex: diapers Arg/CR: conditioner, cotton	Leading brand shampoo (Arg, Br), conditioners	Leading brands, perfume Br: personal shampoo, facial lotion Ch: makeup Mex: body lotion

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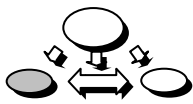
Even with secondary and 'luxury' purchases, lower margin categories have higher penetration in emerging consumer's households

ARGENTINA

Category Penetration in Low Income Households
### (3rd Trimester 2002)

Category	Group	Penetration
Food	Dry pasta	95
	Oils	96
	Cookies	83
	Frozen Foods	32
	Snacks	31
	Dry cereal	17
Beverages	Milk	83
	Soft Drinks	85
	Bottled Water	47
	Yogurt drinks	46
	Instant coffee	32
Personal Care	Bath soap	80
	Shampoo	73
	Deodorant	54
	Makeup	21
Cleaning	Laundry Detergent	92
	Multi-Purpose Cleaners	50
	Fabric softener	35

% Category Penetration

■ Basic   □ Value-added (relative)

COLOMBIA

Category Penetration in Low & Working Class Households
(2001)

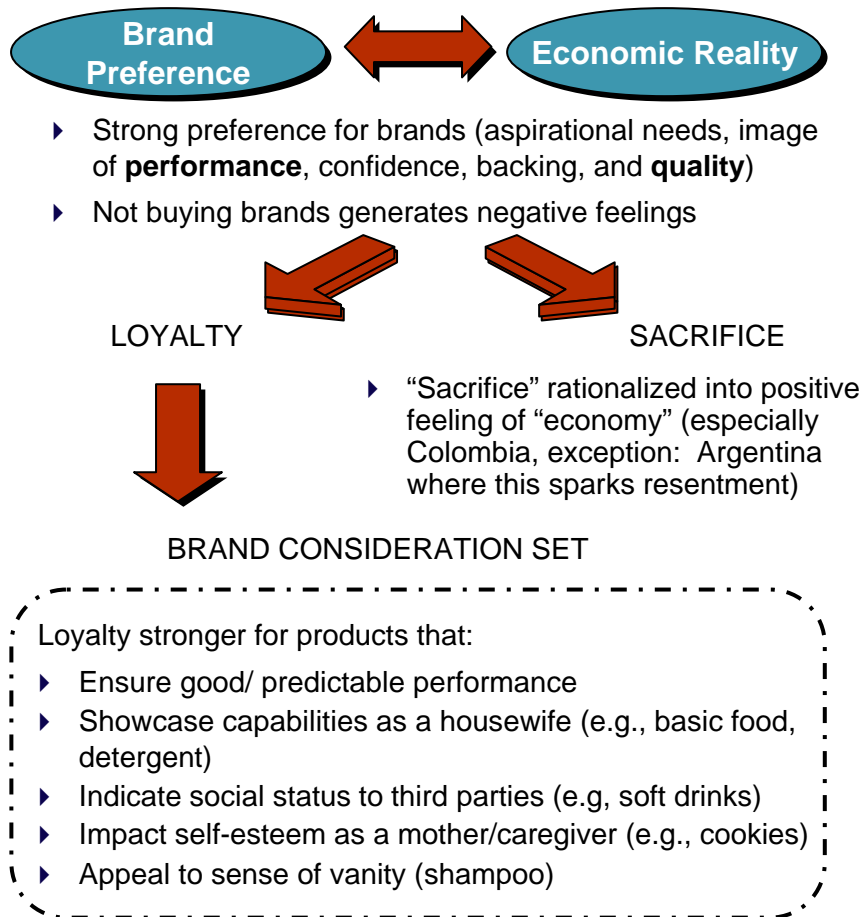| High (>70%)		Low (<50%)
▶ Rice	▶ Toothpaste	▶ Packaged soups / mixes
▶ Dry pasta	▶ Toilet paper	▶ Packaged bread
▶ Cooking oil	▶ Soap	▶ Spaghetti sauce
▶ Jell-O	▶ Shampoo	▶ Cream cheese
▶ Mayonnaise	▶ Deodorant	▶ Seasonings
▶ Ketchup	▶ Talcum powder	▶ Canned vegetables
▶ Canned tuna		
▶ Flours		
▶ Crackers	▶ Detergents	▶ Instant coffee
	▶ Sponges	▶ Milk modifiers
	▶ Bleach	
▶ Butter		▶ Facial tissues
▶ Cheese		
▶ Cold cuts		▶ Dish detergent
		▶ Air fresheners
▶ Milk		▶ Softener
▶ Soft drinks		▶ Insecticides
▶ Hot chocolate		▶ Wax paper
▶ Ground coffee		
▶ Milky drinks		

Source: CCR Latin Panel; TGI Columbia

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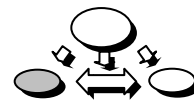
In this segment, consumers have a strong preference for intermediate and leading brands—especially in basic foods
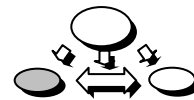
Emerging Consumer Brand Mindset

Brand Preference ↔ **Economic Reality**

▸ Strong preference for brands (aspirational needs, image of **performance**, confidence, backing, and **quality**)
▸ Not buying brands generates negative feelings

LOYALTY   SACRIFICE

▸ "Sacrifice" rationalized into positive feeling of "economy" (especially Colombia, exception: Argentina where this sparks resentment)

BRAND CONSIDERATION SET

Loyalty stronger for products that:
▸ Ensure good/ predictable performance
▸ Showcase capabilities as a housewife (e.g., basic food, detergent)
▸ Indicate social status to third parties (e.g, soft drinks)
▸ Impact self-esteem as a mother/caregiver (e.g., cookies)
▸ Appeal to sense of vanity (shampoo)

Brand and Product Needs

▸ Loyalty to leading and intermediate priced brands can be surprisingly strong on 'basic' items (e.g., rice, cooking oil)

▸ Loyalty is also high in 'aspirational' categories (e.g., colas) but economic reality overrides purchase intent more often

▸ Less loyalty is observed in personal care and cleaning products (exception: laundry detergent in most countries)

▸ In many categories, emerging consumers are more loyal to "brands" in general than to a single, preferred name (e.g., cookies, dry pasta, family shampoo) …

▸ …and purchase the lowest priced product in the consideration set (driven by promotions)

▸ Generally less willing to try value brands and private label, especially in food products that make up a significant portion of the diet
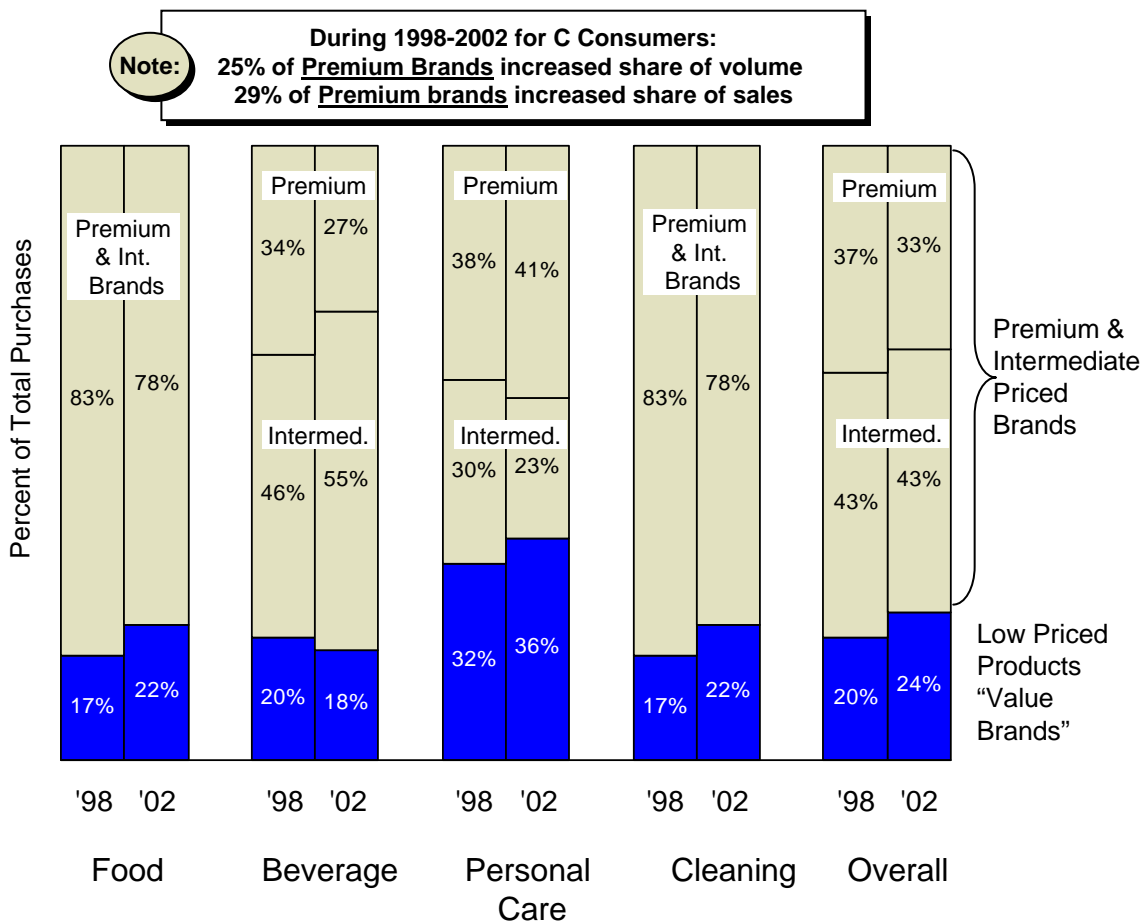
Source: Market research

back

Acceptance of "value" products is growing, particularly in Brazil and Argentina—nevertheless, emerging consumers are still drawn to brands

Emerging Consumer Purchases by Price Tier—Brazil

Note: During 1998-2002 for C Consumers:
25% of <u>Premium Brands</u> increased share of volume
29% of <u>Premium brands</u> increased share of sales

Percent of Total Purchases

	Food '98	Food '02	Beverage '98	Beverage '02	Personal Care '98	Personal Care '02	Cleaning '98	Cleaning '02	Overall '98	Overall '02
Premium	83%	78%	34%	27%	38%	41%	83%	78%	37%	33%
Intermed.			46%	55%	30%	23%			43%	43%
Value Brands	17%	22%	20%	18%	32%	36%	17%	22%	20%	24%

Premium & Int. Brands (Food, Cleaning)

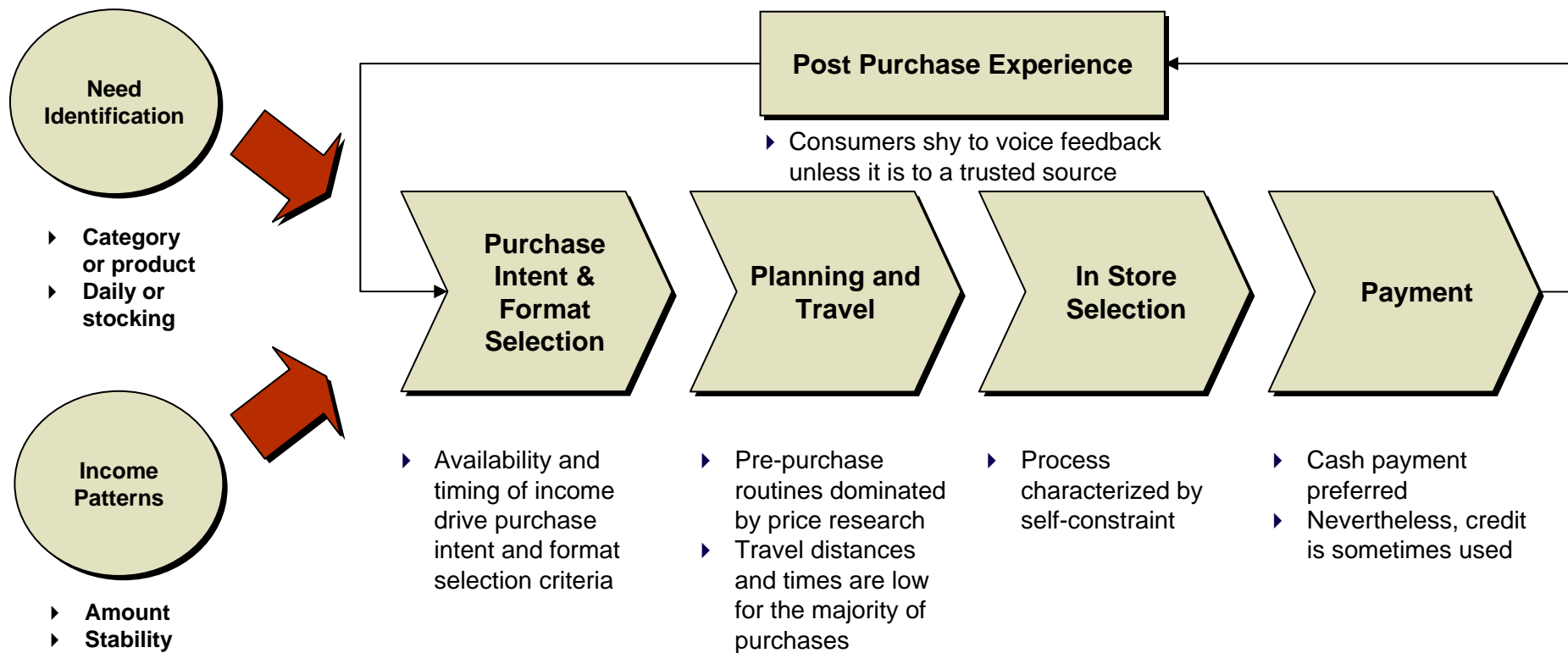Premium & Intermediate Priced Brands
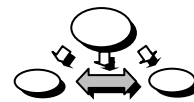
Low Priced Products "Value Brands"

Observations

▸ Emerging consumers hesitate to try value brands—low price points are attractive but can generate mistrust/skepticism about product quality—"lo barato sale caro"

▸ Consumers in Brazil and Argentina were more open to trying lower priced "value brands," especially in cleaning products

▸ Economic necessity clearly plays a role in increasing trial of value brands (Argentina) … as do "word of mouth" testimonials from friends and family about performance

▸ Panel study data indicates that acceptance of 'low priced products' is growing in at least one country (Brazil, class "C" consumers)

▸ Increased sales of low price food products is probably driven by 'secondary' items (e.g., yogurts, cookies)

▸ However, intermediate and leading brands still represent the largest share of purchases

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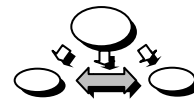
Emerging consumers are certainly price sensitive – as observed by behavior during the shopping process

Need Identification

- **Category or product**
- **Daily or stocking**

Income Patterns

- **Amount**
- **Stability**

Post Purchase Experience

▸ Consumers shy to voice feedback unless it is to a trusted source

Purchase Intent & Format Selection

▸ Availability and timing of income drive purchase intent and format selection criteria

Planning and Travel

▸ Pre-purchase routines dominated by price research
▸ Travel distances and times are low for the majority of purchases

In Store Selection

▸ Process characterized by self-constraint

Payment

▸ Cash payment preferred
▸ Nevertheless, credit is sometimes used

back

Purchase intent: For the emerging consumer, the size and frequency of income impacts the mix of "daily" and "large/stocking" purchases

Needs / Purchase Intent Framework:
Emerging Consumer Income Patterns and Shopping Occasions

	Low ← Average Ticket Size/Frequency → High	
Higher, Bi-weekly or Monthly Salary Payment	Daily Needs Emergency Purchases ▸ **Fresh categories** ▸ **Small sizes (emergency)**	Large / Stocking Purchases ▸ **Larger sizes** ▸ **Promoted items** ▸ **Special items (e.g., Sunday dinner)**
Lower, More Variable Salary Payment	Daily Needs ▸ **Fresh categories** ▸ **Small sizes (necessity)**	Not Applicable due to Economic Constraints

Income (vertical axis)

Average Ticket Size/Frequency (horizontal axis)

Observations

▸ Within the emerging segment, two distinct behaviors are observed:

– Consumers with more stable income tend to fragment their purchases between large (weekly or bi-weekly), daily needs, and emergency purchases

– Consumers with less stable income shop more frequently—shopping process driven by day-to-day necessity as income falls (especially Colombia, increasing trend in Argentina)

▸ As a result of these habits, all emerging consumers shop several stores in a given week, some of which are visited more than 2-3 times per week

▸ Salary payment typically triggers larger ticket purchases while diet drives daily needs (especially Brazil, Mexico, Chile, Costa Rica)

▸ In general, the daily needs shoppers correspond to the "D" class, while stocking purchases occur in the "C" class

▸ Lower percentage of working women in class C & D households accommodates daily shopping

We will discuss format needs and selection criteria shortly

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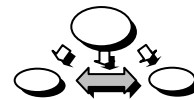
For example:

"C" Consumers

"I do a monthly purchase at the supermarket but I don't buy things for the whole month, I just buy the heavy stuff that my husband is going to carry. I buy the rest at the local grocer's (Argentina)

What I can't stand is to realize that something is missing when I'm in the middle of cooking the meal" (D+, Monterrey, Mexico)

"I go once a month to the supermarket and I buy more or less what I need, but the local shop [tienda] is still an everyday thing" (Chile)

Without fail, it's the farmer's market each week to buy what I'll use that week…that's much easier (Costa Rica)

"Each month I go to [supermarket A] for the big things, everything else I buy at the little markets nearby and the farmer's market every weekend" (C, Recife, Brazil)

"For us, less money means more trips to the little market [mercadinho]" (C, Sao Paulo, Brazil

"D" Consumers

"Since I get paid by the day I can't do the shopping once a week or once a month" (D1/D2, Argentina)

*"Every two weeks one buys 6 to 8 pounds of rice, oil, lentils, beans…the basic things…other food is better to purchase everyday..Now, getting to my sad reality, we purchase every day or as the money comes in (Colombia)*

"We go more to the little market on the corner. There's just no other option for us" (D, Sao Paulo, Brazil)

"You can't stock up anymore. Before you could go to the hypermarket and buy for the whole month,…or you filled the fridge. That's not possible now. You see what you need, then you go and get just that" (D1/D2, Argentina)

"For daily expenses I have 8.000 pesos and we are five people…I'm forced to save by purchasing only the daily food…I buy everything but in small amounts (Colombia)
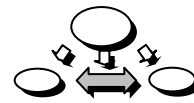
Planning, travel, selection, and payment: Shopping of emerging consumers is fragmented (over time and places) and characterized by price sensitivity

Planning	Travel (To & From)	In Store Selection	Payment & Post Purchase

Planning
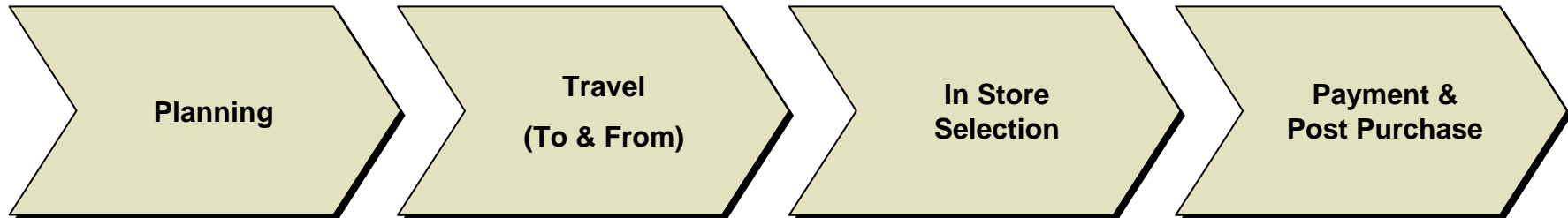
- ▸ Wife generally controls the budget and instigates most purchases—whether working or not
- ▸ Price comparisons are more significant than other pre-purchase routines; lists are usually mental
- ▸ **Factoring in of transportation costs** to arrive at "total purchase cost" [(1)]
- ▸ **Price comparisons are carried out with excruciating detail**; most consumers have a large repertoire of price benchmarks…
- ▸ …obsessive in some cases (e.g., Recife, Brazil)

Travel (To & From)

- ▸ Form of transport differs by purchase type:
  - – Travel by foot for daily purchases
  - – Travel to make large purchases may occur by bus, bicycle, "colectivos" or taxi
  - – In some instances, take advantage of transport services offered by supermarkets (Chile)
- ▸ These groups rarely travel by car since access to autos within the segments interviewed is low (slight exception: Costa Rica, Federal District of Mexico)

In Store Selection

- ▸ Buying process serves as entertainment—fascinated but overwhelmed with the shopping experience offered by the large scale trade
- ▸ Small sizes/single servings often selected as a means to **control expenditures**, fulfill daily needs, and afford brands and "treats"
- ▸ Averse to spending beyond their means—will act on impulse but avoid buying what they don't need⇒willing to give in to impulse depending on who is present but **know what is the limit** ("cookies yes, but the toys go back")

Payment & Post Purchase

- ▸ Prefer to pay cash but take advantage of credit out of necessity on occasion
- ▸ Prefer to **economize during selection rather than remove items from the cart** at checkout ⇒ embarrassment, shame
- ▸ Commonly "come up short" on smaller purchases and rely on "virtual wallet" at small retailers–make up small differences later
- ▸ In most cases/countries, will only raise issues or return products to a trusted source—even then, consumers do this rarely
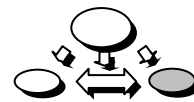
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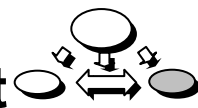
There are strong associations of categories with formats: street & open air formats/fresh goods; large retailers/personal care and bazaar

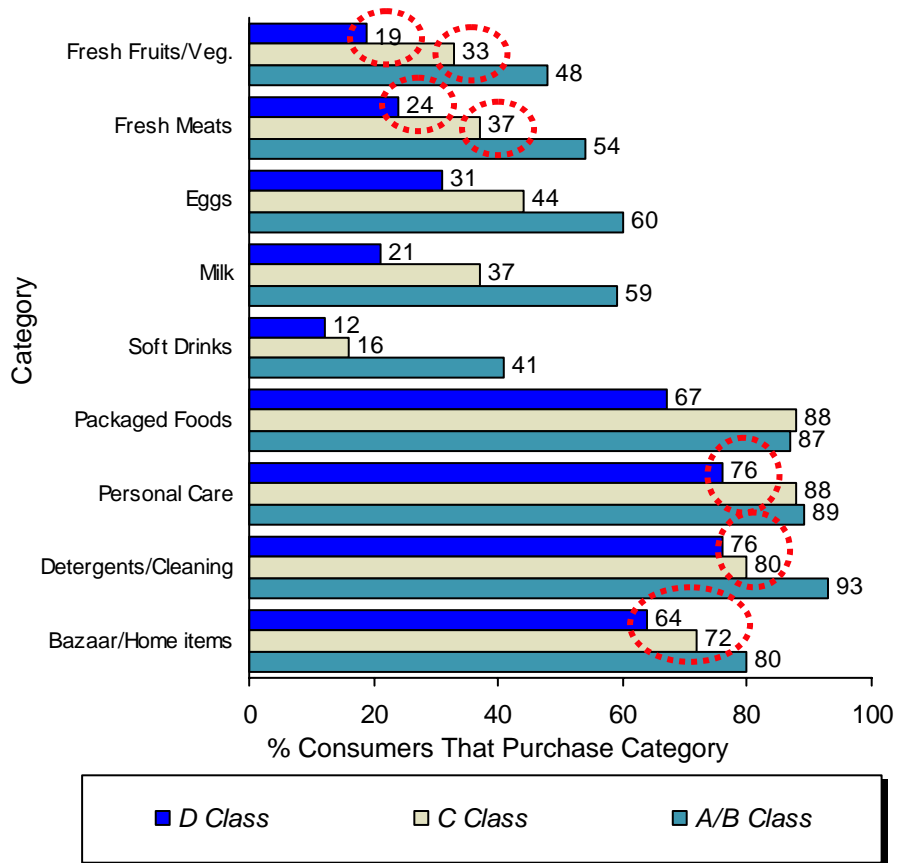|	"Fresh" Categories	All Other
Street / Open Air	+ High quality and wide variety of **fruits, vegetables, and meats** + Lowest perceived prices + Ability to buy the quantity desired − Lack of confidence: under-weighting product or substituting poorer quality at time of sale ⇒ mitigate through personal relationship	+ Attractive price points on **general merchandise** and impulse items for like quality (e.g., hair accessories, clothing, pens) − Lack of quality in some cases ⇒ feeling that you get what you pay for
Small / Traditional Retailers	+ Convenient source of **fresh milk/ bread** + Specialty shops (butchers, bakeries, etc) have similar advantages as street formats + Ability to buy the quantity desired + Acceptable prices − Availability not always consistent − Poor quality	No other strong associations between categories and small / traditional retailers—however, emerging consumers do link other general attributes to these formats, across a range of other products (e.g., product sizes, product assortment)
Large / Self-Service	+ Availability: will have what I need − Poor quality of product, feeling that the ripening /stocking process hurts quality − Less desire for packaged breads − Limited selection / varieties at higher prices − Packaging limits customer interaction − Feelings of shame to ask for small quantities	+ Wide selection of **HBC/ personal care** items⇒ value ability to **browse but do not necessarily buy** (super/hypermarkets) + Wide variety of **general merchandise** and household items (e.g., clothing & kitchenware) − Expensive products − Feeling of having to do without

Source: Market research

back

These attitudes drive format choice—as reflected in actual purchasing behavior

% Consumers Purchasing Category in Supermarkets
(Mexico)

Category (y-axis) — % Consumers That Purchase Category (x-axis)

| Category	D Class	C Class	A/B Class
Fresh Fruits/Veg.	19	33	48
Fresh Meats	24	37	54
Eggs	31	44	60
Milk	21	37	59
Soft Drinks	12	16	41
Packaged Foods	67	88	87
Personal Care	76	88	89
Detergents/Cleaning	76	80	93
Bazaar/Home items	64	72	80

Legend: ■ D Class   □ C Class   ■ A/B Class

Source: ANTAD

Observations

▸ Across all countries, emerging consumers state they purchase the majority of fresh fruits and vegetables at fairs/farmer's markets, and category specialists (e.g., verdulerías, fruterías)

▸ Some consumers purchase these categories at small retailers but this depends on the availability/assortment choices of local stores

▸ Fresh meats are also commonly purchased in markets but there is a greater tendency towards small-scale retail category specialists (e.g., butchers)

▸ Consumers with restricted incomes enjoy browsing personal care and bazaar sections of supermarkets but don't necessarily buy

▸ On the other hand, consumers who can afford "large/stocking" purchases like to take advantage of promotions on cleaning products and personal care items at large supermarkets
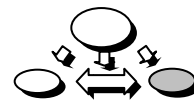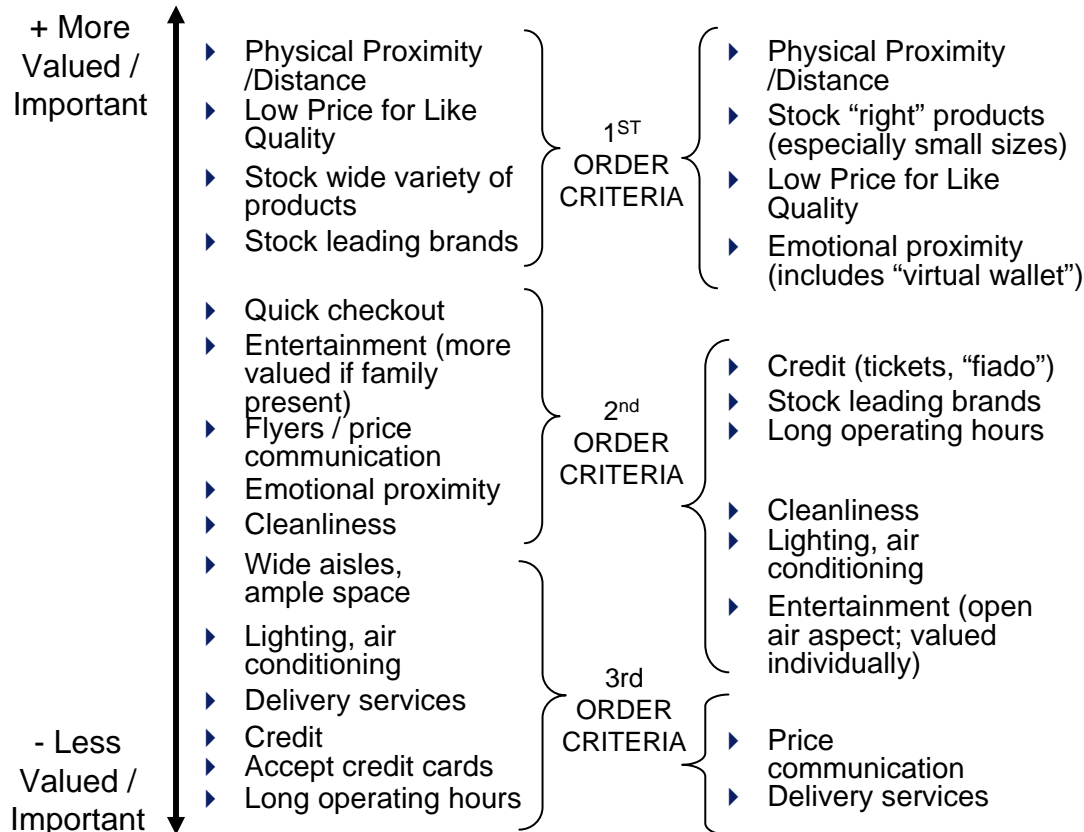
Regarding format choice, emerging consumers overwhelmingly demand affordability and proximity but the criteria differ by "need"

Large, Stocking Trips

+ More Valued / Important

1ST ORDER CRITERIA
- Physical Proximity /Distance
- Low Price for Like Quality
- Stock wide variety of products
- Stock leading brands

2nd ORDER CRITERIA
- Quick checkout
- Entertainment (more valued if family present)
- Flyers / price communication
- Emotional proximity
- Cleanliness

3rd ORDER CRITERIA
- Wide aisles, ample space
- Lighting, air conditioning
- Delivery services
- Credit
- Accept credit cards
- Long operating hours

- Less Valued / Important

Daily Needs

1ST ORDER CRITERIA
- Physical Proximity /Distance
- Stock "right" products (especially small sizes)
- Low Price for Like Quality
- Emotional proximity (includes "virtual wallet")

2nd ORDER CRITERIA
- Credit (tickets, "fiado")
- Stock leading brands
- Long operating hours

- Cleanliness
- Lighting, air conditioning
- Entertainment (open air aspect; valued individually)

**3rd ORDER CRITERIA**
- Price communication
- Delivery services

Findings

- Physical proximity and price are the first level determinants of store choice—emerging consumers do not like to travel very far and look for good prices at stores that are close by

- Significant discounts on a complete shopping basket are required for "stocking" trips–not just 1 or 2 items

- Assortment and emotional proximity become more important (relative to price) for daily purchases–consumers seek small sizes, the "right" leading brands, and emotional validation from interacting with the store employees/owner

- Wide product variety valued as point of interest but only when making larger purchases

- Credit and aspects of physical appearance are second order needs, with infrastructure and hygiene used as a screen rather than a driver of choice

- Some services are valued (especially for "stocking" trips); however, they do not play a key role in store choice (low perceived differentiation)
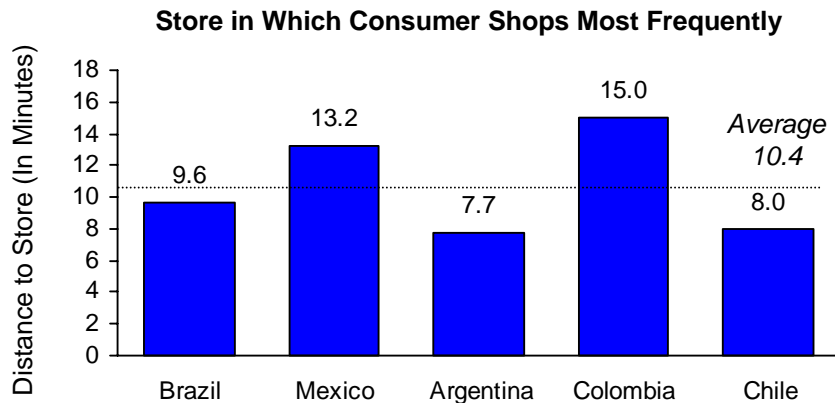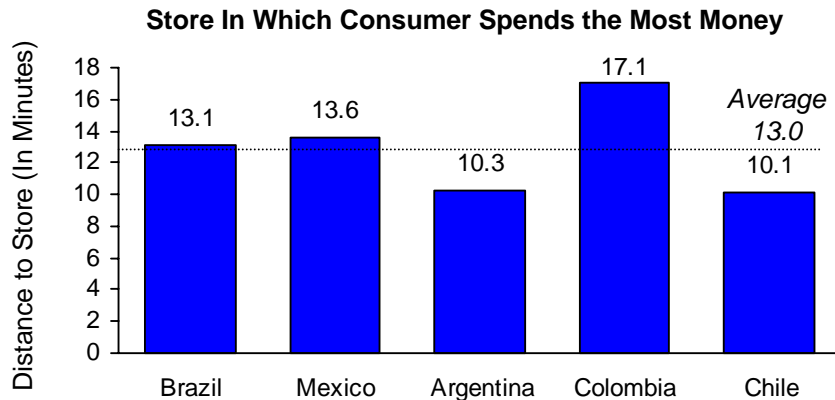
Source: Market research

back
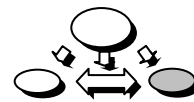
Proximity is the top criteria since emerging consumers factor in transportation costs and are generally not willing to travel very far

Average Travel Times

Store In Which Consumer Spends the Most Money

Distance to Store (In Minutes)

Brazil	Mexico	Argentina	Colombia	Chile
13.1	13.6	10.3	17.1	10.1

Average 13.0

Store in Which Consumer Shops Most Frequently

Distance to Store (In Minutes)

Brazil	Mexico	Argentina	Colombia	Chile
9.6	13.2	7.7	15.0	8.0

Average 10.4

Source: AC Nielsen, Market research

Observations / Selected Quotes

▶ Most consumers need travel only minutes to make daily or stocking purchases

▶ Larger/stocking purchases are made at stores that are farther away (physical distance) than the places where daily needs are met—but not by much

▶ *"I usually shop at the local grocer's. It's close by, two blocks. I pay attention to the sales at [Supermarket B], which is 7 blocks away, or at [Supermarket C], that's 8 blocks." (Argentina)*

▶ *"I generally go to the supermarket because it happens to be close by" (Chile)*

▶ *"[Supermarket A] sells everything but what I would spend on a taxi I can save and use for other things … the situation that we are in today keeps me away from the chain supermarkets" (Colombia)*

▶ *"I'm too lazy to go to the supermarket, although it's pretty close by…it's better to send my son to the local store [pulpería]…it's much closer but sometimes they don't' have what you want" (Costa Rica)*

▶ *"'Close' means being able to push a cart ... 'Far' is when we have to take public transportation" (Recife, Brazil)*

Price and product mix vie for the next level of importance

Price (Regular or Promoted)

"I like brands, but I look for good prices within brands" (C2/C3 Argentina

"I only buy the shampoo that's on sale" (D, Federal District, Mexico)

"They [small local shops] get you by … plus, they've got to make some money too." (D, Chile)

"Before we went to [Supermarket G], but now we no longer have that luxury … the economic situation makes me think more about prices and not so much about quality." (Colombia)

"I look for good prices on all products. Saving between 0,30 or 0,50 I can save 3 pesos per day, in 30 days that's $90, which is a lot of money!" (D1/D2, Argentina)

"I buy pizza sometimes because I really have a craving for it, but only on Fridays when it's on sale 2 for 1 at [supermarket M] " (D, Monterrey, Mexico)

"Shopping around for prices determines what I buy and where I'm going to buy it." (Recife, Brazil)

"I jot down prices for each brand in various supermarkets…I take it home from wherever it's cheaper for the brand I use constantly." (Recife, Brazil)

Product Assortment

"It's good that the stores have OMO and San Luis cookies because sometimes there's money left over and then I can take them home." (D, Recife, Brazil)

"If there are not a lot of brands it makes me feel like they want you to buy whatever it is they want and not what I want." (C, Sao Paulo, Brazil)

"What do I really get from buying a really cheap product if nobody wants to eat it at home? I prefer to spend a little more and eat well."(Colombia)

"How boring when there are only two or three brands!! I don't like it when I feel limited" (Costa Rica)

"I like to buy everything very fresh. If I put leftovers in front of my son he says 'disgusting!' I don't cook food just to throw it out." (Colombia)

"Once I bought some cheap pasta to save money but I cooked it and I didn't like it…I could barely eat it." (Chile)

back
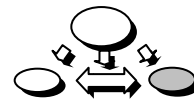
There is also a great degree of value placed on intimacy— relationship is difficult to establish but does drive store choice particularly for small/traditional formats

"At the corner shop, apart from buying the groceries, I run into my neighbors and I chat with them. Knowing the owner is reassuring, and I can buy on credit if I don't have enough money and I need something." (Argentina)

"The owner of the little market waits on you in a much better way ... Even though he's small, he gives me much more attention" (Brazil-Recife)

"I try to buy where they know me so that they give me the choicest meats" (Colombia)

"I go there and if I'm missing a little money I can still buy what I need and I can pay them back later" (Chile)

"One really knows the owner and he sells you what you like ...I've been buying from him for years ... sometimes I owe him 50 cents and he's fine if I pay him back later" (Costa Rica)

▸ Emerging consumers consistently mention personal relationships as key decision criteria for selecting a store
  – Usually the top factor for differentiating between outlets with comparable prices or distance
  – Almost always enters into store choice when making convenience or daily purchases in small/traditional stores

▸ When speaking of this relationship, consumers spontaneously mention one or two individuals at most—trust/familiarity is not automatically granted
  – Typically the result of a history of positive interactions and experiences
  – Clear distinction between "people of confidence" and others but nebulous criteria ("I'll know it when I see/feel it")

▸ Credit is viewed more as an extension of this relationship rather than a transaction or service

back
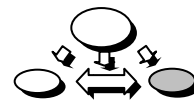
For emerging consumers, some of these disadvantages translate into very real barriers to shopping at large self-service stores

"In hypermarkets, just to find three things you have to wander all over ... You get tired ... [Supermarket A] is very big too and there is everything you could imagine but it comes at a price ... (Argentina)

"When shopping, the advantage is to be able to buy just one box of matches, one Bombril, just a little oil" (Brazil-Recife)

"It is really nice, but it is very far from me … I figured out about what I save and we spend more in transportation in order to get there" (Colombia)

"In small stores you can buy just a quarter kilo if you want … if you ask for that in the supermarket … it's horrible, they roll their eyes" (Costa Rica)

"When you go to buy an avocado at the supermarket they are all hard as a rock" (Chile)

"I hate [Supermarket C] ... What's worst is the people working at the checkout and the lines make me neurotic" (Colombia)

"One time I went to [Hypermarket B] and I actually left the cart full of stuff and went to the local store ... The line was so long, I don't have that much time" (Brazil-Sao Paulo)

"Everything is just so much fresher and cheaper in the open markets than in supermarkets" (Costa Rica)

▸ Large supermarkets and hypermarkets (Br, Arg) viewed as "stocking" places –increasingly at odds with consumers' economic situation

– Sell larger sizes of staple products, raising total bill – out of budget, even if cost per unit is lower (more pronounced the lower the income)

– Offer larger ticket items—major purchases like clothing, school supplies, and kitchen items

– Promotions can imply buying too much – "Buy two get one free"

▸ Long distances require investing time and money in transportation

▸ Poor quality perception in perishable categories that make up large part of diet (fruits, vegetables, meats)

▸ Prices perceived to be higher (perception not always in line with reality $\Rightarrow$ reaction to distance/total purchase cost, large sizes?)

▸ Poor treatment by staff (esp. Mexico)

back

Hence, emerging consumers' needs are met to varying degrees by different retail formats—large supermarkets having some relative disadvantages
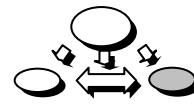
Value Proposition: Relative Assessment

Value Drivers	Street / Open Air	Traditional Stores	Small Supermarkets	Large Supermarket / Hypermarkets	Issues / Comments
▶ Price / Value	●	◔	◑	◕	▶ Significant promotional activity at large retailers ▶ Street fairs noted for price/value but offer limited categories
▶ Product Mix	◑	◔	●	◑	▶ Small retailers carry "sufficient" assortment and small sizes ▶ Large supermarkets offer variety (especially personal care), but are thought to have lower quality in perishable foods
▶ People / Treatment	◔	●	●	◑	▶ Can be significant source of advantage for small retailers – personal relationship with customer base
▶ Store / Location	◔	●	●	◔	▶ Also a significant source of advantage fro small retailers, who are frequently located just steps/a few block away
▶ Services / Other	◔	◑	◔	●	▶ Different sources of advantage: – Small retailers: knowledge of customer base, sometimes credit – Large supermarkets: shopping experience, entertainment

○ *Less Advantaged* ⟶ ● *More Advantaged*

Given these format needs and attitudes, emerging consumers purchase more at small retailers

ARGENTINA

Purchases by Channel

Legend:
- ☐ Other
- ☐ Wholesalers
- ☐ Door to Door
- ☐ Other Retailers
- ▨ Almacenes
- ☐ Autoservice
- ■ Disconuts
- ☐ Supermarket
- ■ Hypermarket

High Middle Class
- 3%
- 4%
- 5%
- 4%
- 6%
- 17%
- 4%
- 34%
- 23%

Impoverished and Poor
- 3%
- 2%
- 5%
- 7%
- 17%
- 32%
- 4%
- 23%
- 8%

Emerging consumer -- Only 31% on Super / Hypermarket
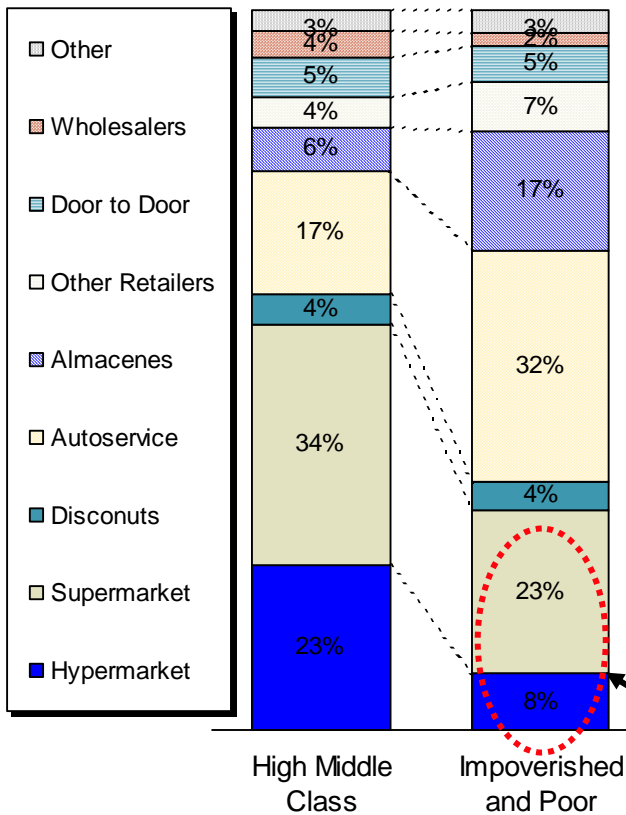
Channel Penetration per Segment

Legend:
- ■ High and Middle Class
- ☐ Impoverished Middle Class
- ▨ Poor

Channel	High and Middle Class	Impoverished Middle Class	Poor
Hypermarket	47%	26%	17%
Supermarket	58%	43%	29%
Discounts	29%	36%	34%
Autoservicios Comunes	23%	28%	36%
Autoservicios Asiáticos	28%	33%	24%
Almacenes	26%	41%	49%
Ferias de Barrio	10%	13%	19%
Negocios Venta Productos Sueltos	23%	27%	29%

Source: CCR Latin Panel

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Shaken by the economic climate, emerging consumers plan to spend less, and are even more price sensitive when shopping

Change in Shopping Behavior

- ▸ Open recognition of a meaningful and increasing loss of purchasing power (Argentina, Brazil, and Colombia)
- ▸ Overall, more willing to make substitutions and less willing to spend on value-added categories
  - – Seek lower priced products, especially in personal care and cleaning
  - – Reduce purchase size / frequency—e.g., cook meat less often, buy only one type of snack
- ▸ Refusal to abandon brands in some categories; reducing quantity and alternating with lower priced products to avoid "doing without" e.g.:
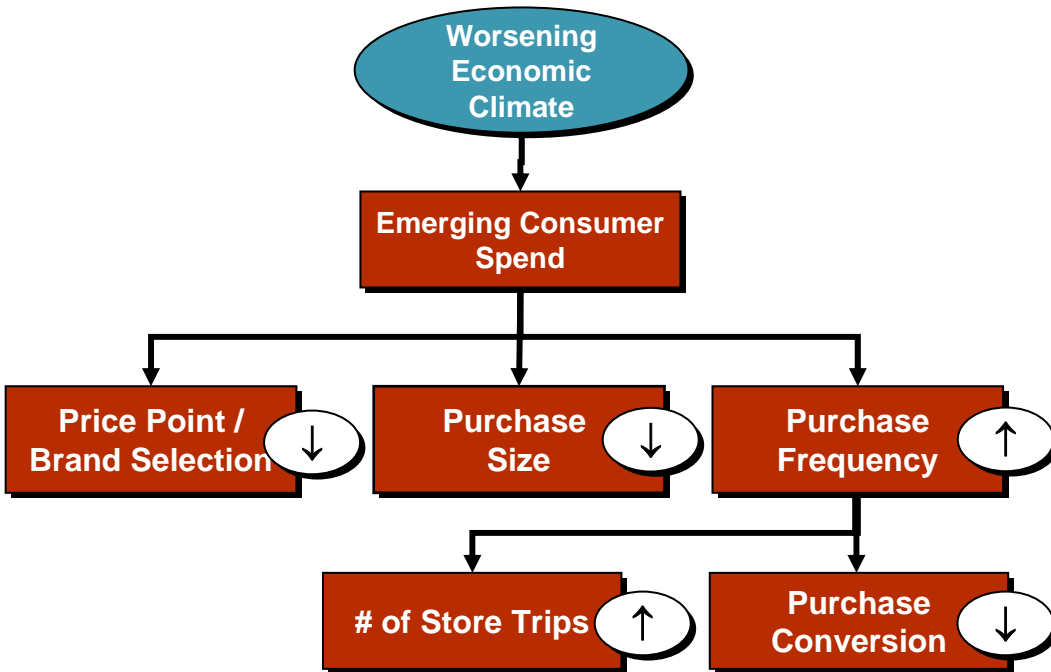 - – Leading brand soft drinks on weekends, value brands during the week
  - – Mixing preferred rice brand with lower priced product
- ▸ Greater frequency of daily, small ticket purchases; fewer trips to "stocking" formats
- ▸ Increased use of credit to support greater purchase frequency (Colombia, Argentina only)
- ▸ Greater self-constraint, less trial (new products) / impulse behavior – requires significant discounts (note: price difference on value brands more tempting)

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Based on the qualitative research, emerging consumers could be segmented according to purchasing power stability and purchase trade-offs

Segmentation Hypotheses & Description

Control
Constraint
Practicality
Traditionalism

Purchase   Trade-off

Status
Emotion
Impulse
Innovation

Permanent
State
"Structural
Constraint"

Stability of Income

Recent State
"Newly
Constrained"

Economizers

Practical
Aspirationals

Value
Hunters

New
Economizers

Crisis Effects
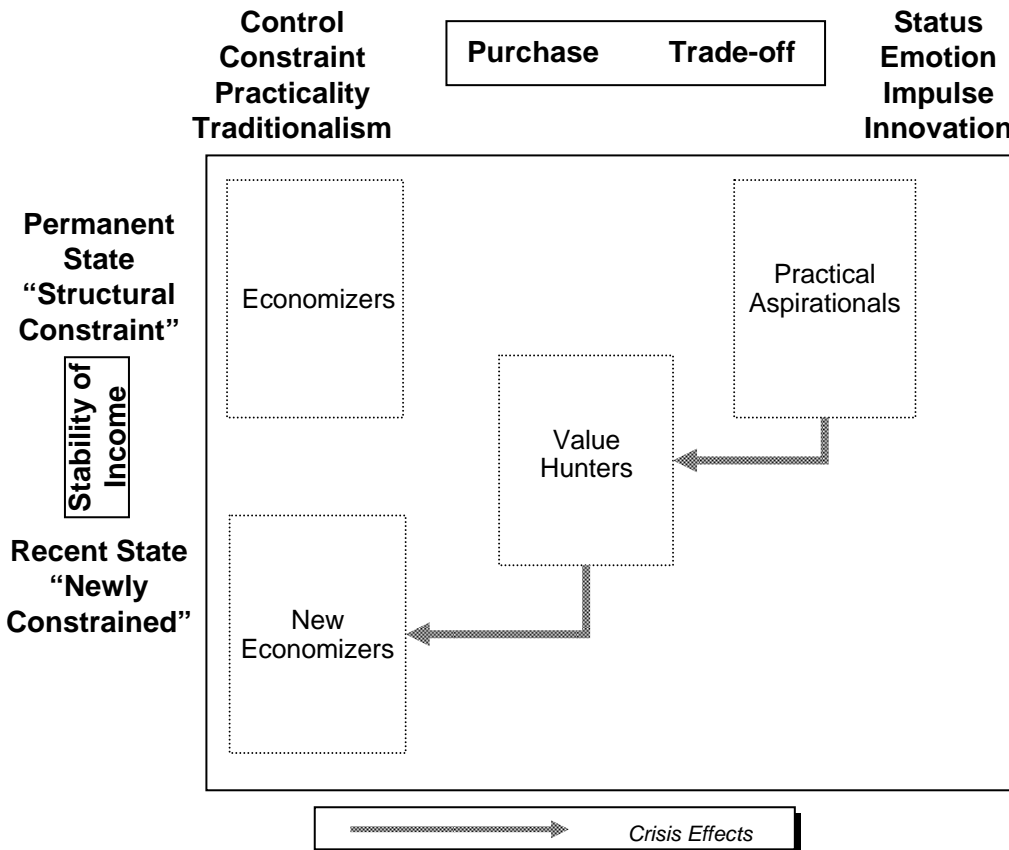
SEGMENT CHARACTERISTICS:	Stability of Income	Variety Categories Purchased	Brand Loyalty	Price Sensitivity	Store Loyalty	Innovation
ECONOMIZERS	--	-	+	+	++	--
NEW ECONOMIZERS	-	+	-	++	--	-
VALUE FOR MONEY	+	+	+	+	-	+
PRACTICAL ASPIRATIONALS	+	++	++	+	+	++

Note: Segment descriptions included in the Appendix. Evaluation of segment characteristics based on qualitative assessment of spontaneous responses by focus group participants to a series of prompted statements under the umbrella topic of "How do you think of yourself as a consumer?"

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In summary, emerging consumers are, as a whole, both austere and demanding

TANGIBLE

Emerging Consumer Values:

INTANGIBLE

The "Right" Product Mix

Ubiquity / Physical Proximity

Product Assortment

PRIMARY NEEDS

Personal Relationship with Retailer "Handshake"

Affordability

Shopping Experience

Services—Delivery, Hours, Promotional Literature, etc.

Entertainment

Cleanliness

Pleasing Appearance

SECONDARY NEEDS

Professionalism "Arm's Length"

Credit and "Virtual Wallet"

Furthermore, differences between emerging consumer segments imply that large retailers may need a differentiated proposition among this group

▸ It may be possible to attract a subset of emerging consumers with 'tweaks' to existing formats; others will require radically different value proposition (e.g., proximity, product mix)

▸ Some emerging consumers may never be profitable to serve with even the current business model, since they avoid purchasing other items while shopping for traffic driving promotions—new pricing, promotion, and merchandising tactics might be in order

▸ Other segments (e.g., Economizers and New Economizers) could be targeted better through increased proximity/ubiquity—provided that "closer" did not translate into high cost

▸ Segments with higher 'innovation' are less likely to respond to a 'bare bones', low cost format—these consumers seek variety and do not like limited product/brand assortment

The opportunity is large but shopping habits do translate into potentially challenging economics

Key Learnings

▸ Emerging consumers like to shop and they spend a large portion of their income on consumer products

▸ However, they shop at large supermarkets or hypermarkets infrequently – or not at all
  - Very little penetration with these consumers in Colombia and Mexico, and now Argentina
  - Some penetration in Brazil as a result of hard discount / independent chains
  - More penetration in Chile and Costa Rica

▸ When they do shop in these formats, they:
  - Spend less since incomes are lower
  - Purchase low margin items and avoid perishables
  - Stay focused on traffic building promotions that retailers often fund at considerable cost
  - Avoid impulse purchases
  - Like to observe and try as means of entertainment but know their limits

Implications

▸ These shopping habits imply challenging economics for retailers:
  - Large inventory position with low turnover
  - Small, lower margin ticket sizes
  - Low purchase conversion
  - Low return on investment for some promotions / customer segments
  - Investment in new locations to increase coverage/ physical proximity
  - Higher credit risk
  - Increased labor costs from addition of personnel in customer service/ checkout

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Glossary of Terms

▸ **"Total Purchase Cost"** represents a fully loaded cost for a basket of goods

– Retail shelf prices naturally make up an important part of the equation…

– … however, emerging consumers mentally factor in transportation costs to arrive at a final price for the shopping basket—that is, the "total purchase cost"

– In addition, they have strong awareness of "hassle factors" (such as finding child care or policing / coping with children's demands while in the store), logistical constraints for bringing purchases home, and time spent commuting or (to a lesser degree) standing in line

▸ **"Virtual Wallet"** is technically a form of short term credit used by emerging consumers who come up short at the register/counter when making purchases at small-scale retailers

– Small scale retailers will allow regular customers to make up small differences on their next shopping trip—usually the next day or shortly thereafter

– Amounts in question are extremely small and no written record is kept—e.g., the 'honor system'

– In effect, is more like an extension of the personal relationship between the consumer and the shopkeeper, rather than a transaction or service

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The Retail Landscape and Informality

▸ Retail Industry Context & Landscape

▸ Small Retailers value proposition for emerging consumers

▸ How small retailers make a sustainable business model

▸ The impact of Informality

The Retail Landscape and Informality

▸ Retail Industry Context & Landscape

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Document Roadmap

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Consumer Understanding

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Macro-Economic Context

Challenges & Opportunities for Retail Chains

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Retail Industry Context

▸ Key trends

▸ Structure

▸ Emerging formats

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Economics Understanding

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Value Propositions Assessment

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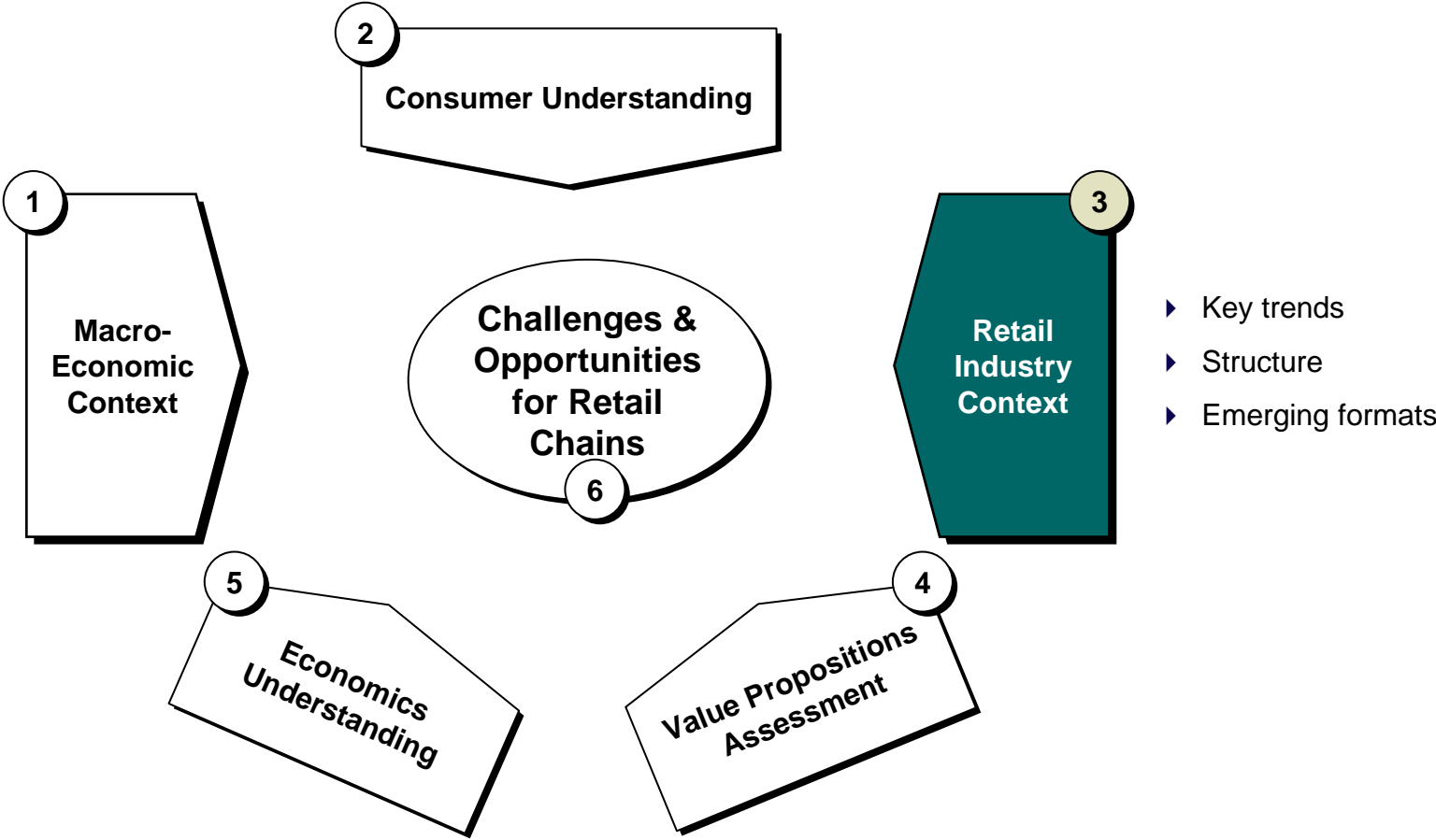
After a decade of growth, channel complexity is increasing and new formats are emerging

Main Trends in Retailing – Latin America

Manufacturers

- Multinationals consolidating and rationalizing the global brand portfolio
- Increased strength of local, national manufacturers
- Growing importance of dramatically lower priced "value" brands
- Increased attempts / successes to serve small retailers directly (e.g., DSD commercial models)

Intermediaries

- Barriers are disappearing as wholesalers enter into retail and vice versa (e.g. "Atacadistas" in Brazil; "Mayoristas" in Argentina)
- Small scale channels sourcing from hypermarkets
- Intermediaries losing share (varies by country) as more products are sold direct

Retailers

- Rise of self-service format-- "winners" and the "losers" varying by country
  - Established players launching new formats: discount/value oriented supermarkets (Pali, Barateiro, Econ) convenience stores (Oxxo) price clubs (PriceSmart)
  - Crisis channels and affordability plays rising – e.g bulk sales, door-to-door
- Traditional formats holding their ground
- Growing number of outlets and increased competition
- Falling financial performance for large retailers (varies)

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Definitions: we grouped retail players in Latin America into "Large Scale Trade" and "Small Scale Retailers"

Retail Landscape Definitions

Large Scale Trade

- Hypermarkets
- National Supermarket Chains
- Convenience Store Chains
- Hard Discount Chains
- Discount Clubs
- Special Destination Chains -- Niche Players

Small Scale Retailers

- Street/ Open Air
- Traditional
- Small Self Service
- Independent local supermarket
- National and Local independent supermarket Chains
- Independent Specialists (Butcheries, Fresh Produce, etc…)

Formal/ Legal

Informal/ Illegal

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Small retailers make Latin America's retail landscape unique in its composition – e.g. traditionals

Mexico

Argentina

Chile

Costa Rica

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Small retailers (cont…) – e.g. street formats

Mexico

Argentina

Chile

Costa Rica

Small retailers (cont…) – e.g. small self-service & small supermarkets

Argentina

Colombia

Chile

Costa Rica

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The retail landscape is rich and diverse – we focused on a subset of formats that account for a large portion of emerging consumers' spend

Retail Shopping Formats by Country

Format Type	Brazil	Mexico	Argentina	Colombia	Chile	Costa Rica
Large Scale Trade	▸ Discount Stores ▸ Hypermarkets ▸ Large Supermarkets ▸ Wholesalers "Atacadistas"	▸ Bodega ▸ Hyper/Megamarkets ▸ Large Supermarkets ▸ Retail club	▸ Discount Stores ▸ Hypermarkets ▸ Large Supermarkets ▸ Wholesalers	▸ Hypermarkets ▸ Large Supermarkets	▸ Hypermarkets ▸ Large Supermarkets ▸ Wholesalers (to public) "Pre-Unic"	▸ Hypermarts ▸ Large Supermarkets ▸ Wholesale Clubs (PriceSmart)
Small Supermarkets ▸ Small independents ▸ Self-service ▸ Less than 4 ckout	▸ Self-service supermarkets ▸ (small supermarkets and "Mercadinhos")	▸ Self-service supermarkets	▸ Self-service supermarkets	▸ Self-service supermarkets "Superetes" & Mini-mercados	▸ Self-service supermarkets	▸ Mini-Supers
"Traditional" ▸ Small independents ▸ Mostly behind the counter service	▸ Mercearias / Mercadinhos	▸ Tienda de Abarrotes	▸ "Almacenes" ▸ Todo Suelto	▸ Tiendas Pequeñas ▸ Tiendas Medianas	▸ "Abarrotes"	▸ Pulperías
"Street" Formats ▸ Limited infrastructure	▸ Feira Livre	▸ Tianguis ▸ Mercado sobre Ruedas	▸ Ferias Mobiles ▸ Ferias de Barrio ▸ Barter Clubs ▸ Door-to-Door ▸ Street sellers	▸ Public Markets / Abastos ▸ Plaza Mayoristas (sales to public) ▸ "Ferias Mobiles" ▸ Casetas	▸ Ambulantes ▸ Feria	▸ Ambulantes ▸ Chinamos ▸ Feria
Category Specialist	▸ Açougue ▸ Sacolão ▸ Padaria	▸ Carnicerías ▸ Cremerías ▸ Fruterías ▸ Pollerías	▸ Carnicerías ▸ Fruterías ▸ Verdulerías	▸ Carnicerías ▸ "Frutiver"	▸ Carnicerías ▸ Panaderías ▸ Verdulerías	▸ Carnicerías ▸ Panaderías
Convenience	▸ Convenience Gas ▸ Bancas / Barracas	▸ Convenience Gas ▸ Estanquillos	▸ Maxikioscos ▸ Convenience Gas	▸ Convenience Gas ▸ Cigarrarías	▸ Convenience Gas	▸ Convenience Gas

▢ **Research Scope**

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The Retail Landscape and Informality

▸ Retail Industry Context & Landscape

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▸ The impact of Informality

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Quote

"I am the worst salesman. Therefore, I must make it easy for people to buy."

F.W. Woolworth

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We completed over 200 in depth interviews with small retailers to complete our value proposition/ business model assessment

Sample Description
(Note: Given sample size, results in some cases are directionally correct but not statistically significant)

Format		Brazil	Mexico	Argentina	Colombia	Chile	Costa Rica	Total
Small Retailers	Traditionals	8	24	19	15	17	4	**87**
	Small Super	14	4	18	8	2	2	**48**
	Street	2	1	7	3	20	1	**34**
	Other	5		4				**9**
Total Small Retailers		29	29	48	26	39	7	**178**
Organized Trade	Hypermarket	2	3	7	1	4	1	**18**
	Supermarket	2	2	3	1	4	3	**15**
	Hard Discount	3			1		1	**5**
	Convenience		1					**1**
Total Organized Trade		*7*	*6*	*10*	*3*	*8*	*5*	*39*
Grand Total		**36**	**35**	**58**	**29**	**47**	**12**	**217**

Totals
▸ 217 store-checks, with 190 interviews
▸ 2,400 prices checks
▸ 820 brand type and size sku counts in 6 categories
▸ 3,800 brand counts in 20 categories

Field Work Description

▸ 217 store visits in 6 countries, each lasting approximately 1-1.5 hours

▸ Visits conducted during January and February of 2003

▸ Each store visit consisted of 3 parts
  – Data capture (prices, assortment)
  – In-depth interview with owner or store manager to complete survey
  – General profiling (floor plan sketch and photographs in some cases)

▸ Interviews with owners covering themes:
  – Sourcing and prices paid for 5 categories
  – Sales mix
  – Customer base
  – Operating model/ costs

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In this chapter we will review small retailer's value proposition to emerging consumers along 5 key variables – place, assortment, price/value, services, and people

Document Roadmap

Roadmap for Value Proposition Profiling

Place
- ▸ Location / Proximity
- ▸ Shopping experience

Assortment
- ▸ Category/ brand assortment
- ▸ Brands, Quality
- ▸ Sizes

Price / Value
- ▸ Shelf price
- ▸ Product quality

Services
- ▸ Store services—e.g., credit
- ▸ Communication
- ▸ Promotions

People
- ▸ Relationship with owner / operator
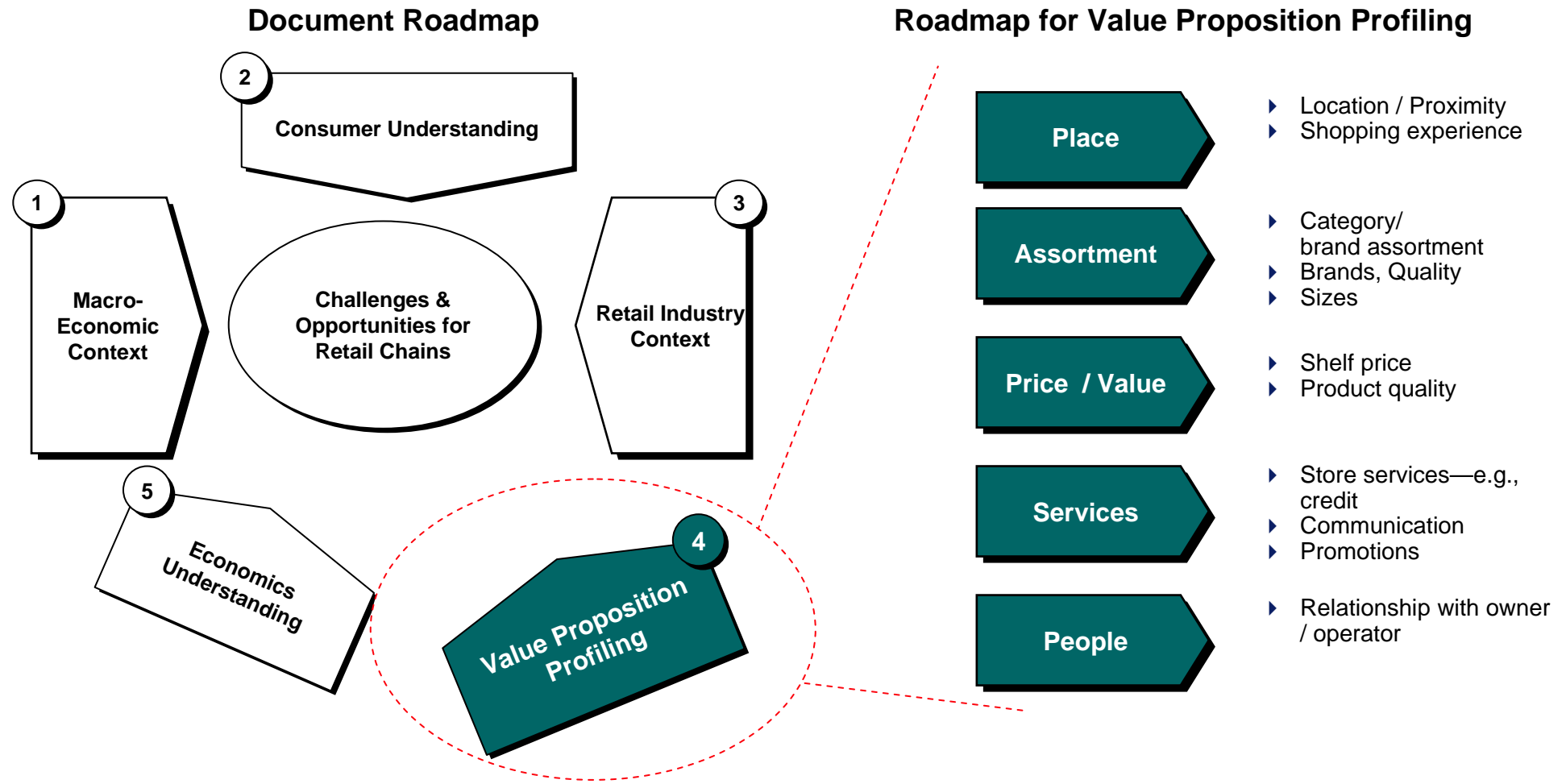
Place: Location is a compelling proposition of small retailers to emerging consumers, who make small daily purchases and value proximity

Frequency of Purchase in Small Retail [1]
(Times per week)
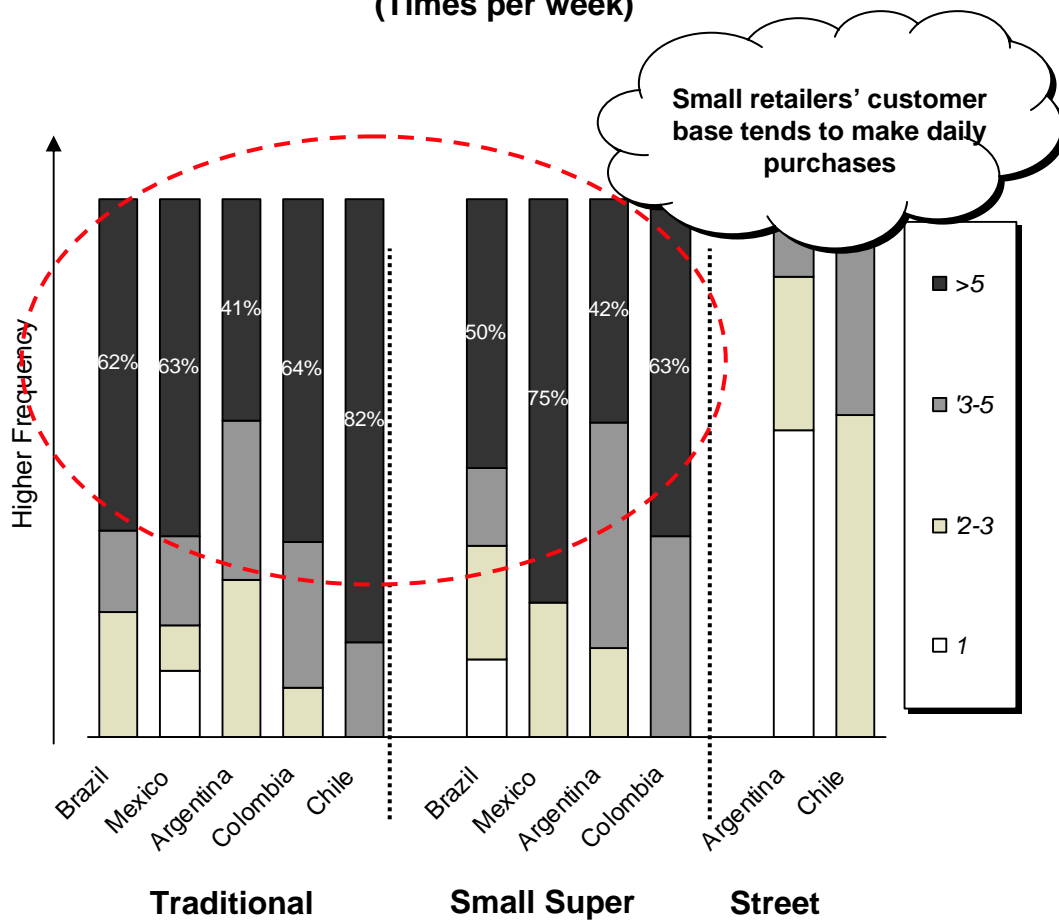
% of Customer Base That Lives Nearby [2]
(Small Retailers)

Small retailers' customer base tends to make daily purchases

… and choose a store nearby

Higher Frequency

Legend: >5, '3-5, 2-3, 1

Brazil, Mexico, Argentina, Colombia, Chile

Traditional **Small Super** **Street**

62% 63% 41% 64% 82% 50% 75% 42% 63%

84% 58% 86% 75% 78% 92% 59% 75% 58% 60% 71%

Traditional Autoservice Street

Legend: ■ *Brazil* □ *Mexico* ■ *Argentina* ■ *Colombia* □ *Chile*
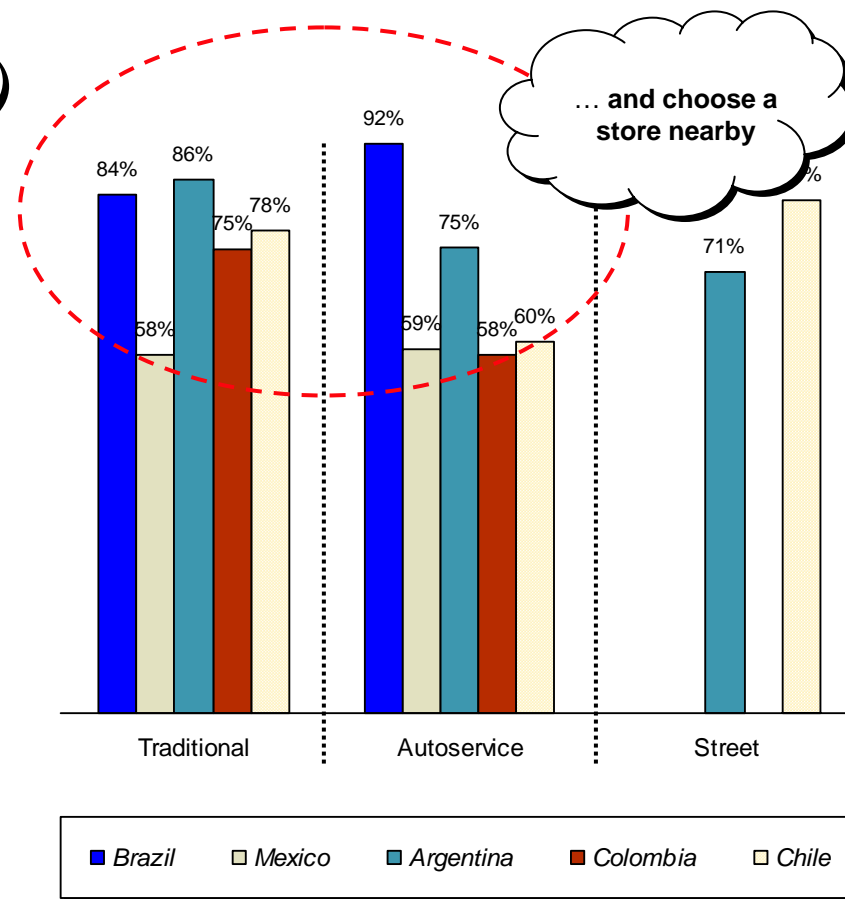
(1) Question to store owner / operator: "How many times per week does your average customer shop at this store?"
(2) Question: "What percentage of your customers live nearby (5 blocks or less)?"
Source: Field Interviews, Booz Allen Analysis

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In fact, proximity translates into significantly lower "total acquisition cost" for emerging consumers if shopping at small retailers

"Break-Even" Analysis:
Price Discount Required at Large Scale Trade to Justify a Bus Trip

Brazil

46%
27%
5%

Traditional Ticket Size (R$ 7.4)
Small Super Ticket Size (R$12.3)
Avg. Large Scale Trade Ticket Size (R$65.0)

Since average ticket size is low, a 25-55% discount would equalize "total cost" between a traditional store and a supermarket located one bus trip away

Mexico

25%
17%
7%

Traditional Ticket Size (M$ 40.6)
Small Super Ticket Size (M$60.3)
Avg. Large Scale Trade Ticket Size (M$139)

Argentina

31%
24%
20%
7%
4%

Traditional Ticket Size ($5.2)
Small Super Ticket Size ($6.8)
Street Format Average Ticket Size ($8.0)
Avg. Large Scale Trade Ticket Size ($21.6)
Large Supermarket Ticket Size $41.3

Colombia

53%
39%
9%

Traditional Ticket Size (C$3,000)
Small Super Ticket Size (C$4,125)
Avg. Large Scale Trade Ticket Size (C$18,100)

Note: Considers bus trip at R$ 1.70 in Sao Paulo, Brazil, Pasero/Microbus at $M 5.00 in Mexico DF, Colectivo trip at A$0.80 for Capital Federal, Argentina, C$800 for a bus trip in Colombia

Source: Field Interviews, Booz Allen Analysis

back

Small retailers generally show a more cluttered and less tidy physical appearance, although emerging consumers still find them acceptable

Selected Snapshots of Traditionals in Latin America

Mexico

Many categories together, visual clutter

Argentina

Unattractive external appearance

Chile

Haphazard display/ stocking of products

Costa Rica

Merchandise very far away, poor visibility

back

Source: Pictures by Booz Allen

Assortment: Small retailers offer an assortment focused on fresh food, drinks and basic food -- the main categories sought by emerging consumers for daily purchases

Category Importance for Store Sales
(0 = None, 5 = Very Important)

Traditionals

Brazil

Category	Value
▶ **Fresh Products**	2.8
▶ Home Cleaning	2.8
▶ **Basic Food**	2.6
▶ **Drinks**	2.4
▶ Personal Care	2.3
▶ Luxury Food	1.7
▶ Other	1.3
▶ Produce	1.1
▶ Cigarettes	0.9
▶ Health	0.9

Mexico

Category	Value
▶ Cigarettes	3.5
▶ **Fresh Products**	3.1
▶ Produce	3.1
▶ **Dinks**	2.8
▶ Home Cleaning	2.8
▶ Personal Care	2.4
▶ **Basic Food**	2.4
▶ Luxury Food	2.0
▶ Health	1.7
▶ Other	0.5

Argentina

Category	Value
▶ **Fresh Products**	3.0
▶ **Drinks**	2.7
▶ **Basic Food**	1.7
▶ Personal Care	1.3
▶ Home Cleaning	1.3
▶ Cigarettes	1.3
▶ Luxury Food	1.0
▶ Other	0.4
▶ Health	0.3
▶ Produce	0.2

Colombia

Category	Value
▶ Produce	3.6
▶ **Fresh Products**	2.6
▶ **Basic Food**	2.5
▶ Home Cleaning	2.4
▶ **Drinks**	2.0
▶ Personal Care	1.4
▶ Cigarettes	1.4
▶ Luxury Food	1.2
▶ Other	0.4
▶ Health	0.3

Small Supermarkets

Brazil

Category	Value
▶ **Fresh Products**	3.2
▶ **Basic Food**	3.0
▶ Home Cleaning	2.9
▶ **Drinks**	2.6
▶ Personal Care	2.4
▶ Produce	1.9
▶ Luxury Food	1.8
▶ Other	0.9
▶ Cigarettes	0.6
▶ Health	0.5

Mexico

Category	Value
▶ Cigarettes	4.0
▶ **Drinks**	3.4
▶ **Fresh Products**	3.3
▶ **Basic Food**	3.1
▶ Produce	3.0
▶ Home Cleaning	2.9
▶ Luxury Food	2.4
▶ Personal Care	2.3
▶ Health	1.8
▶ Other	0

Argentina

Category	Value
▶ **Drinks**	3.2
▶ **Fresh Products**	3.1
▶ **Basic Food**	2.6
▶ Home Cleaning	2.2
▶ Personal Care	1.6
▶ Luxury Food	1.2
▶ Produce	0.6
▶ Cigarettes	0.3
▶ Health	0.3

Colombia

Category	Value
▶ Home Cleaning	3.3
▶ **Basic Food**	3.1
▶ Produce	3.0
▶ Cigarettes	3.0
▶ Personal Care	2.9
▶ **Fresh Products**	2.7
▶ **Drinks**	1.8
▶ Luxury Food	1.7
▶ Health	1.1
▶ Other	0

Note: Question asked: "Please rank the following categories in terms of importance to store sales (20 categories)"
Source: Field Interviews, Booz Allen Analysis

**back**

In most countries 1st tier brands dominate small retailers' assortment – with the exception of Argentina and to a lesser degree in Brazil

% of SKUs That are 1st Tier Brands
Selected Categories – Large Scale Trade vs. Small Retailers
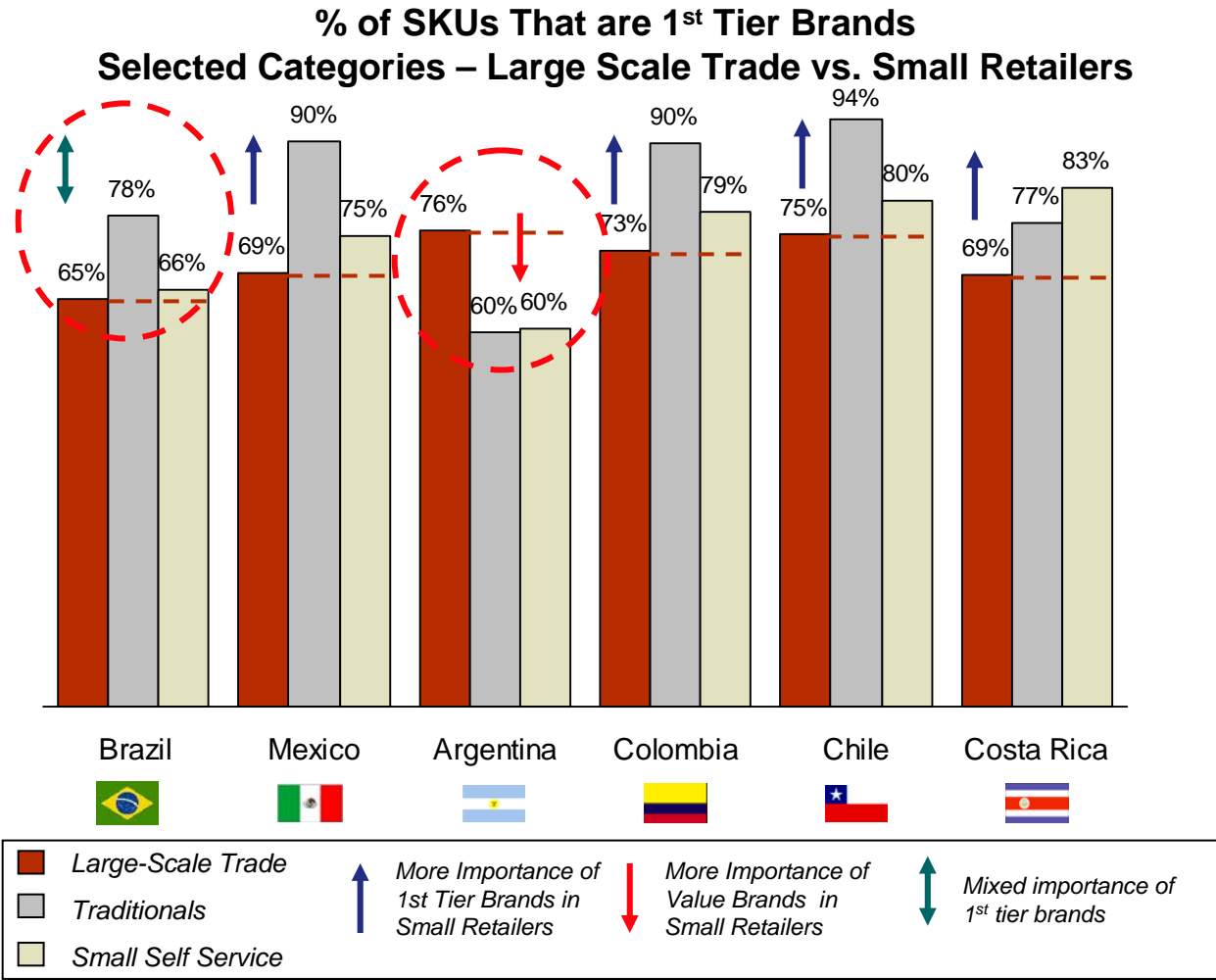
- Mexico, Colombia, Chile, Costa Rica
    - Small retailers offer an assortment with greater % of 1st tier brands
    - Most of the lower priced brands offered by small retailers are the lower price positioned products of multinational companies
    - Important value brands are supermarkets' private labels – e.g. Carrefour and Unimarc Cola, Éxito and Dia Laundry Detergents, Ekono Spaghetti – which are not distributed to small retailers

- Argentina and Brazil
    - Strong presence of local manufacturers that offer multiple brands
    - Additionally, in Argentina wholesalers' private labels are strongly prevalent at small retailers – e.g. "Marolio"

Legend:
- **Large-Scale Trade**
- **Traditionals**
- **Small Self Service**
- ↑ More Importance of 1st Tier Brands in Small Retailers
- ↓ More Importance of Value Brands in Small Retailers
- ↕ Mixed importance of 1st tier brands

Source: Field Interviews, Booz Allen Analysis

back

Small retailers serve daily purchase needs better by offering a higher proportion of smaller sizes and by "fractioning" products

% of SKUs That are "Small" [1]
**Selected Categories[2] – Large Scale Trade vs. Small retailers**
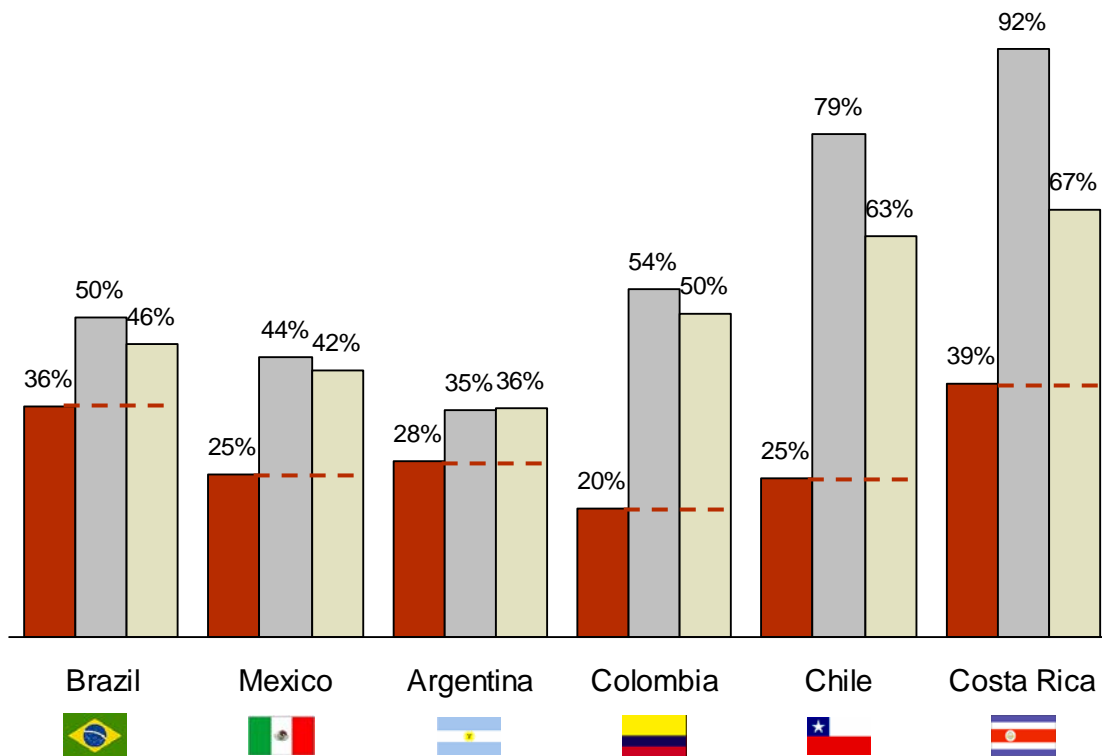
▶ Consistently across the region, small retailers offer an assortment with higher presence of small size SKUs

▶ Many small retailers – especially traditional formats – "fraction" products and break bulk on even the smallest package size, e.g:
  – French fries
  – Cereals
  – Sugar
  – Cigarettes

Legend:
- Large Scale Trade
- Traditionals
- Small Self-Service

↑ More Importance of Large Products in Small Retailers

↓ More Importance of Small Products in Small Retailers

Chart data:

Country	Large Scale Trade	Traditionals	Small Self-Service
Brazil	36%	50%	46%
Mexico	25%	44%	42%
Argentina	28%	35%	36%
Colombia	20%	54%	50%
Chile	25%	79%	63%
Costa Rica	39%	92%	67%

(1) Classification based in size relative to "standard" package , e.g. 2 liters of Cola, 500g of pasta, 1 kilo of tomatoes, etc. (2) Selected Categories: Colas & Laundry Det. plus: Mexico: Bar Soap; Argentina Oil; Colombia Spaghetti, Bar Soap; Costa Rica Spaghetti
Source: Field Interviews, Booz Allen Analysis

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Moreover, demand for small sizes is driving growth of new specialized formats – e.g. "todo sueltos" in Argentina

Retail Prods.

Liquid Dispensers (Bleach, Detergent, etc)
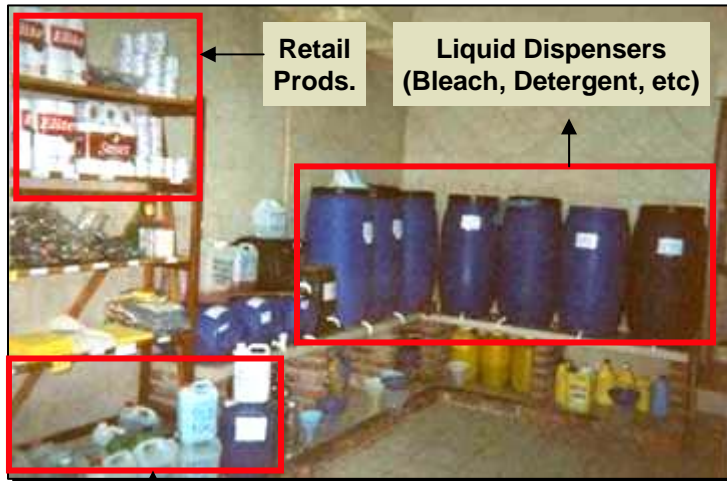
Used Bottles (bleach, beverages)

Typical Price Sign

General Appearance
- Less than 25m² on average, cheap fixture and/or products stacked on the floor (liquid dispensers, powders, bins with basic food)
- As a local convention, an outside sign with prices is mandatory

Product Assortment
- Two main types of stores, one focused on cleaning products (laundry soap, detergent, bleach) and the other on basic food (flour, dry pasta, rice, sugar, oil, spices)
- In some categories product description/name refers to known brands ("Skip-like", "Ace-Like")
- Liquid products sold on beverage bottles or used 1st-tier brands bottles (some times, at a cost), basic food products sold on plastic bags

Prices / Value
- Prices slightly below or near those of value brands found only in traditional stores
- No minimum quantity, no predefined size – ticket size can be as little as 20 peso cents
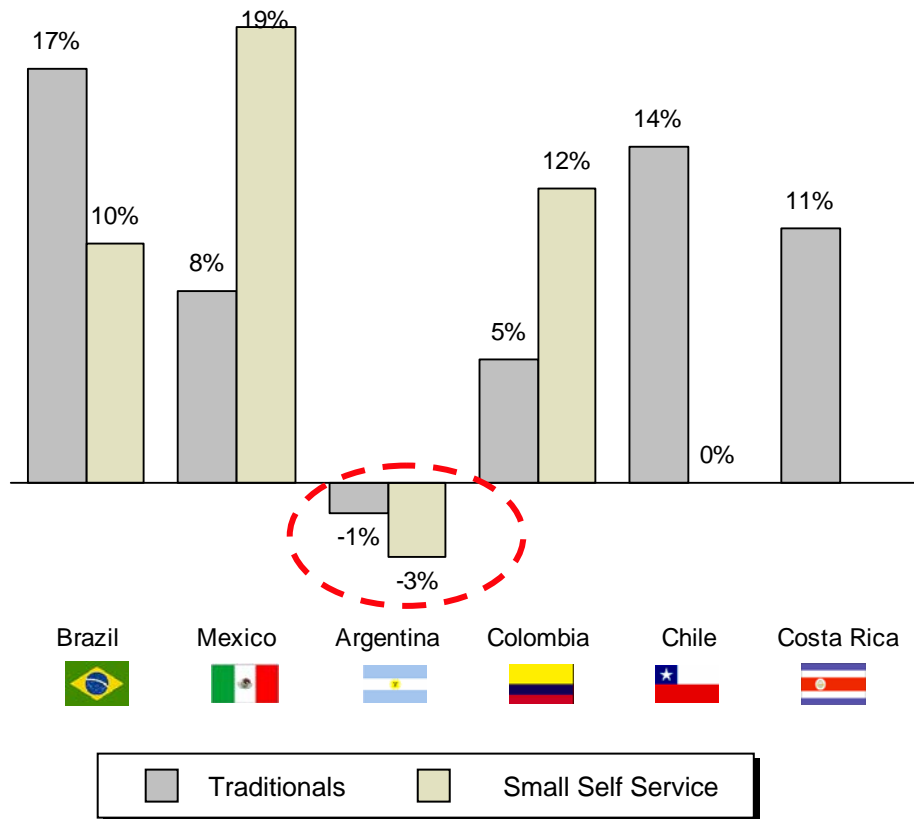
Procurement / Economics
- Most products are acquired in large containers by the store at a chemical distributor, with included instructions for on-site (final store) diluting/preparation of final product
- Mark up: Around 50%
- Some retail product are bought at wholesalers

Typical Consumer
- Mostly Mid/Lower Class in Gran Buenos Aires.
- Recently some stores are targeting the upper class

Source: Field Interviews, CCR Latin Panel, Booz Allen Analysis

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Price / Value: Contrary to what emerging consumers perceive, small retailers offer higher shelf prices than the large scale trade – Argentina a notable exception

Price Comparison Selected SKUs
(% Price Difference against Hypermarkets, Bundle of Selected Categories)

Brazil: 17% / 10%
Mexico: 8% / 19%
Argentina: -1% / -3%
Colombia: 5% / 12%
Chile: 14% / 0%
Costa Rica: 11%
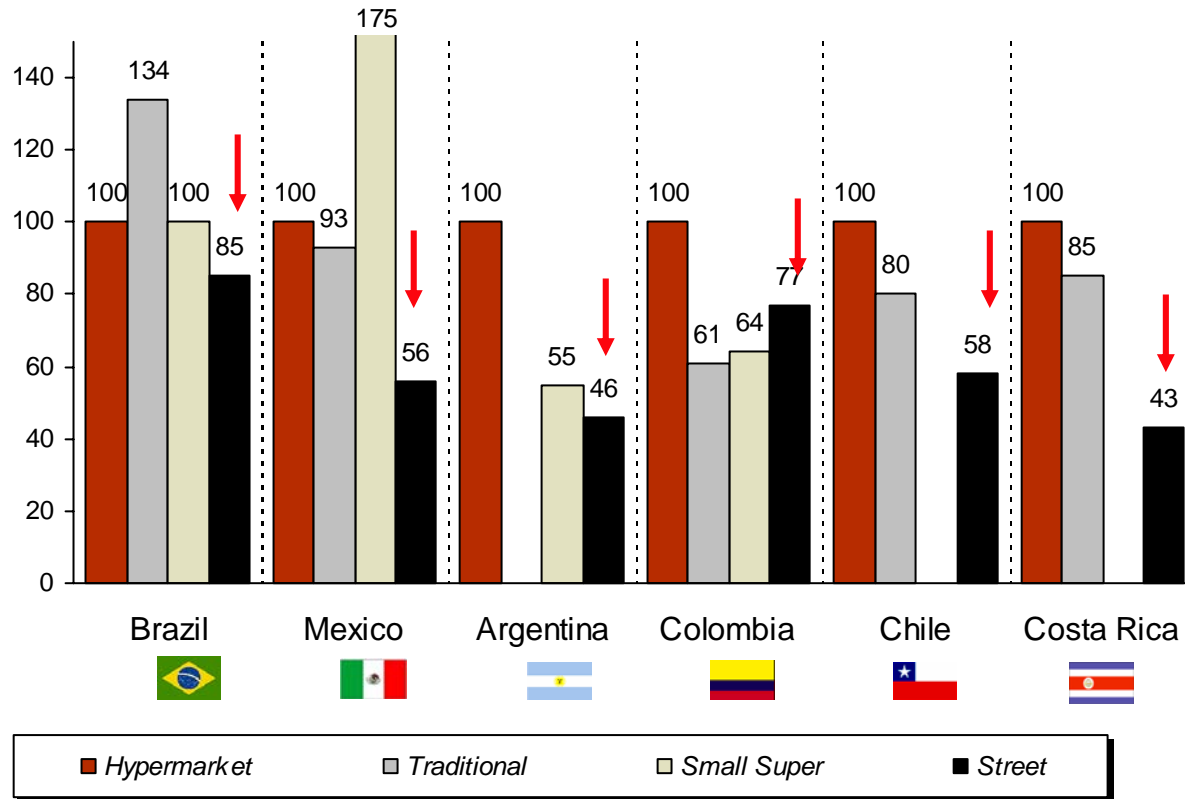
Legend: ☐ Traditionals ☐ Small Self Service

Observations in Argentina

▸ Since the devaluation in 2002, small retailers are becoming increasingly cheaper than large scale retailers for the same SKUs

▸ This effect is strengthened when considering brand tier mix – small retailers offer very inexpensive "value brands" that are not available at the organized trade (e.g. Beach Cola, Spaghetti Cordoba)

▸ Potential explanations are:
  – Large supermarkets raising mark-ups
  – Small retailers selling at or just above acquisition cost to stay in business
  – Growing importance of large self-service wholesalers (Maxiconsumo, Vital) who are sharing purchasing scale benefits with small retailers

▸ This trend helped small retailers re-gain 2% share of total food sales from organized trade in 2003

Note: Prices taken in February 2003. Selected categories include colas, spaghetti, laundry detergent, bar soap, vegetable oil
Source: Field Interviews, Booz Allen Analysis

back

Another noticeable exception is fresh produce -- an important category for emerging consumers where the large scale trade has a clear price disadvantage
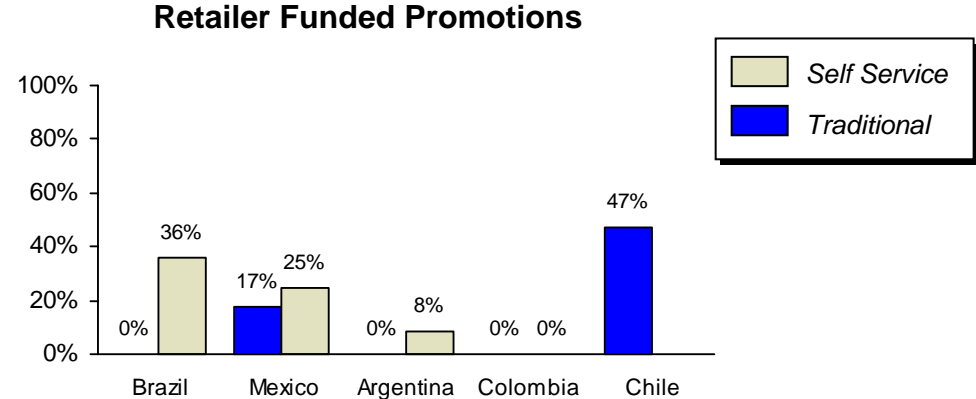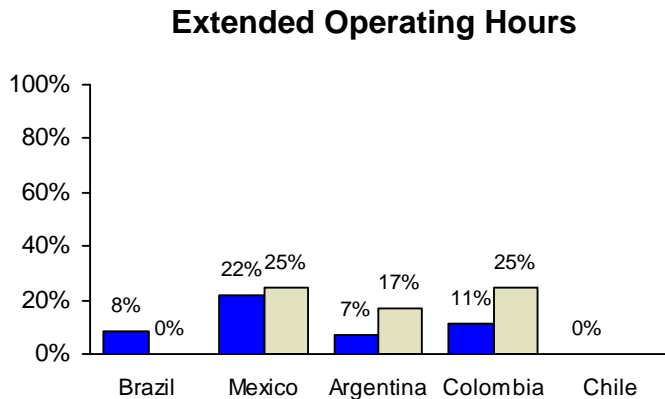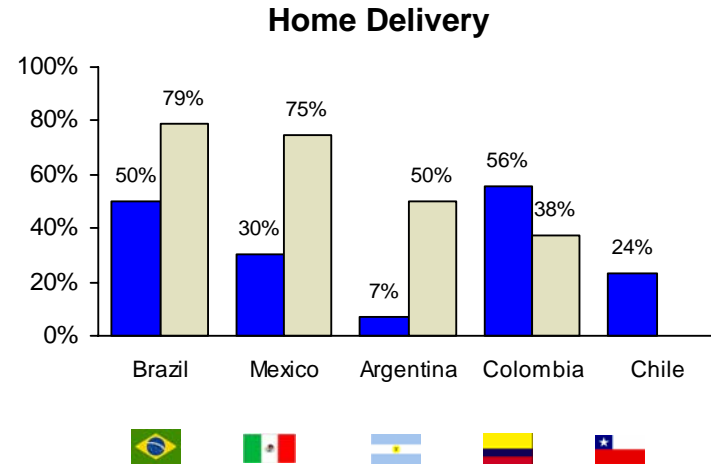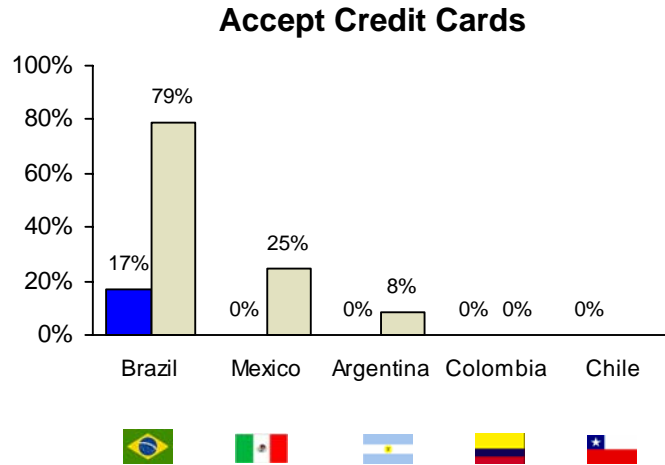
Price Comparison Tomatoes
(100 = Hypermarket Price)

Legend: ■ Hypermarket　□ Traditional　□ Small Super　■ Street

Countries: Brazil, Mexico, Argentina, Colombia, Chile, Costa Rica

- In almost all cases, street/open air formats offer the lowest prices for tomatoes, a representative category

- While supermarkets usually offer only 1st grade products, small retailers offer both 1st and 2nd grade products, at different stages of maturity

- Small retailers have the ability to change the price of produce several times a day – e.g. ferias in Brazil – according to demand and supply

- Some small retailers are either farmers or purchase directly from them – this may provide some informality advantages due to tax evasion

- Street formats ("ferias", "tianguis") and category specialists ("fruterias" / "verdulerias") are the most relevant formats where emerging consumers purchase fresh produce

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Services/ Other: Small retailers offer limited services when compared to the large scale players…

% of Small Retailers that offer Services

Accept Credit Cards

Brazil 17% / 79%
Mexico 0% / 25%
Argentina 0% / 8%
Colombia 0% / 0%
Chile 0%

Home Delivery

Brazil 50% / 79%
Mexico 30% / 75%
Argentina 7% / 50%
Colombia 56% / 38%
Chile 24%

Extended Operating Hours

Brazil 8% / 0%
Mexico 22% / 25%
Argentina 7% / 17%
Colombia 11% / 25%
Chile 0%

Retailer Funded Promotions

Brazil 0% / 36%
Mexico 17% / 25%
Argentina 0% / 8%
Colombia 0% / 0%
Chile 47%

Legend: *Self Service* / *Traditional*

back

…but have an advantage particularly with emerging consumers since they offer a "virtual wallet"/informal credit

**Percentage of Small Retailers
that offer Informal Credit**

Traditional Autoservice

Brazil: 42% (Traditional), 64% (Autoservice)
Mexico: 48% (Traditional), 25% (Autoservice)
Argentina: 60% (Traditional), 33% (Autoservice)
Colombia: 78% (Traditional), 25% (Autoservice)
Chile: 65% (Traditional)
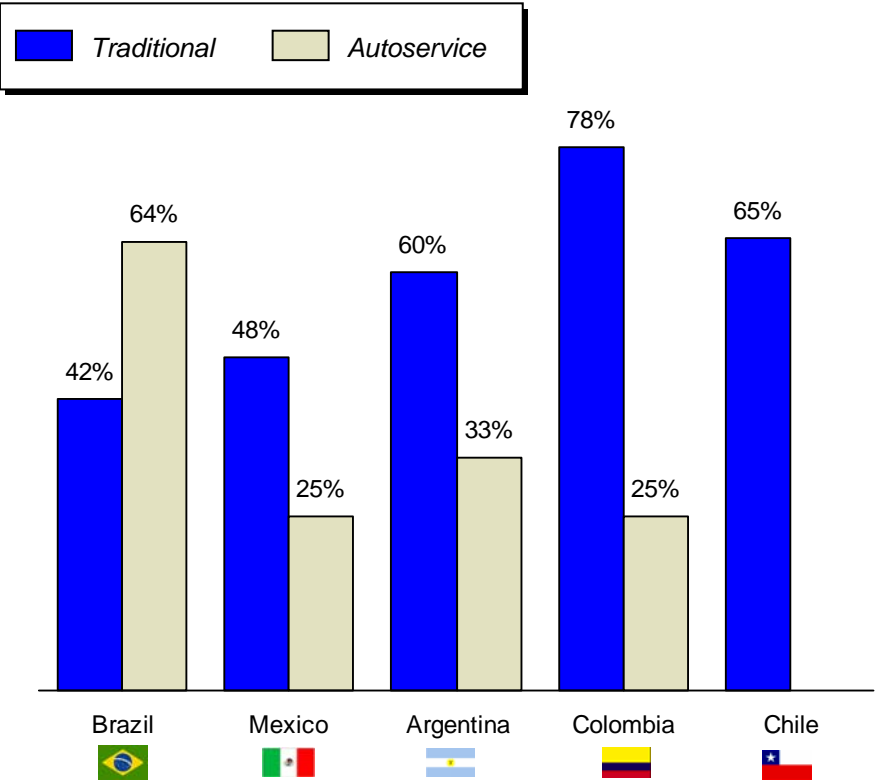
Credit at Small Retailers

▶ A large percentage of small retailers offer credit to their customers, in one of two forms:

  – "Informal Credit", which can go from 1 week to 1 month, where the owner/operator writes the name of the debtor in a small handbook – for sums that range from 5 to 80 dollars

  – "Virtual Wallet": when the customer is short of small amount of cash at the register the owner/operator allows payment "the next time"

▶ "The 'Virtual Wallet" is offered by almost every small retailer, but only to their known customers

▶ "Informal Credit" acts as a sort of loyalty program -- , once a customer uses this service, there are strong incentives to continue shopping at the store

▶ The social costs of default are high for consumers, since bad debts are made public knowledge in the neighborhood

back

Although promotional and merchandising activities are more prevalent in the large scale trade, small and traditional retailers' have limited but effective in-store communication

BRAZIL

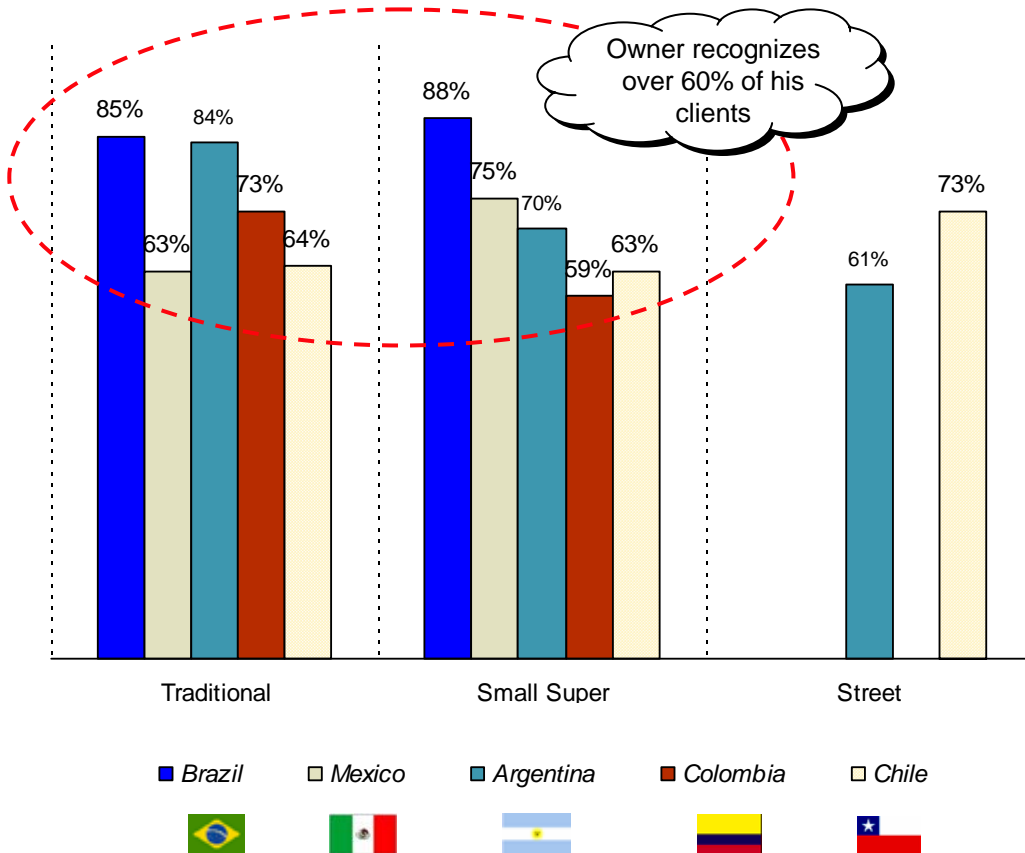**% of Stores Where Merchandising Vehicle is Present**

Large Scale Trade
▶ Special offers / price discounts: 50%
– 25% of shoppers purchased the offer
▶ Tastings / free sample distribution: 49%
– 26% of shopper took a sample
– 24% of shoppers tasted products
▶ Islands: 48%
▶ Product demonstrations: 40%
– 32% of shoppers stopped to watch the demonstration
▶ POS signs: 33%
▶ Qualitative assessment:
– More merchandising space, larger number of items on display
– High level of competition between brands to capture consumer attention

Small Retailers
▶ Freezers/ refrigerators: 78%
▶ Islands or stacked product: 36%
▶ Counter displays: 35%
▶ Price signs (handwritten): 33%
▶ Shelf talkers (brands): 24%
▶ Shelf talkers, stickers, banners for price communication: 24%
▶ Qualitative assessment:
– Less merchandising space and greater visual clutter = less recall
– High level of competition between some products such as cigarettes, drinks, boiled candy, chocolate, and soft drinks

back

People: Small retailers benefit from the presence of the local owner-operator who can tailor their business model to local needs and provide a 'personal touch'

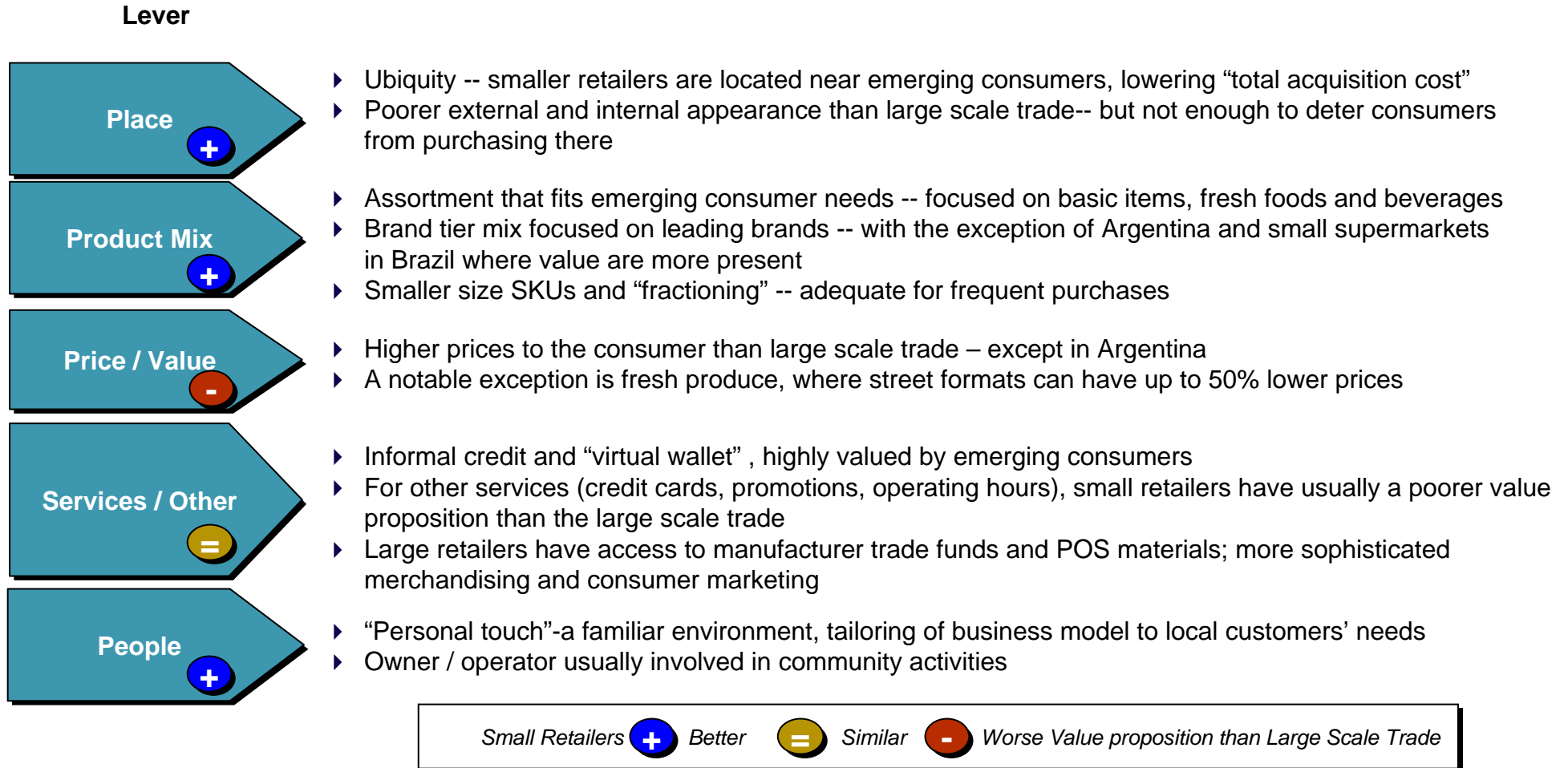**% of Customers that Owner Recognizes / Knows by Name**

Owner recognizes over 60% of his clients

Traditional: 85%, 63%, 84%, 73%, 64%
Small Super: 88%, 75%, 70%, 59%, 63%
Street: 61%, 73%

■ *Brazil* □ *Mexico* ■ *Argentina* ■ *Colombia* □ *Chile*

Value of Relationship at Small Retailers

▸ Successful store owners/operators usually have close relationship with their customers

▸ In some cases, store owners create barriers to switching by deleting customer names from the credit list if they are observed shopping at other stores nearby

▸ Store owner quotes:

– "I've known this customer for 20 years and I've known his kids since they were born"

– "I know I can give credit to this customer, he always pays me … I was at his grandfather's burial last month"

– "This customer comes here 2 times a day. She is old and lives alone, and comes here to talk with me and to other customers, purchasing is sometimes an excuse"

back

In summary, despite higher prices small retailers have several advantages that make them highly attractive to emerging consumers
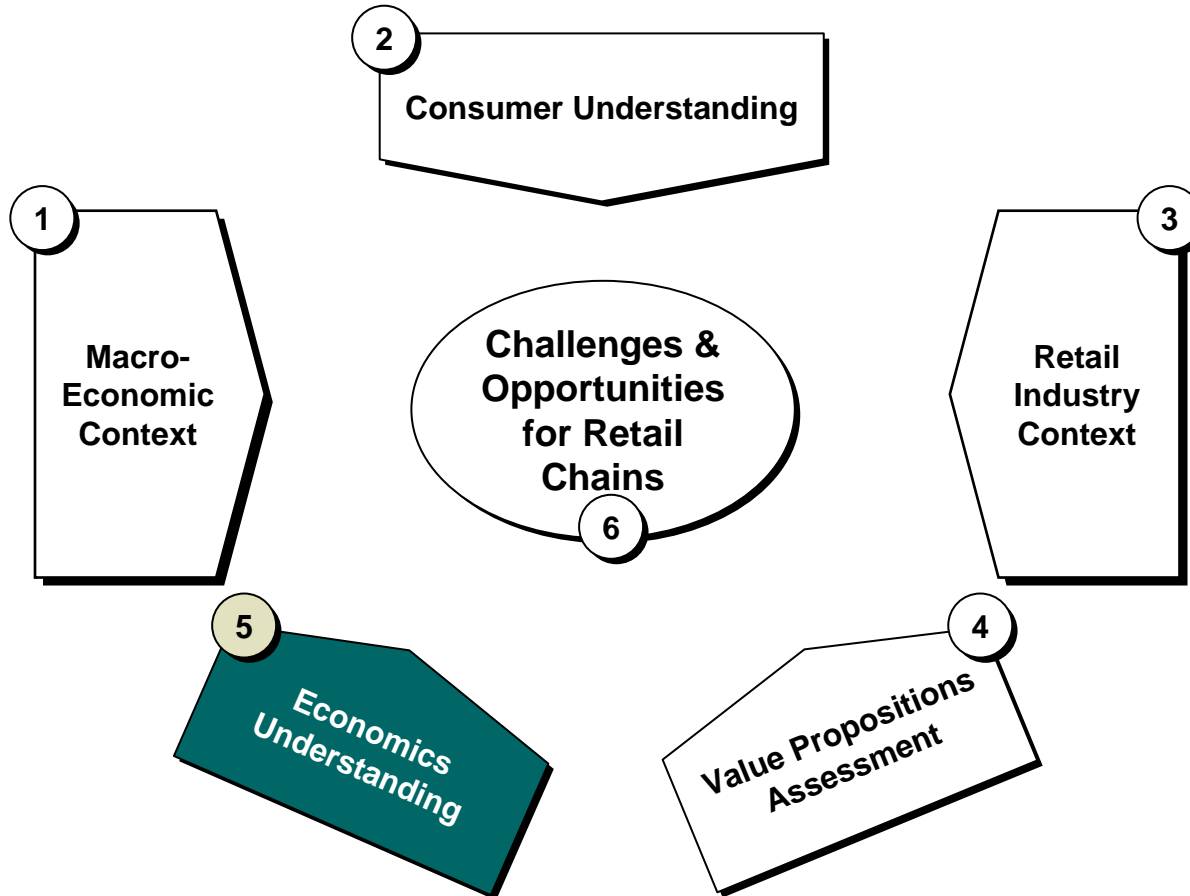
Small Retailers Value Proposition for Emerging Consumers -- Summary

Lever

Place +
- Ubiquity -- smaller retailers are located near emerging consumers, lowering "total acquisition cost"
- Poorer external and internal appearance than large scale trade-- but not enough to deter consumers from purchasing there

Product Mix +
- Assortment that fits emerging consumer needs -- focused on basic items, fresh foods and beverages
- Brand tier mix focused on leading brands -- with the exception of Argentina and small supermarkets in Brazil where value are more present
- Smaller size SKUs and "fractioning" -- adequate for frequent purchases

Price / Value -
- Higher prices to the consumer than large scale trade – except in Argentina
- A notable exception is fresh produce, where street formats can have up to 50% lower prices

Services / Other =
- Informal credit and "virtual wallet" , highly valued by emerging consumers
- For other services (credit cards, promotions, operating hours), small retailers have usually a poorer value proposition than the large scale trade
- Large retailers have access to manufacturer trade funds and POS materials; more sophisticated merchandising and consumer marketing

People +
- "Personal touch"-a familiar environment, tailoring of business model to local customers' needs
- Owner / operator usually involved in community activities

Small Retailers + Better = Similar - Worse Value proposition than Large Scale Trade
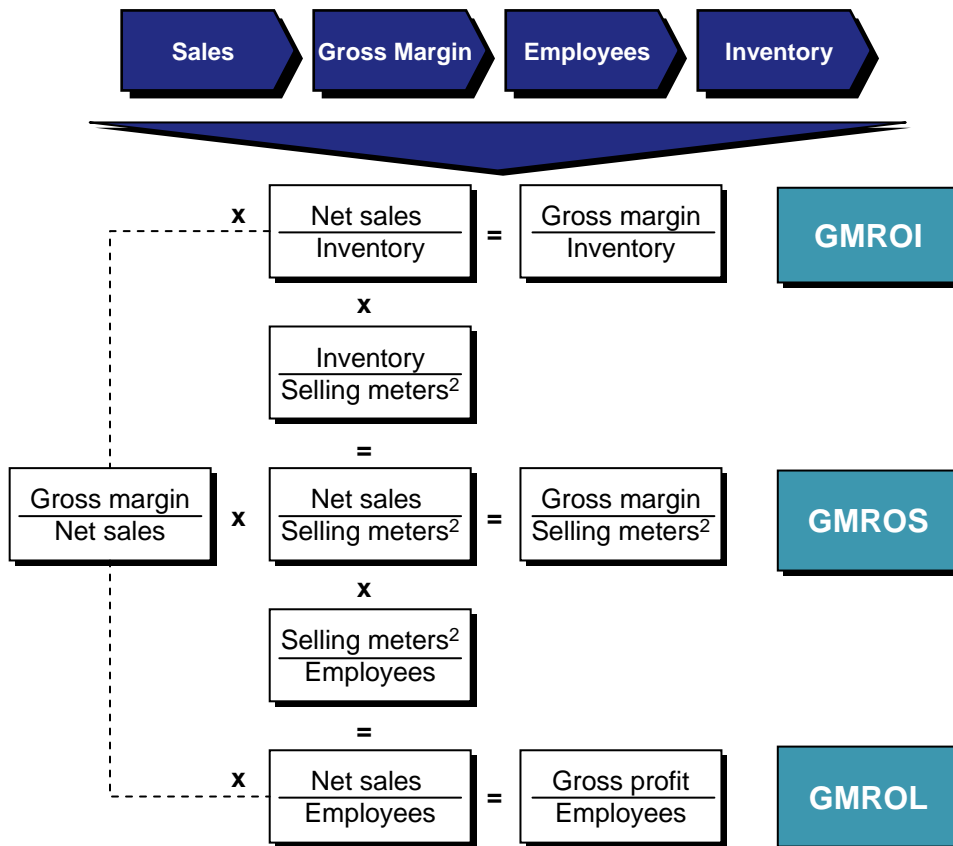
back

The Retail Landscape and Informality

▸ Retail Industry Context & Landscape

▸ Small Retailers value proposition for emerging consumers

▸ How small retailers make a sustainable business model

▸ The impact of Informality

back

Discussion Roadmap

2 Consumer Understanding

1 Macro-Economic Context

3 Retail Industry Context

Challenges & Opportunities for Retail Chains **6**

5 Economics Understanding

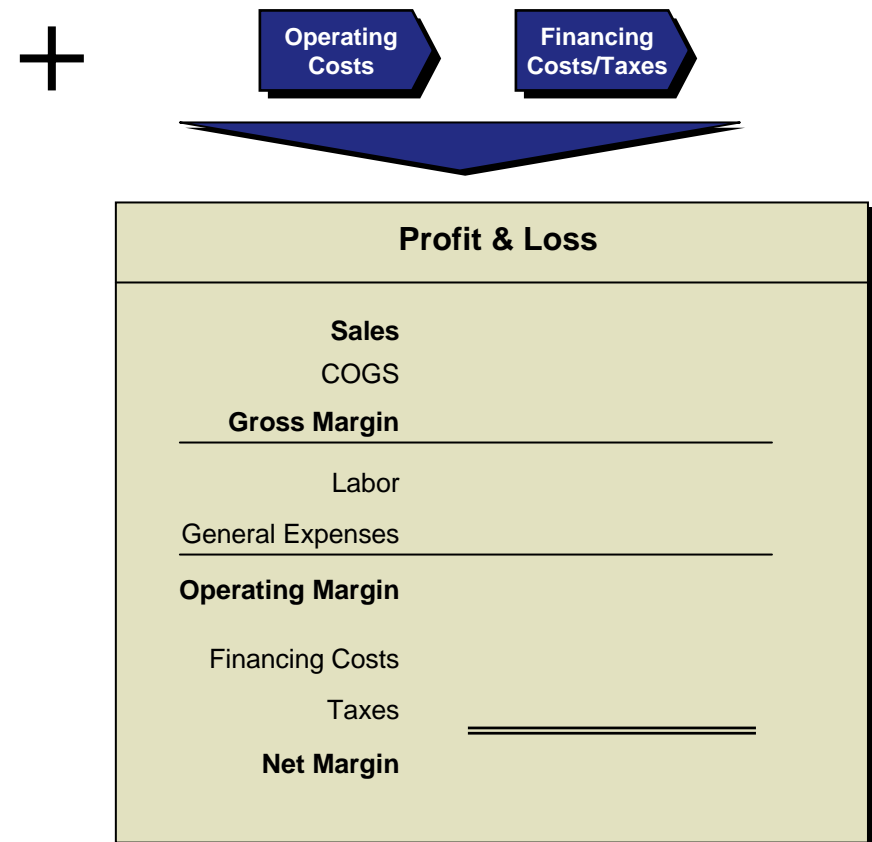**4** Value Propositions Assessment

back

In this chapter we will review the main drivers of profitability and net income / cash flow for small retailers, focusing on traditionals

Strategic Resource Model Ratios

P&L Statement

| Sales | Gross Margin | Employees | Inventory |

$+$

| Operating Costs | Financing Costs/Taxes |

$$\frac{\text{Net sales}}{\text{Inventory}} \times = \frac{\text{Gross margin}}{\text{Inventory}} \quad \textbf{GMROI}$$

$$\times$$

$$\frac{\text{Inventory}}{\text{Selling meters}^2}$$

$$=$$

$$\frac{\text{Gross margin}}{\text{Net sales}} \times \frac{\text{Net sales}}{\text{Selling meters}^2} = \frac{\text{Gross margin}}{\text{Selling meters}^2} \quad \textbf{GMROS}$$

$$\times$$

$$\frac{\text{Selling meters}^2}{\text{Employees}}$$

$$=$$

$$\frac{\text{Net sales}}{\text{Employees}} \times = \frac{\text{Gross profit}}{\text{Employees}} \quad \textbf{GMROL}$$

Profit & Loss

Sales
COGS
Gross Margin

Labor
General Expenses
Operating Margin
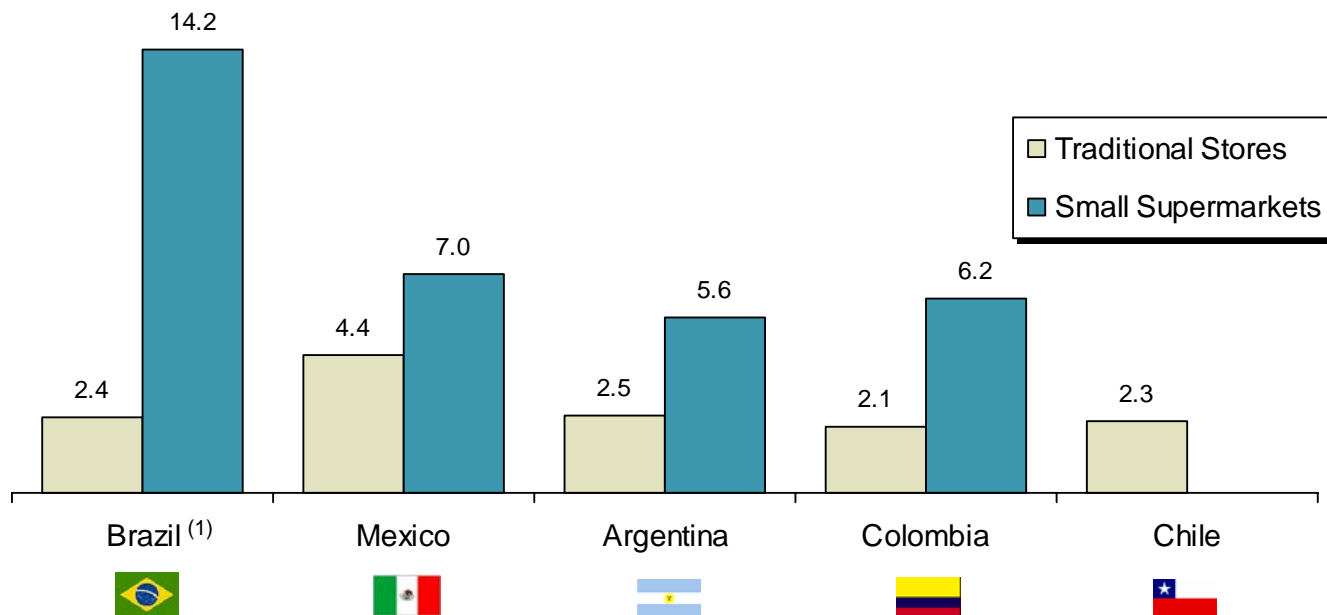
Financing Costs
Taxes
Net Margin

back

Points to consider before we review our findings:

▸ Source data on sales, gross margins, operating costs, and number of employees originate from the in-depth interviews / questionnaires completed

▸ "Best efforts" were made to check the accuracy of the responses, since interviewees may feel pressured to understate revenues and margins—or may not know accurate cost figures
  - Double checking the prices retailer stated they paid for products by comparing against prices collected from distributors or public wholesale markets
  - Observing store traffic and sizes of purchases made while in the store; collecting tickets and receipts
  - Comparing costs and revenues among retailers to check for 'outliers'

▸ Survey questions typically probed for 'ranges' since small retailers often do not track business metrics with the same rigor as the organized trade and usually struggle to respond to requests for exact values

▸ The results shown in this chapter reflect average performance—in reality, there is wide dispersion in economic performance with some small retailers making money comparable to a mid-management job while others are barely breaking even or even loosing money

▸ While we evaluated these businesses in terms of standard business metrics, it is worthwhile to note that the usefulness of comparisons between small retailers and the large scale trade is limited
  - Small retailers care almost exclusively about cash flow … and whether or not they can cover costs each month and have money left to replenish inventory—they do not manage their businesses to these metrics
  - Conceptually, their businesses are quite different than the large-scale trade

▸ Of the three small retailers profiled in the previous section (street, traditionals and small supermarkets), we focused on traditional stores

back

Sales per store for small retailers are significantly lower than those of the large scale trade – traditional stores sell US$ 2K-4K monthly

Estimate

**Average Small Retailer Monthly Sales
(In US$ '000/Month)**

Legend:
- □ Traditional Stores
- ■ Small Supermarkets

Brazil [1] — 2.4 / 14.2
Mexico — 4.4 / 7.0
Argentina — 2.5 / 5.6
Colombia — 2.1 / 6.2
Chile — 2.3

Example Sales per Store (US$ '000/Month) for Large Scale Retailer	Pao de Açucar	Gigante	Disco	Éxito	D&S
	350	1,220	320	1,000	1,680

(1) Excludes Supermarkets with 3 or more checkouts to make comparisons consistent across countries
Source: Field Interviews; Annual reports; Booz Allen analysis

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Additionally small retailers have lower sales/m2 partly driven by smaller ticket size
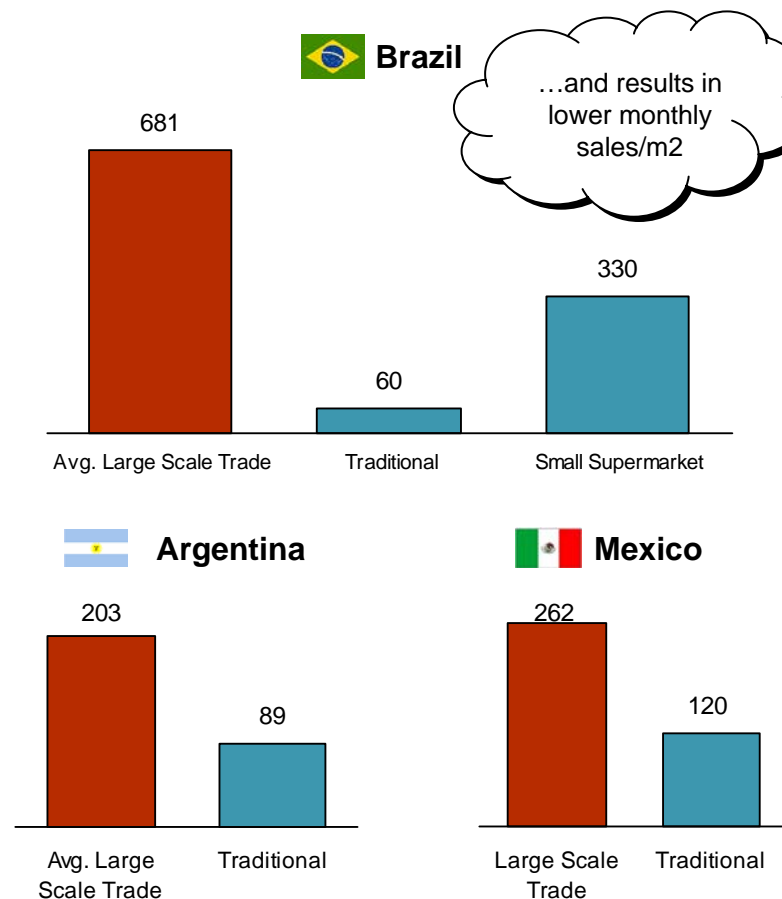
ESTIMATE

Average Ticket Size for Large Scale Trade vs. Small Retailers (In US Dollars)

A value proposition based on high frequency purchases implies lower ticket sizes than organized trade...
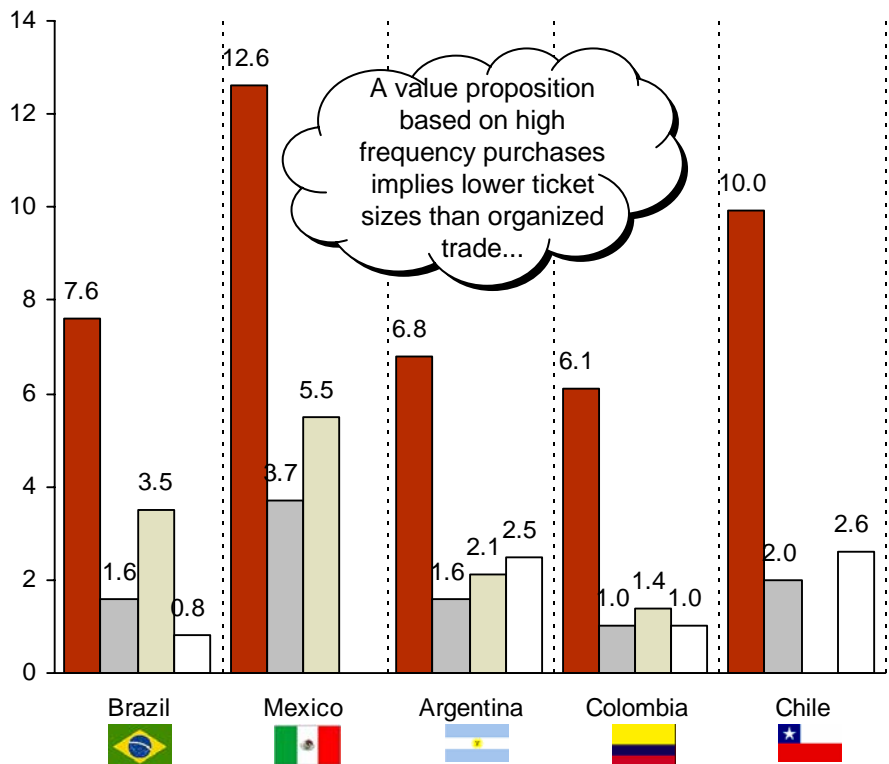
Legend: ■ *Large Scale Trade[1]* ■ *Traditionals* ☐ *Small Super* ☐ *Street*

Countries: Brazil, Mexico, Argentina, Colombia, Chile

**Monthly Sales / m² - U$S
Organized vs. Small Retailers**

🇧🇷 **Brazil**

...and results in lower monthly sales/m2

	Avg. Large Scale Trade	Traditional	Small Supermarket
Brazil	681	60	330

🇦🇷 **Argentina**

	Avg. Large Scale Trade	Traditional
Argentina	203	89

🇲🇽 **Mexico**

	Large Scale Trade	Traditional
Mexico	262	120

(1) Brazil organized trade ticket size based on CBD, Chile on D y S, Mexico, Argentina and Colombia based on average large players
Source: Field interviews (small retailers); INDEC, Antad Mexico, and AC Nielsen (organized trade)
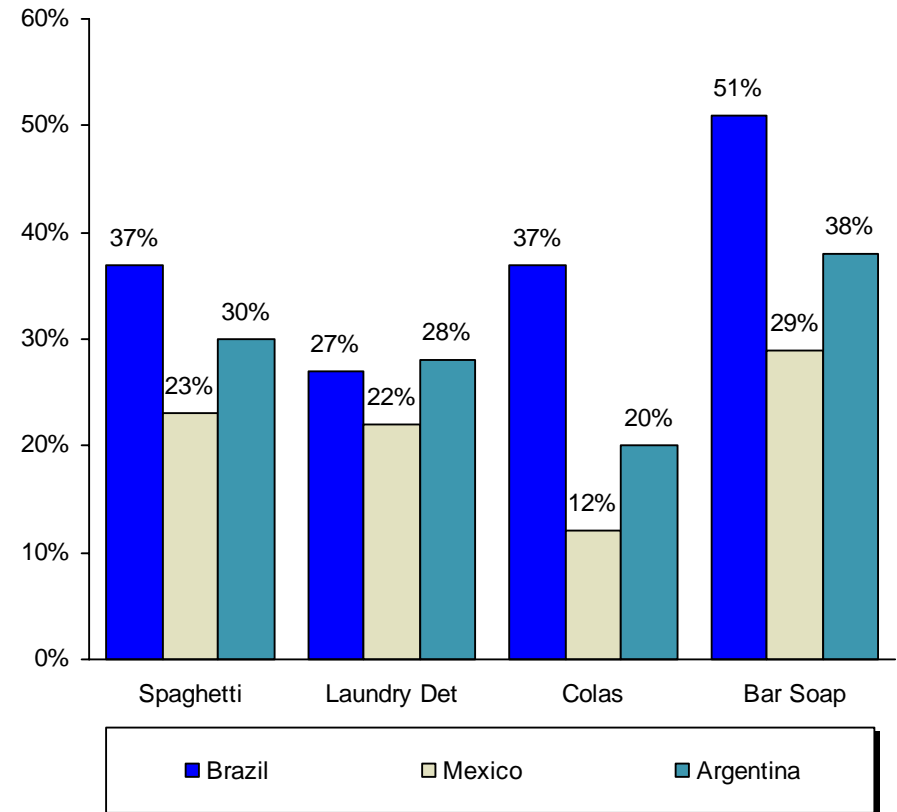
back

Traditional store's gross margins are similar to or lower than those for large scale retailers

ESTIMATE

**Gross Margins
Large Scale Trade vs. Traditionals**

Brazil: Large Scale Trade 28%, Traditionals 26%
Mexico: Large Scale Trade 20%, Traditionals 20%
Argentina: Large Scale Trade 32%, Traditionals 23%

■ Large Scale Trade [1]   □ Traditionals
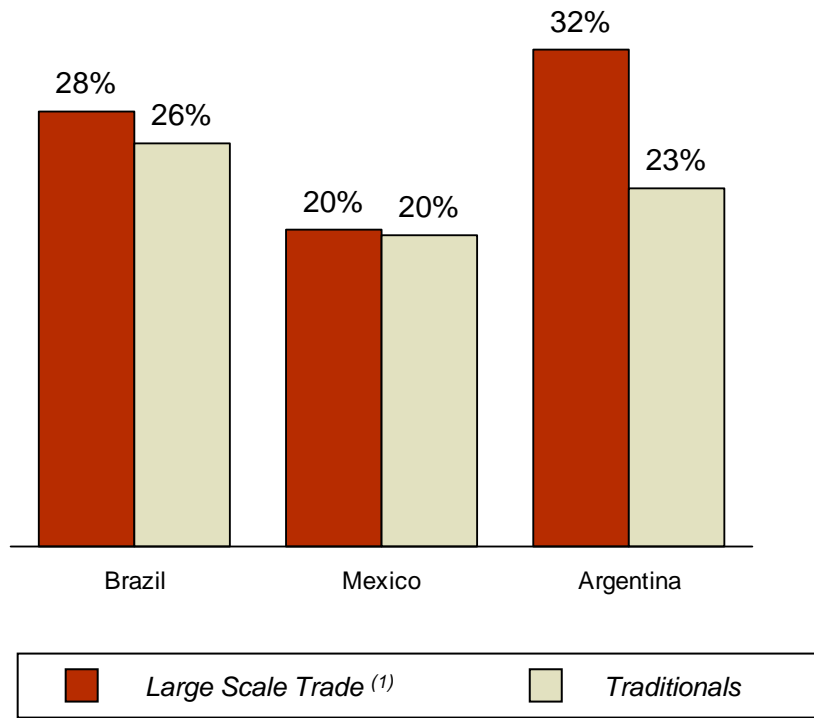
Traditionals Mark-up by Category

Spaghetti: Brazil 37%, Mexico 23%, Argentina 30%
Laundry Det: Brazil 27%, Mexico 22%, Argentina 28%
Colas: Brazil 37%, Mexico 12%, Argentina 20%
Bar Soap: Brazil 51%, Mexico 29%, Argentina 38%

■ Brazil   □ Mexico   ■ Argentina

(1) Large Scale Trade is CBD in Brazil, WalMex in Mexico, and Disco in Argentina
Source: 2002 Annual Reports, Price checks at stores and wholesalers, Booz Allen analysis
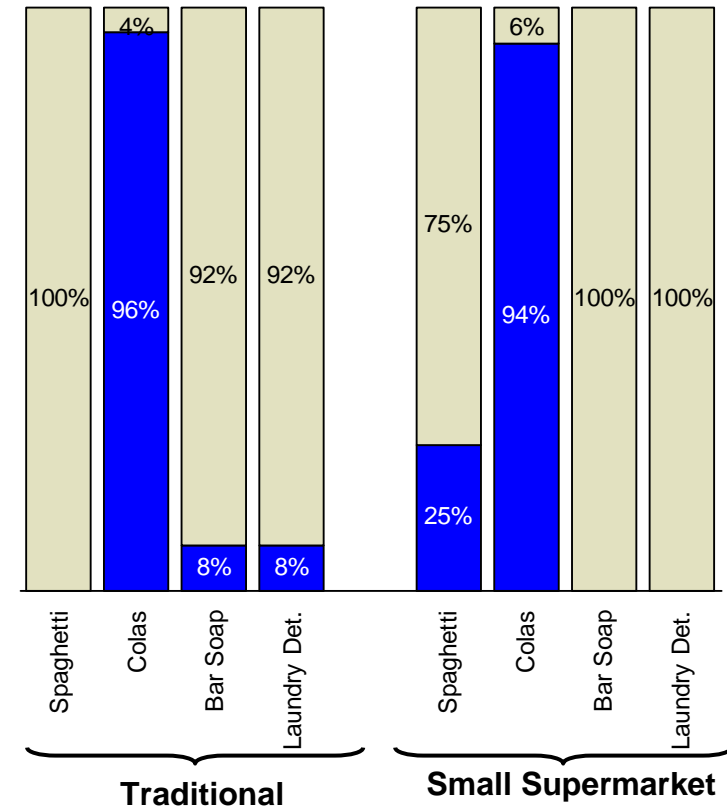
back

Small retailers face procurement disadvantages — they purchase from intermediaries…

Small Retailer Sourcing in Brazil
% Products Purchased Direct vs. Indirect
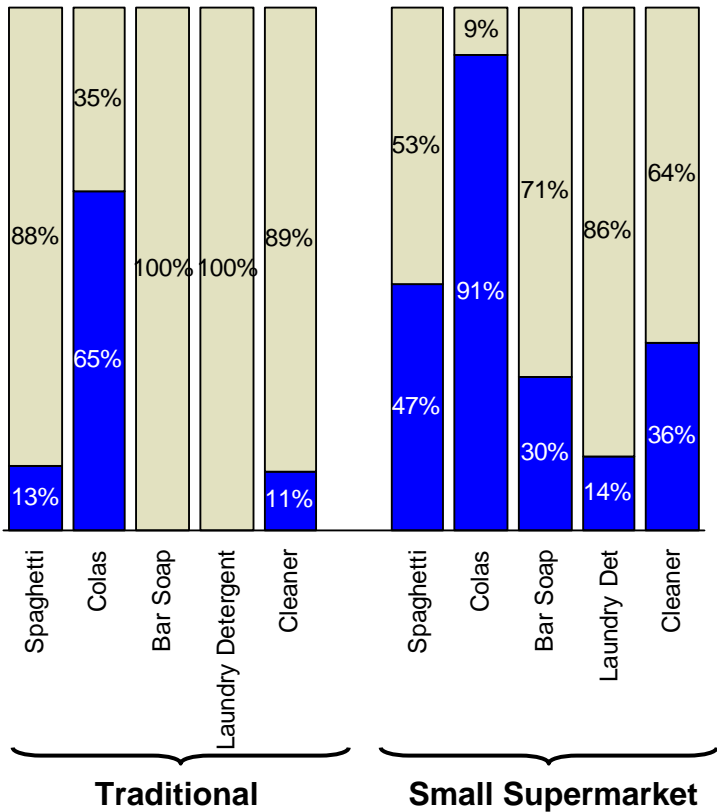
Small Retailer Sourcing in Mexico
% Products Purchased Direct vs. Indirect

Brazil — Traditional

Product	Intermediaries	Manufacturer
Spaghetti	88%	13%
Colas	35%	65%
Bar Soap	100%	
Laundry Detergent	100%	
Cleaner	89%	11%

Brazil — Small Supermarket

Product	Intermediaries	Manufacturer
Spaghetti	53%	47%
Colas	9%	91%
Bar Soap	71%	30%
Laundry Det	86%	14%
Cleaner	64%	36%

Mexico — Traditional

Product	Intermediaries	Manufacturer
Spaghetti	100%	
Colas	4%	96%
Bar Soap	92%	8%
Laundry Det.	92%	8%

Mexico — Small Supermarket

Product	Intermediaries	Manufacturer
Spaghetti	75%	25%
Colas	6%	94%
Bar Soap	100%	
Laundry Det.	100%	

Legend:
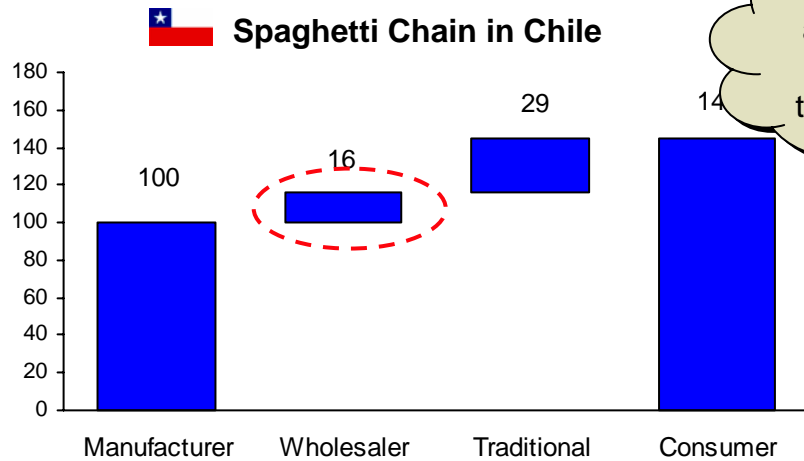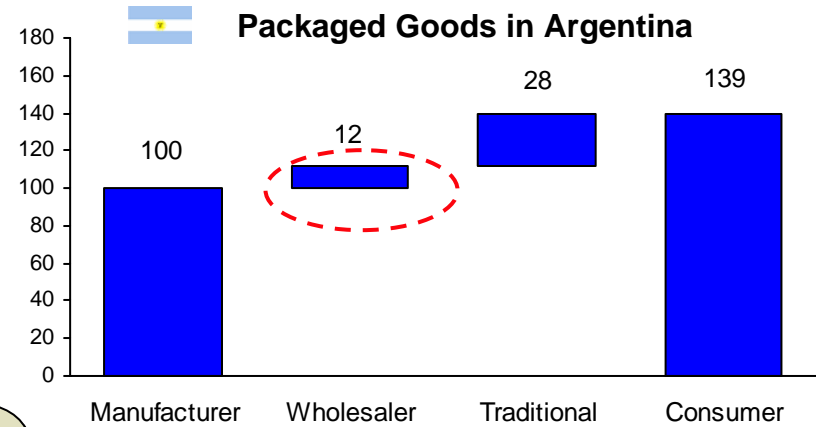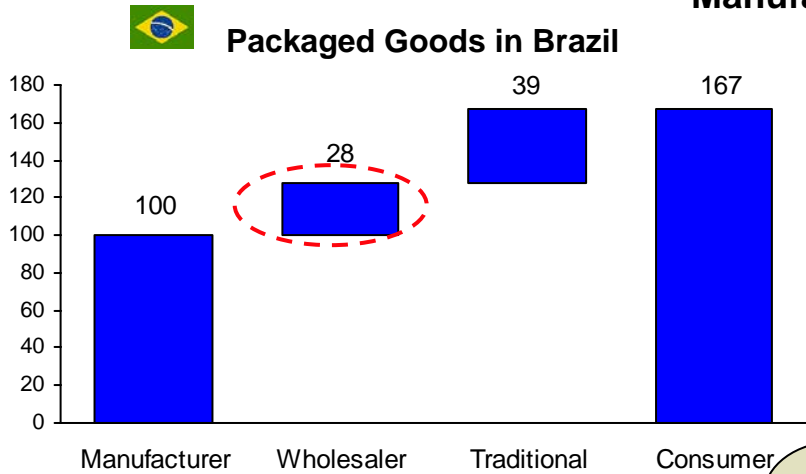- *Intermediaries (Wholesalers, Distributors, Hypermarkets, Central Markets, etc...)*
- *Manufacturer*

Source: Field Interviews, Booz Allen analysis

… which charge higher prices than manufacturers to cover distribution costs and their own margin (double marginalization)

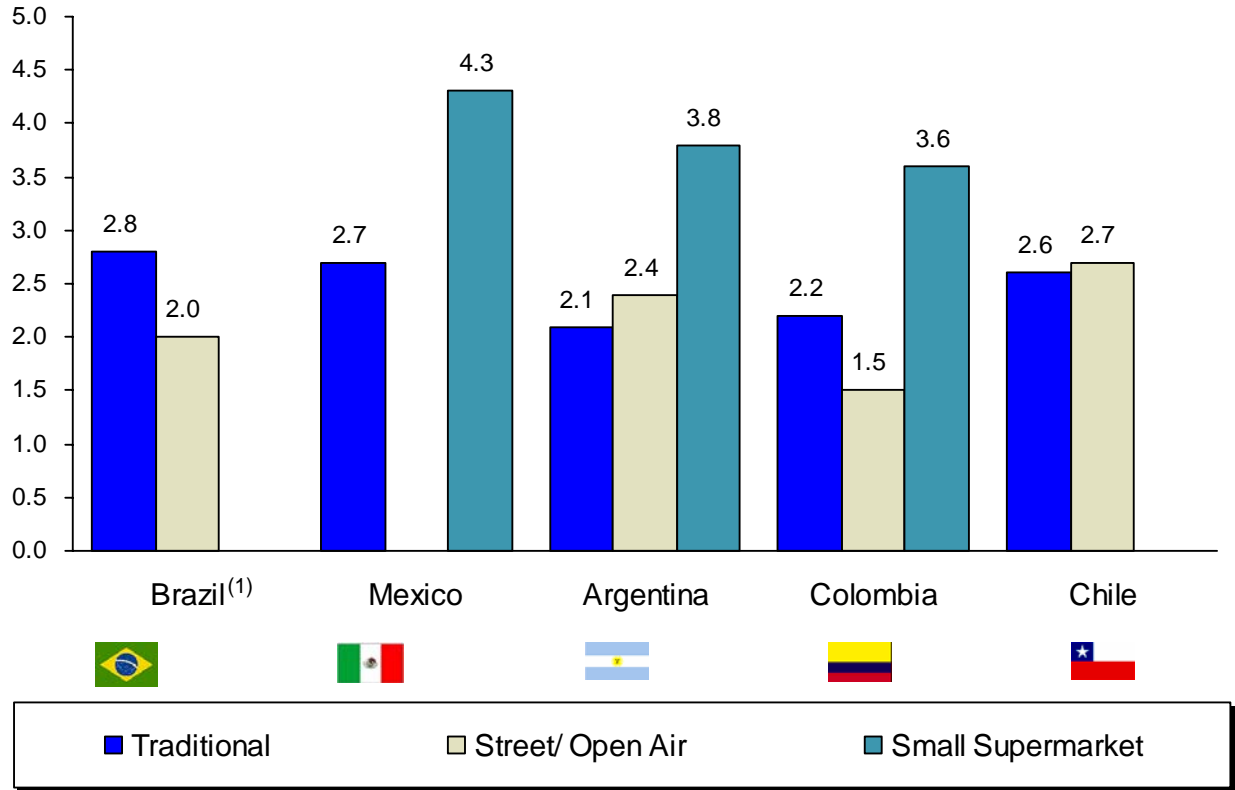ESTIMATE

Value Chain Indexes
Manufacturer Price = 100

Packaged Goods in Brazil

- Manufacturer: 100
- Wholesaler: 28
- Traditional: 39
- Consumer: 167

Packaged Goods in Argentina

- Manufacturer: 100
- Wholesaler: 12
- Traditional: 28
- Consumer: 139

Spaghetti Chain in Chile

- Manufacturer: 100
- Wholesaler: 16
- Traditional: 29
- Consumer: 14_
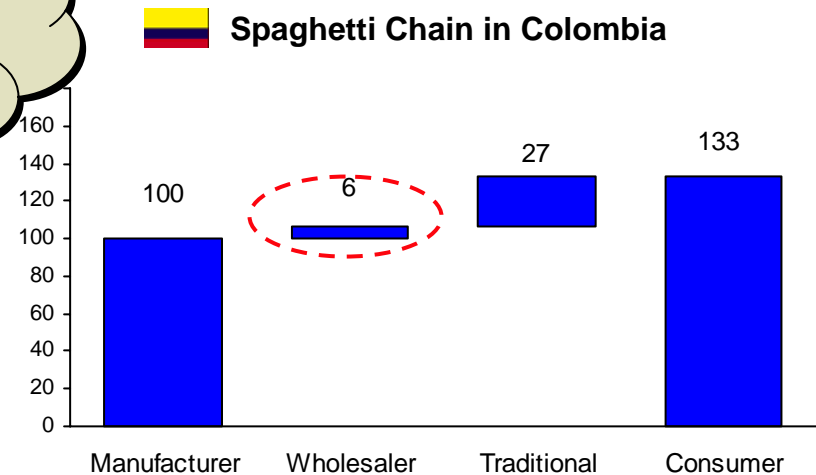
Small retailers pay an extra 6% to 28% for merchandise than organized trade

Spaghetti Chain in Colombia

- Manufacturer: 100
- Wholesaler: 6
- Traditional: 27
- Consumer: 133

Source: Retail and Wholesaler interviews, BAH Analysis

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Small retailers work with 2 to 5 employees in the store – traditional stores no more than 3
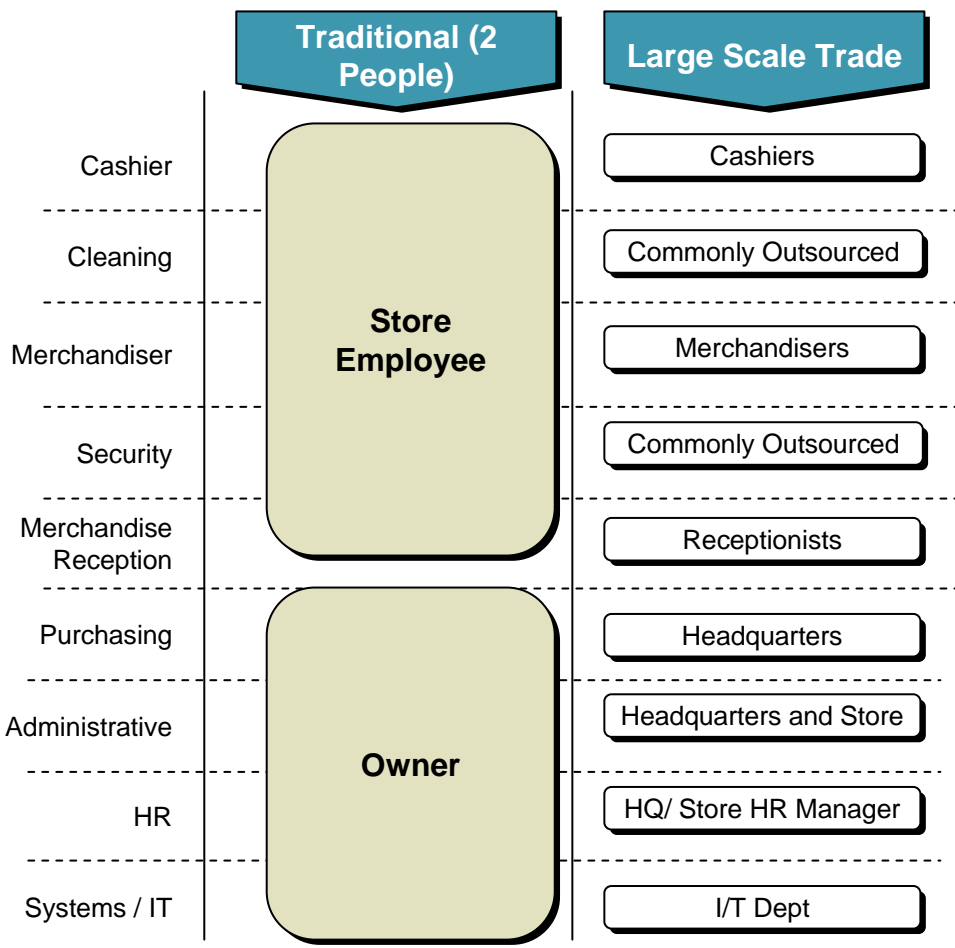
ESTIMATE

Average Number of Employees per Store

	Brazil(1)	Mexico	Argentina	Colombia	Chile
Traditional	2.8	2.7	2.1	2.2	2.6
Street/ Open Air	2.0		2.4	1.5	2.7
Small Supermarket		4.3	3.8	3.6	

■ Traditional □ Street/ Open Air ■ Small Supermarket

Note: (1) Excludes supermarkets with 3 or more checkouts (average = 20.5 employees) to make comparisons consistent across countries
Source: Field Interviews, Booz Allen analysis

back

Despite the multi-functionality of the owner/ operator, traditional stores show lower sales/FTE than the large scale trade

ESTIMATE

**Employee Positions & Functions
Small Retailers vs. Large Scale Trade**

**Monthly Sales per Employee
US$ - Traditionals vs. Large Scale Trade**
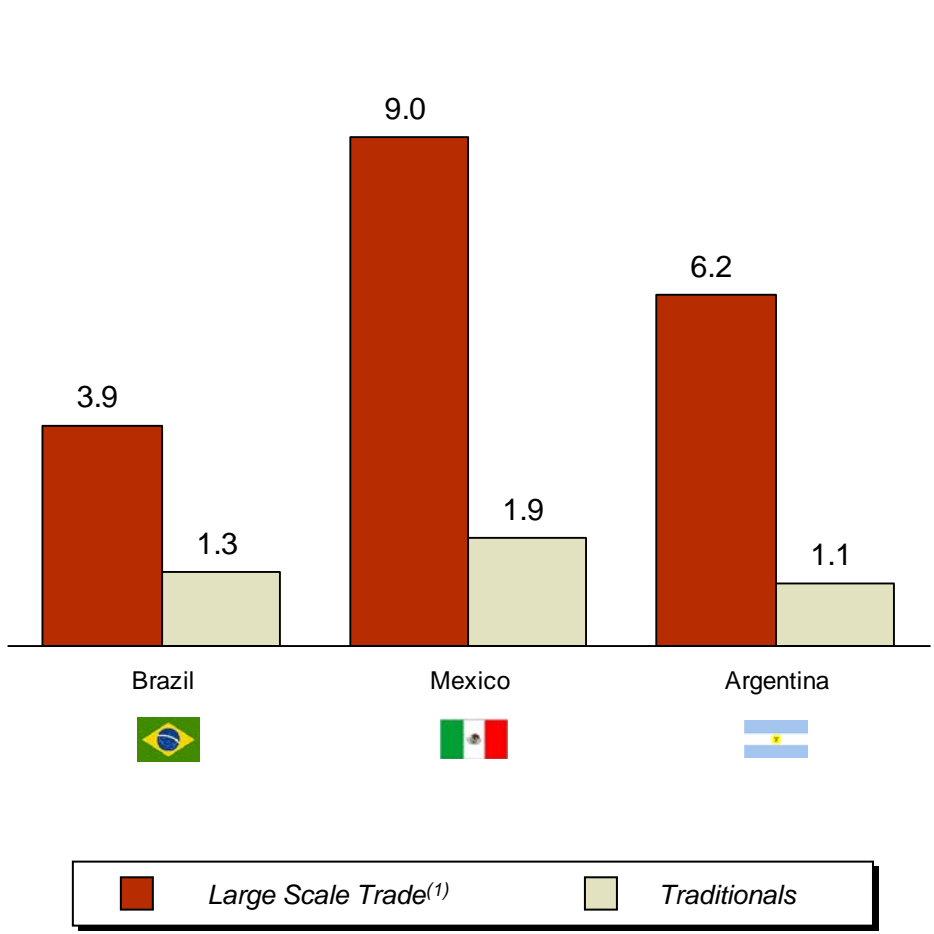
Traditional (2 People)	Large Scale Trade
Cashier	Cashiers
Cleaning	Commonly Outsourced
Merchandiser	Merchandisers
Security	Commonly Outsourced
Merchandise Reception	Receptionists
Purchasing	Headquarters
Administrative	Headquarters and Store
HR	HQ/ Store HR Manager
Systems / IT	I/T Dept

Store Employee

Owner

Brazil: Large Scale Trade 3.9, Traditionals 1.3
Mexico: Large Scale Trade 9.0, Traditionals 1.9
Argentina: Large Scale Trade 6.2, Traditionals 1.1

■ Large Scale Trade[1]   ☐ Traditionals

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Inventory turnover for traditional stores is more than two times higher than that of the large scale trade …

**Inventory Turnover
Monthly Sales / Inventory**

Brazil — 0.8 / 2.1
Mexico — 0.8 / 2.5
Argentina — 0.9 / 2.5
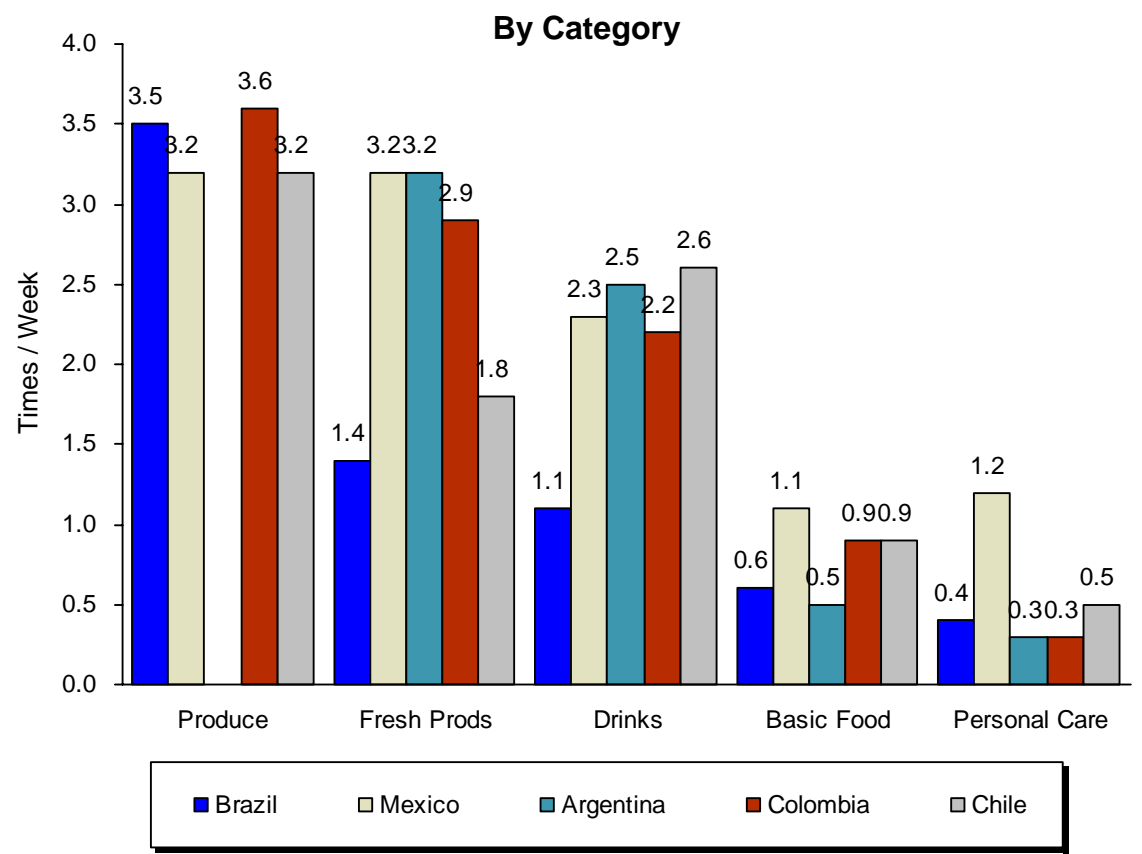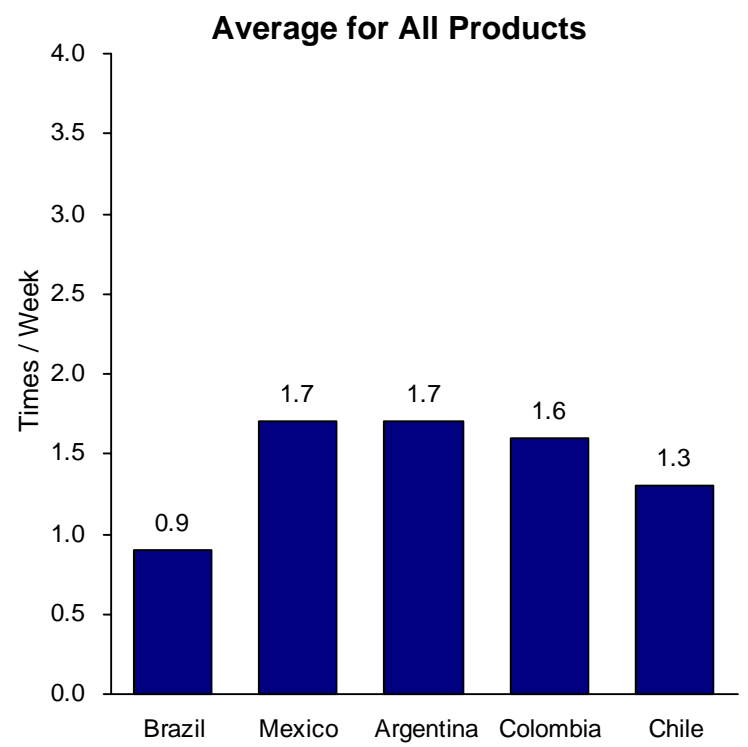
■ Large Scale Trade(1)   ☐ Traditionals
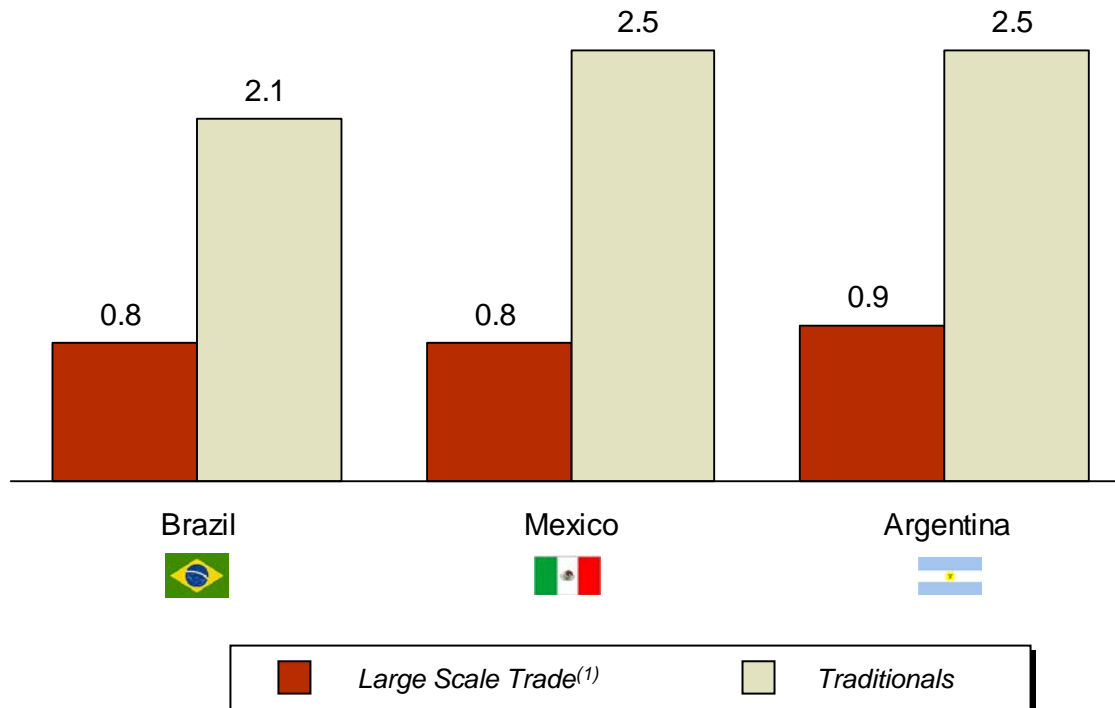
Comments

▸ Stock significantly fewer SKUs—while a Hypermart or large supermarket may offer 30,000–60,000 SKUs

▸ Assortment has relatively less general merchandise, which often has lower turnover

▸ Deep knowledge of customer base

▸ Easy to identify "ordering mistakes" (stock outs, unsold merchandise)

▸ Implications of 'ordering mistakes" are large—creating incentives to manage working capital well

▸ Help from distributors and manufacturers shipping direct to determine appropriate order size

▸ As a result, the business model is consistent and robust—consumers don't demand for much inventory or credit and small retailers don't provide it

(1) Large Scale Trade is CBD in Brazil, WalMex in Mexico and Disco in Argentina

Source: Annual Reports 2002, field interviews, Booz Allen analysis

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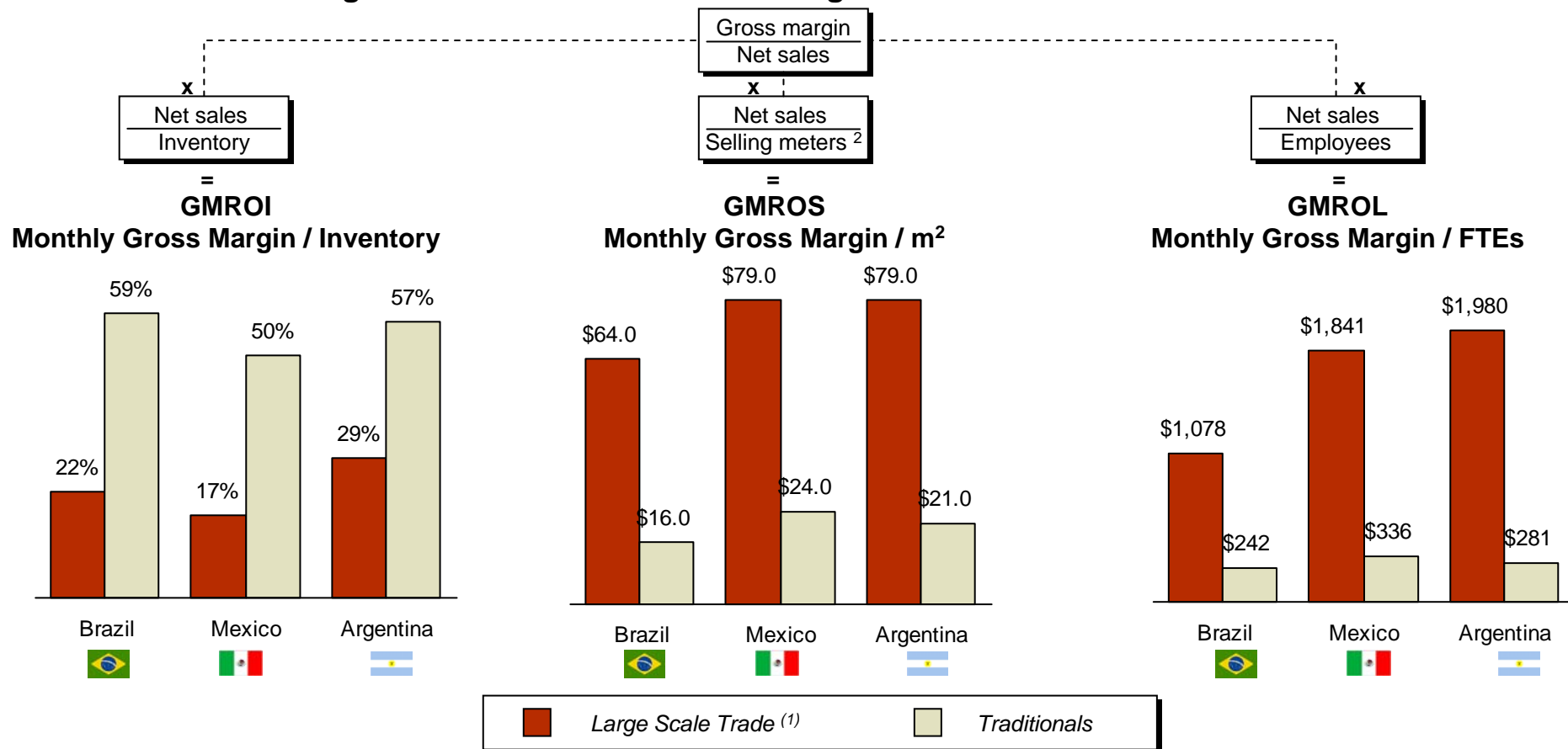# … not surprisingly, traditionals replenish frequently – more than 3 times/week for fresh products and drinks

Replenishment Frequency for Traditional Stores
Times per week

Average for All Products

Times / Week

- Brazil: 0.9
- Mexico: 1.7
- Argentina: 1.7
- Colombia: 1.6
- Chile: 1.3

By Category

Times / Week

Category	Brazil	Mexico	Argentina	Colombia	Chile
Produce	3.5	3.2		3.6	3.2
Fresh Prods	1.4	3.2	3.2	2.9	1.8
Drinks	1.1	2.3	2.5	2.2	2.6
Basic Food	0.6	1.1	0.5	0.9	0.9
Personal Care	0.4	1.2	0.3	0.3	0.5

Legend: ■ Brazil □ Mexico ■ Argentina ■ Colombia ■ Chile

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In summary, traditionals lack scale and labor productivity benefits but turn inventories quicker than the large scale trade

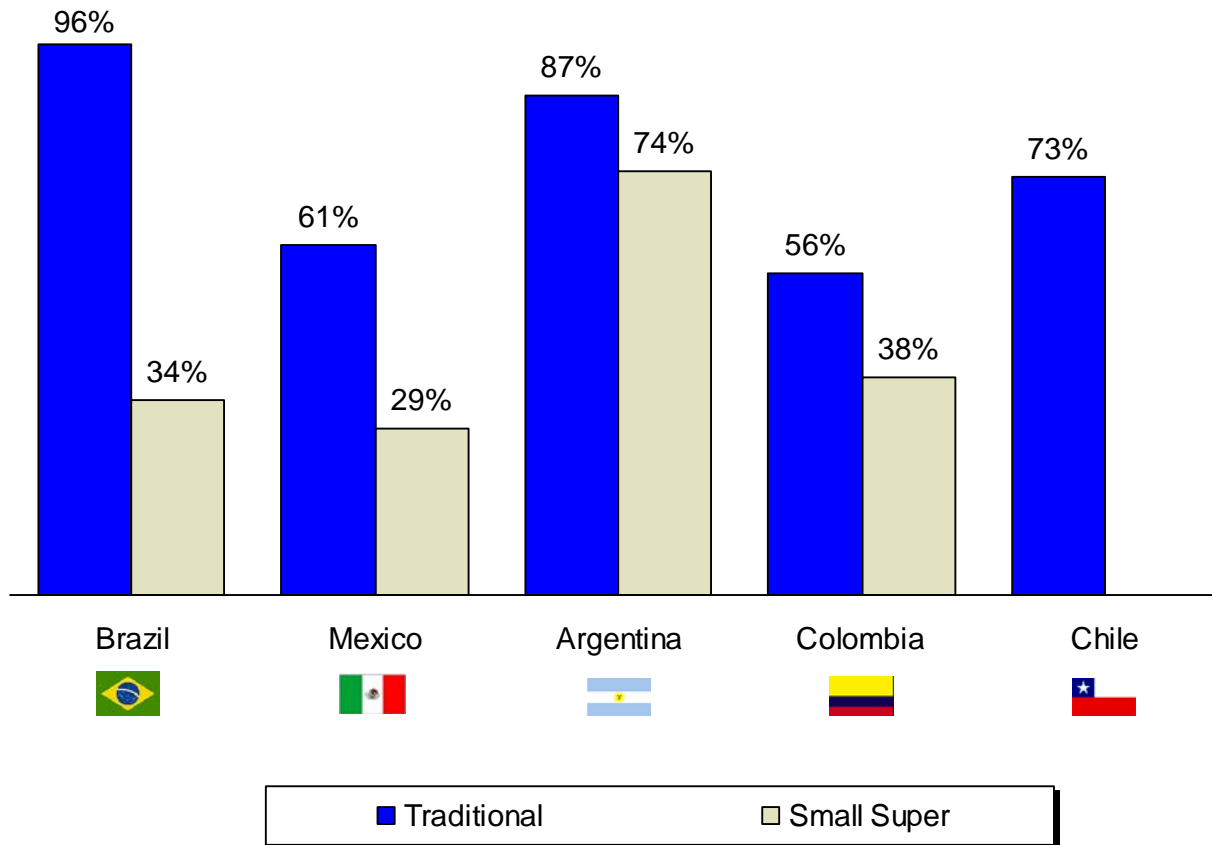**Strategic Resource Model Ratios – Large Scale Trade vs. Traditionals**

$$\frac{\text{Gross margin}}{\text{Net sales}}$$

x

$$\frac{\text{Net sales}}{\text{Inventory}}$$

x

$$\frac{\text{Net sales}}{\text{Selling meters}^2}$$

x

$$\frac{\text{Net sales}}{\text{Employees}}$$

=
GMROI
Monthly Gross Margin / Inventory

=
GMROS
Monthly Gross Margin / m²

=
GMROL
Monthly Gross Margin / FTEs

GMROI:
- Brazil: 22% (Large Scale Trade), 59% (Traditionals)
- Mexico: 17% (Large Scale Trade), 50% (Traditionals)
- Argentina: 29% (Large Scale Trade), 57% (Traditionals)

GMROS:
- Brazil: $64.0 (Large Scale Trade), $16.0 (Traditionals)
- Mexico: $79.0 (Large Scale Trade), $24.0 (Traditionals)
- Argentina: $79.0 (Large Scale Trade), $21.0 (Traditionals)

GMROL:
- Brazil: $1,078 (Large Scale Trade), $242 (Traditionals)
- Mexico: $1,841 (Large Scale Trade), $336 (Traditionals)
- Argentina: $1,980 (Large Scale Trade), $281 (Traditionals)

Legend: ■ Large Scale Trade [1]   □ Traditionals

Over the following pages we will estimate traditionals' P&Ls…

back

Labor costs for small retailers are generally lower and more variable than for large scale retailers -- most employees are family members

% Employees That are Family Members for Small Retailers

Brazil — Mexico — Argentina — Colombia — Chile

Traditional: Brazil 96%, Mexico 61%, Argentina 87%, Colombia 56%, Chile 73%
Small Super: Brazil 34%, Mexico 29%, Argentina 74%, Colombia 38%

■ Traditional   □ Small Super

Benefits of Having Family Members as Employees

▶ Lower labor cost due to:

– Lower pay since "non cash" compensation can be included in pay (e.g. when a son lives at his parent's home)

– Easier labor tax evasion, little threat of filing claim/grievance

– Greater flexibility to adapt hours worked to store traffic

– Ability to defer salaries in the event of a liquidity crisis

▶ Lower shrinkage due to theft

Source: Field Interviews, Booz Allen Analysis

back

Additionally, small retailers save on several general expenses items that are significant for the large scale trade

ESTIMATE

Key Drivers of Cost Differences — Overhead

	Large Scale Trade	Example Traditional
Energy	▸ Usually high expenses driven by air conditioning, refrigerators & freezers, illumination, automatic elevators, etc… ▸ Can account for 0.5 - 1.5% sales	▸ Usually no air conditioners, sharing of freezers among categories (e.g. ice cream with frozen foods), poor illumination
Security	▸ Usually an outsourced company ▸ Can account for 0.2% –- 0.9% sales	▸ No security personnel, taken care of by owner / operator with mirrors in the store ▸ Occasionally an alarm system for the night
Cleaning	▸ Usually an outsourced company ▸ Can account for 0.3% – 0.8% of sales	▸ Usually performed by the owner / operator during "down" times
Telephone	▸ Intensive use of telephone (HQ, delivery, etc.)	▸ Can work with minimal use of telephone
Maintenance	▸ Driven by a high number of equipment/fixtures in the stores and mistreatment of equipment by employees ▸ Can account for 0.2% –- 0.8% of sales	▸ Owner usually takes care of equipment
Overhead and HQ Expenses	▸ Can account for 0.2% – 1% of sales	▸ Non existent
I/T, Technology	▸ Driven by number and sophistication of cash registers (POS systems), and other information needs (inventory management systems, etc.)	▸ Non existent
Shrinkage	▸ Can account for 2% – 5% of sales	▸ Family ties lower employee theft shrinkage ▸ Deep customer understanding allow better demand management of fresh products

back

In rent expense, most traditionals own the site where they operate and do not consider non-cash expense (depreciation) or ROIC as part of their cost

Type of Ownership of Store – Own vs. Rented

Traditionals

Brazil: 43% / 0% / 57%
Mexico: 57% / 13% / 30%
Argentina: 37% / 37% / 26%
Colombia: 43% / 50% / 7%
Chile: 65% / 24% / 12%

In Argentina and Colombia between 40% and 50% of owners of a traditional store also live in the store, helping them to save on security and share other expenses

☐ Rent Store
☐ Own/Co-located with Residence
■ Own Store

Small Supermarkets

Brazil: 57% / 0% / 43%
Mexico: 50% / 0% / 50%
Argentina: 79% / 0% / 21%
Colombia: 50% / 33% / 17%

Source: Field Interviews, Booz Allen Analysis

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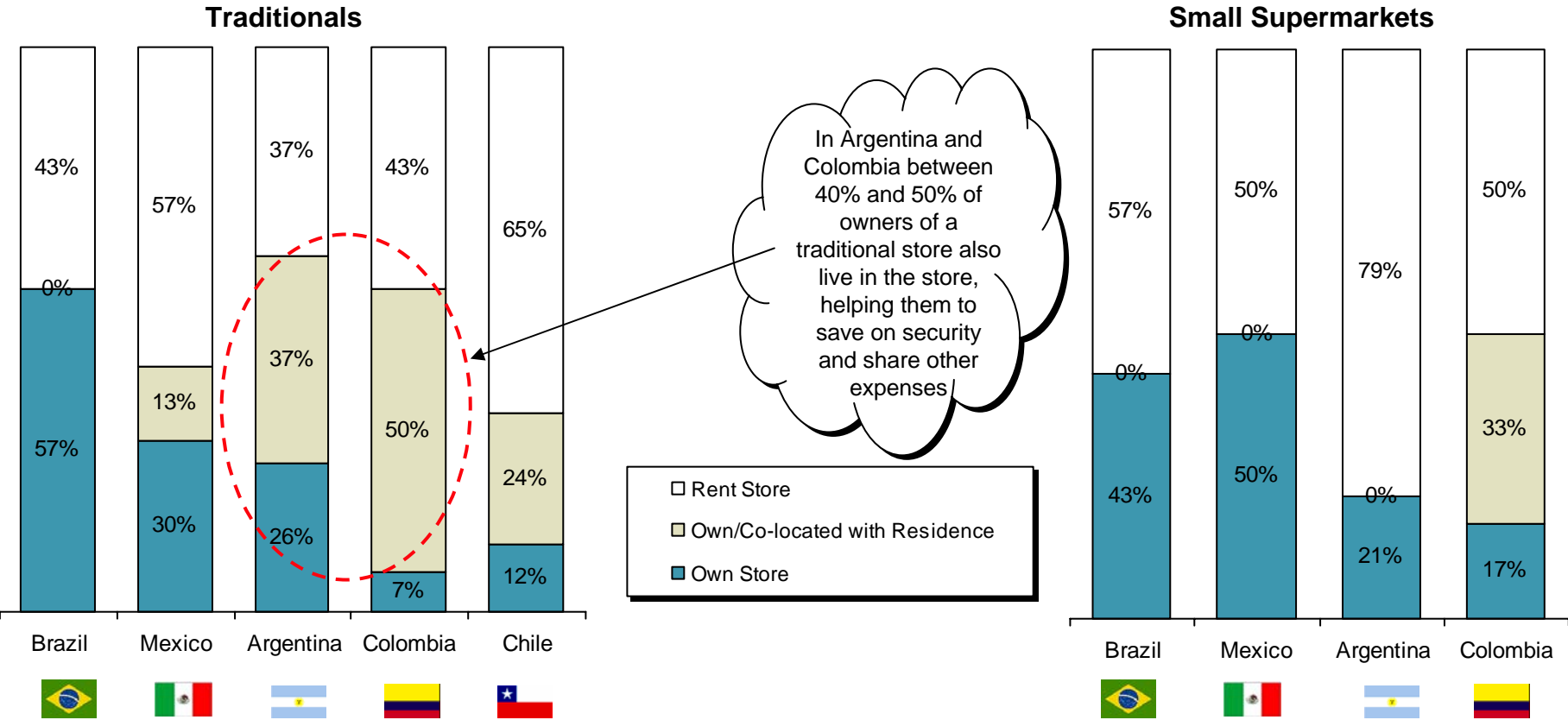
Summing up operating costs, small retailers show similar or lower expenses as a % of sales than the large scale trade

ESTIMATE

**Operating Expenses as a % of Sales
Large Scale Trade vs. Traditionals**

| Brazil | Mexico | Argentina |

Large Scale Trade[1]   Traditionals
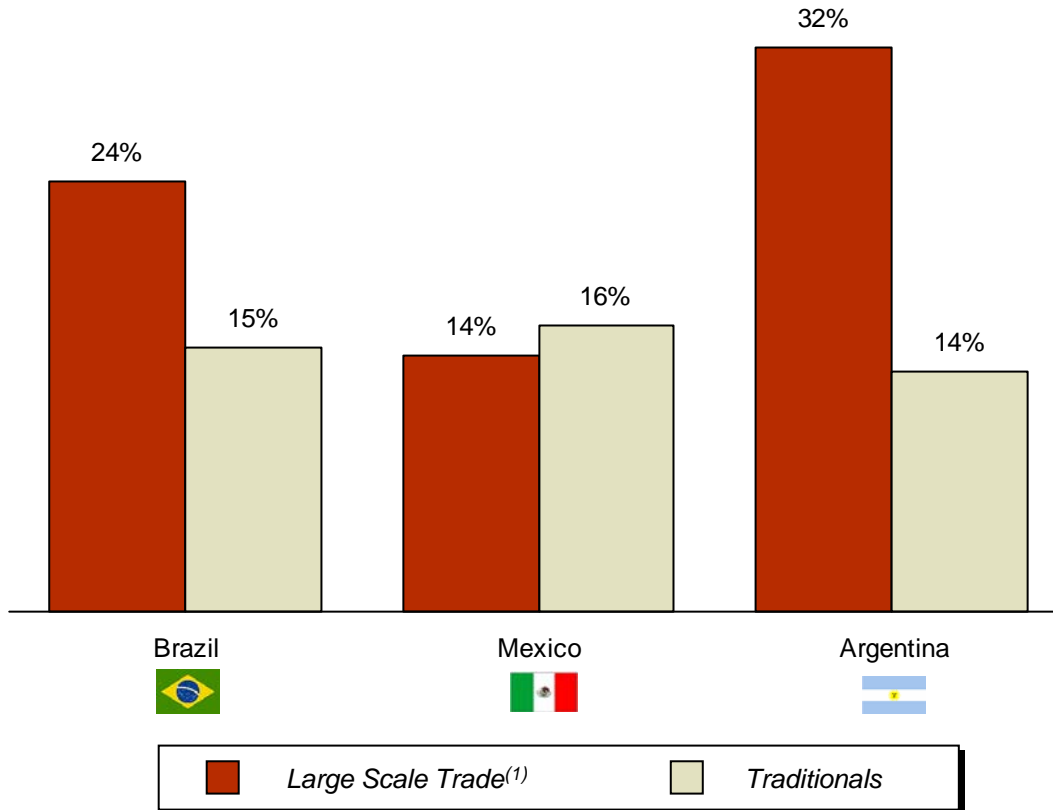
Comments

▸ Labor expenses do not include a salary for the owner since net income from the business is his/her compensation

▸ Main items included in operating expenses for small retailers:
  – Rent (when they are not owners of the site)
  – Electricity and other utilities
  – Telephone
  – Car maintenance and expenses
  – Insurance (seldom)
  – Advertising & promotional expenditures (very seldom)
  – Banking fees, cash management
  – Accounting, legal support

(1) Large Scale Trade is CBD in Brazil, WalMex in Mexico and Disco in Argentina
Source: 2002 Annual Reports 2002, field interviews, Booz Allen analysis

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Traditionals generally qualify for small business tax regimes which are advantageous — e.g., they are not responsible for VAT

ESTIMATE

**Impact of Sales, VAT and Income Taxes for FMCG Retailers
Taxes as a % of Sales
Standard vs. Small Business Tax Regimes**

- Brazil: 10%, 8%
- Mexico: 4%, 2%
- Argentina: 11%, 7%

□ Standard Tax Regime ■ Small Business Tax Regime
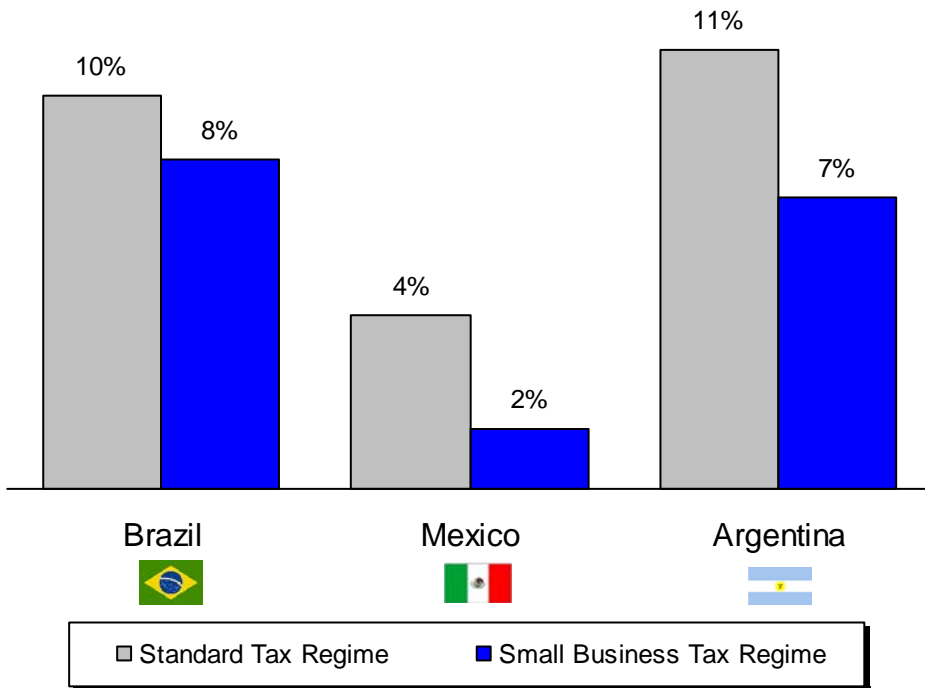
Comments

- ▸ In most countries, there are special tax regimes which allow small businesses to substitute a fixed contribution or a single tax (calculated as a % of sales) for all or most other taxes, including:
  - − VAT
  - − Sales taxes
  - − Business income tax
- ▸ There are limitations on the size of businesses (based on annual revenues) that may file under the single tax, but most small retailers qualify
- ▸ Small business regimes are generally beneficial – resulting in lower tax expense as a % of sales (Note: to correctly compare both regimes, net VAT– debits less credits–must be considered as a cost item rather than a balance sheet liability)
- ▸ Care must be taken when comparing costs as a % of sales for small retailers and the large scale trade – for the large scale trade, sales are reported as the price paid by the consumer <u>less</u> applicable VAT

Note: For standard Regime assumes gross margins of 30% and total labor costs of 12%. Mexico assumes average VAT of 10%, Brazil ICMS+PIS average 17.6%
Source: Deloitte & Touche, Baker & McEnzie, Economist Intelligence Unit, AFIP (Argentina), Receita Federal (Brazil), SAT (Mexico), Interviews, Booz Allen Analysis

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Taking all into account, the "average" net income for a traditional store ranges from 4% to 11% of sales …

ESTIMATE

Monthly P&L for Traditional Player
Index Gross Sales = 100

	Brazil	Mexico	Argentina
Sales	**100**	**100**	**100**
COGS	**73**	**80**	**77**
Gross Margin	27	20	23
Operating Expenses			
Labor	5	4	5
General Expenses	10	12	9
Total Op. Expenses	15	15	14
EBIT	**13**	**5**	**10**
Interest	0.7	0.1	-
Taxes	1.1	0.7	2.0
Net Income	**11**	**4**	**8**

Source: field interviews, Booz Allen Analysis

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…Which translates into US$200 - 300 /month, or between 2-3 times the minimum wage – with unemployment as an alternative, retailing is for them a profitable and sustainable model

ESTIMATE

Average Monthly Profits For Traditionals (In US$)

$260 — Brazil
$190 — Mexico
$190 — Argentina
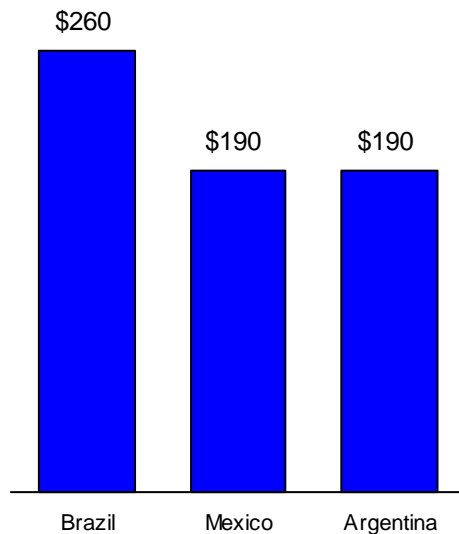
Average Monthly Profits For Traditionals as Multiple of the Minimum Wage

3.3x — Brazil
1.6x — Mexico
2.x — Argentina
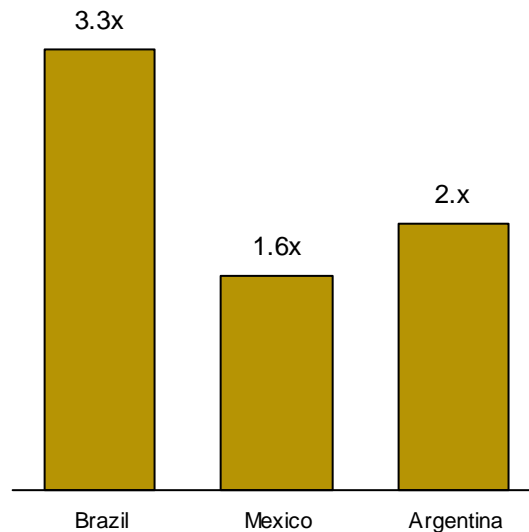
Comments

▸ Some governments encourage the development of traditionals to combat unemployment, through special credits (e.g. Mexico), training programs, or micro-lending

▸ The market of traditional stores is very dynamic, and only the best stores survive -- e.g. in Colombia less than 40% of new traditionals last 1 year

Source: Field Interviews, Booz Allen Analysis

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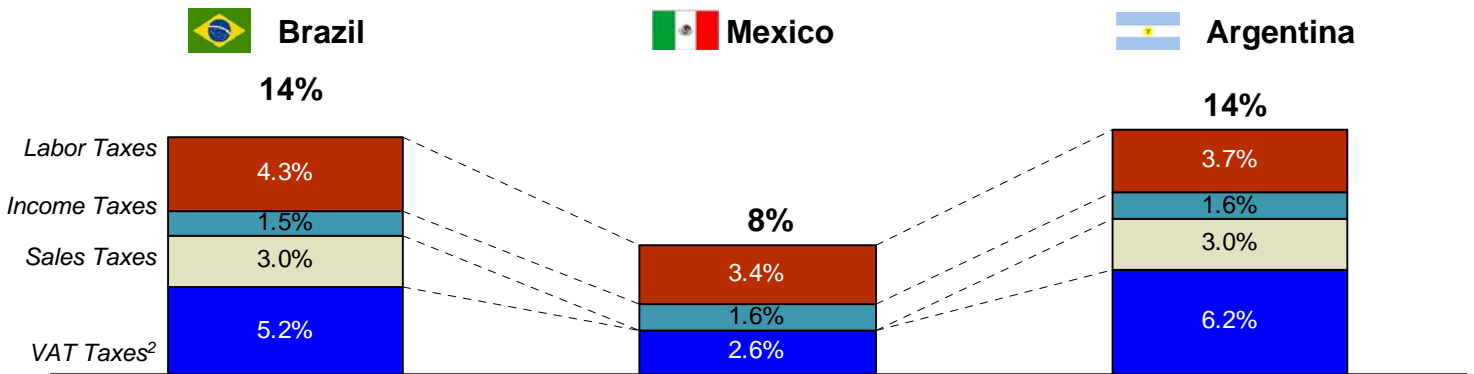# The Retail Landscape and Informality

▸ Retail Industry Context & Landscape

▸ Small Retailers value proposition for emerging consumers

▸ How small retailers make a sustainable business model

▸ The impact of Informality

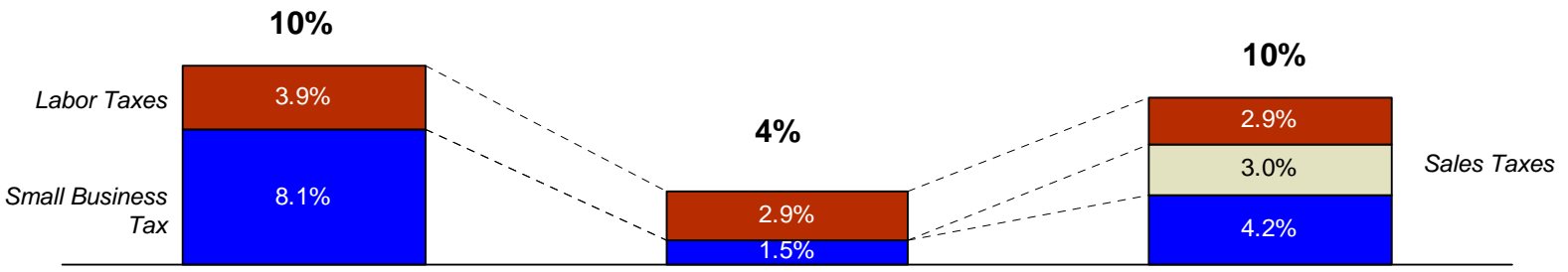# Most small retailers qualify for small business tax regimes, under which taxes are legally lower

ESTIMATE

**Estimated Taxes as a % of Sales[1] for Retailer
(Full Compliance with Labor / Tax Law)**

Brazil   Mexico   Argentina

Standard Regime

Brazil — 14%
- Labor Taxes: 4.3%
- Income Taxes: 1.5%
- Sales Taxes: 3.0%
- VAT Taxes[2]: 5.2%

Mexico — 8%
- 3.4%
- 1.6%
- 2.6%

Argentina — 14%
- 3.7%
- 1.6%
- 3.0%
- 6.2%

Small Business Regime

Brazil — 10%
- Labor Taxes: 3.9%
- Small Business Tax: 8.1%

Mexico — 4%
- 2.9%
- 1.5%

Argentina — 10%
- 2.9%
- 3.0% — Sales Taxes
- 4.2%

(1) Ratios calculated using net sales (consumer price - VAT and sales taxes) for the "Standard Regime" and gross sales (price paid by consumer) for the "Small Business Regime

(2) VAT is treated as a cost (instead of as a balance sheet liability) in order to compare both regimes. Assumes all purchases are formal – I.e. they provide VAT credits

Note: Standard Tax regime assumes COGS 70% of net sales, General Expenses 12%, Labor cost 12%, net profit 3%. Brazil assumes average ICMS + PIS of 17.6%. Mexico assumes VAT 10% (33% sales of basic food at 0% VAT, rest at 15%). Small business regime assumes average sales of traditionals in each country and one employee at min. wage.

Source: Deloitte & Touche, Baker & McEnzie, Economist Intelligence Unit, AFIP (Argentina), Receita Federal (Brazil), SAT (Mexico) interviews, Booz Allen Analysis

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There are two potential sources of informality in retailing – evading taxes and/or selling stolen and forged merchandise

Sources

Description

Tax Evasion

▸ Avoiding or paying less taxes and labor contributions than required by law:
  - Not declaring accurate figures in order to pay less sales, VAT and income taxes
  - Staffing stores with non-registered personnel or under-declaring wages to pay less labor and social contributions
  - Declaring lower sales in order to be treated as a small business and take advantage of a special tax regime
  - Failing to register a company and operating completely as an informal player

Stolen & Forged Merchandise

▸ Purchasing stolen merchandise at well below market price from organizations dedicated to stealing or hijacking trucks full of merchandise ("road pirates")

▸ Purchasing "forged" products – products that carry leading brand names, logotypes, and look-a-like packaging—but that are substandard quality

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There are many creative means by which "informal" players reduce the tax burden

EXAMPLES

Commonly Used Tax Evasion Methods

VAT / Sales Taxes

▶ Understating revenues to take advantage of small regime tax structure
▶ Purchasing or selling without an invoice (VAT tax) or selling without official ticket (sales tax)
▶ Tampering with the cash register so it does not record sales
▶ "Closing" the cash register near the end of day/shift and switching to cash transactions
▶ Issuing an "unofficial" ticket or coupon (sales tax)
▶ Using purchase invoices from shell / phantom companies to increase VAT credits
▶ Selling with "half" invoices, which list only a fraction of the volume delivered, and depositing an additional payment to a bank account under different name ("Caixa Dois")
▶ Generating mirror invoices—separate documents for tax and freight purposes
▶ Re-using the same invoice several times – including it with different shipments
▶ Registering company in the name of a third person and defaulting on tax liability
▶ Charging different prices for sales with and without an invoice

Income Taxes

▶ Making an incomplete declaration of earnings (based on lower sales and VAT declarations)
▶ Classifying personal expenses as business costs and charging them to the company
▶ Purchasing invoices from shell/phantom companies to increase costs (e.g., phony purchase of supplies, consulting fees, etc.)
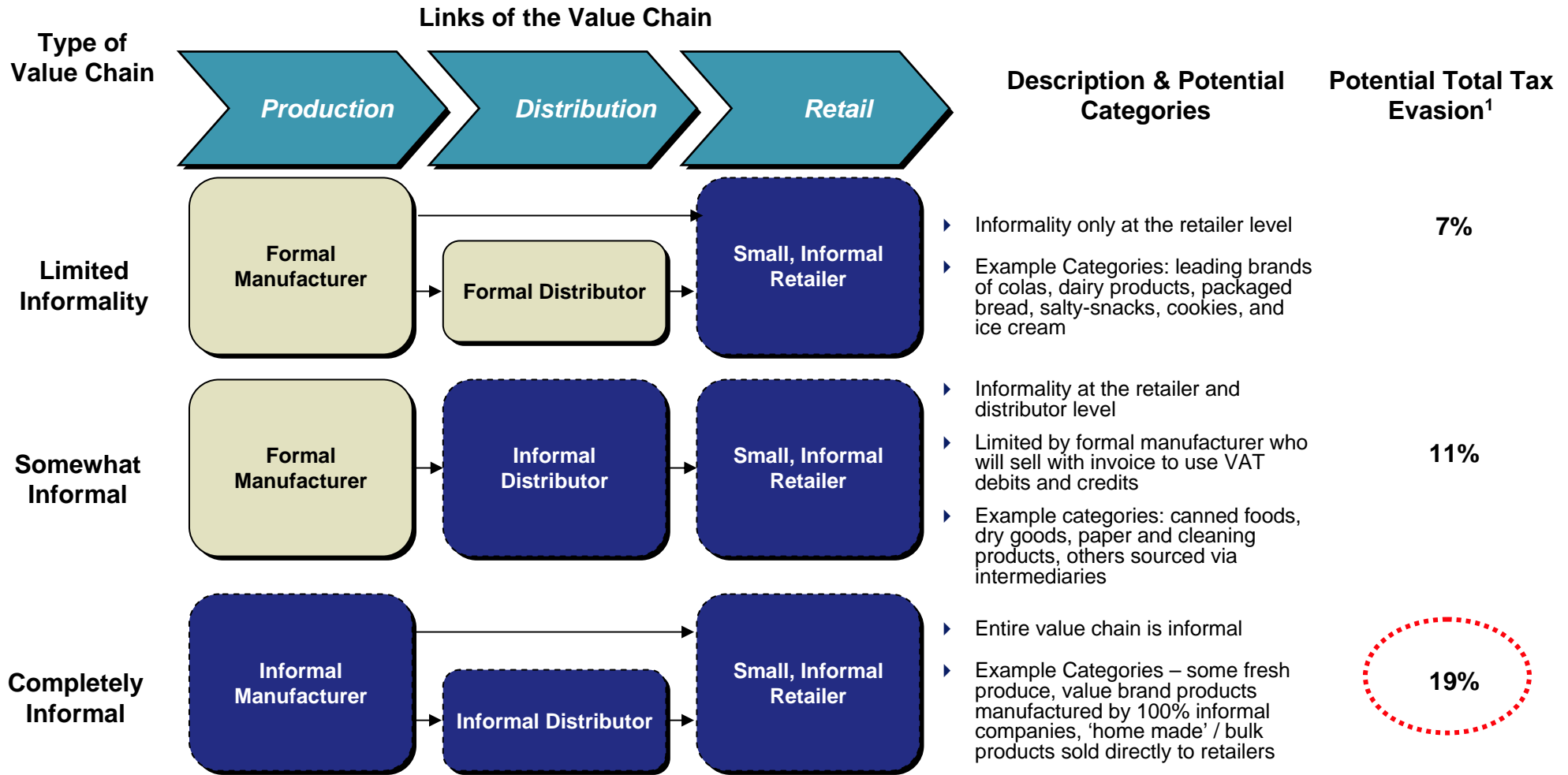
Labor Costs

▶ Failing to register all or some employees
▶ Registering employees with low salaries and paying additional monies on the side – e.g., "commissions"
▶ Failing to make social security payments, bankrupting the company to avoid or renegotiate the liability, and re-opening business under new name

Source: Interviews, Booz Allen analysis

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… However complete evasion is unlikely even in countries with high informality

▶ Large companies and multi-national manufacturers—who sell formally—still supply the majority of consumer products in Latin American markets

  – When these companies sell through intermediaries, compliance tends to "travel" along the value chain since middlemen have strong incentives to also sell formally and recover their VAT credit

  – Moreover, many of these companies are actively trying to sell direct to retailers (e.g., Nestlé, Frito Lay, Coca-Cola, Bimbo, beer companies, etc.), introducing "formality" to a portion of small retailers' sales

  – Once retailers purchase formally, it is more difficult for them to evade VAT, sales and income taxes – if they do not declare revenues they would have to justify why purchases exceed sales

▶ Large labor litigation risks often introduce self-policing

  – Most countries are heavily regulated and labor litigation costs are significant

  – In some countries there is essentially no statute of limitations – e.g. in Brazil employees have the right to file a claim even after 30 years

▶ In some countries government agencies are improving capabilities and small retailers perceive a higher probability of being caught

  – In most countries, cash registers with recording devices are being introduced ("caixa lacrada")

  – In Brazil, the tax agency links sales and financial operations tax information--making it difficult to declare lower sales for retailers (I.e., easier to identify inconsistencies)

  – Chile implemented an extensive information matching mechanism the allows the collections agency to discover tax evaders with great precision

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The economic benefits of tax evasion can be significantly increased when informal practices are present along the whole value chain

Links of the Value Chain

Type of Value Chain	Production	Distribution	Retail	Description & Potential Categories	Potential Total Tax Evasion[1]
Limited Informality	Formal Manufacturer	Formal Distributor	Small, Informal Retailer	▸ Informality only at the retailer level ▸ Example Categories: leading brands of colas, dairy products, packaged bread, salty-snacks, cookies, and ice cream	**7%**
Somewhat Informal	Formal Manufacturer	Informal Distributor	Small, Informal Retailer	▸ Informality at the retailer and distributor level ▸ Limited by formal manufacturer who will sell with invoice to use VAT debits and credits ▸ Example categories: canned foods, dry goods, paper and cleaning products, others sourced via intermediaries	**11%**
Completely Informal	Informal Manufacturer	Informal Distributor	Small, Informal Retailer	▸ Entire value chain is informal ▸ Example Categories – some fresh produce, value brand products manufactured by 100% informal companies, 'home made' / bulk products sold directly to retailers	**19%**

(1) Takes into account a VAT of 18% and a sales tax of 3%, with a typical manufactured product value chain. Actual numbers vary by country. Does not include income taxes
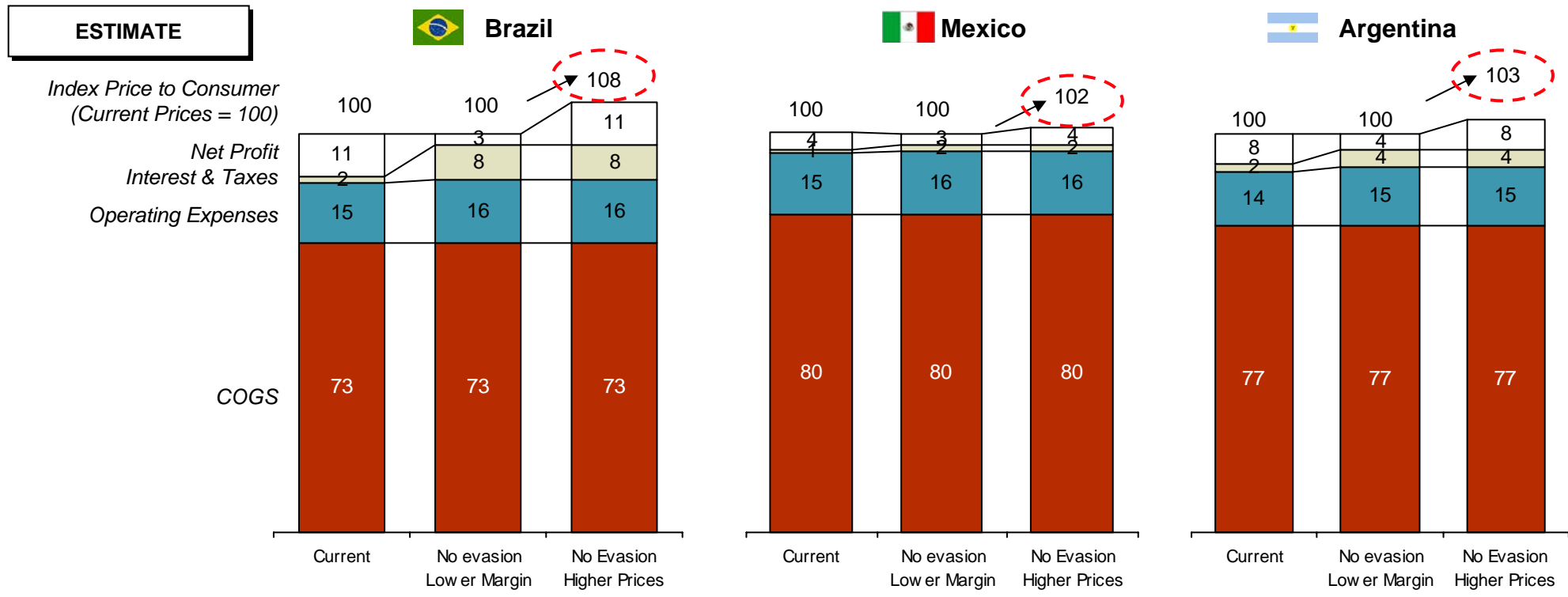
Source: Interviews, Booz Allen Analysis

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For example, value brands and fresh produce are example value chains where tax evasion is more likely to be present

▶ In Argentina and Brazil, there is a strong presence of small, local manufacturers who produce the "value brands" available for sale in (mostly) small retail stores

  – 16 value brands of spaghetti in Argentina and 19 in Brazil, while there were at most 2 value brands in the other countries

  – For colas, 17 value brands in Argentina and 14 in Brazil – maximum of 5 in the other countries

▶ Shelf price differences between leading and "value" brands can be up to 3.5 times (e.g. value brand colas at R$0.80 vs. Coca-Cola at $R 2.5 in Brazil)—implying that these manufacturers have a dramatically lower total cost base

▶ Some of this difference could be explained by tax evasion since the selling methods used by these manufacturers can lend themselves to informality

  – Pack and Peddle method – manufacturer sales representative loads a car or small truck with product and calls directly on the store owner, with cases of free product provided as an incentive to stock the brand

  – Payment is made in cash at the moment of delivery – no receipts or documents are interchanged

▶ Fresh produce is another example of potential value chain tax evasion – in some traditionals, fresh produce was delivered directly by farmers or their agents

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Reducing evasion could cut an informal retailers' profit or require a price increase of up to 10%…but not necessarily cause them to exit the business

Impact of Eliminating Tax Evasion – P&L for Average Traditional Player Under Three Scenarios
(1) Current, (2) Full Tax Compliance When Prices Cannot be Raised, (3) Full Tax Compliance with Shelf Price Increase

ESTIMATE

🇧🇷 **Brazil**　　　🇲🇽 **Mexico**　　　🇦🇷 **Argentina**

Index Price to Consumer (Current Prices = 100)

Net Profit
Interest & Taxes
Operating Expenses
COGS

	Brazil			Mexico			Argentina		
Monthly Profit USD[1]	260	70	260	190	120	190	190	110	190
Times Min. Wage	3.3x	0.9x	3.3x	1.6x	1.1x	1.6x	2.0x	1.2x	2.0x

(1) Assumes no volume loss when increasing prices as a simplifying assumption

Note: Based on results of survey, adjusted for full tax compliance at the retail level only (full tax rate applied to sales, registration of all employees) Source: Field interviews, Deloitte & Touche, Baker and McEnzie, Tax agencies, Booz Allen analysis

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Possible outcomes are increased failure rates, higher prices, or lower margins for small retailers – which prevails depends on several factors

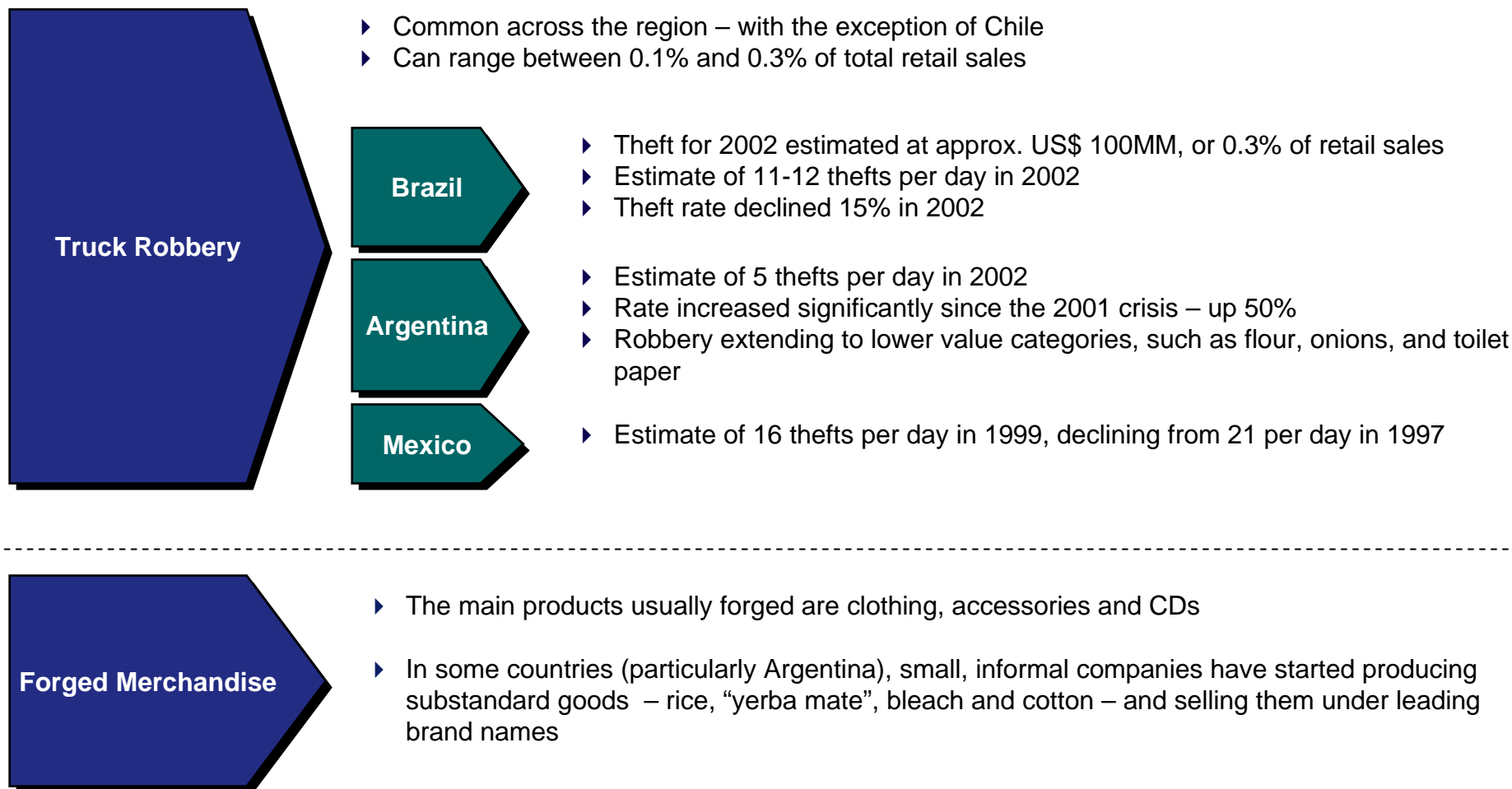| Response of Informal Retailers to Elimination of Evasion	Likeliness	Response of Consumers
Increase shelf prices	◗	▶ Accept higher prices at the same store ▶ Shop at a cheaper retailer – move to larger supermarkets with lower prices
Stay in business and accept lower margins	◔	▶ No change – consumer does not see the impact of informality reduction
Close Business	◔	▶ Consumer must go to another retailer – could be formal trade or another small retailer
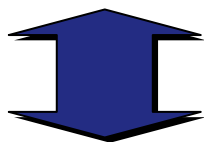
Impact of Reducing Tax Evasion for Informal Retailers

▶ If informal retailers paid full taxes they would make approximately one minimum wage—enough to stay in business and unemployment a likely alternative

▶ A more likely response to an across-the-board initiative to eliminate evasion is for small retailers to pass any increased costs (taxes) on to customers in the form of higher prices

▶ This price increase would raise total acquisition cost vis-à-vis the large scale trade and could cause part or all of the customer base to migrate to large supermarkets

▶ Final outcome would depend on:
  – Current non-price related value proposition of informal retailers vs. larger supermarkets
  – Existing price differential between formal and informal trade
  – Availability of alternatives – proximity of formal/lower price retail alternatives

▶ Naturally, individual players would be affected quite differently, depending on the health of their business and degree of any existing informality

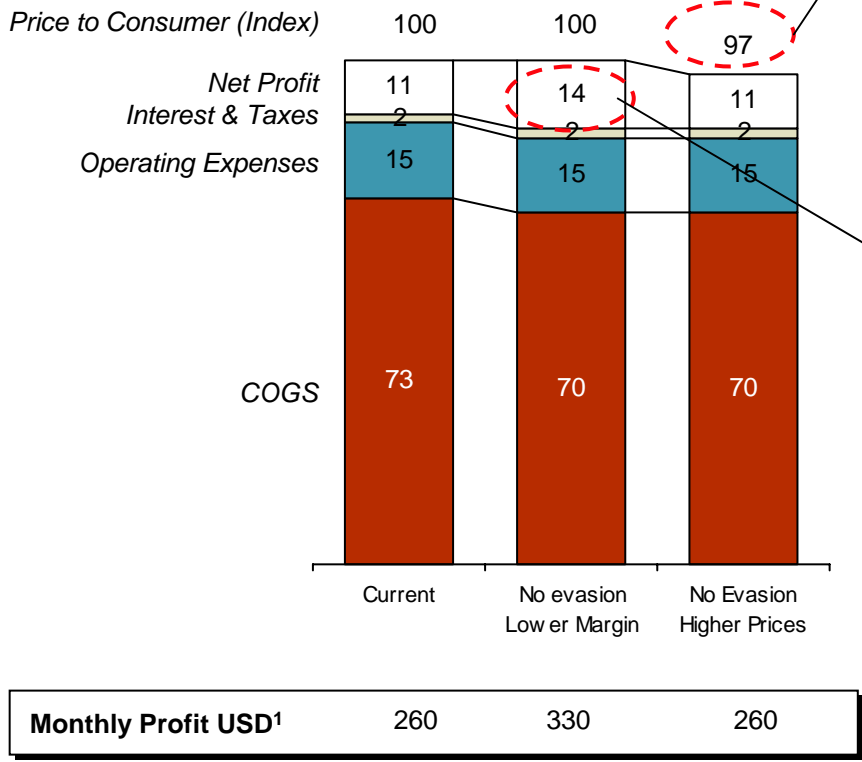# Merchandise theft and forgery is present in the region and growing in some countries

Truck Robbery

▸ Common across the region – with the exception of Chile
▸ Can range between 0.1% and 0.3% of total retail sales

Brazil
▸ Theft for 2002 estimated at approx. US$ 100MM, or 0.3% of retail sales
▸ Estimate of 11-12 thefts per day in 2002
▸ Theft rate declined 15% in 2002

Argentina
▸ Estimate of 5 thefts per day in 2002
▸ Rate increased significantly since the 2001 crisis – up 50%
▸ Robbery extending to lower value categories, such as flour, onions, and toilet paper

Mexico
▸ Estimate of 16 thefts per day in 1999, declining from 21 per day in 1997

Forged Merchandise

▸ The main products usually forged are clothing, accessories and CDs

▸ In some countries (particularly Argentina), small, informal companies have started producing substandard goods – rice, "yerba mate", bleach and cotton – and selling them under leading brand names

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Truck robbery is carried out by professional organizations with established distribution channels – not by "amateur" thieves

▶ Robberies carried out by "Piratas del Asfalto" (Road Pirates), mafias that rely on established networks to hide, transport and distribute robbed merchandise – they are well organized and equipped (heavy weaponry, wireless communications, cars)

▶ Robberies are performed by groups of armed men (can reach up to a group of 15), each with a specific task to perform – e.g. taking the merchandise, blocking roads, monitoring police radio channels

▶ Robbers carefully select the merchandise to steal, preferring products with a high value to volume (m^3) ratio

– In Brazil the main targets are electronics (40%), food (22%), cigarettes (19%) and medicine (14%)

–   Within retail products the most sought after are batteries, razor blades, cosmetics, diapers, etc…

▶ Immediately after the robberies, the merchandise is distributed along an established network

– In some cases, robbers use intermediate warehouses, but only for a limited time to reduce the chance of discovery

– Merchandise can be distributed on street formats (mainly Brazil and Mexico) or traditionals/ small supermarkets – e.g. in Argentina, a large supermarket chain is currently suing a small "Asian" supermarket after finding it was selling stolen private label merchandise

▶ Robbers can sell merchandise at 50-70% below the market price

Source: Newspaper clippings, Booz Allen analysis

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While mainly a problem for manufacturers, theft and forgery can affect retailers via "unfair" competition – but overall impact seems limited

ESTIMATE

P&L for Typical Retailer vs. Retailer Sourcing 10% Stolen Merchandise

Brazil

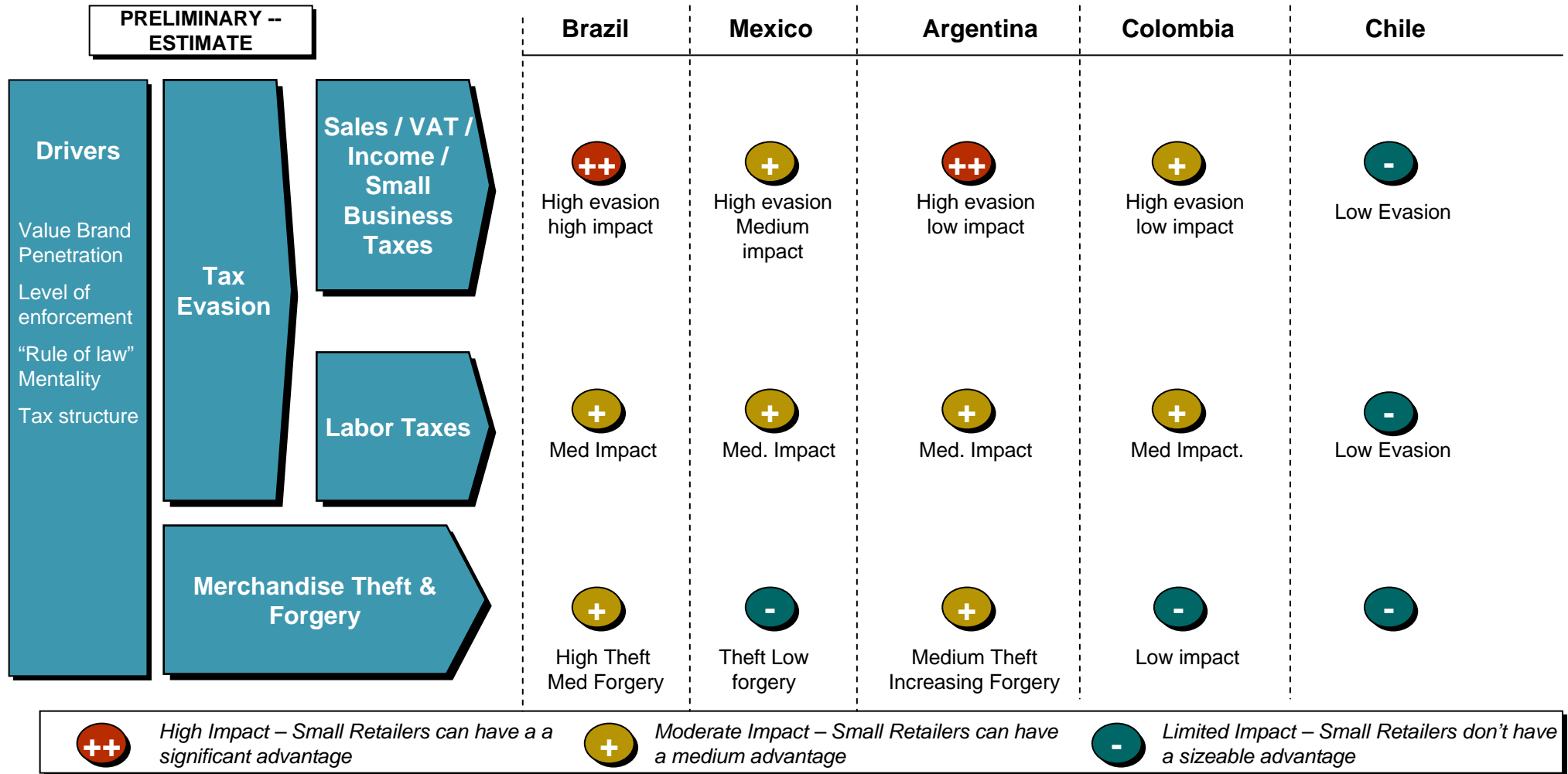|	Current	No evasion Lower Margin	No Evasion Higher Prices
Price to Consumer (Index)	100	100	97
Net Profit	11	14	11
Interest & Taxes	2	2	2
Operating Expenses	15	15	15
COGS	73	70	70

	Current	No evasion Lower Margin	No Evasion Higher Prices
Monthly Profit USD[1]	260	330	260

Impact for Formal Retailers

▸ **Alternative 1**: Benefits of selling stolen/forged merchandise used to lower shelf prices of product
  – In some cases retailers use stolen merchandise as traffic drivers
  – This can lead to an "unfair" price competition with neighboring stores, damaging their profitability if they lower prices to at or just above their (higher) cost

▸ **Alternative 2:** Benefits of selling stolen/forged merchandise used to increase profits
  – This can help unprofitable retailers to stay in business, taking business away from formal neighboring retailers
  – Otherwise retailers that sell stolen merchandise can use the extra profit to finance a price reduction across the board, starting a price competition

While present and important, theft and forgery do not seem to significantly explain the dynamics of informal retailing – overall impact limited to at most 0.3% of total retail sales

Note: Assumes stolen merchandise sold at 60% of market price
Source: Booz Allen analysis

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On a preliminary basis, any advantage provided by informality to small retailers appears to be greatest in Brazil and Argentina
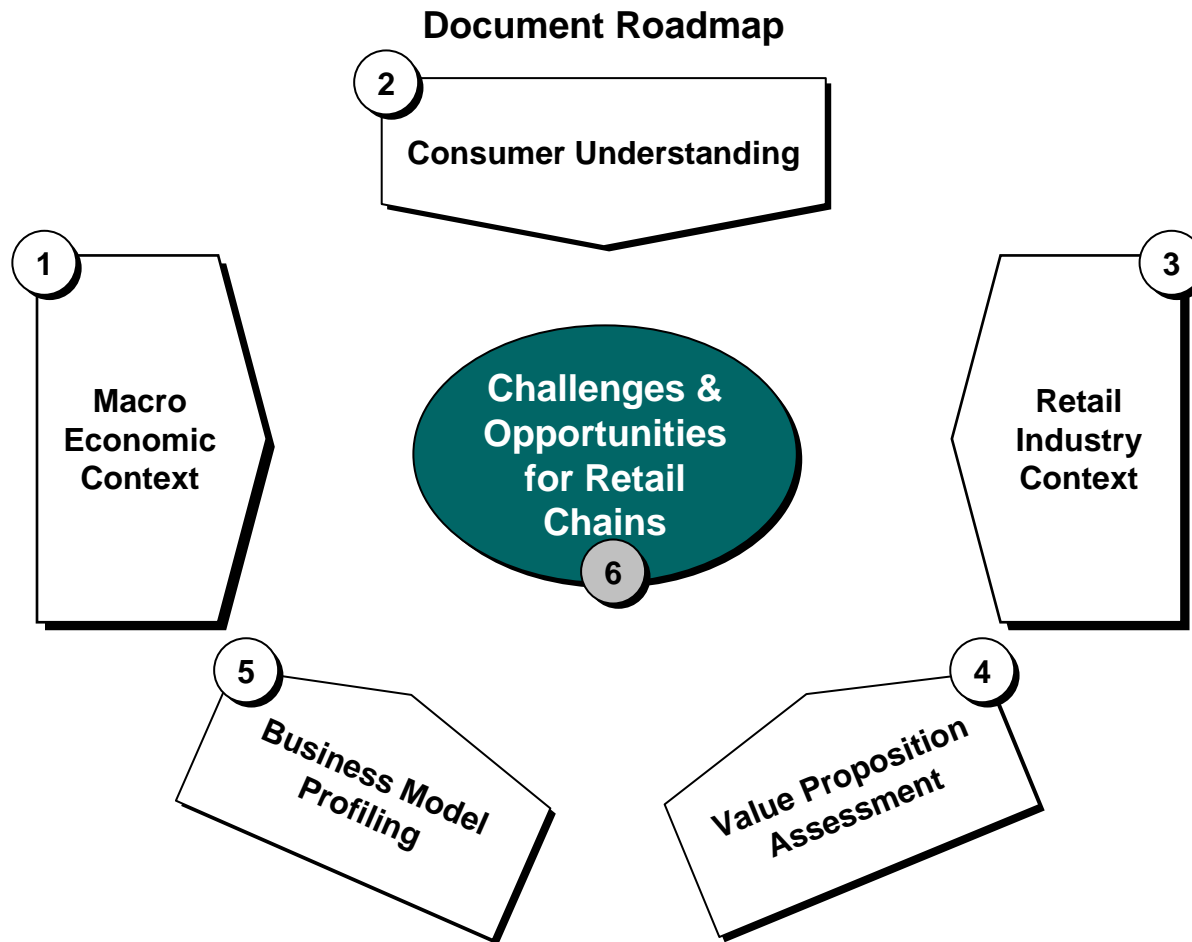
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① Macro Economic Context

Challenges & Opportunities for Retail Chains

⑥

③ Retail Industry Context

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④ Value Proposition Assessment

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The starting point: despite the advances made by large supermarkets, small retailers are holding their ground

▸ After a decade of reform and moderate economic growth, Latin America still presents dualistic social structures with consumer segments at each extreme—having very different purchasing power and posing highly differentiated demands

▸ Economic growth, investment, and improved retailer capabilities helped fuel the penetration of large supermarkets, which have successfully targeted the middle and high income consumer segments …

▸ …capturing and consolidating retail sales in the range of ~40% (Colombia) to ~60% (Chile, Costa Rica)

▸ On the other hand, small retailers in Latin America continue to supply a significant portion of the FMCG market – especially to "Emerging" consumers – since lower income segments purchase more at small retailers

▸ Furthermore, small retailers are not only attracting low-end consumers, but also customers from upper levels—particularly in "fresh" categories that make up an important part of the Latin American consumer diet (e.g., ferias, open markets)

▸ Finally, the experience of mature markets, including G-7 countries, indicates that small, independent supermarkets and traditional formats do manage to sustain 10% – 20% market share …

Is this the product of a 'dysfunctional' system or market imperfections?

▶ Larger retail chains may be surprised by the position that small retailers seem to enjoy, e.g.

– Significant presence with emerging consumers

– Success at serving customers from upper levels—particularly in "fresh" categories

▶ It is tempting to succumb to conventional wisdom and attribute the continued success of small retailers to market inefficiencies

– On the demand side: "poor, unsophisticated consumers who shop in dirty, unpleasant stores – sometimes trapped by credit relationships or the lack of a car"

– On the supply side: "a fundamentally inferior value proposition and unproductive business model that is artificially propped up by informality"

▶ Larger industry players should be careful about falling into the "informality trap" and losing sight of consumers' needs, how small retailers have effectively addressed them, and gaps in their own value proposition

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The "truth" about emerging consumers

▸ In spite of being perceived as "poor," emerging consumers in fact have a considerable amount of money as a group to spend on consumer products—although incomes are lower and less stable, they dedicate a larger portion to household purchases

▸ Emerging consumer product needs are "basic" but not "simple" – although these consumer segments overwhelmingly purchase more basic foodstuffs and perishables, they are willing to pay for intermediate and leading brands in basic categories

  – <u>Not</u> a lemming-like response to advertising campaigns or blindly ignoring economic constraints

  – Instead, consumers are fulfilling their need for the performance, confidence, and backing that brands convey …

  – …in categories that make up the bulk of the daily diet (implies significant risk for switching) or that showcase capabilities as a caregiver

▸ Emerging consumers are certainly "price sensitive," as evidenced by the meticulous tracking of price benchmarks, the exercise of self-constraint while shopping, and averseness to debt / credit when purchasing consumables

The "truth" about emerging consumers (continued)

▸ However, purchasing decisions are more driven by a desire to minimize "total acquisition cost" – making pricing and proximity the top criteria for selecting a retail format

– Tendency to mentally factor in transportation costs to arrive at "final price" for shopping basket

– Strong awareness of "hassle factor" and time spent commuting or (to a lesser degree) standing in line

– Association of some formats with a better price/quality tradeoff in "fresh categories"

– Logistics constraints for bringing purchases back home

▸ Product assortment and personal relationships become more important and price less important as the amount and stability of incomes decline

– Lower, more frequent / uncertain incomes preclude large sizes or "stocking" trips

– Consumers knowingly incur higher per unit cost (e.g. price per gram) on smaller sizes to keep ticket size down and in line with cash on hand

▸ Hence, when shopping, emerging consumers actually demonstrate quite rational and savvy behavior with respect to both product and retail format choice

▸ That said, there are some noticeable differences between emerging consumers—with some segments acting more like lower middle income consumers and others more focused on daily needs

– Some sub-segments have incomes that afford "stocking" and "daily" shopping occasions and are characterized by greater experimentation and breadth of purchases

– Other consumers are more focused on daily needs and tend to avoid changing brands or even stores, unless they are 'newly poor' and struggling with the work of defining what they can do without

Reality check #1: small retailers fit the needs of emerging consumers quite well

▸ Proximity / ubiquity $\Rightarrow$ Location is a compelling proposition of small retailers to emerging consumers

– Make small daily purchases

– Not willing or able to travel very far and incur the transportation costs usually required to shop at large supermarkets

▸ The "right" assortment $\Rightarrow$ Small retailers are able to optimize the mix to the micromarket they operate in – offering the main categories and brands that fill emerging consumers' daily needs – while large retailers lack small sizes and the desired price/quality tradeoff in perishable food categories

▸ Affordability $\Rightarrow$ Price / value: perceived to be poor at large supermarkets (even though shelf prices are almost always lower), since consumers think in terms of total acquisition cost and often equate the "luxurious" infrastructure of supermarkets with "cost"

▸ "Personal Touch" $\Rightarrow$ While small retailers benefit from the presence of the local owner-operator who can provide emotional proximity, large supermarkets are seen at best as professional (not personal) … or even as alienating

▸ Service and other extras $\Rightarrow$ Large retailers fare better in this category but some small retailers are improving their capabilities to shorten the gap ("local" promotions, transportation & delivery) and they offer both informal credit and "virtual" wallet (e.g., "pay me the 50 centavos next time/tomorrow")

Reality check #2: small retailers have a sustainable business model—even before the benefits of informality

▸ Small retailers do have a scale disadvantage in some areas

  – Lower ticket sizes drive significantly lower sales and gross margins per store/square meter

  – Procurement disadvantages—e.g., double marginalization since middlemen supply a large portion of the product mix and higher delivered cost due to small order sizes—as well as sourcing complexity

▸ However, small retailers manage to offset these disadvantages and have a sustainable business model—even before the effects of informality

  – Small retailers charge higher prices

  – Labor costs are lower due to flexibility and small retailers have reduced/ non-existing operating costs (overhead, security, cleaning, etc.) that are significant for the large scale trade

  – Small retailers have higher inventory turnover and lower inventory risk (i.e., fewer SKUs, "regular" customer base)

▸ Traditionals may have high operating margin in % terms but this translates into a small absolute amount (e.g., 2-3 times the minimum wage) – however, with unemployment as an alternative, retailing is for them a profitable and sustainable model

▸ In fact, the small retail sector can be quite efficient

  – A "fluid" market—ease of entry and lack of viable employment alternatives can create a steady stream of new retailers who replace failed operations – e.g. near 40% of small retailers fail in the first year in Colombia

  – Successful small retailers would have trouble replicating their business under the same cost structure–need to add general expenses and contract more employees

Let's not be mistaken—informality matters—but there is much more to small retailers' value proposition and business model

▸ Informality is certainly present – and its relevance cannot be denied

– Taxes can represent up to 14% of net sales for a retail player that complies with all regulations

– If informality is present along a whole value chain, VAT and sales taxes alone can represent over 20% of sales

▸ However, complete tax evasion is unlikely even in countries with high informality – in most countries large companies and multi-national manufacturers—who sell formally—still supply the majority of consumer products and force all the chain to pay taxes

▸ Moreover, small retailers have a strong value proposition that would most likely still draw consumers – even if prices were raised 2-8% to cover increased tax & labor expenses in the event of a crackdown on informality

– Closer – physically and emotionally

– Prices not that much higher … people are willing to absorb that premium today …

– Large portion of consumers will still have lower and less stable incomes

▸ The impact of reducing informality would only put the most egregious cheaters out of business—and the benefits would probably be higher in categories such as apparel, footwear, and music where price points are higher and differences between "formal" and "informal" players are greater

Restating the Problem: there are noticeable gaps between large supermarkets' value proposition and emerging consumer needs

▸ A portion of emerging consumers are drawn to the shopping experience in large supermarkets

 – In the "fantasy world" of no economic constraints they almost universally envision themselves shopping in a large supermarket

 – In the "real" world: large supermarkets offer entertainment value from a wide assortment and a "luxurious" environment for some, a place to seek promotions and 'stock up' for those that can afford it

▸ But by and large the large supermarket chains currently fall short in key areas in the mind of these consumers

 – Viewed as "stocking" places or as too "tempting" – product assortment increasingly at odds with consumers' economic situation (large sizes, large ticket items, promotions can imply buying too much)

 – Long distances require investing time and money in transportation

 – Poor perceived quality in perishable categories that make up large part of diet

 – Shelf prices perceived to be higher (even though this perception is not in line with reality in most cases)

 – "Cold" treatment by staff or other customers while shopping—e.g., scrutiny of security personnel

▸ Small retailers, in comparison, have several advantages that make them highly attractive to emerging consumers

There are opportunities for large retailers with both emerging and higher income segments but the challenge is significant

The Opportunity

- **Emerging consumers** in Latin America represent ~50% to ~60% of the population and ~30% to ~40% of the purchasing power[1]

- Overall, this segment is increasing as economic conditions worsen

- This segment in aggregate spends a significant amount on FMCGs, which are typically more resilient to declining incomes/consumer confidence

- Despite significant barriers, these consumers are still drawn to modern supermarkets

- Most retailers specifically targeted middle and upper class SES — emerging consumers were not their focus

- **Middle and upper class consumers** may be underserved – particularly in "fresh" categories

Issues / Concerns

- Extending the current value proposition/ formats of large chains to address "proximity" issues is likely to affect performance negatively
  - Lower gross margins ...
  - Higher costs

- Altering the current value proposition may alienate the existing customer base

The Challenge: Making It Happen

- How should retailers address the needs of emerging segments—in advance of channel necessities to do so?

- Is a new format needed to profitably serve these segments?

- Is an execution play (e.g., ajustando el surtido or people element) sufficient?

(1) Note: Directional only—assumes that some "C" (higher income) and "D" (lower income) consumers fall outside target segment
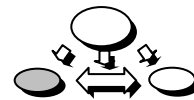
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Appendix

▶ Emerging Consumers

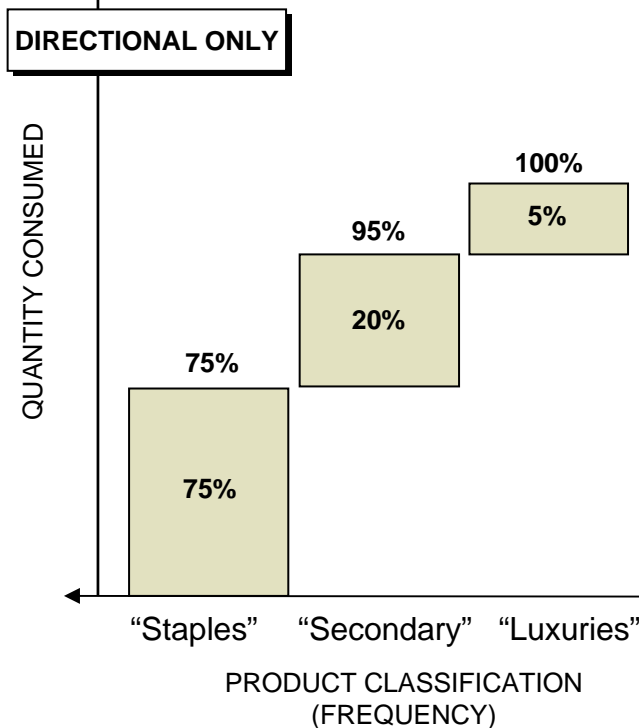▶ Retail Landscape and Informality

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Appendix

▶ Emerging Consumers

▶ Retail Landscape and Informality

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Emerging consumer spend is weighted towards "staple" products in Food, HPC and Household care

Food Spend / Consumption by Major Product Type for Emerging Consumers

DIRECTIONAL ONLY

QUANTITY CONSUMED

- 100%
  - 5%
- 95%
  - 20%
- 75%
  - 75%

"Staples" "Secondary" "Luxuries"

PRODUCT CLASSIFICATION (FREQUENCY)

Purchase Frequency:	Regular	Occasional	Rarely

"Staples"	"Secondary"	"Luxuries"
PACKAGED FOODS Dried pasta, rice, beans, oil, lard (Col), flour, sugar, salt, tomato sauce, tea (Arg, Ch), canned fish (Br/Class C), cookies (Br, CR, Arg/C2&C3), salty snacks for children (Col)	**PACKAGED FOODS** Sweet and salty snacks, dressings, cookies, branded cookies (Br, CR), mayonnaise (Ch)	**PACKAGED FOODS** Arg: Canned tuna, olives, cereals, olive oil Br: Condensed milk, ice cream Col: Salty snacks (adults), canned fish and vegetables, sauces
PERISHABLE FOODS Fruits and vegetables, eggs, bread, meat (Ch, Arg/C2&C3), cold cuts (Arg, CR), yogurt (Arg/C2&C3, Br/C)	**PERISHABLE FOODS** Sausages (Arg, Ch), cheese (Br), Chicken (Br/C), ground meat (Br/D), cold cuts (Col), yogurt (Br/D), margarines (Col), butter (Col, Ch)	**PERISHABLE FOODS** Seafood (Col), Cream cheese (Col), ready-to-eat pizza (Br)
BEVERAGES Juice concentrate, chocolate bars (Col), value brand sodas (Br), sodas (Ch), Coffee (CR, Col), powdered drink mix (Ch)	**BEVERAGES** Value brand sodas (Arg, Col), branded sodas (Br/C, CR), beer (Arg, Br), powdered drinks (CR)	**BEVERAGES** Wine and spirits, branded sodas (Arg, Col, Br/D),
CLEANING PRODUCTS Powdered laundry detergent, bleach, disinfectant, floor cleaning products, softener (Br/C)	**CLEANING PRODUCTS** Multi-purpose cleaners (Arg), Air fresheners (Arg, CR), branded detergents/softeners (Br/C), softener (Col, CR), dish detergent (Col)	**CLEANING PRODUCTS** Premium brands, most categories (Arg), furniture polish (Br)
PERSONAL CARE Toilet paper, soap, toothpaste, sanitary napkins, deodorant, family/value shampoo, conditioner (CR, Arg)	**PERSONAL CARE** Branded shampoo (Arg, Br), conditioners	**PERSONAL CARE** Lotion (Br), perfume (Arg, Ch), branded soaps (Arg, CR)

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Emerging consumer perception of advantages and disadvantages by format—Large Scale Trade:

VARIES BY RETAILER

Large Self Service—Hypermarkets/Chain Supermarkets

(+) **(−)**

Price / Value

+
- Multiple price points (related to brand variety); allows great choice (Chile)
- Many offers and promotions
- Private label products with good cost / benefit (Col)

−
- Expensive; high prices
- Loss of control, risk of impulse buying
- Promoted unnecessary items; promotions seen as deceptive (Argentina & Costa Rica)
- Promotion savings not sufficient to compensate for time / transportation costs

Product Mix

+
- Large product assortment and brand variety (Exception for some chains)
- Interesting product presentations/packaging
- Cover all needs and tastes

−
- Only expensive brands, can't find "popular brands"
- Sell only large sizes; no bulk sales
- Fruits and vegetables less fresh
- "Everything in packages"—difficult to interact with merchandise

People

+
- "Correct" on the part of employees [professionalism vs. personal]
- Professional about exchanging merchandise (Br)

−
- Impersonal; "Cold", indifference
- Improper treatment from employees (Monterrey/Mex)
- Source of frustration—"only for people with money"
- Feeling of being watched / treated as a potential thief

Place

+
- Clean and comfortable environment (air conditioning)
- Pleasing infrastructure—ample size, good appearance, luxurious (hypermarkets)
- Presence of toilets, 'satellite businesses' (Ch)
- Family entertainment (especially Colombia, less in BR)

−
- Far away; require transportation by car/bus/taxi (exception: CR)
- Crowded; long lines
- "I have to walk a lot" – tiring, too large, difficulty in finding the right aisle or products
- Fear of losing children who wander off

Services

+
- Accept credit cards with 'parceled' payments
- Home delivery; provide baggers at checkout (Br)
- Long operating hours
- Regular advertisements (print, TV, in-store) to help budgeting

−
- Delivery linked to large purchase size
- Require exact change; do not offer credit /restrict bonus (Arg) do not offer informal credit (Col, CR)
- Difficult/shameful to return expired or poor quality merchandise

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Emerging consumer perception of advantages and disadvantages by format—small, independent self-service:

Small self service—Mercadinhos (Br), Auto-servicio (Arg), Super de Barrio/Minimercado (Col), Mini-Super (CR)

	+	−
Price / Value	• Cheaper than supermarkets / hypermarkets (perception—probably factoring in transport) • "Economy" – lack of transport expense • Good prices on some items (Arg) • Promotional savings (Br/Col/Arg) [markets where larger independent grocers are present]	• Fewer promotions • Certain categories perceived to be relatively expensive (e.g, meats, soft drinks)
Product Mix	• Assortment that "meets my needs" • Good variety of brands (AS Barrio/Arg) • Offer bulk sales and value brands at good prices (Arg) • Weigh-to-order deli counter available (Arg/Br); Meats (Br)	• Low variety of products and brands • Uninspiring, unexciting mix (Col)
People	• Familiarity, recognition • May offer credit "fiado"—if not, will allow use of "virtual wallet" to pay small differences the next time	• Xenophobic feelings; lack of confidence; feeling of being mistrusted/watched by staff (Arg)
Place	• Proximity to home – viewed as practical, "flexibility" • Calm environment • Cleanliness, relative to traditionals (Col) • Fewer lines	• Small, crowded, poor lighting • Some: dirty, poor product presentations • Some: full of people, line
Services	• Self-service—no need to ask to be waited on • Multiple payment options (checks/tickets in BR, bonus in Arg) • Some offer credit "fiado" (except Sao Paulo,Br) • Even if no credit, informally offer it for small amounts when short of cash at the register – no shame of returning items • Informative promotional brochures • Lend shopping carts / provide delivery help • Long operating hours (Arg)	• Lack of credit and payment flexibility (Col/Arg) • No help with packing groceries

Note: Small self-service less prevalent in Chile and Mexico where primary research was conducted
Source: Market research

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Emerging consumer perception of advantages and disadvantages by format—traditionals:

Traditionals—Mercearias (Br), Almacenes (Arg/Ch), Tiendas de Albarrotes (Col/Mex), Pulperías (CR)

+   –

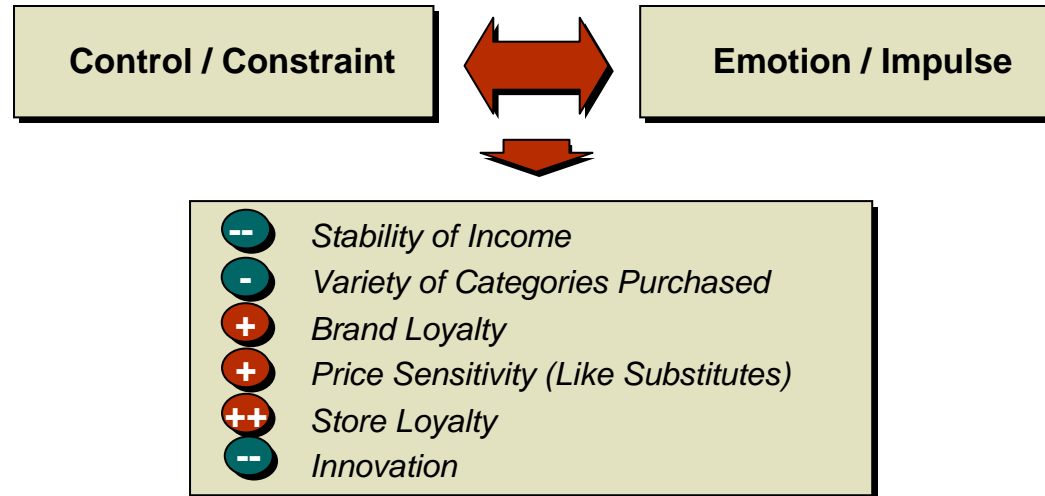|	**+**	**–**
Price / Value	• Occasionally prices are good • Good prices on some premium brands (Arg) • Ability to bargain • Economy—savings on transport	• High prices • Lack promotions • Price per unit is high (Col); difficult to compare prices • Resentment, resignation – feeling in some instances that owners can "abuse" their location and charge high prices
Product Mix	• Meet emergency and daily basic needs • Ability to buy by weight / bulk sales • Break bulk on packages • Fresh vegetables/legumes (Col)	• Low variety of brands, especially in personal care categories • Only offer one or two expensive brands • "Scarcity" of products • Uninspiring, unexciting mix (Col) • Expired products/products too close to expiration date
People	• Personalized attention and treatment, "caring" – but, differentiation between "people of confidence" and others • Personal relationship = "advantages" and "solutions"	• Lack of privacy – places of gossip (Chile) – some owners "cross the line" (Col)
Place	• Close to home (especially Colombia) • Ease of shopping – no lines, less crowded • Can send the children to make quick purchases	• "Dirty" environment, "unkempt" – but, recognition that this varies by location • When located near a bar, disagreeable environment – anxiety to walk past drinking men (Br)
Services	• Credit available • Defer payment when short on cash – "let me pay it later when I'm missing a few centavos" • Easy to change products when necessary	• Waiting for service and recognition (counter service) • Limited operating hours • No help with packing groceries or delivery • No price communication – products are not market, hampering price comparisons

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Emerging consumer perception of advantages and disadvantages by format—street/open air:

Street/Open Air—Feira Livre (Br), Feria Movil (Col), Mercado sobre Ruedas (Mex), Feria/Chinamo (CR)

	+	−
Price / Value	▶ Excellent prices (fresh items, general merchandise) ▶ Ability to manage price/value by choosing time to visit (Br) –cheaper yet at end of day ▶ Ability to bargain ▶ Greater quantity for the same price paid in supermarkets (CR)	▶ Realized price is higher if stall owner shorts customer on weight or quality
Product Mix	▶ Superior quality and freshness – "farm fresh" – direct from farmer implies quality, honesty, and wellness ▶ Superior mix of varieties (produce) within a category ▶ Offer other "farm products" and quality seafood (Br, Col) ▶ Bulk sales of grain (Br, Arg)	▶ In some cases, question quality/hygiene of meat (linked to lack of refrigeration) ▶ In some cases, question quality of general merchandise – "It looked cheap but turned out expensive since I lost my money"
People	▶ Personalized attention and treatment when you know the owner ▶ Easy to choose with whom to do business—or to walk away	▶ Feeling of being cheated by some owners – place poorer quality product in bag while tallying purchase – "some are thieves"
Place	▶ Closed to home, "in my neighborhood" ▶ Open air = agreeable, pleasant to see abundance / products on display ▶ Meeting place for socializing / entertainment (Ch)	▶ Dirty stalls ▶ Open air = hot, too close to cars and exhaust ▶ Lack of infrastructure – "Not supermarkets" (Col) ▶ Poor environment to shop for clothes, utensils, household items
Services	▶ Willing to make home delivery for reasonable fee (CR)	▶ Operate on fixed days; not available every day ▶ "Total lack" of services

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Hypothesis for Segment Description: "Economizers"

| Control / Constraint | ⟷ | Emotion / Impulse |

- **--** *Stability of Income*
- **-** *Variety of Categories Purchased*
- **+** *Brand Loyalty*
- **+** *Price Sensitivity (Like Substitutes)*
- **++** *Store Loyalty*
- **--** *Innovation*

Description:

Lower and less stable income (generally "D" class); Daily shopping according to money availability
Juggling to make ends meet; Meeting family needs within the household budget consumes significant time
Very rational: prevailing orientation towards small neighborhood shops to avoid travel expenses
"Save" through product selection rather than through promotions (not usually offered at small shops)
Loyal to leading brands in basic items and selected products that impact esteem as 'caregiver' (e.g., detergent)
Low range of products purchased: mostly basic raw foods and low breadth of personal care & cleaning categories
High degree of resignation towards financial situation and shopping but rationalize feelings into sense of "economy"
High degree of price sensitivity but peppered with "reality"—e.g., may knowingly incur higher per unit costs on small sizes

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Hypothesis for Segment Description: "New Economizers"

Control / Constraint	⟷	Emotion / Impulse

- **(-)** *Stability of Income*
- **(+)** *Variety of Categories Purchased*
- **(-)** *Brand Loyalty*
- **(++)** *Price Sensitivity (Like Substitutes)*
- **(--)** *Store Loyalty*
- **(-)** *Innovation*
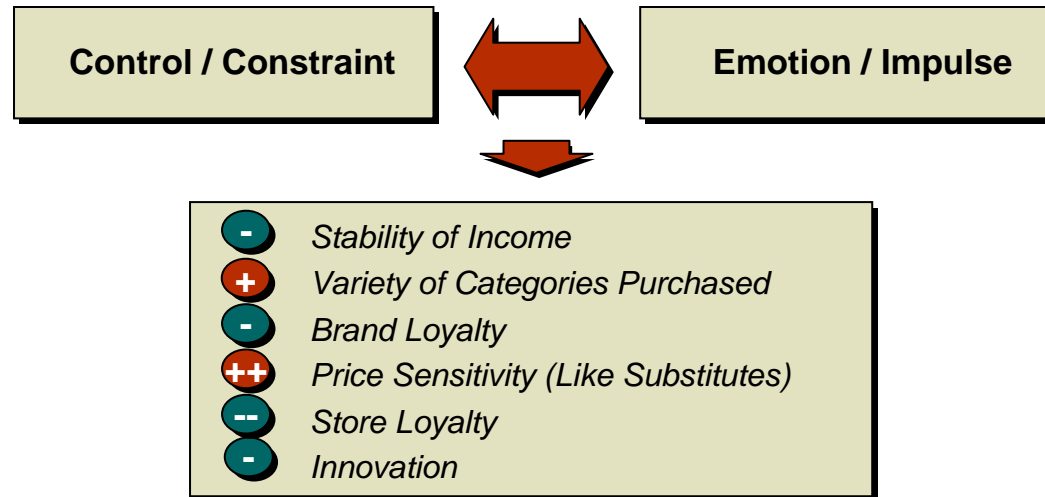
Description:

Recent and sizeable drop in amount and stability of income; Resulting in more frequent shopping (nearly every day)

Struggling with the hard work of defining what they can give up; newly opting for credit in some cases

Trying to reduce quantity or will move to lower price brands rather than give up categories

Range of products purchased is reduced but still greater than 'Economizers'—trying to maintain former dietary habits

Ultra rational: have stopped spending in large supermarkets to avoid travel costs …

… but shop among many small retailers as they obsessively seek the best prices on even 1 or 2 products

Also "save" through product selection – now trying value brands – and have very low loyalty to leading brands

High degree of resentment towards shopping in discount stores (which they used to despise) …

… while former distaste for value brands is channeled into a 'backlash' against leading brands

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Hypothesis for Segment Description: "Value for Money"
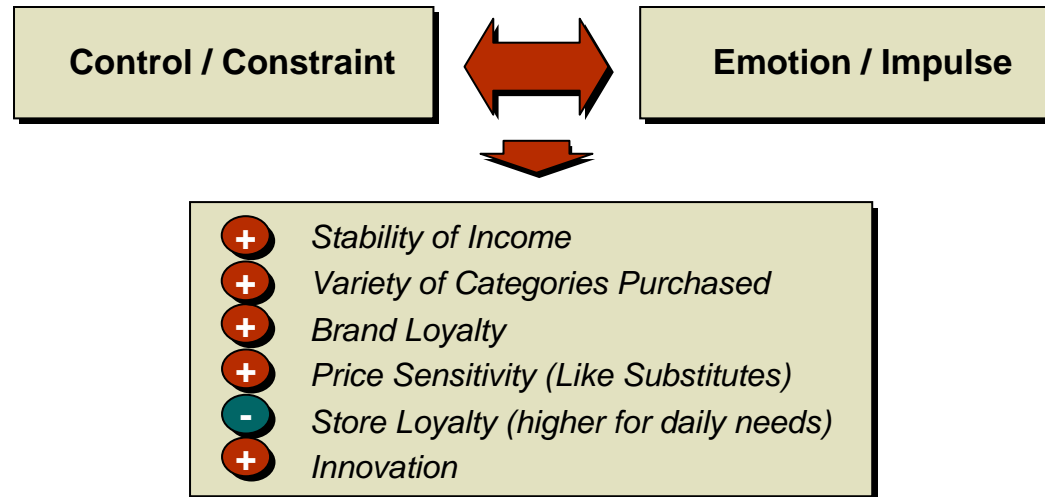
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┌─────────────────────────┐         ┌─────────────────────────┐
│   Control / Constraint   │  ◄───►  │    Emotion / Impulse     │
└─────────────────────────┘         └─────────────────────────┘
```

┌──┐
│ **+** *Stability of Income*   │
│ **+** *Variety of Categories Purchased*   │
│ **+** *Brand Loyalty*   │
│ **+** *Price Sensitivity (Like Substitutes)*│
│ **-** *Store Loyalty (higher for daily needs)*│
│ **+** *Innovation*   │
└──┘

Description:

Relatively higher and more regular income (generally "C" class); which allows for both daily and "stocking" shopping trips

Also face difficulties and have to control what they spend …

… but ultimately find an element of satisfaction in the planning and systematization of resistance strategies

"Smart shopper" rational: shop around for the best prices on their preferred brands, at stores within acceptable distance

Save through places rather than products – willing to change supermarkets based on the best collective offer/specials

Loyal to (but not dogmatic about) leading brands—consider 1-3 brands as acceptable substitutes for many categories

Higher range of products purchased: will purchase simple prepared foods and add categories to 'treat' husband/kids

Store loyalty higher for daily needs and when purchasing fruits, vegetables, and meats in neighborhood/street formats

Price sensitive and try not to give in to impulse while shopping

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Hypothesis for Segment Description: "Practical Aspirationals"
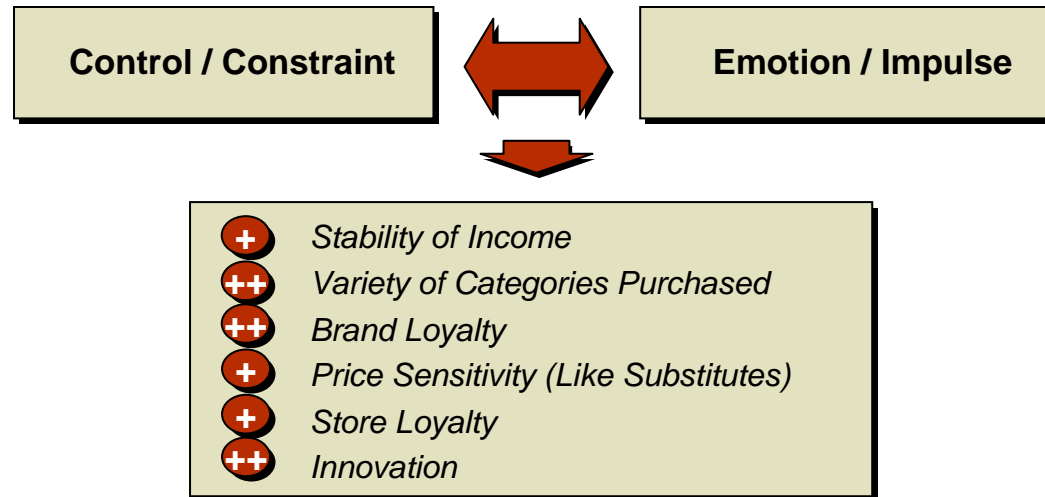
Control / Constraint	⟷	Emotion / Impulse

- **+** *Stability of Income*
- **++** *Variety of Categories Purchased*
- **++** *Brand Loyalty*
- **+** *Price Sensitivity (Like Substitutes)*
- **+** *Store Loyalty*
- **++** *Innovation*

Description:

Relatively higher and more regular income (generally "C" class); which allows for both daily and "stocking" shopping trips
Also have to control what they spend but factor small "slip ups" (usually driven by husband/kids) into the shopping budget
Place higher value on 'entertainment' factor of shopping
Rational but less frugal: keep an eye out for the best prices on preferred brands, at stores within acceptable distance …
… but store loyalty is higher and they may exclusively frequent only a few stores (comfortable with the prices & mix)
Loyal to leading brands (especially for personal care and categories that indicate prosperity to outsiders)
Higher range of products purchased: will purchase simple prepared foods and add categories to 'treat' husband/kids
Respond to interesting in-store promotions / samplings even for items that are not necessarily needed

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Appendix

▶ Emerging Consumers

▶ Retail Landscape and Informality

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Assortment -- 1st tier brands vs. "value" brands

% of SKUs That are 1st Tier Brands
Large Scale Trade vs. Small Retailers

Mexico

	Spaghetti	Laundry Powder	Colas	Bar Soap
Large Scale Trade	68%	48%	89%	71%
Traditionals	98%	65%	100%	96%
Small self-service	75%	75%	100%	

Colombia

	Spaghetti	Laundry Powder	Colas	Bar Soap
Large Scale Trade	69%	69%	91%	61%
Traditionals	89%	83%	100%	87%
Small self-service	66%	67%	100%	83%

Chile

	Spaghetti	Laundry Powder	Colas	Bar Soap
Large Scale Trade	74%	67%	87%	74%
Traditionals	92%	99%	93%	90%

Legend:
- Large Scale Trade
- Traditionals
- Small self-service
- More Importance of 1st Tier Brands in Small Retailers
- More Importance of Value Brands in Small Retailers
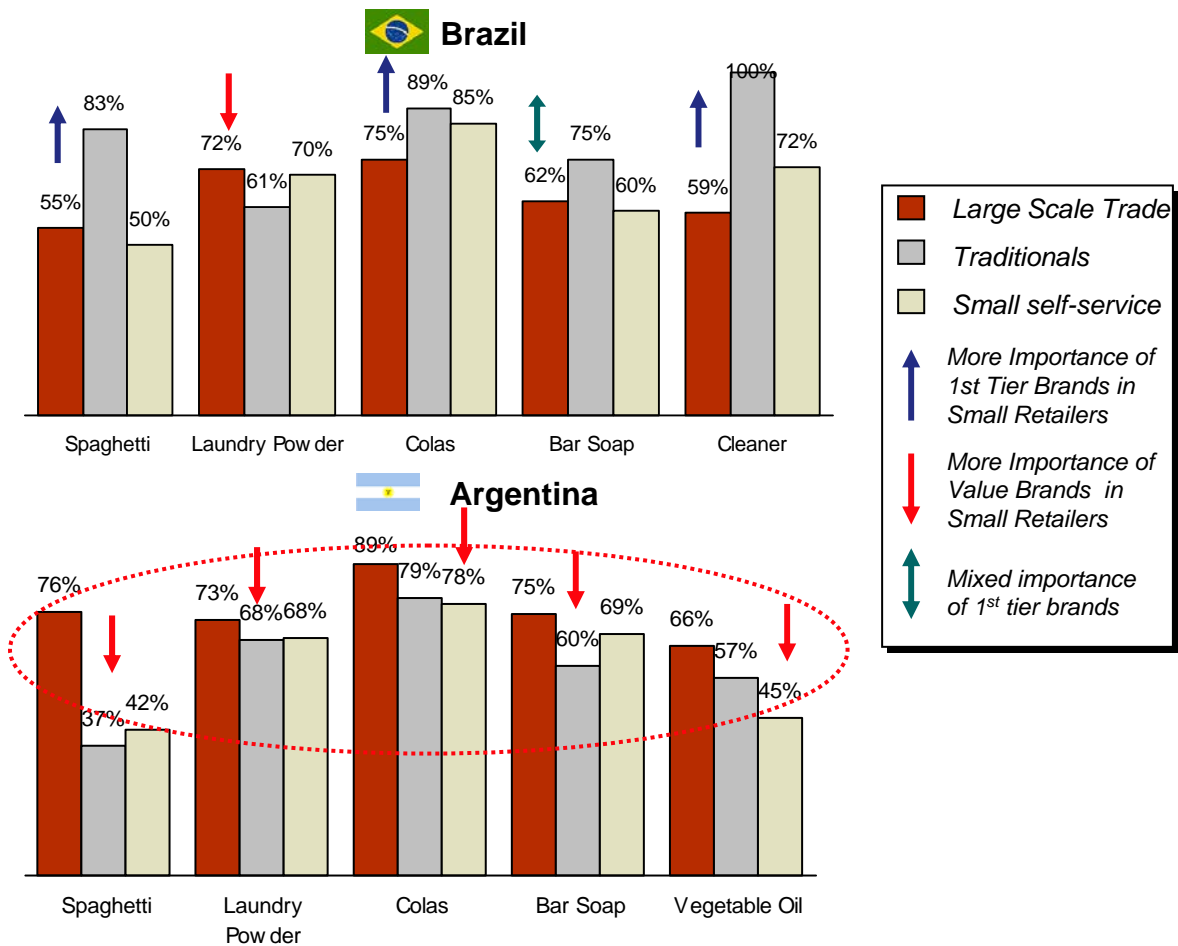- Mixed importance of 1st tier brands

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Assortment -- 1ˢᵗ tier brands vs. "value" brands

% of SKUs That are 1ˢᵗ Tier Brands
Large Scale Trade vs. Small Retailers

Brazil

Spaghetti: 55%, 83%, 50%
Laundry Powder: 72%, 61%, 70%
Colas: 75%, 89%, 85%
Bar Soap: 62%, 75%, 60%
Cleaner: 59%, 100%, 72%

Argentina

Spaghetti: 76%, 37%, 42%
Laundry Powder: 73%, 68%, 68%
Colas: 89%, 79%, 78%
Bar Soap: 75%, 60%, 69%
Vegetable Oil: 66%, 57%, 45%

Legend:
- Large Scale Trade
- Traditionals
- Small self-service
- More Importance of 1st Tier Brands in Small Retailers
- More Importance of Value Brands in Small Retailers
- Mixed importance of 1st tier brands

Source: Field Interviews, Booz Allen Analysis

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Assortment -- % of small sizes

% of SKUs That are "Small" [1]
Large Scale Trade vs. Small retailers

Brazil

- 24% — Laundry Detergent (Large Scale Trade)
- 61%
- 40%
- 48% — Colas (Large Scale Trade)
- 53%
- 52%

Laundry Detergent   Colas

Mexico

- 21% — Laundry Detergent (Large Scale Trade)
- 67%
- 63%
- 52% — Colas (Large Scale Trade)
- 62%
- 67%

Laundry Detergent   Colas

Argentina

- 0% — Laundry Detergent (Large Scale Trade)
- 49%
- 49%
- 59% — Colas (Large Scale Trade)
- 44%
- 47%

Laundry Detergent   Colas

Legend:
- ■ *Large Scale Trade*
- ■ *Traditionals*
- ■ *Small self-service*

↑ *More Importance of Large Products in Small Retailers*

↓ *More Importance of Small Products in Small Retailers*

(1) Classification based in size relative to "standard" package , e.g. 2 liters of Cola, 500g of pasta, 1 kilo of tomatoes, etc.
Source: Field Interviews, Booz Allen Analysis

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Assortment -- % of small sizes

% of SKUs That are "Small" [1]
Large Scale vs. Traditionals and Small Self-Service

Colombia

Chile

Legend:
- Large Scale Trade
- Traditionals
- Small self-service

↑ More Importance of Large Products in Small Retailers

↓ More Importance of Small Products in Small Retailers

Colombia

- Spaghetti: 24%, 91%, 72%
- Laundry Powder: 14%, 91%, 71%
- Colas: 37%, 64%, 50%

Chile

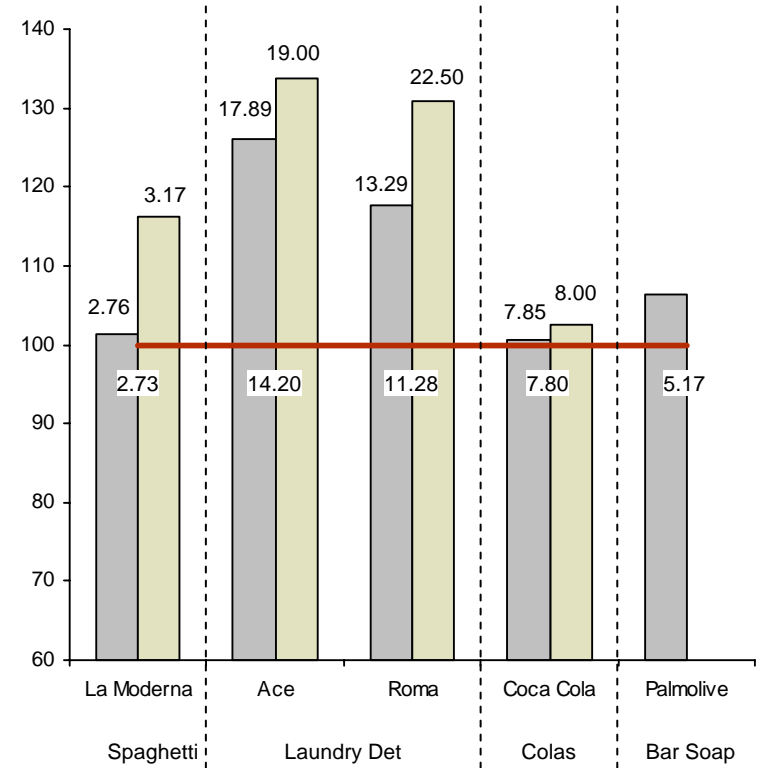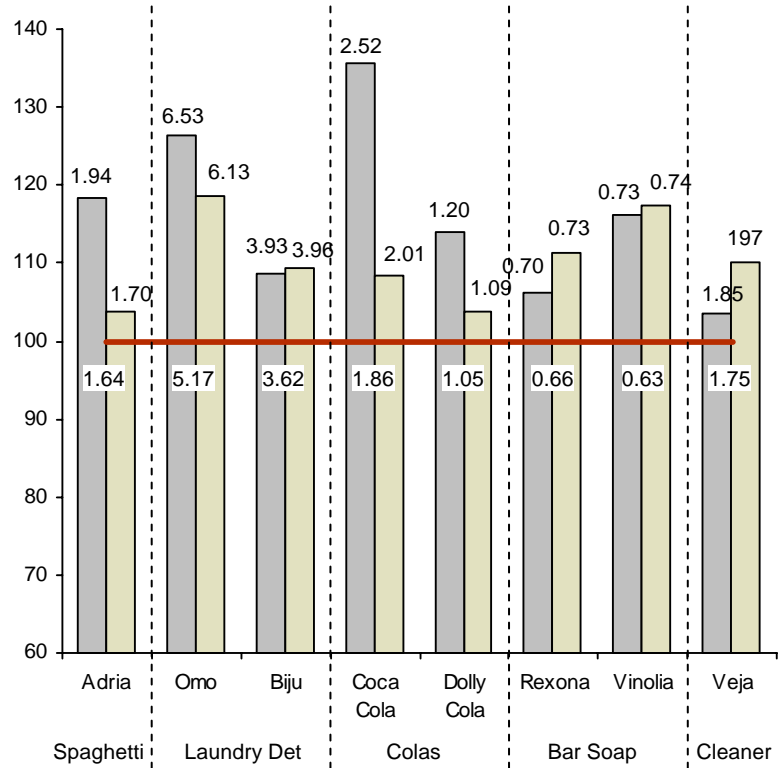- Laundry Powder: 22%, 93%, 54%
- Colas: 28%, 65%, 71%

(1) Classification based in size relative to "standard" package , e.g. 2 liters of Cola, 500g of pasta, 1 kilo of tomatoes, etc.
Source: Field Interviews, Booz Allen Analysis

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Price / Value: Price Comparison

Price Comparison Selected SKUs
(Axis shows index with hypermarket = 100, Actual prices shown in local currency)
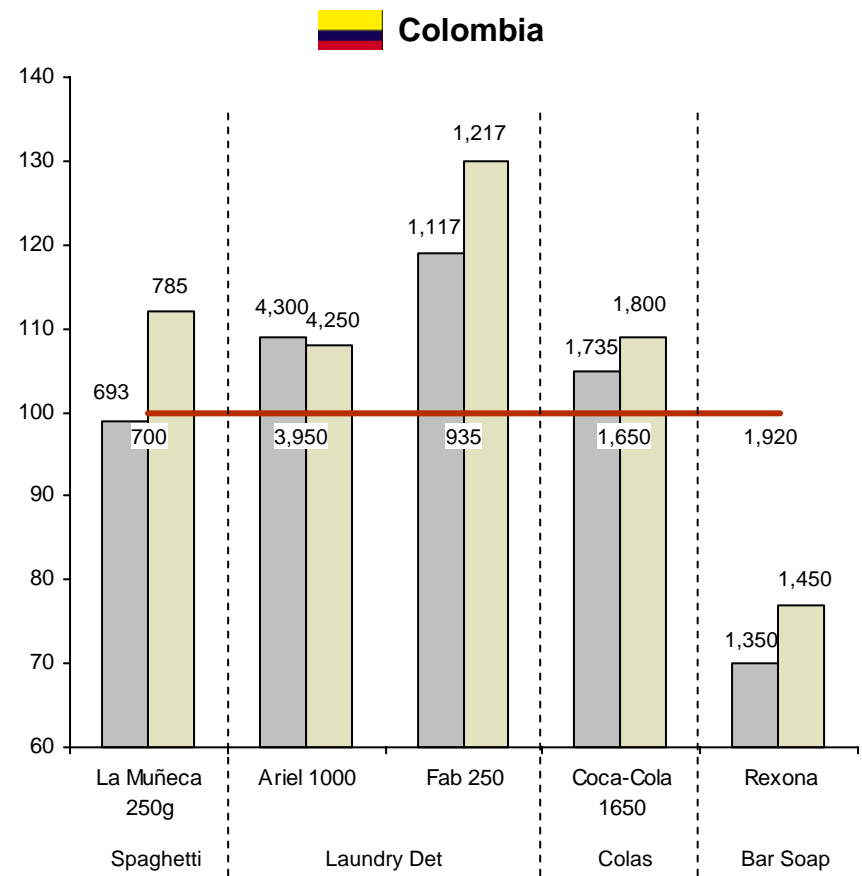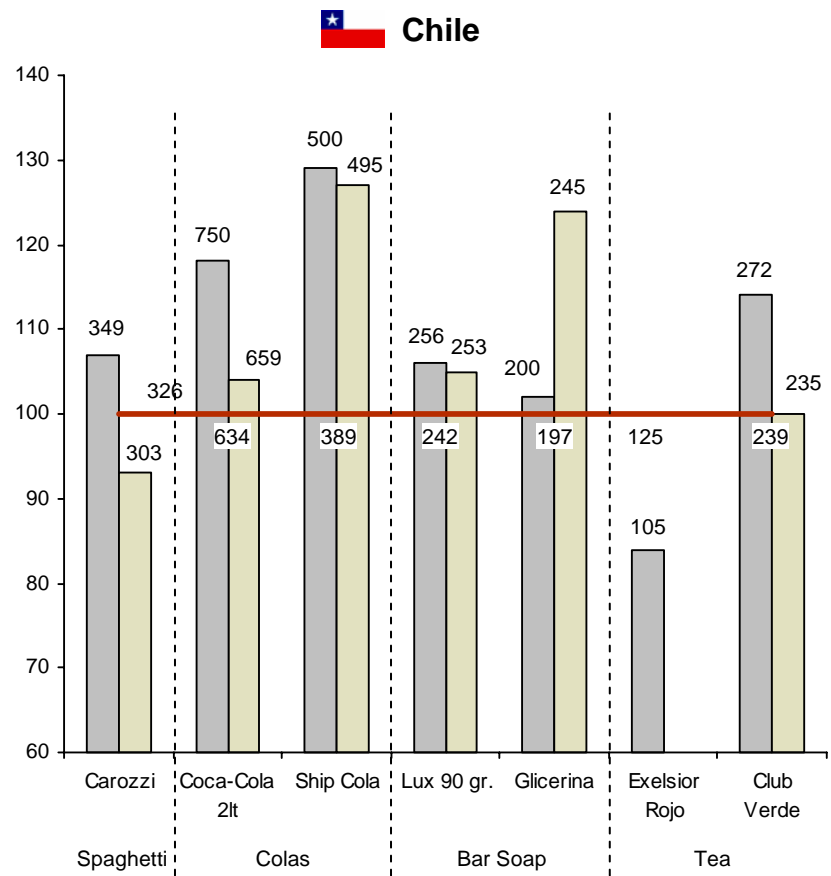

Brazil

Mexico

Legend: Avg. Hypermarket Price (line) — Traditionals (grey) — Small Self-service (light)

Brazil categories: Spaghetti (Adria), Laundry Det (Omo, Biju), Colas (Coca Cola, Dolly Cola), Bar Soap (Rexona, Vinolia), Cleaner (Veja)

Mexico categories: Spaghetti (La Moderna), Laundry Det (Ace, Roma), Colas (Coca Cola), Bar Soap (Palmolive)

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Price / Value: Price Comparison

Price Comparison Selected SKUs
(Axis shows index with hypermarket = 100, Actual prices shown in local currency)

Chile

Colombia

Chile chart labels: Carozzi, Coca-Cola 2lt, Ship Cola, Lux 90 gr., Glicerina, Exelsior Rojo, Club Verde — categories: Spaghetti, Colas, Bar Soap, Tea

Chile values: 349, 326, 303; 750, 634, 659; 500, 389, 495; 256, 242, 253; 200, 197, 245; 105, 125; 272, 239, 235

Colombia chart labels: La Muñeca 250g, Ariel 1000, Fab 250, Coca-Cola 1650, Rexona — categories: Spaghetti, Laundry Det, Colas, Bar Soap

Colombia values: 693, 700, 785; 4,300, 3,950, 4,250; 1,117, 935, 1,217; 1,735, 1,650, 1,800; 1,350, 1,920, 1,450

Legend: — Avg. Hypermarket Price ▨ Traditionals ▨ Small Self-service

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Price / Value: Price Comparison

Price Comparison Selected SKUs
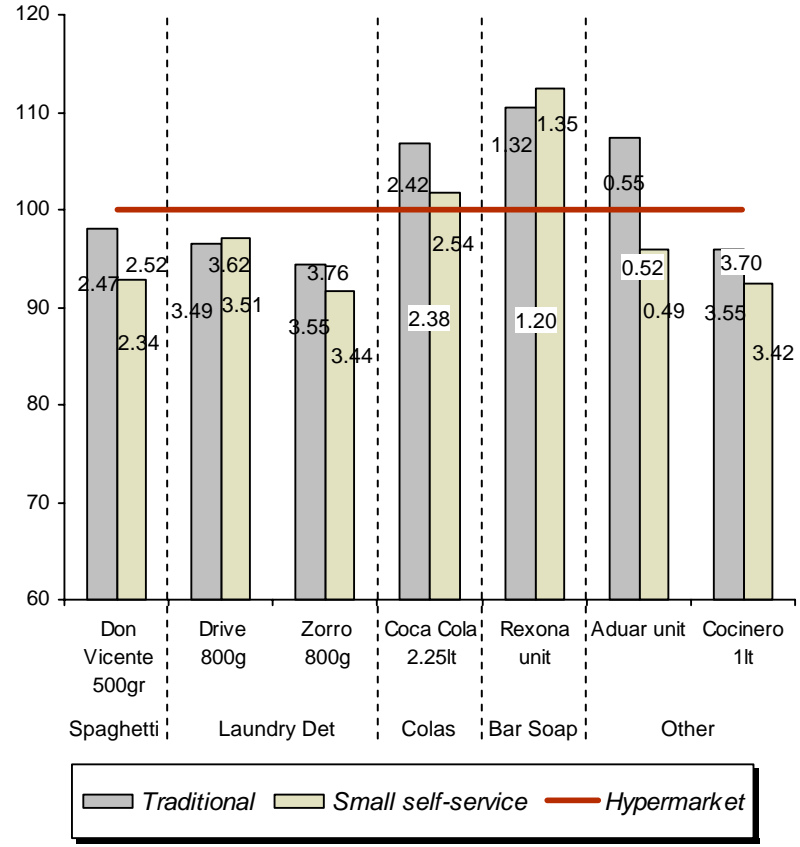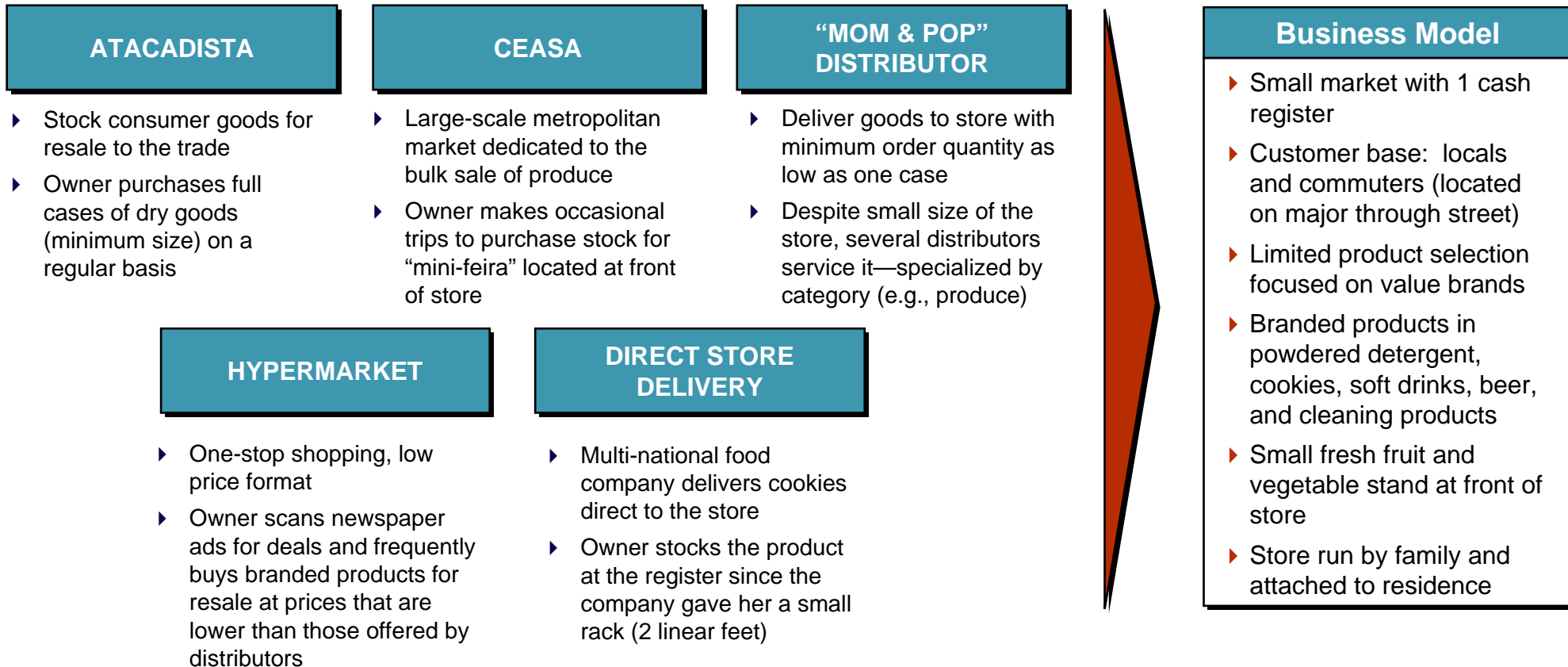**(Axis shows index with hypermarket = 100, Actual prices shown in local currency)**
Argentina

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Additionally, small retailers purchasing scheme can become considerably complex

Sourcing Example— Brazil
Format: Mercadinho

ATACADISTA

▸ Stock consumer goods for resale to the trade

▸ Owner purchases full cases of dry goods (minimum size) on a regular basis

CEASA

▸ Large-scale metropolitan market dedicated to the bulk sale of produce

▸ Owner makes occasional trips to purchase stock for "mini-feira" located at front of store

"MOM & POP" DISTRIBUTOR

▸ Deliver goods to store with minimum order quantity as low as one case

▸ Despite small size of the store, several distributors service it—specialized by category (e.g., produce)

HYPERMARKET

▸ One-stop shopping, low price format

▸ Owner scans newspaper ads for deals and frequently buys branded products for resale at prices that are lower than those offered by distributors

DIRECT STORE DELIVERY

▸ Multi-national food company delivers cookies direct to the store

▸ Owner stocks the product at the register since the company gave her a small rack (2 linear feet)

Business Model

▸ Small market with 1 cash register

▸ Customer base: locals and commuters (located on major through street)

▸ Limited product selection focused on value brands

▸ Branded products in powdered detergent, cookies, soft drinks, beer, and cleaning products

▸ Small fresh fruit and vegetable stand at front of store

▸ Store run by family and attached to residence

Tax Structure – Standard Tax Regime

ESTIMATE

**Main Taxes as a % of Net Sales for a Typical Medium / Large Scale Retailer
Under Standard Tax Regime**

Brazil   Mexico   Argentina   Colombia

Brazil: 14%
- Labor Taxes: 4.3%
- Income Taxes: 1.5%
- Sales Taxes: 3.0%
- VAT Taxes[2]: 5.2%

Mexico: 8%
- 3.4%
- 1.6%
- 2.6%

Argentina: 14%
- Labor Taxes: 3.7%
- Income Taxes: 1.6%
- Sales Taxes: 3.0%
- VAT Taxes: 6.2%

Colombia: 10%
- 3.2%
- 1.9%
- 0.7%
- 4.3%

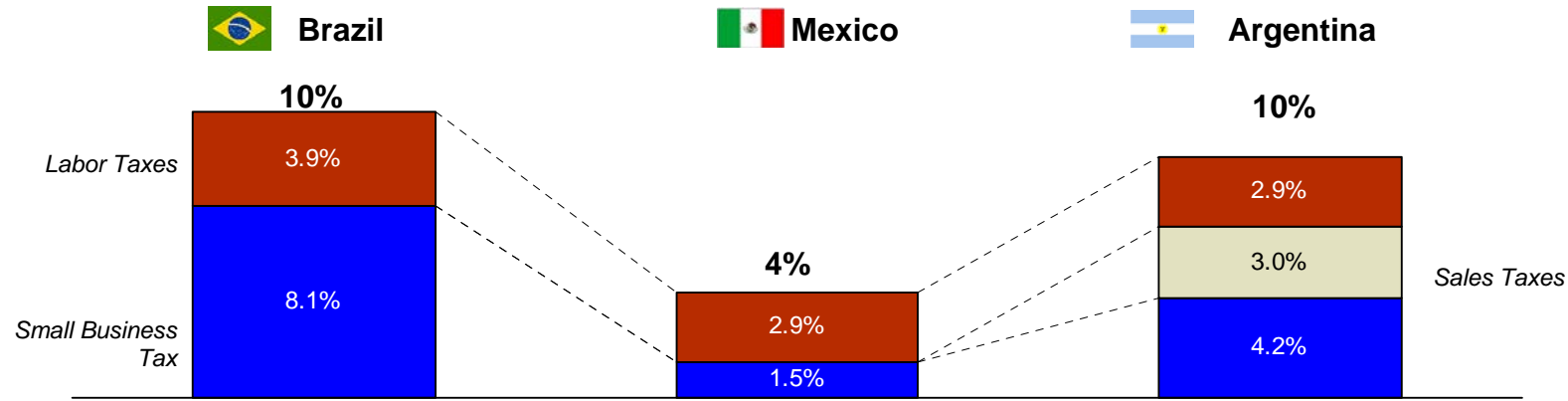| Main Taxes and Rates	Brazil	Mexico	Argentina	Colombia
VAT Taxes[2]	▶ ICMS (State): varies by state. SP:18% general, 7% basic food, 25% luxury goods ▶ PIS (Federal): 1.6% ▶ IPI (Federal) – for industrial prods.	▶ IVA (Federal): 0% for unprocessed food products, 15% for the rest	▶ IVA (Federal): 21%	▶ IVA (Federal): 7% for basic products, 16% average, 20% luxury products
Sales Taxes	▶ COFINS (Federal)- 3%	▶ N.A.	▶ IIBB, (State): Bs. As. 3%	▶ Industria y Comercio (Municipal): between 0.4% and 1.0%
Income Taxes	▶ IRPJ + CSLL: (Federal) 34%	▶ Renta: (Federal) 35%	▶ Ganancias (Federal) 35%	▶ Renta (Federal) 38.5% for 2003, 35% historical rate
Labor Cost	▶ 57%	▶ 40%	▶ 44%	▶ 36%

(1) For medium and large Retailers net sales are equal to price to consumer minus VAT taxes minus sales taxes. (2) In this analysis VAT debits and credits are treated as revenue and costs in order to compare costs with small business tax regime. In formal P&L statements they are treated as assets and liabilities.

Note: Assumes COGS 70% of net sales, General Expenses 12% of net sales, Labor cost including taxes 12% of net sales, net profit after tax and interest 3% of net sales. Brazil assumes average ICMS + PIS of 19.6%. México assumes retailer with 1/3% sales of basic food (at 0% VAT)

Source: Doing business in Mexico and Brazil, Deloitte & Touche, Doing Business in Colombia, Baker & McEnzie, Economist Intelligence Unit, AFIP (Argentina), Receita Federal (Brazil), SAT (Mexico) interviews with D&T in Argentina, Brazil and Mexico, Booz Allen Analysis

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Tax Structure – Small Business Tax Regime

ESTIMATE

**Main Taxes as a % of Gross Sales for a Typical Small Retailer
Under Small Business Tax Regime**

🇧🇷 **Brazil**

10%

Labor Taxes — 3.9%

Small Business Tax — 8.1%

🇲🇽 **Mexico**

4%

2.9%

1.5%

🇦🇷 **Argentina**

10%

2.9%

3.0%

4.2%

Sales Taxes

Small Business Tax Regime Description

	Brazil	Mexico	Argentina
Regime Name	▸ SIMPLES	▸ Régimen Fiscal de Peqeños Contribuyentes	▸ Monotributo
Taxes it replaces	▸ PIS, COFINS, IRPJ, INSS, IPI and for some states also ICMS	▸ All federal taxes (except	▸ VAT, Income Tax and Social security of the owner
Sales limit	▸ U$S 360 K/year	▸ U$S 160 K/year	▸ U$S 50K per year
Tax Rate	▸ 4.5% - 13% of sales	▸ 0.5% - 2% of sales	▸ 4.3% - 4.7% of sales ▸ Plus 3% State sales tax
Labor Taxes	▸ Sames as Std. Regime	▸ Sames as Std. Regime	▸ Sames as Std. Regime

(1) For small retailers sales are equal to price to consumer

Note: Assumes monthly sales of 12K reais in Brazil, 56K Mexican pesos and 7,000 Ar$, and one employee in each country,

Source: Doing business in Mexico, D&T, Doing Business in Brazil, D&T, Doing Business in Colombia, Baker & McEnzie, AFIP (Argentina), Receita Federal (Brazil), SAT (Mexico) interviews with D&T in Argentina, Brazil and Mexico, Booz Allen analysis

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Impact of Informality – Large Scale Trade vs. Traditionals, Brazil

ESTIMATE

Impact of Eliminating Tax Evasion – P&L for Organized Trade and Traditional Player Under Three Scenarios
(1) Current, (2) Full Tax Compliance When Prices Cannot be Raised, (3) Full Tax Compliance with Shelf Price Increase
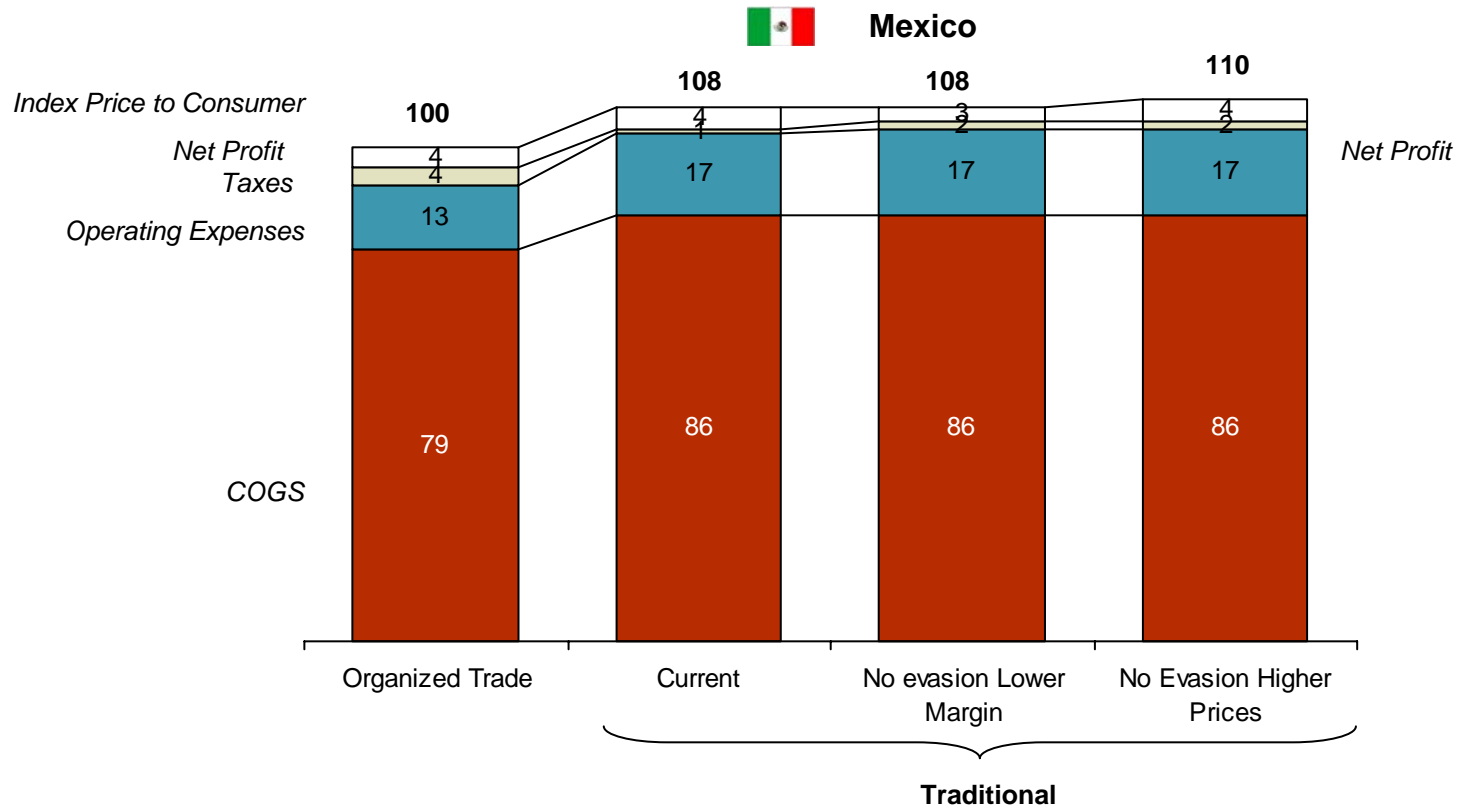
Brazil
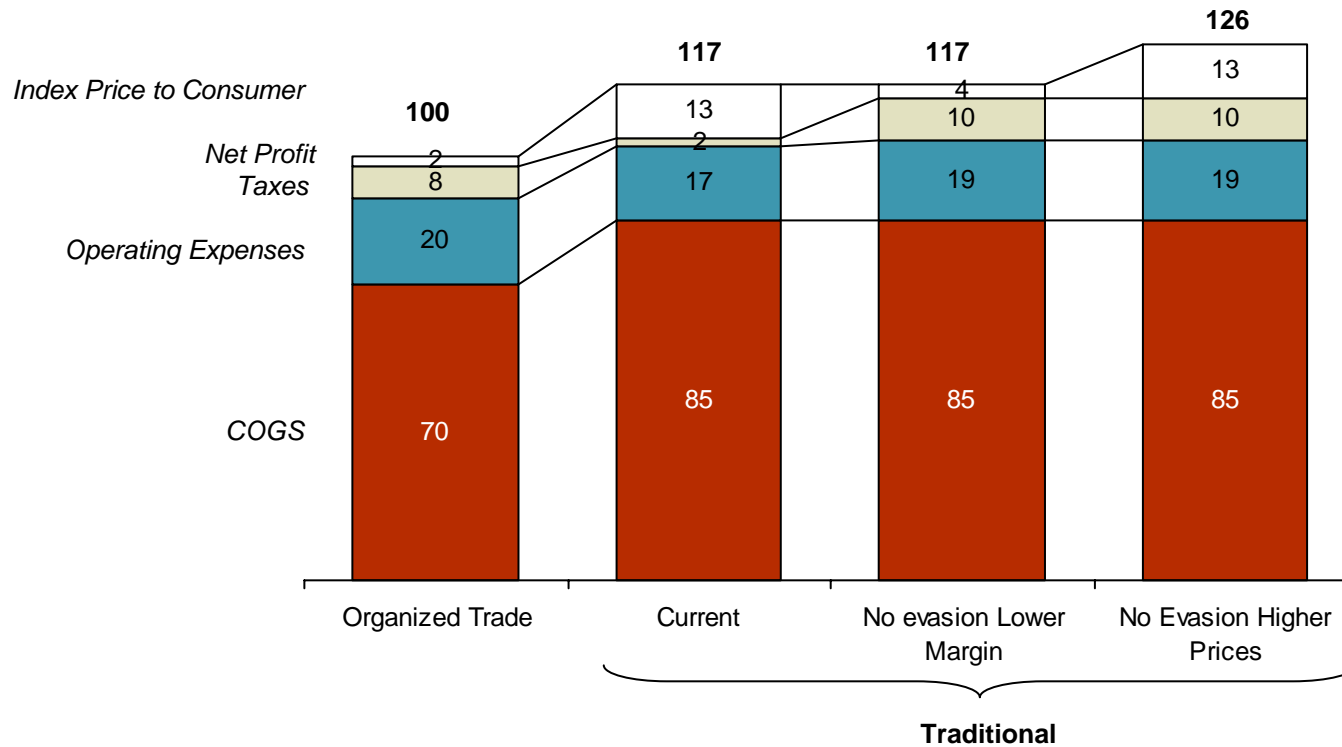
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Impact of Informality – Large Scale Trade vs. Traditionals, Mexico

ESTIMATE

Impact of Eliminating Tax Evasion – P&L for Organized Trade and Traditional Player Under Three Scenarios
(1) Current, (2) Full Tax Compliance When Prices Cannot be Raised, (3) Full Tax Compliance with Shelf Price Increase

Impact of Informality – Large Scale Trade vs. Traditionals, Argentina

ESTIMATE

**Impact of Eliminating Tax Evasion – P&L for Organized Trade and Traditional Player Under Three Scenarios
(1) Current, (2) Full Tax Compliance When Prices Cannot be Raised, (3) Full Tax Compliance with Shelf Price Increase**
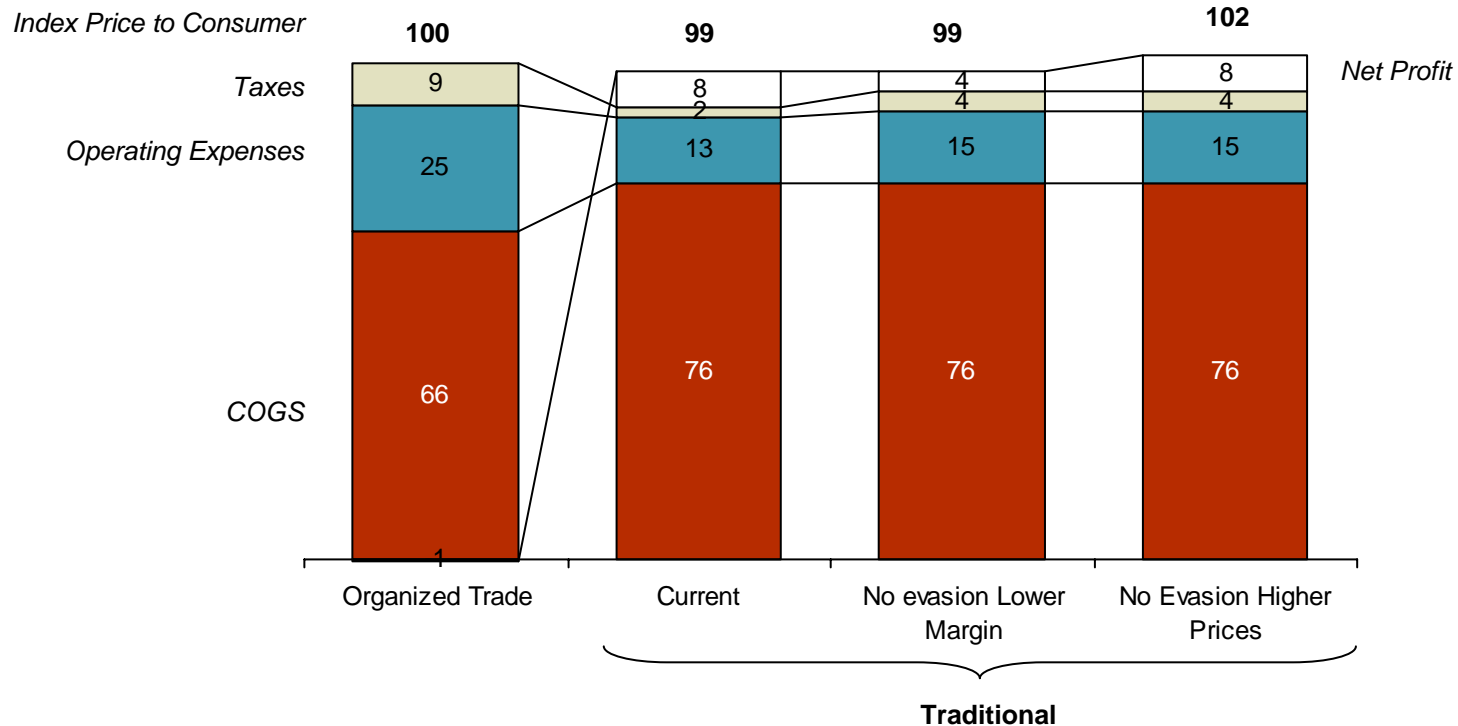
Argentina

	Organized Trade	Current	No evasion Lower Margin	No Evasion Higher Prices
Index Price to Consumer	100	99	99	102
Net Profit		8	4	8
Taxes	9	2	4	4
Operating Expenses	25	13	15	15
COGS	66	76	76	76
	1			

Traditional

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