by
Leticia Costa
leticia.costa@booz.com
Fernando Fernandes
fernando.fernandes@booz.com

booz&co.

Successful Retail Innovation in Emerging Markets

Latin American Companies Translate Smart Ideas Into Profitable Businesses

Coca-Cola
RETAILING
RESEARCH
COUNCIL

Booz & Company is a leading global management consulting firm, helping the world's top businesses, governments, and organizations.

Our founder, Edwin Booz, defined the profession when he established the first management consulting firm in 1914.

Today, with more than 3,300 people in 57 offices around the world, we bring foresight and knowledge, deep functional expertise, and a practical approach to building capabilities and delivering real impact. We work closely with our clients to create and deliver essential advantage.

For our management magazine *strategy+business*, visit www.strategy-business.com.

Visit www.booz.com to learn more about Booz & Company.

CONTACT INFORMATION

São Paulo

Leticia Costa
Partner
+55-11-5501-6205
leticia.costa@booz.com

Fernando Fernandes
Partner
+55-11-5501-6222
fernando.fernandes@booz.com

Originally published as:

Successful Retail Innovation in Emerging Markets: Latin American Companies Translate Smart Ideas Into Profitable Businesses,
by Professor Guillermo D'Andrea, Leticia Costa, Fernando Fernandes, and Fabio Fossen, Booz Allen Hamilton, 2006.

Successful Retail Innovation in Emerging Markets

Latin American Companies Translate Smart Ideas Into Profitable Businesses

Overview

What role do consumers play in leading retail innovation? The Coca-Cola Retailing Research Council (CCRRC) and Booz Allen Hamilton have answered this question through a jointly conducted study aimed at understanding how successful innovation in retail translates into effective business. In addition to its focus on the role of consumers, the study also identified and assessed cases of true consumer-centered innovation that originated and have been successfully implemented in Latin America.

While this study focused on the major Latin American markets, we believe its findings and conclusions could be applicable to the retail industry in other emerging markets as companies attempt to benefit from sales to the low-income consumer.

Our research found that truly customer-centered, innovative retailers are characterized by offerings that address an apparently impossible value equation—for example, catering to the aspirational needs of the emerging consumer. Successful retailers have built sustainable businesses by meeting these consumers' needs in a truly creative fashion.

About This Report

The objective of this study was to understand how successful innovation translates into effective, sustainable business for retailers. More specifically, the efforts focused on:

- Identifying how innovation in retailing can drive leadership with consumers;
- Mapping the most common avenues to building innovation in different retail segments, with an emphasis on format dimensions;
- Identifying the key pillars from which retail concepts are developed and understanding drivers of innovation success; and
- Identifying and selecting innovative retailers in the region and developing an in-depth understanding of each case.

The findings of this study are the result of a research conducted in the major Latin America markets: Argentina, Brazil, Chile, Colombia, Peru, Mexico, and Venezuela. The focus of the study was the end consumer of common goods in various retail sectors. Common goods include food/non-food; grocery; home appliances/furniture/home improvement; drug/mass drug; apparel; and personal/beauty care.

The Retail Landscape in Latin America

How have retailers responded to consumers' aspirations in Latin America? How has successful innovation been translated into effective, sustainable business for retailers? To answer these questions, it is important to understand the evolution of retailing in the region and the impact this evolution has had in different socio-economic strata.

Largely influenced by American and European formats, mainstream retail in Latin America has historically focused on adopting and/or adapting existing retail concepts from more developed regions, such as fast-food chains like McDonald's and retail groups like Zara, Home Depot, and Blockbuster.

Latin American hypermarkets are a classic example of adoption: Both multinational and local chains, such as Extra (a chain in Brazil owned by Casino and CBD), Jumbo (a Chilean chain), Carrefour, and Wal-Mart have imported their original big-box formats of all-inclusive stores, offering everything from gardening material to clothing, home supplies to fresh foods.

Other retailers have adopted existing concepts but made important adaptations to cater to local consumers. For instance, drugstores such as FASA and Farmatodo have expanded their product assortment beyond drugs, selling food and beverages to offer more convenience to their customers. As another example, Brazilian supermarket chain Pão de Açucar in Brazil imported its concept from foreign supermarkets, but adapted the service offering and levels to local high-end consumers' habits, selling freshly prepared meals including well-known brands of barbecue, sushi, and pasta.

The examples above point to an interesting trend: Both international players and local entrepreneurs have primarily directed their major customer-centered innovation toward mid- to high-income consumers, since adoption or adaptation of concepts created in developed economies clearly tend to be more appropriate for such income levels.

To a large extent, however, the emerging consumer continues to be served by so-called traditional retail—characterized by small, individually owned stores with a high level of service. In Latin America, such retailers

Who Are the Emerging Consumers?

Emerging consumers represent about 50 percent to 60 percent of Latin America's population, and typically fall into the "C" or "D" socio-economic strata (SES) in each country.[1] They exhibit a very specific set of product, category, and store-format needs that distinguish them from consumers in the middle- and higher-income segments.

When shopping, they exhibit rational and sophisticated behavior as they seek to reconcile preferences with their economic reality. They have a distinct set of product and format needs—which are not, as is often assumed, related to the products with the lowest prices or the stores with the easiest credit policies. Rather, emerging consumers value personal relationships and a sense of community, which are mostly found in small-scale retail formats. They also have a strong preference for intermediate and leading brands and not buying them can generate frustration, even though they are keenly aware that leading brands carry a price premium.

This group's shopping behavior is characterized by small ticket sizes, comprised of lower-margin items; exercise of self-restraint and low purchase conversion; and a focus on traffic-building promotions. The shopping basket of these consumers is weighted toward staple products, such as rice, beans, cooking oil, wheat powder, coffee, and pasta, rather than prepared or precooked foods; higher-value-added categories like frozen foods, ready-to-eat meals, yogurt, and fabric softener have lower penetration in these households, driven in part by the low penetration of household appliances like freezers and microwaves.

This characterization of the emerging consumer is a result of a previous study, also jointly conducted by CCRRC and Booz Allen Hamilton.[2]

[1] It is important to note that SES ratings are relative to each country—and an affluent household in one country can have quite different purchasing power and characteristics when compared to an affluent household in another country. Many countries have multiple methods for classifying consumers into SES.

[2] Value for Emerging Consumers in Retailing, May 2003, a study conducted by Booz Allen Hamilton for the Coca-Cola Retailing Research Council Latin America.

have managed to hold their ground; for instance, in Brazil and Colombia, small and traditional formats account for approximately 55 percent and 62 percent, respectively, of food sales. A previous study, also jointly conducted by the CCRRC and Booz Allen, shows that emerging consumers are attracted by the emotional proximity and feeling of community and by informal credit, neither of which are usually found in large chain formats (see “Who Are the Emerging Consumers?”).

In recent years, however, as the competitive environment has become increasingly fiercer and growth has become a challenge, many mainstream retailers have tried to reach emerging consumers, attempting to innovate in many dimensions and to varying degrees. However, as adoption or adaptation of existing formats does not necessarily meet emerging consumers’ needs and aspirations, successful innovation has required new, creative formats and concepts (see Exhibit 1).

Truly innovative retailers are not about novelties, yet innovative models may require new products and/or services. Such innovations are consumer-centered initiatives, driven by the development of new retail concepts, targeted to specific local consumer segments and needs. These innovations are also characterized by continuous, incremental improvements. The true innovators generally achieve a leadership position in the minds of their target consumers.

Given the significant mass of emerging consumers and the growth challenges of adopting or adapting existing formats, our study naturally centered around innovation aimed at emerging consumers, as the very high and low extremes of the socio-demographic pyramid have needs that have either already been met or are very hard to meet due to economic constraints. At the top of the pyramid, for instance, the desire for exclusivity, convenience, little interaction with retail staff, and caché are met by retail formats that draw their inspiration from the United States and Europe. Consumers at the bottom of the pyramid, on the other hand, need inclusion and basic access; they have limited exposure to mainstream retail.

The emerging consumer has very specific functional and emotional needs, as evidenced by our research (see Exhibit 2, next page). Such needs clearly require a targeted, differentiated value proposition from retailers.

Contrary to expectations, price is not the single driver of purchasing decisions for emerging consumers, though they are more sensitive to promotions, in light of their tighter budget constraints. However, our research shows that there are other important factors, such as proximity, variety and assortment, quality, and service, that play important roles in emerging consumers’ retailer selections and purchase decisions.

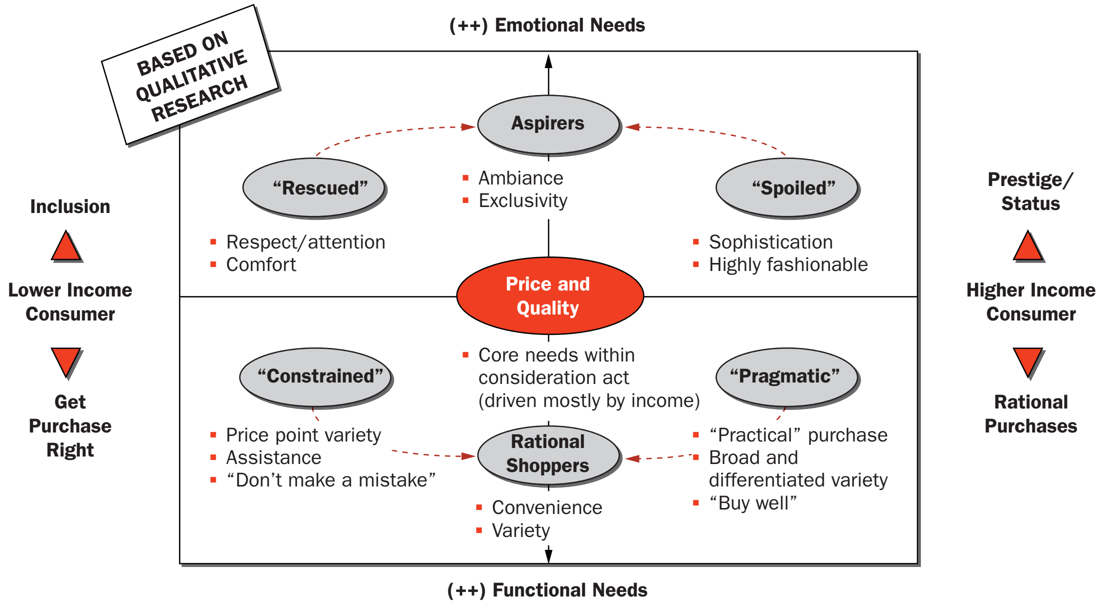
Exhibit 1
Evolutionary Process: Innovation in Local Retailing

	“Adoption”	“Adaptation”	“New to the World”
Description	▪ Adoption of already existing, global concepts	▪ Adoption of already existing concepts, with important adaptations to cater to local consumer needs	▪ Development of new concepts, targeted to specific, local consumer segments and needs ▪ Continuous, incremental innovations thereafter
Examples	▪ Hypermarkets (e.g., Extra, Jumbo) ▪ Department stores (e.g., Falabella) ▪ Hard discounts (e.g., Eki Discount, Bara)	▪ Drugstores (e.g., FASA, Farmatodo) ▪ Supermarkets (e.g., Pão de Acúcar)	▪ Home appliances (e.g., Casas Bahia, Elektra) ▪ C-Stores (e.g., Oxxo) ▪ Fresh food (e.g., Surtifrutiver, Horti Fruti)

– – **Degree of Innovation** ++

Source: Booz Allen Hamilton

Exhibit 2
Broad Consumer Segmentation



Source: Booz Allen Hamilton

Our fieldwork also indicated that emerging consumers cannot be treated as a single segment. For example, there is a sub-segment within the emerging consumer group for which emotional needs are critical. This segment values service and comfort, and aspires to have access to upscale consumer choices, such as free product delivery, extended-hours service, and expert sales assistance—all of which they see as a means of social inclusion.

In summary, truly innovative retailing in Latin America is mostly centered around serving the emerging consumer. Adoptions or adaptations of existing concepts are usually more suitable for higher-income classes, as the "imported" formats tend to come from developed economies. In this context, our study focused on understanding innovation for the emerging consumer in Latin America.

Consumers' Paradigms: A Challenge for Retailers
Consumers know that they can't have it all, in terms of getting the best of everything, all the time. Most purchasing decisions involve some form of trade-off in light of constraints such as price, distance, time to shop, or credit.

Our study revealed that consumers have preconceived notions of how to address these trade-offs in the retail world. Whether these notions reflect negative experiences or simply consumers' perceptions, they often hide frustrations and desires in equal measure. We call these preconceived notions "consumers' paradigms" and they are associated with the trade-offs that need to be made with respect to products, services, design, quality, assortment, and location.

Although not exhaustive, the following paradigms are based on our fieldwork and reflect the most relevant information at the time of this research. While the concept of trade-offs is applicable to most income classes, our analysis and examples are focused on emerging consumers.

1. **"Access to high-ticket items requires a long term-sacrifice."** As shown in our previous study, emerging consumers dedicate a proportionally higher portion of their income to household purchases: In Latin America, they spend approximately 50 percent to 75 percent of their budget on consumer products.

   As a general rule, daily needs are the top priority for emerging consumers, followed by emergency purchases and large purchases to stock up. As a result, savings are very limited and so is the emerging consumer's ability to acquire high-ticket items, such as cars, computers, and household appliances like freezers and microwaves. As an illustration, a 42-inch plasma TV can cost as much as 20 percent to 25 percent of the annual salary of an emerging consumer in Brazil.[3]

The purchase of high-ticket items is made even more challenging for emerging consumers as access to financing is limited. The primary reason for this limitation is clear: Only about 45 percent[4] of emerging consumers possess bank accounts in Brazil, for example. Yet even for the "bankable" consumers, obtaining credit can be a challenge, since financial institutions require extensive documentation, such as proof of income, which the vast majority of emerging consumers do not have. Furthermore, even when consumers are able to obtain credit, there is little or no room for debt renegotiating, which impacts the consumers' credit history, another important factor in the financial institutions' decision to grant credit.

In the context of their limited savings capability and financing options, the key question for emerging consumers is, "Can I possibly buy a personal computer or a car?" Our discussion groups indicate that emerging consumers do not believe this is the case, unless they are willing to make a long-term sacrifice: They have to save for an extended period of time and pay relatively high installments, thus giving up on shorter-term consumption. A C-class consumer in Mexico characterizes this situation very well: "Before Elektra, I remember how hard it was to have the discipline and the sacrifice to save to get us our first color TV."

2. **"Better quality must be more expensive."** "Can I find trendy, quality furniture at a reasonable price? Are my choices limited to traditional, unfashionable staple products if my budget is limited? Can I get higher-quality products at competitive prices?" In the minds of emerging consumers, the answers to these questions are, "No, yes, and no." They believe superior quality, which they generally associate with intermediate or leading brands, carries a premium in price. This belief can drive the purchasing process to the point where emerging consumers don't even compare prices and limit the number and type of stores that they visit. A D-class consumer in Chile stated, "I buy my clothes in La Polar or in Lider, because Falabella is not for me." The same belief holds when emerging consumers shop for other products, such as furniture and electronics.

3. **"If a store is nice and trendy, its products must be expensive."** Emerging consumers take for granted that a modern, trendy shopping environment, carrying stylish products, also carries a premium price. "C&A stores are really nice and chic; it is not for people like me," stated a Brazilian C-class consumer. Alternatively, as a B-class Mexican consumer said, "Palacio is expensive, but you find better things, more modern, exclusive; they get the products before other stores, and they run the best brands." The perception is clear: If a store is trendy, the products must be trendy as well, and therefore expensive.

4. **"If the store is small, the assortment must be very limited."** Emerging consumers believe the store area is an indication of the available assortment. Consequently, they believe that if the store is small, one has to shop around in many other stores or commute to a larger store to access greater variety and, in certain cases, feel comfortable about making the "right choice."

It is important to note that emerging consumers have often stated their preference for shopping at small stores nearby, as going to larger stores a distance away requires more time and more expensive transportation, which is significant in the context of their limited budgets.

In the case of mid- to high-ticket items, this paradigm of a clear trade-off between store size and assortment has a much greater impact, as lower-income consumers usually do more research to purchase. As a D-class consumer in a small town in Brazil said: "I bought a new washing machine last month to replace the old one. But it took me five months to have my husband take me to Campinas, where there was a store with broad variety."

[3] Calculation based on the average monthly salary of an non-registered worker in January 2006, according to the Banco Central do Brasil, and the average price of a 42-inch plasma TV at Ponto Frio online store as of March 20, 2006.
[4] Institute for Applied Economic Research (IPEA), 2004.

5. **"Better service and sales assistance must be more expensive."** Our study identified service as a highly valued attribute for emerging consumers. Nonetheless, they usually do not have positive experiences in this respect. It is common for them to find sales assistants too "sophisticated" to understand lower-income consumers, or believe that assistants have a cold and snobbish attitude toward them.

   Accustomed to not having technical assistance and good service, emerging consumers believe that complimentary services can only be obtained with higher prices. When one C-class consumer in Colombia commented, "I like K-tronix; they have good products, nice people to help, and they even installed the refrigerator I bought for free," another consumer responded, "Nothing is for free, my friend. The cost is somewhere inside the price you paid."

All of the paradigms described above could also be characterized as "impossible equations" in the consumers' minds.[5] But while emerging consumers may see them as impossible, they are nonetheless central to developing an attractive value proposition for these consumers.

The key question, then, is whether it is possible to break these paradigms. Can a lower-income consumer effectively choose and buy a stylish gift at an affordable price? Is it possible for an emerging consumer in Latin America to buy a high-ticket item without significant sacrifices? If so, how?

Our fieldwork and case studies have allowed us to gain insight into what makes an emerging consumer engage with a specific retailer, particularly in the context of innovation: Successful, innovative retailers were able to break existing paradigms. More specifically, retailers who have built sustainable, innovative models for emerging consumers were able to develop unique value propositions based on what were believed to be impossible equations. They have managed to challenge dogmas by offering new possibilities of trade-offs. Many of these new possibilities, outlined in the following examples, cater to the aspirational needs of the emerging consumer.

- ***Casa & Ideas***, a home décor retailer in Chile, reinvented its sector by making design and fashion affordable. The company's innovative retail value proposition allows mid- to low-income consumers to have access to modern, fashionable, exclusive home décor at competitive and affordable prices. Comments from consumers in our field research stated: "C&I has beautiful stuff, colors with low prices" and "C&I changed habits among consumers in decoration; they introduced colors, design, etc."

- ***Casas Bahia*** in Brazil has made home appliances affordable to low-income consumers through installment plans that feature low payments over long periods of time, a large assortment of products, fast delivery, and convenient locations. Apart from these innovative features, Casas Bahia customers also highlight the personalized treatment given to defaulters as a key differentiator; unlike competitors that might automatically blacklist defaulters or turn them over to a collections agency immediately, Casas Bahia builds loyalty by being flexible and working with customers to find solutions.

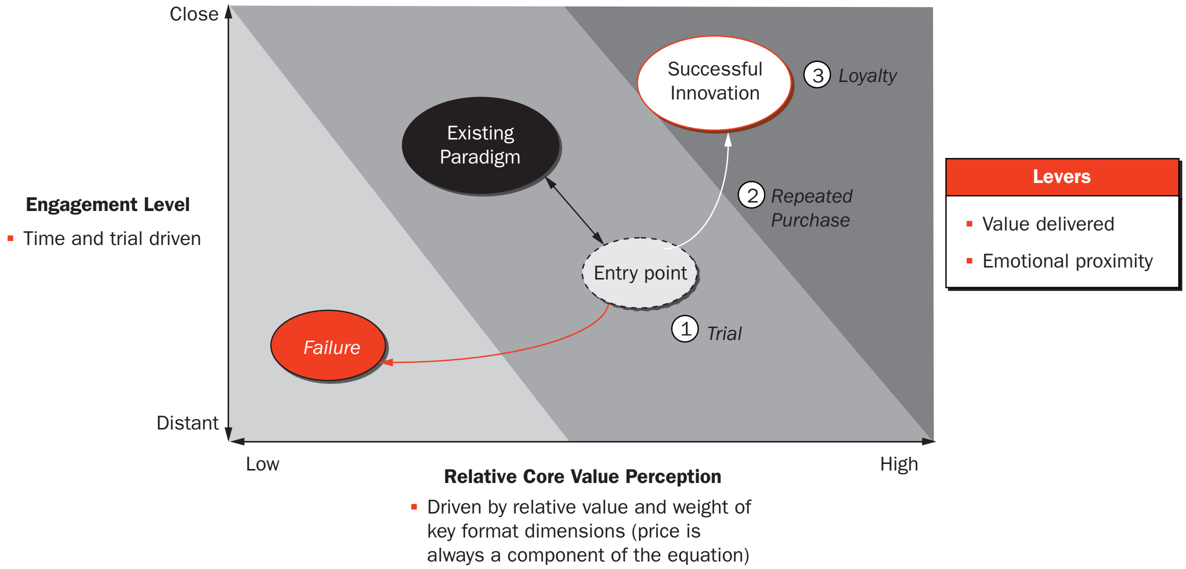
  Elektra, a Mexican chain, developed a similar model. One consumer explained, "They give you payment options; a lot of poor people, without credit cards, can get installments in Elektra."

- ***Farmacia Similares***, a 2,200-store retail healthcare chain in Mexico, provides access to low-cost medicine, affordable check-ups, laboratory services, and health plans for those who cannot access the public health system or pay the private health sector. In spite of the successful model that allows savings of up to 75 percent on medicine, Farmacia Similares customers are mostly driven to the retailer by the "medical consultation service that makes people feel reassured."

Innovation, however, is not enough. Successfully innovative retailers have also identified mechanisms to engage consumers, strengthening their emotional bonds. Consequently, such retailers are seen as creating more value for their customers and, in the long run, generating loyalty (see Exhibit 3, next page).

[5] The term "impossible equations" comes from Brazilian management guru Oscar Motomura, founder of Amana Key. Motomura believes that only by challenging these impossible equations can companies break from traditional thinking and approach their businesses from a perspective of reinvention, transformation, cultural change, and radical innovation.

Exhibit 3
Retail-Consumer Relationship Dynamics



Source: Booz Allen Hamilton

The importance of these engagement levers—value delivered and emotional proximity—cannot be overemphasized. In particular, it is clear that lower-income consumers value emotional proximity. Consequently, only an adequate combination of value proposition and emotional proximity is needed for success. Some innovative initiatives, such as the one described next, failed to recognize this—and were unsuccessful.

A trend in Brazil toward implementing self-service in gas stations experienced an unexpected reaction from the public. As it is such a common model in the United States and Europe and allows price and cost reduction, a number of chains expected the pilot for a self-service gas station to attract lower-income consumers by offering cheaper gasoline. The outcome, however, was the opposite. Emerging consumers value their few opportunities to shop with "free service," as they get in gas stations, and were not inclined to change their behavior. Surprisingly, some high-income consumers, accustomed to being served in various circumstances, were attracted by the model, perhaps because of its novelty. However, due to the general unpopularity, all self-service gas stations were converted back into the traditional model.

Innovative retailers must also understand the importance of execution. Our survey identified executional problems as the most probable reason for a consumer to switch retailers. The two statements below, from a Brazilian consumer and a Mexican consumer, respectively, offer clear evidence of this finding:

- "I will never return to Hypermarket A. I once saw a promotion in a leaflet and when I was at the cashier, the woman said the product was no longer in promotion."
- "Once I bought a game for my son in Store A and it was defective. I went to the store to change it and it took me two months to receive a new one. I will never go back there."

Cases of Success on Innovation Platforms

Our fieldwork, including the case studies, have allowed us to identify three unique innovation platforms in Latin America (see Exhibit 4, next page). Each of these platforms represents a change to the paradigm existing in consumers' minds and allows the consumers to think of trade-offs in a different manner. In addition to the value proposition, each one of these platforms shows the importance of engagement levers as a means to generate loyalty.

The so-called "Product or Service Access" platform represents cases in which retailers innovated by fulfilling previously unmet aspirations of emerging consumers. The value proposition of these retailers creates the necessary conditions for emerging consumers to be able to afford basic products such as TVs, audio products, and washing machines. Sales assistance and services, such as extended warranty and home delivery, also play an essential role in engaging customers in the long run.

The "Affordable Design, Quality, and Assortment" platform represents those companies that innovated by creating models in which mid- to low-income consumers can buy well-designed, stylish, high-quality products at reasonable prices. Sophisticated retail environments allow these retailers to convert a choice that was traditionally based on functionality into an emotionally driven decision.

Access to choice through a broad assortment in small surface stores characterizes the third platform, "Assortment and Location." Located in relatively premium sites, retailers have innovated by offering variety at competitive prices and with creative financing conditions, enabled by non-traditional credit processes.

All platforms and cases have a common characteristic: They are all based on compelling formats, which are simple for emerging consumers to understand and are complemented by engagement levers that aim at generating repeat purchases and, therefore, loyalty in the long run.

From an execution standpoint, all successful cases share other characteristics as well: a format definition, in all of its dimensions, that is very well-aligned to the value proposition; key, core capabilities that truly become differentiators; and positional assets that directly and explicitly support the value proposition. Communication is also a key common factor as a means to reinforce positioning and executional capabilities. All of these variables need to be set out in a coherent, cohesive fashion for the value proposition to be executed to its fullest potential (see Exhibit 5, next page).

Platform 1: Product or Service Access—From Resignation to Fulfillment

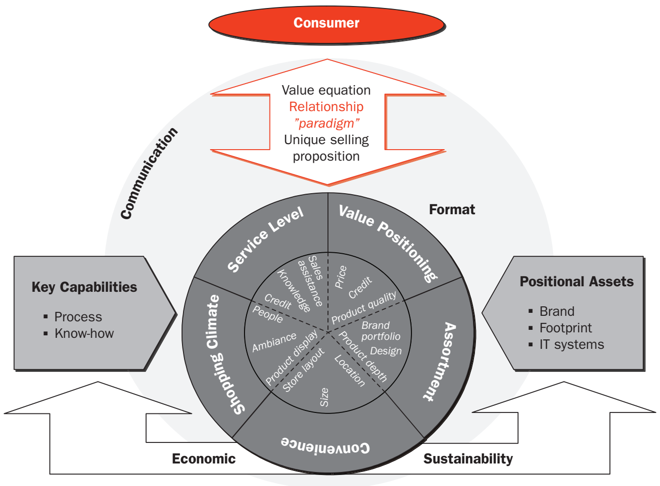
Casas Bahia: Casas Bahia has become an example to emerging consumers and other household-goods retailers in Brazil of how to make high-ticket items affordable through easily accessed, flexible, tailored credit. Casas Bahia is the leading household goods retailer in Brazil; with approximately 430 stores in eight

Exhibit 4
Unique Innovation Platforms

Innovation Platforms	"Paradigm Breaker"	Engagement Levers
"From resignation to fulfillment" **Product or Service Access**	▪ Provide consumer access to basic products and services	▪ Sales assistance—e.g., individual respect, source of trust ▪ Services—e.g., extended warranty, home delivery
"From functional to emotional" **Affordable Design, Quality, and Assortment**	▪ Enable design, quality, and assortment at reasonable price point for the middle/lower classes	▪ Sales assistance—e.g., fashion and make-up consulting ▪ Ambiance—e.g., sophistication
"Access to choice" **Assortment and Location**	▪ Provide a large assortment (breadth and depth) in small store ▪ Access to lower prices at premium location to lower classes	▪ Credit process—e.g., for M. Luiza, account opening process and renegotiation of debts ▪ Sales assistance–e.g., individual respect, source of trust ▪ Services—e.g., extended warranty, home delivery

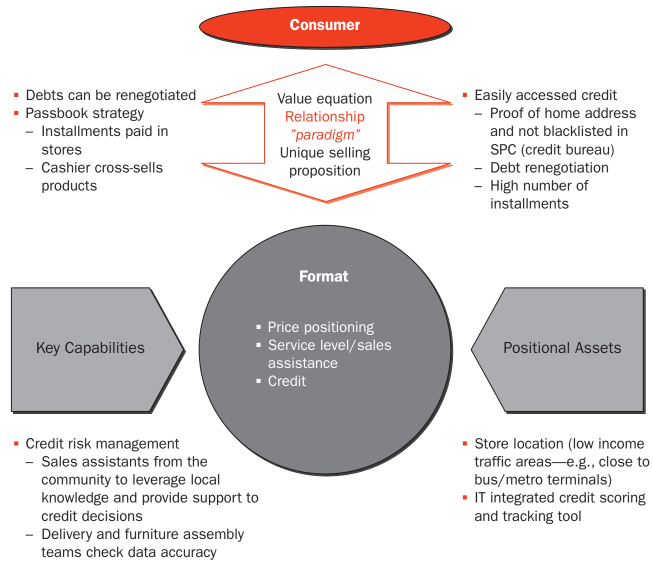
Source: Booz Allen Hamilton

Exhibit 5
Executing the Value Proposition



Source: Booz Allen Hamilton

Exhibit 6
Casas Bahia



Source: Booz Allen Hamilton

states, it is larger than its five biggest competitors combined. Since 1999, its revenue (R$9 billion in 2004)[6] has grown an average of 16 percent per year and revenue per store has grown an average of 6 percent per year. In the last two years, those rates reached 28 percent and 11 percent respectively. What is the company's recipe for success?

Casas Bahia engineered an effective risk-management solution and leveraged a passbook model to sustain its sales-on-credit strategy (see Exhibit 6). Credit granting follows a very straightforward process: By simply collecting a document with proof of home address and checking that the customer is not blacklisted by the SPC (Credit Protection Service), sales assistants, who are trained on credit-profiling techniques, are able to submit credit approval through an online central credit system. By delegating processes, systems, and decision rights to salespeople, Casas Bahia has brought speed and flexibility to credit approval. In general, customers receive credit concession very quickly: immediately for values below R$600 if the name is not blacklisted at SPC; one to two minutes for credit system approval; and up to 10 minutes for a credit analyst evaluation if credit is rejected by the system.

Casas Bahia understood that in order to sell to low-income consumers, the product does not have to be cheap, as long as it is affordable: 90 percent of Casas Bahia customers are from C/D/E social classes, and 65 percent have no formal job. Currently, payments can be made in up to 18 installments for home appliances; further credit is offered to those customers who have fully paid the last purchase; and some debts can be negotiated, and divided in an even larger number of installments.

This model is well-regarded by emerging consumers, whose comments included: "For the first time in my life, I was able to buy a laundry machine"; "It is a store for low-income people"; "The payments are easier to manage"; "I work in the construction business and nobody ever gave me the opportunity to buy something in installments."

Once the customer finances the purchase, he has to go to the store every month to pay the passbook, unless the client opts to add a bank fee. More visits result in more opportunities to deepen the company's relationship with the customer.

Casas Bahia has invested in tightening emotional proximity and creating a feeling of community with its customers. Most sales assistants are from nearby communities, which helps leverage local knowledge and provide support to credit decisions. Salespeople educate customers to buy in accordance to their budgets, in order to prevent default and avoid customer frustration.

[6]Source: Publicly available information from different sources (Exame, Valor Economico, Gazeta Mercantil, etc.)

Store locations in low-income traffic areas, such as near bus and metro terminals, combined with an IT-integrated credit scoring and tracking tool, enable the format. As one customer mentioned, “You can find a Casas Bahia store anywhere.”

Elektra: Elektra is the retail arm of the large conglomerate Grupo Salinas in Mexico, which includes retailing, financial services, mobile telecommunications, and TV broadcasting. Elektra has become the leading electronics and white goods retail chain in Mexico after almost going bankrupt in the early 1980s, with annual revenue of US$1.8 billion in 2003, and operating income of US$218 million.[7] It currently has 741 stores in Mexico.

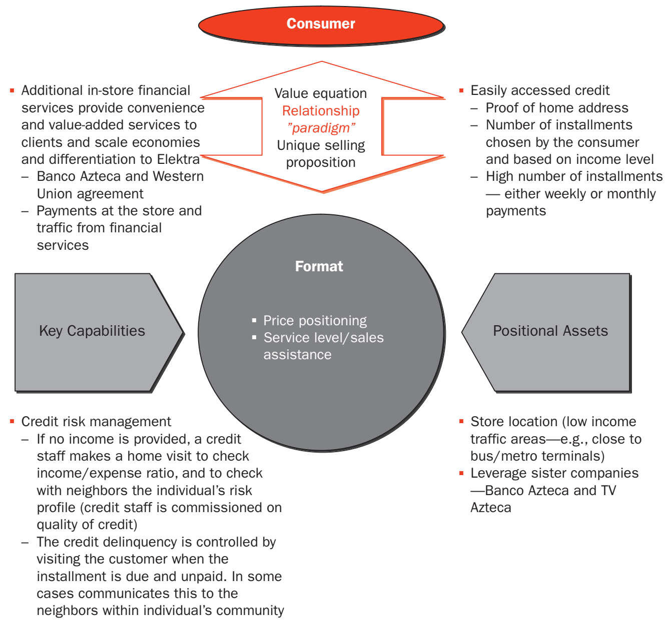
Elektra’s innovation has given low-income consumers access to basic home-equipment needs and lifestyle-related goods. Its model is based on having a wide assortment of products, covering most popular brands and some private-label electronics, coupled with fast consumer financing for lower-income consumers (see Exhibit 7).

Within the stores, Banco Azteca, also part of Grupo Salinas, manages all of Elektra’s financial services. Customers can choose between weekly and monthly installments, with the number of installments chosen by the customer, based on his salary. Payments must be made at the Elektra store, increasing the customer’s number of store visits; the length of the payment plan varies from three months to two years. Credit approval and collection processes are designed from scratch, which is simpler yet effective for the target segment.

Consumer financing is provided for lower-income consumers with or without proof of income, accommodating consumers all the way at the bottom of the pyramid. The credit-approval process follows an application and credit scoring, but when a consumer fails to provide his income, the credit staff makes a home visit, performing a socioeconomic study to determine the subject’s income/expense ratio and verifying the subject’s risk with neighbors.

Elektra controls credit delinquency by visiting the customer when the installment is due and unpaid. In

Exhibit 7
Elektra Case



Source: Booz Allen Hamilton

some cases, the company communicates this fact to the neighbors in the customer’s community. Prices for cash purchase are competitive, but the main driver is the weekly installment amount—reducing the amount and increasing the term has been a constant advertising strategy. As a result, almost 70 percent of sales are on credit.

Low-income consumers appreciate Elektra’s financing options, as illustrated by the following customer comments: “It is very important for people who don’t have credit cards, because they do get credit”; “It is very important that there is no need for upfront payment”; “You choose how much you want to pay depending on your possibilities”; and “The weekly payments and opportunities are innovative.”

Elektra’s service offerings supplement its retail business; the Banco Azteca outlets within Elektra stores are full-service retail banks, which means that customers come into the store to do all of their banking, as well as making their payments to Elektra. This convenience and one-stop shopping results in high traffic for the stores and generates additional sales. Banco Azteca services include local or international money transfers, credit products, and personal loans.

[7] Source: Company’s 2003 annual report

Elektra customers commented: "The bank is in the store and closes later than other banks"; "It is useful for people sending and receiving money from the United States."

Distinct in-house capabilities, built over time, are key strengths that have enabled the sustainable financing innovation and a unique positioning. Using its own financing solution, mobile telephony services, and money-transfer operation has provided Elektra with more flexibility and responsiveness, especially within the typical Latin American environment. After observing Elektra's consumer-finance innovation, other companies targeting the same segment have launched similar models.

Elektra's stores are located in convenient sites—in suburbs, in main commercial zones, near subway stations, and in areas with high pedestrian traffic. They range from 500 to 1,000 square meters; the largest stores have more displays of furniture, which comprises Elektra's highest-margin category, and offer home delivery.

A proprietary IT system provides real-time information on key performance and decision-making metrics, as well as extensive drill-down capabilities, such as contribution per customer, as well as sales and contribution per store, per SKU, and per day. Currently, more than seven million customers are in the database, with approximately 3.6 million of those as active customers.

In terms of HR development and motivators, Elektra has its own "university" to train its employees, coupled with a strong supervision and coaching process to drive capabilities development. Compensation at all levels of the organization is mainly variable, and for the innovation-facing personnel it promotes quality credit sales—that is, variable compensation is based on the "quality" of the sale, not only on quantity.

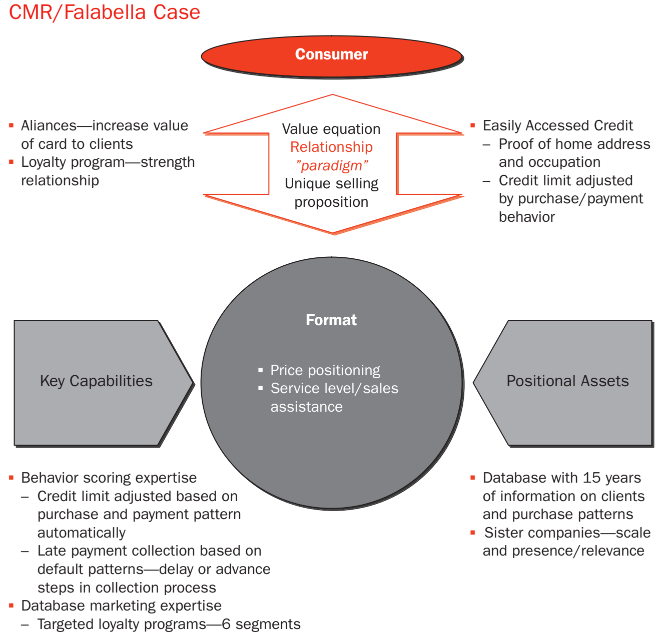
As a result, customers' historical information, which is kept in databases, provides input for future transaction; for example, a returning customer requesting credit will be approved if his record is clean. Supervisors focus on coaching to salespeople, since they depend on their employees' performance for their own compensation. In the same context, executives and salespeople focus on building close relationships with customers because their compensation also depends on customers' sales and collection performance.

CMR/Falabella: CMR/Falabella has brought innovative solutions to Chilean emerging consumers by providing access to credit for a broader set of product and service categories. CMR/Falabella, the leading retail conglomerate in Chile, also has a presence in Argentina, Colombia, and Peru. Unlike Elektra and Casas Bahia, CMR/Falabella's solution is based on technology and technical expertise (see Exhibit 8).

CMR/Falabella is the largest card issuer and one of the largest consumer credit providers in Chile, holding about 25 percent of active cards of major players. CMR/Falabella's cardholder base has grown at 11 percent in recent years and in 2003, it had about 2.2 million active cardholders, with Ch$453 billion of outstanding loans and Ch$57 billion in earnings. CMR/Falabella has a significant penetration in the lower strata of C and D social classes—a part of the population that banks have difficulty penetrating.

Emerging consumers in Chile have a preference for retail cards over bank cards, as they are considered

Exhibit 8
CMR/Falabella Case



Source: Booz Allen Hamilton

easier to get, more convenient for making payments during working hours, and more flexible with payments. CMR/Falabella, however, takes advantage of its presence and scale as a conglomerate to sell up to 70 percent of its new cards. This strategy ensures a cost advantage compared to banks, which helps support a low-interest strategy.

The approach to in-store sales is very effective and comes at a relatively low cost: Consumers get a 10 percent discount on their purchase if they activate the card. Reinforcing mechanisms for the sales staff include mystery shopping, performance goals, bonuses for newly opened cards, and bi-weekly training.

CMR/Falabella's risk-management capability is superior to that of banks, and the company has a much better risk profile than that of retailers and bank credit cards: In 2004, CMR/Falabella reached 3.1 percent of provisions/outstanding loans ratio, compared to 4.0 percent of banks.[8]

Account opening is one of the three areas where CMR/Falabella based its low risk, using a behavior-based credit-scoring system that considers information regarding purchases and payments from a database with information going back 15 years. The system determines the credit line based on address (proxy to social class and potential income), occupation (potential income), and proof of income. CMR/Falabella is successfully opening new cards to higher-risk segments, such as lower SES and students, with very low initial credit lines (Ch$60,000 for students and Ch$100,000 for lower SES) and then increasing it later, using the behavior system.

The company's credit-limit management also enhances its risk profile. Unlike other banks, CMR/Falabella's credit system runs every night and updates access to credit line or products accordingly. Certain "red flag" purchase behaviors, like buying gas on credit, automatically decreases the credit line, whereas the credit line is increased for clients with "good" payments habits on a three-month basis.

And finally, CMR/Falabella counts on an innovative collection behavior system, using information about previous payment delays in order to predict future defaults. For example, a client may have a pattern of delayed payments, which indicates that the fact that he is delayed does not necessarily mean that he is not going to pay. The system combine this information with recent purchase behavior to predict future default.

If the system identifies a client who is not willing to pay, it automatically accelerates the collection process in order to reach the customer and collect money from him before other retailers and banks. On the other hand, if it identifies a client who is delayed on his payments but is also a very loyal customer who is probably willing to pay, it will slow down the collection effort, saving the company money.

Relationships with target customers are enhanced by alliances that increase the value of cards and by loyalty programs. Alliances with retailers have allowed CMR/Falabella to capture a higher share of wallet by following consumers where they are most likely to spend their money; however, because CMR/Falabella also operates in the retail sector, it does not form alliances with competitors, even if those competitors are the leaders in the field. Some examples of alliances include Copec gas stations, FASA drugstores, McDonald's, Blockbuster, Cinemark, and Kodak.

Platform 2: Affordable Design, Quality, and Assortment—From Functional to Emotional

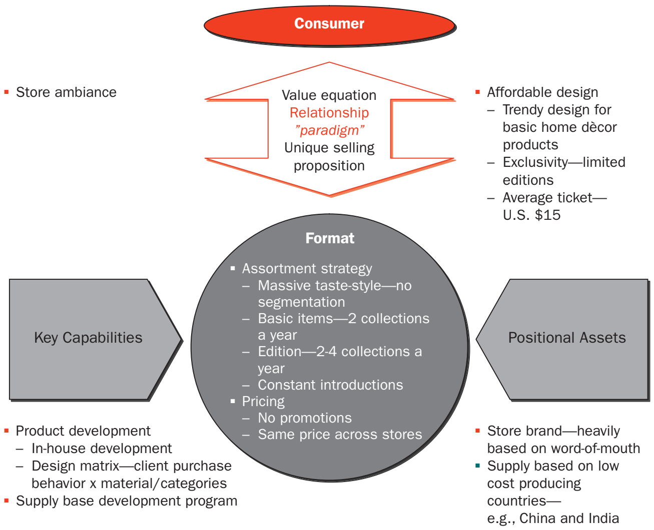
Casa & Ideas: Casa & Ideas is a 24-store home décor retailer based in Chile, which has recently expanded to Peru, and has annual revenue of US$55 million. The company has democratized design by offering affordable, exclusive, good-quality home décor products and defying the conventional wisdom that quality design products must come at prohibitive prices.

From its original "quick and cheap" value proposition, it developed an offering of "colors and design" that has cost the same since 1999, targeting 25- to 65-year-old women and creating a new market that has not yet been successfully copied by competitors.

The Casa & Ideas model relies on a design team of 35 professionals responsible for maintaining a feeling of exclusivity via limited editions—that is, permanently

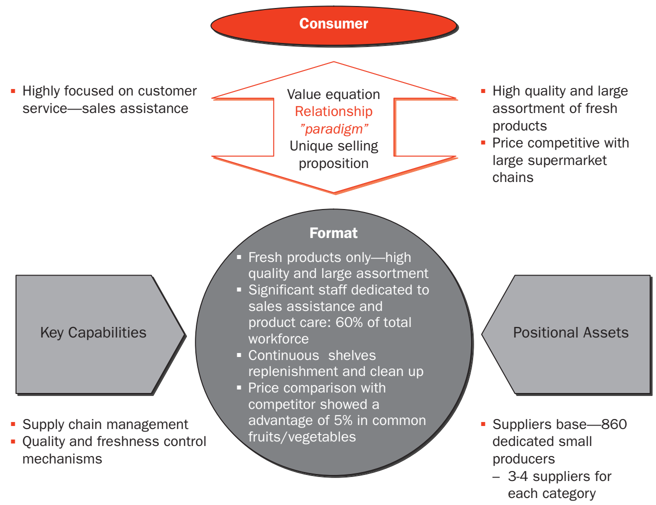
[8] Sources: Superintendencia de Bancos e Instituciones Financieras; Falabella press release, 2004. Considers only bank credit cards; provisions are calculated using the same methodology and parameters as used by banks and stated by Superintendencia de Bancos e Instituciones Financieras.

Exhibit 9
Casa & Ideas Case



Source: Booz Allen Hamilton

Exhibit 10
Surtifruver Case



Source: Booz Allen Hamilton

developing new products (see Exhibit 9). This capability, coupled with exclusivity agreements with suppliers from low-cost producing countries, allows high turnover of products.

At the same time, the company has an ample product assortment for Kids (Babies, Kids, and Juveniles) and Home (organized around purchasing behavior). Its strategy includes two collections per year for basic items and two to four collections for "editions," allowing frequent introductions.

In spite of an average US$15 ticket, Casa & Ideas stores have a modern and trendy ambiance. Casa & Ideas has built strong customer loyalty; 70 percent of sales are reported to be from frequent shoppers, and marketing is heavily based on word of mouth.

Surtifruver: Surtifruver's value proposition is to provide high-quality fresh food at market plaza prices in Colombia. This seven-store retailer has successfully innovated by offering a large assortment of fresh, natural products at low prices. It excels in managing a large supply base and has implemented a refined quality control mechanism to guarantee the delivery of its value proposition (see Exhibit 10).

During our fieldwork, we verified an advantage of 5 percent in its common fruits and vegetables prices, compared to competitors. This low-cost strategy relies on a low-cost organization—no advertising, no bar codes, and a very lean organizational structure, with store managers reporting directly to the CEO and salaries that are lower than multinational standards.

But that doesn't mean customer service falls behind. Around 60 percent of the total workforce is dedicated to sales assistance and replenishment of goods—from customer service at the entrance of every store to cleaning up and arranging goods—and is highly valued. One customer commented, "I like Surtifruver not only because of its products, but also because of the attention I got from the store personnel."

On the other hand, in order to guarantee high-quality, fresh fruits, vegetables, meat, seafood, dairy products, and flowers, Surtifruver has long-term contracts with suppliers and must negotiate with up to four suppliers per product.

Fruit is examined before it is accepted for purchase, then cleaned and polished before being displayed. Unfresh fruits and vegetables are taken away from shelves, repacked, and sold in the back of the stores at very low prices. Customers commented: "I buy here because of the freshness and quality of the products"; "You can be sure that the products here at Surtifruver are of the best quality"; and "This store has an incredible variety and quantity of products."

Despite a modest décor, Surtifruver's store layout affects the positive perception of quality, confirmed by customers: "I like this store because it is always clean and quiet"; "The way products are displayed makes them look amazing."

Platform 3: Assortment and Location—Access to Choice

Locatel: Locatel is a healthcare retailer with 42 stores in Venezuela, two in Bogota, and one in Florida. Founded as a medical equipment rental store, it has evolved into a one-stop-shop for all health-related needs, including products, equipment, and services (see Exhibit 11). Its value proposition is to live up to its slogan: "Todo para la salud en um mismo techo" ("Everything for your health under the same roof").

Apart from the wide and deep assortment of pharmaceuticals, health, beauty, and equipment products, Locatel's differentiation comes from an innovative offering of medical examinations for low and competitive prices, such as eye exams and blood tests, which it has offered since 2002.

Locatel has managed to leverage clear synergies among its two pillars: Pharma products, which are basic necessities, bring customers into the store and increase interest in the medical equipment, health foods, and in-store health services; while the equipment and service offerings provide differentiation and generate trial for the other products and services.

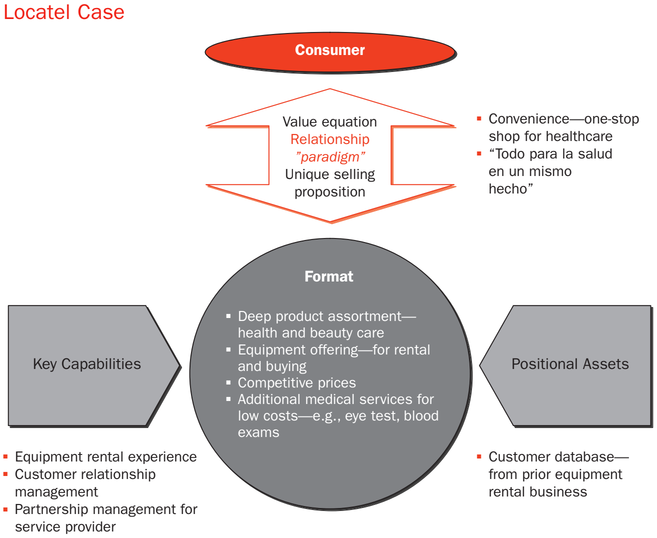
Additionally, the company offers the convenience that customers are seeking, with parking at main locations, an intense focus on in-store service assistance, medical diagnostic check-ups at zero cost, and assurance of product availability.

Magazine Luiza: Facing the impossible question of how to grow with scarce capital, rationalizing costs, and logistic footprint, Magazine Luiza's management came up with an innovative virtual model, which accounts for 52 stores of the 350-store chain. By defying the notion that "if the store is small, the assortment must be very limited," Magazine Luiza provided access to a megastore's assortment of basic home needs to populations in small cities (see Exhibit 12).

The virtual model, which relies on an electronic format, is based on four major pillars: no on-site products; offering of additional services; strong technological support; and integration with the community. While launching the virtual model, Luiza Helena, the company's CEO, fostered an environment of innovation, collaboration, personal stimulation, and eagerness to achieve the company's goals.

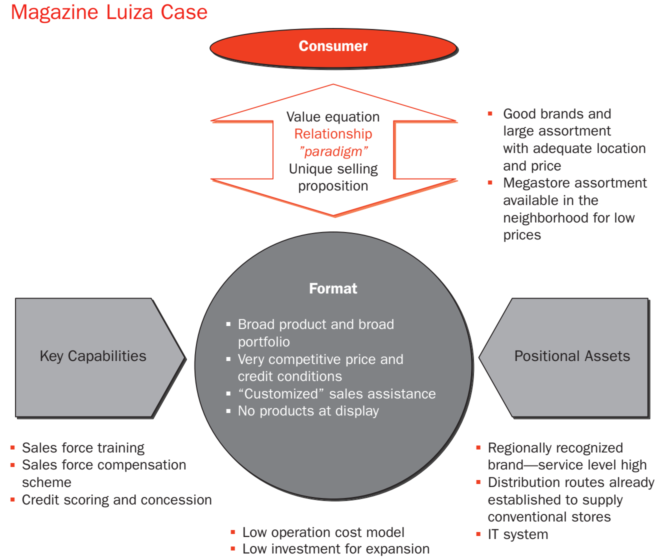
Unlike other companies' failed attempts at a virtual

Exhibit 11
Locatel Case



Source: Booz Allen Hamilton

Exhibit 12
Magazine Luiza Case



Source: Booz Allen Hamilton

store, Magazine Luiza did not apply a self-service model. On the contrary, it counted on customer service not only to sell, but also to educate customers on the new concept and format. At first, the virtual store model started with sales on video; it later moved to an online approach.

As another means of differentiation, Magazine Luiza launched one-hour Internet access for customers, with an additional hour for bringing in a new customer. The company also sets aside space within the virtual stores for consumer education, partnering with local charities to provide their customers with information sessions on topics including literacy, healthy living, disease prevention, and childcare.

Lessons Learned

The need to reach emerging consumers, coupled with microeconomic restrictions and discontinuities or specific challenging circumstances (such as severe capital limitations and clients' bankruptcy), has been the main driver of innovation. From our research, we

Other Successful Cases in Latin America

It is worthwhile to mention a few other cases that have also represented brand-new innovation initiatives in the region:

- ***Tok & Stok,*** a furniture retailer in Brazil, has made well-designed products and attractive stores affordable for the middle class. Stores are conveniently well-located (some with free valet parking) and offer several showrooms with a modern sense of vivid color and unusual shapes and materials. Customers can "self-serve" products and have the option to take products home or have them delivered in a few days at an additional cost. Apart from its fashion appeal, prices are considered reasonable for its "price-quality ratio."
- ***O Boticário,*** a beauty care retailer in Brazil, offers attractive stores, sales assistance, and a good quality/value offering for low-income consumers. Present at 1,500 cities in Brazil at well-located sites, and with more than 900 points of sales abroad, O Boticário is well-regarded for its expert sales assistance in targeting emerging consumers, good-quality products, and brand reputation.
- ***Vivara,*** a jewelry retailer in Brazil, has become a symbol of sophisticated design at affordable prices for the middle class. Renowned young celebrities in Vivara advertisements help develop consumers' association of Vivara with modern fashion and good-quality jewelry. Once limited to either jewelry retailers with good quality and high prices or low quality and cheap prices, middle-class consumers have found a good quality/price equation at Vivara.
- ***Farmacia Guadalajara,*** a long-established drug retailer in Mexico, created the Superfarmacia, offering 24-hour service with convenience and ubiquity. The assortment varies from drugstore items to fresh food, butchery, and bakery, with medicine as the big consumer magnet. Pricing is aggressive for drugstore categories, while prices in the shared categories, products, and brands are comparable to convenience stores. Available parking and a fast checkout line have helped Superfarmacia gain credibility among consumers.
- ***Lojas Americanas,*** a "category killer" in confectionery, personal care, lingerie, and music/CDs, has brought innovative retail solutions to Brazil by offering the lowest prices at premium locations, with 65 percent of its stores in shopping malls. Low prices are a perceived attribute, though high promotions are focused on seasonal products. In addition, personal credit is offered in all stores, making high-ticket items affordable.
- ***Farmacia Similares,*** a mass drug retailer in Mexico with 2,200 stores, has innovated by providing access to basic health care for low-income consumers. Playing in a price-driven market of generic and similar drugs, Farmacia Similares has successfully consolidated by offering check-ups for US$2 next door to the retail outlets, as well as laboratory services with savings up to 75 percent compared to other laboratories. It has also implemented a health plan for consumers that can't access the public health system or pay the private sector.

have learned that truly “new to the world” innovation is more likely to happen in the mid-portion of the socio-economic pyramid. On one hand, innovation for higher income groups generally happens through adoption or adaptations of already existing models from developed economies, particularly the United States and Europe. On the other hand, innovation for the very bottom of the pyramid is heavily constrained by the economics of that segment, where the challenge is to provide access to basic goods.

True innovation happens when an apparently impossible value proposition is created, breaking existing paradigms on perceived trade-offs, such as quality vs. price. In most instances, this happens as a previously unaffordable value proposition is made affordable either through price, financing, or low-cost models, catering to the latent aspirations of lower-income consumers (such as designer accessories and affordable durable goods).

Additionally, the sustainability of an innovative retail format is dependent on creating a sense of emotional proximity either through convenience or sales assistance—again leveraging the aspirational component in lower-income segments.

We observed that innovative retailers have a very clearly defined set of capabilities and positional assets to support the value proposition and differentiation over time. In most instances, capabilities such as training of sales personnel or a proprietary credit-scoring system have become the truly differentiating factor. Innovation usually involves engineering solutions to

- deepen the understanding of target customer needs to address changes in format components, at a low cost;
- provide flexible, tailored, convenient credit;
- build loyalty;
- develop alliances in an extended enterprise model;
- create the ability to focus on the most important needs via a high-impact format component; and
- build vision and leadership.

In all of the cases studied in this research, top-level leadership with a vision of the future and experimentation were key to overcoming market barriers and internal skepticism. A robust execution is critical to the sustainability of an innovative retailer, for mistakes in execution are the primary driver for a consumer to change retailers. Successful innovation requires a disciplined and structured implementation approach, for its process involves discontinuities, trial and error, adjustments, and execution fine-tuning along the way.

Over time, more constrained emerging consumers will become the target of other initiatives, highlighting the potential for another new wave of truly innovative models. As we’ve learned from the cases studied in this research, it will require further understanding about their paradigms of consumption and behavior, building a differentiated value proposition, given their socioeconomic conditions, and how to implement it.

We believe the framework used in this study and its lessons may be of great value in geographies other than Latin America, for it provides profitable and sustainable examples of how to potentially serve groups with latent needs by breaking paradigms of consumption. Though it needs to consider singularities of culture, behavior, and economy, the framework could be applicable to emerging economies such as Southeast Asia, India, China, and also to specific groups, such as minorities and immigrants in the United States and Europe.

Consumer Research Methodology and Expert Panel

Our methodology followed a pragmatic approach, with comprehensive fieldwork, supported by actual examples explored through consumers' interviews, expert panels, and field research.

Primary consumer research employed for this study included 14 focus groups in Argentina, Brazil, Chile, Colombia, and Mexico, with approximately 14 participants each. In addition, more than 200 interviews with consumers at store intercepts were conducted to gather insights on innovation and on potential cases.

The methodology employed for our primary research also included an expert panel with 15 leading retail executives, five academics with relevant knowledge of retailing, and more than 20 retail field managers and sales managers from consumer goods companies in Argentina, Brazil, Chile, Colombia, Peru, Venezuela, and Mexico. Primary research was complemented with companies' public information.

Finally, fieldwork also included approximately 30 interviews with store managers to gather their insight on consumers' perspectives on innovation and key factors in shopping decisions Interviews were complemented with visits to more than 43 pre-selected retailers in seven segments.

Case studies were selected from five different broad categories and five different countries, following criteria defined upfront: The cases had to be "made in Latin America," with a relevant scale and a track record of several years, as part of a profitable and growing business that was viewed as innovative by consumers.

Most of our findings are supported by the innovators' perspectives and their own experience of what they did differently. We conducted direct interviews with key executives to understand how retailers conceptualize innovation and engineer sustainable solutions to deliver that innovation.

The Coca-Cola Retailing Research Council, Latin America

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

For more information about the work of the Coca-Cola Retailing Research Council Latin America and on how to order further copies of this report, please visit the Council Global Website at www.ccrrc.org and follow the link to Latin America page.

Special thanks for their collaboration on this study to:
Alejandro Stengel, Senior Executive Advisor
Francis Liu (In Memorium)

BOOZ & COMPANY WORLDWIDE OFFICES

Asia
Beijing
Hong Kong
Seoul
Shanghai
Taipei
Tokyo

Australia, New Zealand, and Southeast Asia
Adelaide
Auckland
Bangkok
Brisbane
Canberra
Jakarta
Kuala Lumpur
Melbourne
Sydney

Europe
Amsterdam
Berlin
Copenhagen
Dublin
Düsseldorf
Frankfurt
Helsinki
London
Madrid
Milan
Moscow
Munich
Oslo
Paris
Rome
Stockholm
Stuttgart
Vienna
Warsaw
Zurich

Middle East
Abu Dhabi
Beirut
Cairo
Dubai
Riyadh

North America
Atlanta
Chicago
Cleveland
Dallas
Detroit
Florham Park
Houston
Los Angeles
McLean
Mexico City
New York City
Parsippany
San Francisco

South America
Buenos Aires
Rio de Janeiro
Santiago
São Paulo

The most recent list of our office addresses and telephone numbers can be found on our Web site, www.booz.com.

Printed in France