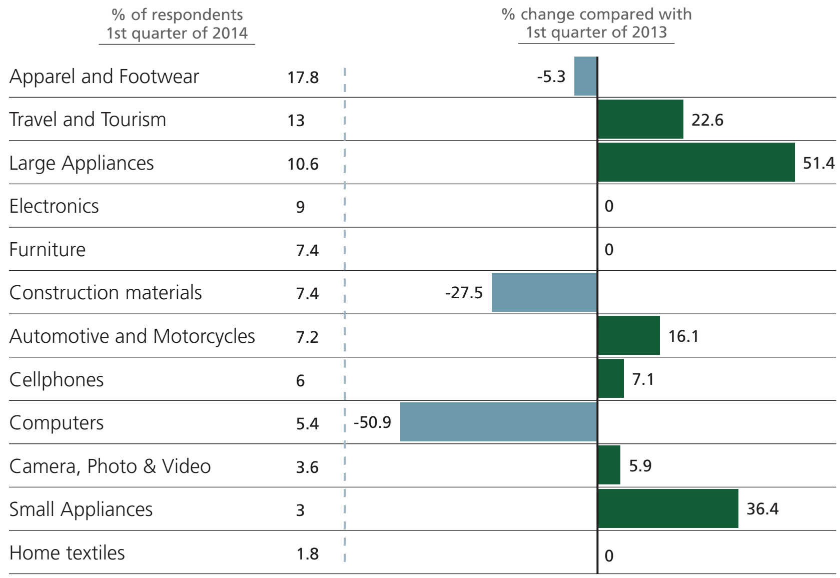
Spotlight on Brazil
Understanding the Brazilian Consumer

Once the darling of the BRIC group, Brazil has recently fallen out of favor. GDP growth over the past four years has halved since the heady years of 5% growth between 2004 and 2008, and the market expects a similarly weak performance of around 2% GDP growth in 2014. The reasons for the decline are well understood: a closed and protected economy, low productivity, heavy government intervention and bureaucracy, and famously weak infrastructure. If the hype is over, however, Brazil still remains a large and attractive consumer market. The country has the sixth largest GDP in the world and a population of around 200 million, half of which can be safely categorized as middle class. On the whole, Brazilian consumers remain underserved in many retail categories, presenting plenty of opportunities for retailers able to understand where and how to place their bets.

Retail sales in Brazil were weak in 2013, growing at 4.5% from 2012, according to CNDL, a national confederation of shopkeepers; a similar performance is expected for 2014. In a recent survey undertaken by Provar/FIA, a business school, consumers seem to be particularly interested in electronics, large appliances and travel/tourism for 2014. On the other hand, purchase intention on computing equipment and construction material are substantially down compared with 2013. (See Figure 1)

Figure 1

Consumer purchase intention in São Paulo for the first quarter of 2014



Source: Provar/FIA

Looking toward the long term, demographic change will affect Brazilian consumption patterns significantly. If the growth of the lower middle class has been the defining characteristic of the previous decade's demographic shifts, the growth of the middle and upper-middle classes will be the main factor for change over the next 10 to 20 years. By 2030, the richest Brazilians will increase from 1% to 5% of the population, and the middle and upper-middle classes will increase from 36% to 56% of the population. Both demographic changes will drive consumption changes, in particular an increased interest in luxury and aspirational goods.

Today's typical Brazilian luxury consumer is usually between 35 and 55 years old and lives in either São Paulo or Rio de Janeiro. The Brazilian luxury consumer is not price sensitive, as luxury goods are more expensive in Brazil than elsewhere in the world. Taxes are the main reason for this price premium – some items are taxed up to 300%. Luxury consumers also expect exceptional service, so they tend to prefer high-end malls. Some of them, such as JK Iguatemi in São Paulo and Village Mall in Rio de Janeiro, have helped launch several international brands in Brazil.

Another important factor changing Brazilian retailing is technology. Brazilian Internet penetration is reasonably high at around 50% (versus 75% for the U.S.) and eight out of 10 Brazilians visited a social networking site during the last six months. *The Wall Street Journal* recently reported that Brazil has 65 million Facebook users, second only to the U.S.

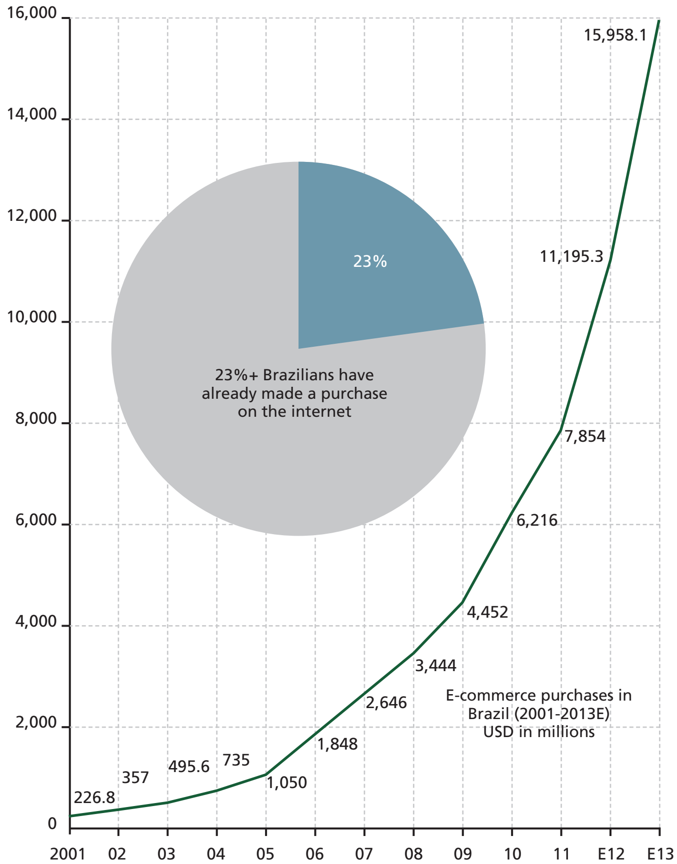
This high level of Internet usage signals promising opportunities for e-commerce. E-commerce sales in 2013 reached R$28 billion ($11bn), according to e-bit, an Internet data provider—a 25% increase over 2012 and 3.6% of total retail sales in Brazil (compared to 5.2% in the U.S.). Brazil is expected to become the fourth largest e-commerce market by 2016. The main established e-commerce categories in Brazil include travel, electronics, books, appliances, clothing and footwear. Up and coming categories include home items as well as beauty and health products. While the e-commerce market in Brazil is growing, profitability remains a distant objective and most players are still focused on capturing market share at any cost; companies considering e-commerce should be prepared to play a long game in Brazil. They also have to face many logistics challenges that increase shipping costs while decreasing customer satisfaction.

The next frontier in Brazilian e-commerce is smartphone usage. Smartphone penetration is rapidly increasing, especially among the young. Brazil is the fifth largest global market for smartphone sales with 26% of the population owning a smartphone in 2013. Among 18 to 24-year-olds the penetration rate is 46%. Many Brazilians, however, have yet to use their smartphones to shop. Forty-two percent of Brazilians say they do not use their smartphones for shopping, while 33% use their phones to look for ideas and to comparison shop but not to make purchases.

While overall retail growth is expected to be muted during the next few years, smaller metropolises are expected to deliver above-average growth. We expect cities between 20,000 and 500,000 inhabitants to grow 1-2% more than larger cities until 2020, and the population of Brazil's north and northeast are expected to grow 3% more quickly than the country's southeast during the same period.

Figure 2

E-commerce in Brazil



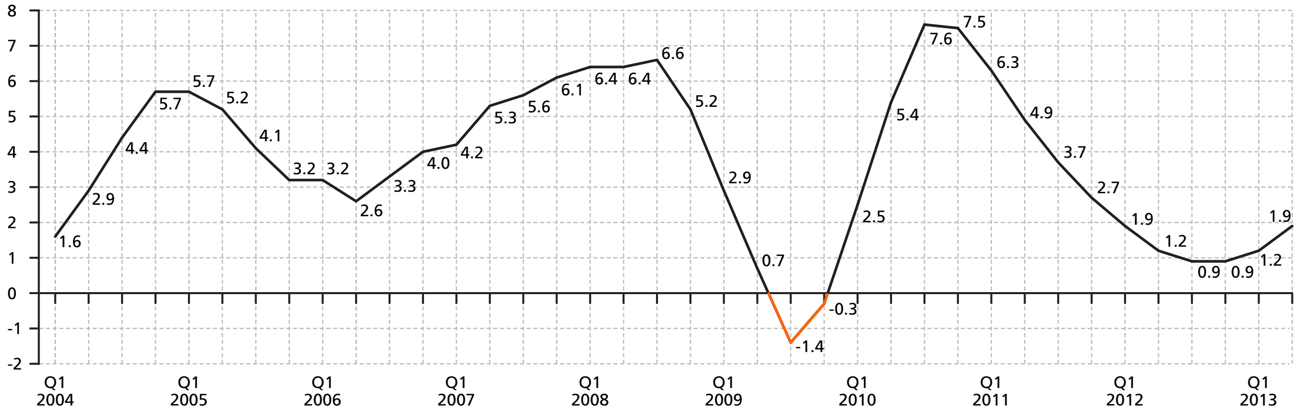
Source: Interbrand, Euromonitor International, Canadean, Consultoria e-Bit, E-commerce Brasil, PR Newswire, L.E.K. analysis

Finally, the rise of female consumers is changing the demographic mix of Brazil's shoppers. More women in the workforce means households have more discretionary income. Women have gained increased financial independence and as a result have developed unique purchasing tastes. The health and beauty category, for instance, is expected to grow by about 12% annually from 2012 to 2017.

Retailers have responded to these demographic changes in different ways. Some players are expanding aggressively to take advantage of opportunities outside the big, urban centers. They are also experimenting with new retail models and store formats. Neighborhood markets, for instance, are competing more aggressively with supermarkets. Smaller outlets (1-4

Figure 3

Brazil's growth rate - percentage change in GDP



Source: IBGE, Adaptação NE&PE/GS&MD

checkouts) experienced 1.2% of sales volume growth in 2012, while larger outlets experienced a sales decrease. Some larger retailers have been experimenting with stores that open late as well as 24-hour shopping.

Retailers have also experimented with product mix. Consumers with more discretionary spending power are now searching for broader product variety and new products to try. For instance, consumer electronics sales in hypermarkets have grown rapidly in recent years. Private labels, particularly in the food and house cleaning categories, are also gaining share and expanding beyond grocery retail.

In short, the sheen may have rubbed off Brazil's economy, but this large country still provides an enticing opportunity to international retailers, particularly those that can identify pockets where consumers are spending more, are underserved, or both.

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