Spotlight on Mexico
Understanding the Mexican Consumer

With a population of 118 million, Mexico offers a potentially significant market for international retailers. The country not only boasts the second-largest population in Latin America, but the region's second highest per-capita income. It also has an expanding consumer class that is relishing its new-found spending power. *Foreign Affairs* recently noted that Mexico's middle class "now comprises anywhere from 40 million to over 60 million Mexicans," depending on how it's measured. "These individuals and their families own cars, houses, and every modern appliance, as well as new cell phones."

The good news is that Mexico's consumer class is poised to expand for years to come. HSBC predicts that the proportion of Mexican households earning at least $50,000 a year will surge from 11% in 2012 to 21% in 2017.

It is no surprise, then, that foreign retailers have invested so heavily in Mexico in recent years and many have become successfully entrenched in the country. Leading foreign brands in the market include Wal-Mart de México, the country's largest grocery retailer, along with other international powerhouses such as Home Depot, Best Buy, Office Max and Sears, each of which has become a dominant player in its respective field. In 2013, the *Wall Street Journal* also reported that U.S. and European clothing retailers such as Gap, Hennes & Mauritz and American Eagle Outfitters have all opened stand-alone stores in Mexico, aiming to "compete for an enviable niche carved" by Inditex, the Spanish operator of Zara, which already has more than 246 stores in Mexico.

Still, the Mexican market is not an easy nut to crack. Significant barriers to entry exist for foreign retailers including entrenched competitors, a complex domestic culture and consumer preferences, and high upfront capital costs. Many foreign retailers are also wary of Mexico because of press reports about drug-related violence and lawlessness. In the World Economic Forum's *Global Competitiveness Report 2013-2014*, the "most problematic factors for doing business" in Mexico were listed as corruption, crime and theft, and inefficient government bureaucracy. Euromonitor International says: "The most visible unofficial challenge is security issues, which force most retailers to make substantial investments to prevent crime in large cities and in the northern region of the country."

However, it would be a mistake to exaggerate these security concerns, which inevitably gain more attention in the media than less dramatic – but equally important – news of positive economic trends. It's worth noting, for example, that Mexico ranked a solid 55th out of 148 countries for overall competitiveness in the *Global Competitiveness Report 2013-2014*, ahead of Brazil (56th), India (60th), and Russia (64th). Moreover, Mexico ranked 11th out of 148 nations for the size of its domestic market – a compelling reminder of why so many foreign retailers are willing to look beyond the challenges of law and order.

The country's international image is also improving under the leadership of President Enrique Peña Nieto, who took office in December 2012. It's too early to know if his administration will live up to its business-friendly promise, but corporate executives have been encouraged by his strong emphasis on structural reform, his promotion of foreign investment, and his commitment to improving infrastructure. If the government's proposed financial reforms are adopted, it should also provide a much-needed expansion of consumer credit, which would provide a significant boon for retailers.

Unfortunately, GDP growth during Peña Nieto's first year in office has been very low at 1.3%. Commentators consider the low growth rate normal, as the new administration reduced spending and delayed public investments until it could get a better understanding of Mexico's future priorities. Going forward, Standard & Poors estimates that GDP growth will average 3.4% annually for the next several years – hardly electrifying, but healthy enough to provide retailers with a decent tail wind.

Meanwhile, Mexico's burgeoning middle class will continue to drive growth in a wide array of retail segments. As discretionary incomes rise, sectors such as fashion, personal care, jewelry, air travel, and high-end coffee are attracting enthusiastic attention from consumers. Gourmet plazas are becoming increasingly popular, offering luxury-minded Mexicans the opportunity to stop for high-quality food during their shopping excursions. And many malls – once anchored by drab grocery stores – now offer a more alluring blend of restaurants, cinemas and other entertainment. All of this reflects the growing wealth and discernment of Mexican consumers.

Still, there is plenty more scope for development and growth as consumers gain in sophistication. For example, e-commerce has not yet achieved the levels of acceptance seen in Latin American countries such as Brazil, Chile and Argentina, in part because of low credit card penetration and a widespread perception that online transactions are unsafe. According to eMarketer, Internet penetration stood at just 36.5% in Mexico at the end of 2012, placing the country only eighth in Latin America. On the other hand, about two thirds of Mexicans who use the Internet are teenagers: as they reach adulthood, the online retail market is expected to take flight.

Another important trend within Mexico's retail sector is a shift toward smaller, less-developed urban markets. As the largest cities become more saturated, many department stores, supermarkets and other retailers are expanding into mid-sized cities.

Given the growth of Mexico's population and the mounting wealth of its consumers, opportunities like this will continue to proliferate for international retailers. This is still not a market for the faint of heart, but Mexico's positive long-term trajectory makes it too attractive to ignore.

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