Retail & Consumer

Glimmers amid the gloom

The outlook for the retail and consumer products sector in emerging markets

Foreword

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Well before the current global economic malaise, multinationals have been shifting strategy to concentrate on emerging markets: they know that's where the growth is going to be. Now, as the developed world economies face many challenges, emerging world economies look like they will be relatively better off in the next few years – with emerging Asia appearing to be the star performer.

Some sub-sectors within retail and consumer products are actually performing quite well even now. Which are those sectors and why are they out-performing? Which sectors are being especially hard hit? How are companies in these sectors responding, and what does the mid-term outlook hold?

This report, produced in co-operation with the Economist Intelligence Unit, focuses on six segments: food and general retail, fashion and apparel, fast food restaurants, fast moving consumer goods, luxury goods and consumer durables and electronics – and on emerging markets in Asia, Latin America and Central and Eastern Europe.

The good news from the report is that the industry as a whole appears to be more resilient than many others – even though some short-term pain is certainly expected. We may see that the fortunes of certain sub-sectors are even more divergent post-recession.

Thank you to our colleagues and the Economist Intelligence Unit. The insights in the report provide much food for thought for addressing the challenges and opportunities that lie ahead.

Sincerely,

Carrie Yu

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This report was written in co-operation with the Economist Intelligence Unit's industry and management research division. The economic and industry forecasts included are those of the Economist Intelligence Unit.

Executive summary

Multinational retail and consumer-products firms that have increasingly looked to emerging markets in Asia, Central and Eastern Europe (CEE) and Latin America to drive the next wave of growth will be concerned by their recent economic performance. Consumer sentiment has been buffeted on all sides by a steady stream of negative developments: crashing real estate markets, plummeting international trade, factory closures, unemployment and falling remittance flows. The latest bad news, particularly for Central America, is the outbreak of H1N1 flu (swine flu).

Yet not all is gloomy. There are some sub-sectors within retail and consumer products that are performing very well despite market conditions. For example, fast-food restaurants are experiencing almost universal growth in emerging markets. This report, written in co-operation with the Economist Intelligence Unit, discusses the outlook for six retail and consumer-products sub-sectors in emerging markets: food and general retail, fashion and apparel, fast-food restaurants, fast moving consumer goods (FMCG), luxury goods and consumer durables and electronics. It focuses on how companies in these sectors are responding to the financial crisis and what the short- to medium-term holds for these firms.

The main findings of the report are as follows:

There is little evidence that the expansion plans of multinational supermarket chains will falter. Multinational retailers such as Wal-Mart, Carrefour, Tesco and Metro will continue to expand their operations in emerging markets. Asia remains particularly buoyant despite the global economic downturn. CEE and Latin America are tougher trading environments. In the latter, retailers are concentrating on Brazil as their investment market and scaling back their plans in other countries. Worldwide, discount and private-label goods are performing well and retailers are expecting a larger share of revenue to come from private-label goods.

For apparel retailers, Asia is the most exciting growth region. China and India are both expecting double-digit growth in sales. European retailers have made significant strides into CEE and Russia, spurred on by the region’s low cost base for manufacturing. However, consumer spending on apparel has shrunk significantly, with the exception of a buoyant discount sector. Latin America also offers little growth in 2009.

Fast food is proving to be recession-proof in emerging markets. In Asia, affluent consumers are trading down from fine-dining options, but they and lower-income consumers continue to be able to afford to eat out. Restaurant chains are rapidly increasing their outlets and are keeping costs down to fund this expansion. Russia and Turkey are the focus for international restaurant chains in CEE. Brazil is a battleground for fast food in Latin America, and McDonald's is in the lead.

The FMCG sector faces competitive threats from retailers' private-label goods. FMCG companies face an increasingly competitive environment, as consumers focus more on cost and less on brand name. Additionally, the FMCG environment remains immature and fragmented in some areas, particularly CEE and Latin America. The exceptions are some of the chocolate and confectionary brands. The trend across Asia and Latin America is for firms to penetrate markets more deeply and reach lower-income consumers. At the same time, they are concentrating on reducing their supply chain costs and investing in marketing.

Sales of luxury brands are tumbling in CEE and Russia. Depressed oil prices and the real estate slump have slashed the number of Moscow billionaires by 60%. This has had a serious impact on the sales of luxury goods. In CEE and Turkey, brand awareness in the luxury sector does not necessarily equate to sales. Sales are slowing in Latin America, but luxury firms will continue to expand cautiously and focus on long-term brand building. Asia has the brightest outlook by comparison. Despite the financial crisis, rich Chinese consumers are developing a voracious appetite for luxury goods. India also has huge potential, but regulation prevents rapid expansion.

Sales of household audio-visual equipment are suffering in the downturn; PCs and TVs continue to sell. These are turbulent times for consumer electronics companies, as their goods are expensive one-off purchases that consumers can delay or forego. Of the three regions examined in this report, the picture is most rosy in Asia. Asian consumers are likely to continue spending on electronics, particularly on TVs and computers. CEE, Russia and to some extent Turkey will see household electronics and audio-visual equipment selling in lower volumes in 2009 than in 2008, although there is still growth in sales of PCs and TVs. The same trend is true in Latin America. Household audio-visual equipment is set to see a double-digit decline in Brazil across 2009. Computer sales will hold their ground.

Introduction

The global economy remains in a volatile state. Though there are some glimmers of hope, mostly in the form of slowing rates of decline in some key indicators such as unemployment, a genuine and sustained economic recovery remains a longer-term prospect. The global economy will contract by 2.6% in 2009 and return to marginally positive growth of 1.8% in 2010, with a real recovery setting in after 2013. Even then, the hangover from the financial crisis—the loss of jobs, the bankruptcies of many businesses and the destruction of wealth—could prevent global economic growth from returning to the speed witnessed in 2004-2007 for some years to come.

While the outlook for the developed world over the next two years is not optimistic—the US, the Euro zone, the UK and Japan will see economic contractions of between 2% and 7% and only sluggish recovery in 2010—the emerging world economies look relatively better off. Overall, emerging Asia will be the fastest-growing region in 2010-2013, although this rosy outlook relies heavily on relatively robust growth in China and India. Parts of CEE will be severely hit, with the recession compounding already serious economic problems such as large—and potentially unserviceable—external financing requirements. Prospects in Latin America do not look much brighter.

Given the deeper impact of the economic downturn on developed economies, many multinationals (outside the financial services sector) are expected to put renewed emphasis on emerging markets as an engine of future growth. Retailers and consumer-products makers are no exception. But how are industry-changing trends being felt elsewhere in the world affecting these markets? The aim of this report is to provide an overview of how the economic downturn has affected the retail and consumer-products industries in emerging markets thus far and the outlook for the medium term.

For now, consumer confidence, with a few exceptions, remains low. Credit is tight in developed markets despite government stimulus packages, and there is uncertainty in emerging markets as well. Globally, retail sales are down. But not all regions are suffering equally.

Estimates
Forecasts

Growth in retail sales by volume, global (% pa)

	2006	2007	2008	2009	2010	2011
North America	2.0	0.6	-4.1	-4.7	0.0	0.8
Western Europe	1.0	0.9	-1.9	-4.0	-0.9	1.1
Economies in Transition*	9.5	10.7	9.6	-3.6	2.2	4.6
Asia and Australasia	4.6	5.0	6.4	0.4	4.2	4.3
Latin America	4.5	5.9	6.5	-5.3	0.4	3.0
Middle East and Africa	4.8	5.0	2.3	-1.1	5.4	5.7
World	3.1	2.8	1.0	-2.9	1.4	2.5

Source: Economist Intelligence Unit
**Bulgaria, Czech Republic, Hungary, Poland, Romania, Russia, Slovakia and Ukraine*

Asia. Asian retail sales will be less badly affected by the global crisis than those elsewhere. Where growth in worldwide sales slowed to an estimated 1.0% in 2008, from 2.8% the year before, Asia and Australasia witnessed growth of 6.4%, up from 5.0% in 2007. There will be marginal growth of 0.4% in real terms during 2009, with growth dragged down by the slump in Japan, while North American sales are predicted to fall by 4.7% and those in Western Europe by 4.0%.

Estimates
Forecasts

Growth in retail sales by volume, Asia (% pa)

	2006	2007	2008	2009	2010	2011
China	11.8	11.4	17.2	7.6	9.0	8.3
Hong Kong	4.5	8.4	7.0	-5.8	0.8	1.1
India	5.0	4.3	4.3	7.5	6.0	6.5
Indonesia	2.0	11.3	5.5	1.0	3.3	3.2
Japan	0.6	-0.2	1.4	-7.8	0.2	-0.3
Malaysia	4.9	10.1	3.5	1.1	2.9	1.7
Philippines	4.3	5.3	7.6	-13.8	3.5	4.6
Singapore	4.6	7.2	-2.2	-8.8	2.7	2.7
South Korea	2.4	4.8	-1.8	-5.4	3.0	3.4
Taiwan	3.8	4.4	0.4	-0.6	1.2	2.4
Thailand	2.7	1.5	5.1	-3.9	1.6	6.3
Vietnam	4.1	9.3	3.2	9.1	5.2	2.1

Source: Economist Intelligence Unit

This is not to say that the global recession is not affecting Asia. Both mature and developing markets in the region will contract during 2009, led by the Philippines, Singapore and Japan. China, the region's biggest retail market, will see growth slow to 7.6% in 2009, down from 17.2% in 2008 and will recover momentum only slowly thereafter. In India, Asia's third largest retail market after China and Japan, the volume of retail sales is forecast to rise by 7.5% in 2009, up from 4.3% in 2008. Vietnam will be the star performer, with growth of 9.1% in 2009, though this is forecast to slow in 2010.

Economies in transition.

Compared to Asia, the situation is more serious in central, eastern and southern Europe, where a decade of retail and brand growth has come to a shuddering halt. Transition economies have gone from a 9.6% annual growth rate in 2008 to a projected contraction of 3.6% in 2009. The widely held view that the regions' economic engines were strong enough to maintain growth levels in spite of the declining economies of the West has shown itself to be spectacularly off the mark. Unlike in Western Europe, where retail markets are more mature, multinationals operating in emerging Europe have found their fortunes intrinsically entwined with the health of real estate markets.

Many countries in CEE had ambitious plans for shopping centre construction but have seen their funding dry up. This trend is particularly evident in Russia, Ukraine, Bulgaria and Romania. By regional standards Poland and the Czech Republic are more mature and economically transparent, cushioning the impact of the downturn on their retail sectors.

Growth in retail sales by volume, CEE (% pa)

Estimates (2006–2008) / Forecasts (2009–2011)

	2006	2007	2008	2009	2010	2011
Bulgaria	6.1	2.8	0.1	-7.3	-0.5	2.4
Czech Republic	3.8	5.4	1.5	-7.7	1.1	3.6
Hungary	2.5	-4.3	-4.6	-6.1	-1.3	2.9
Poland	7.2	8.0	10.3	-2.9	1.5	4.3
Romania	24.0	17.8	14.2	3.0	4.3	6.9
Russia	14.1	16.1	13.5	-3.0	2.5	4.3
Slovakia	5.9	4.7	20.7	-3.8	1.6	4.7
Turkey	3.0	3.4	-1.2	-5.0	-0.2	2.4
Ukraine	10.0	15.3	2.0	-12.1	-2.3	2.3

Source: Economist Intelligence Unit

Turkey is still well regarded as a long-term prospect because of its youthful population and its geographical position as a bridgehead between the Middle East and Europe, but it will suffer a slump in the short term.

Central and South America.

Data show that countries in Central America, particularly Mexico, have been hit hard as the economic woes in the US damage exports as well as remittance flows from foreign workers. More recently, the swine flu drama has acted as an additional drag on consumer confidence in the northern part of this region.

Further south, notably in Venezuela and Argentina, other problems such as inflation are affecting purchasing power and the retail sector. Brazil and Chile stand out as markets where retailers have confidence in the latent potential, regardless of the current economic circumstances.

Growth in retail sales by volume, Central and South America (% pa)

Estimates: 2006–2008; Forecasts: 2009–2011

	2006	2007	2008	2009	2010	2011
Argentina	4.8	11.4	16.6	1.0	0.1	4.1
Brazil	3.4	5.7	9.0	0.1	0.5	2.0
Chile	3.8	6.3	6.4	-3.0	5.1	5.5
Colombia	4.9	4.4	0.6	-2.3	2.7	4.0
Ecuador	5.1	1.8	2.7	-7.8	-2.7	-0.1
Mexico	4.4	4.0	3.1	-14.1	0.3	2.7
Peru	3.1	8.3	8.3	5.9	6.0	4.7
Venezuela	15.4	13.9	4.9	-4.7	-6.3	0.5

Source: Economist Intelligence Unit

Section 1: Retail

Western-style retail outlets have been springing up across emerging markets for the past 15 years. These include supermarket and hypermarket chains that sell branded consumer products as well as the retailers' private-label goods, footwear and clothing stores and fast-food restaurants and coffee chains.

This section discusses how these industries have been faring in the financial crisis. Have they been able to build brand loyalty despite their relatively short history, or will consumers return to their previous consumption habits? Will a Big Mac seem like a luxury item when times are hard? And how will retailers manoeuvre to maintain and even gain market share?

Food and general retail

Key findings:

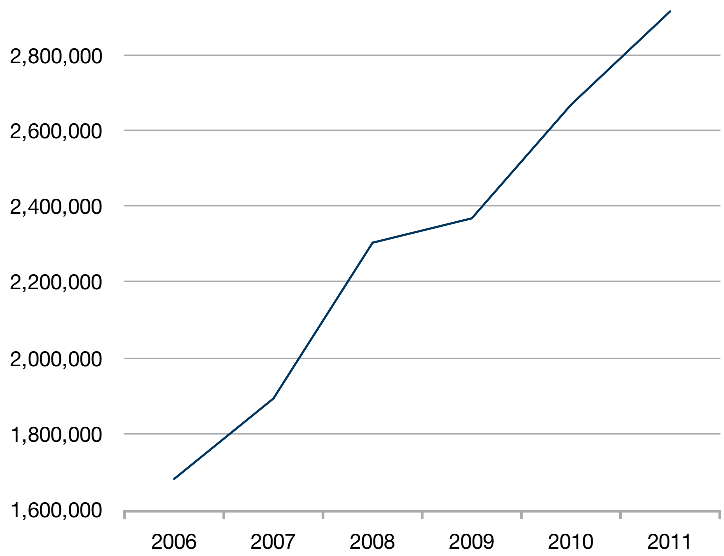
- Asia's food retail environment remains buoyant despite the global economic downturn.
- There is no evidence that the expansion plans of multinational retailers in Asia will falter.
- Private-label goods are performing well worldwide.
- CEE is a fiercely competitive region for the retail sector, and European multinationals are fighting for dominance.
- Discount retail is performing well in the CEE region.
- Consumer confidence is at a particular low in Mexico, due to the financial crisis.
- Multinational retailers are continuing to invest in Brazil, while reining in spending elsewhere in Central and South America.

Although sales of food and other essentials are less affected by economic recession, this is true largely in volume terms. Consumers can cut back on expensive food items such as meat, switch to lower-priced brands or buy in bulk to benefit from economies of scale. They can choose to shop at discount stores or even revert to the informal sector. All of these require a response from retailers, who may also be grappling with constraints in regulations or real estate markets.

Rising food and grocery sales in Asia

The outlook for general retail in Asia is relatively buoyant despite the recession and still reflects broader trends. Asians, many of whom used to buy food at wet markets, are increasingly purchasing meat, fruit, milk and coffee at supermarkets. Diets are becoming richer. In 2008 meat consumption in China reached 67.6 kg per person, up 15.3% from 2004. In India milk consumption was 75.6 litres per person in 2008, an increase of 9.4% from four years ago. Food retail sales in Indonesia and Vietnam were up 63.2% and 58.4% respectively in the same period. Although growth in spending on food is expected to slow in 2009, it will then rebound sharply.

Food sales in Asia (US$m)



Source: Economist Intelligence Unit

Growth in the food, beverage and tobacco sector will be sluggish in most of Asia until 2010. China is one of the only markets that is expected to see positive growth in 2009, with sales rising by 7% from 2008 levels. Elsewhere in Asia the picture is less rosy. Indonesia, Malaysia and Thailand are just some of the countries that will witness a contraction in their food, beverage and tobacco sectors in 2009. However, data show that, in most cases, figures will bounce back to 2008 levels or higher by 2010.

Consumer expenditure in Asia: food, beverages and tobacco (US$m)

Estimates (2006–2008) / Forecasts (2009–2011)

	2006	2007	2008	2009	2010	2011
China	338,235	405,352	504,617	540,588	597,066	662,743
Hong Kong	15,323	16,917	17,756	17,228	17,924	18,614
India	207,079	244,094	265,334	266,961	293,564	322,128
Indonesia	121,113	142,085	161,556	150,245	164,939	170,425
Japan	435,114	426,684	494,054	520,487	524,962	531,090
Malaysia	16,733	19,815	22,952	21,319	22,197	22,789
Philippines	41,236	49,998	59,407	59,907	63,399	70,688
Singapore	5,596	6,301	7,157	6,405	6,640	7,011
South Korea	89,713	96,899	84,777	76,188	81,844	87,041
Taiwan	51,874	54,847	58,826	47,828	49,611	53,241
Thailand	34,054	38,841	43,993	40,859	42,510	44,446
Vietnam	18,310	21,878	27,914	28,032	29,726	32,644

Source: Economist Intelligence Unit

The trend towards richer diets has not been lost on food and general retail companies. Enterprises such as meat processor Yurun Food in China, Reliance Retail in India and Hero Supermarket in Indonesia have been expanding at a rapid pace, though some are now being forced to rein back growth and opt for rationalisation as their finances come under strain. Multinational supermarket chains like Tesco, Wal-Mart and Carrefour are also making great strides now that they are allowed to invest in the region.

The global recession is not expected to slow the expansion of foreign retailers, but it may have a negative impact on local companies, particularly small-scale or single-store retailers that do not enjoy the economies of scale and deep pockets of their larger rivals. Larger chains are in a better position to add discount lines to their offerings, including private-label goods, and also have the buying power to negotiate cheaper supplier prices. The situation is not entirely stable for the largest retailers, however, which run the risk that hard-pressed Asian consumers may return to purchasing at informal outlets such as wet markets where prices are cheaper but selection, quality and amenities are limited. The success of out-of-town hypermarket developments will be linked to the volume of auto sales in the region since without cars consumers are more likely to continue shopping in town centres.

For now, food and retail companies in Asia appear to be operating on the assumption that economic recovery will start in 2010 and gain strength in 2011, in part because of hefty government fiscal stimulus spending. The Chinese government has allocated the equivalent of nearly 13% of GDP on infrastructure and incentives for the purchase of retail goods, which is propping up the sector.[1] Sales of cars, furniture and household appliances in particular have been boosted by subsidies and sharp increases in lending, pushing June and July retail growth back up towards 2008 levels. Household income has also been sustained by a fall in inflation, as a slump in exports increased the supply of goods on the local market.

Despite this, local companies are working to contain costs, even if it means cutting back on their ambitious expansion plans. Yurun Food in China continues to expand and upgrade its production and distribution networks but is also focusing on efficiency and productivity.[2] Reliance Retail in India recently announced that it will rationalise its 4.2m square feet of retail space, which could result in the closure or relocation of some 40 outlets.[3] Reliance is also renegotiating rents on many of its properties and has also scaled back new store openings. Like its local rivals, the Future Group, Videocon and Indiabulls, it is switching its focus away from the cash-and-carry sector towards smaller stores.

One reason for setting up smaller stores is that the payback period is shorter; the other is the increasing competition in the cash-and-carry sector as international retailers move in. In India, foreign companies cannot invest in multi-brand retail businesses, but they can own up to 51% of consumer-targeted retail chains in partnership with local companies and 100% of cash-and-carry wholesale ventures. Metro of Germany already has five cash-and-carry stores in large Indian cities, while Wal-Mart of the US recently opened its first store under its deal with India's Bharti Enterprises. Tesco of the UK plans a similar venture with local Tata Group and Reliance itself is in talks with French retail giant Carrefour, which hopes to open its first store at the end of 2009.

Carrefour and Wal-Mart have also made significant inroads into China, where they own 137[4] and 146[5] stores respectively and plan to open another 12-20 each per year over the next few years. Their presence has helped to reshape the retail market in the larger cities, but the four biggest retailers (which also include local groups Lianhua and China Resources Enterprise) still control just 3.2% of total retail sales, suggesting plenty of room for development. The government is actively trying to encourage consolidation among smaller retailers to increase their competitiveness.

Consumers turn to private label

The downturn has put the spotlight on one trend in particular: private label or “private-label” retailing, in which supermarket chains sell goods under their own name. These goods appeal to consumers because they are cheaper and to retailers because they offer higher margins. Private label has grown strongly in the US and Europe, but until now the trend has been slow to catch on in Asia.

Retailers across the region—and particularly in India—report a strong increase in the sales of private-label goods. For example, Vishal MegaMart, a major Indian retailer, reports that in recent months the sale of private-label products has risen from 5-6% of revenue to 17-18%. The company expects private label to account for 50% of revenues by 2011.[6]

India may be Asia’s most receptive market for private-label goods. Today, private-label goods account for 10-12% of the retail market there, and leading brands are far less dominant than in other countries. In the apparel sector, for example, the top seven brands account for less than 10% of total clothing sales. Indeed, Indian customers are often more loyal to retailers than to the branded products that they stock.

The biggest local players in the Indian private-label market are Trent (nearly 90% of the products it sells are private label), Reliance Retail, Pantaloon, Nilgiris, Indiabulls/Piramyd and Foodworld. The main foreign retailers focusing on private label are Wal-Mart and Tesco. While the strongest sectors for private label are apparel, consumer durables, home care and food, there is activity in other areas such as electronics. Infiniti Retail recently announced plans to sell its own brand of computer laptops.

China has historically been a more difficult market for private label. Research by the Boston Consulting Group found that Chinese consumers are more brand conscious than Americans or Europeans. Nevertheless, acceptance is growing as Western retailers push private label.[7] UK retailer Tesco plans to introduce 400 of its own brands into its Hymall Stores in China. In electronics retail, Best Buy recently added private-label LCD TVs to its existing line-up of private-label items.

In Vietnam, the economic slowdown has similarly pushed domestic and multinational retailers to focus on private label. Metro Cash & Carry of Germany recently introduced private labels for food in its Vietnam stores. France’s Casino Group intends to introduce its own brands for 80 items. Local retailers have been active, too. The Citimart chain of stores plans to introduce its own brands. Likewise, Saigon Corp, the country’s leading retailer, has launched a Co-op Mart brand for frozen and dried foods and a separate brand for apparel.[8]

In Indonesia, several retailers, including Hero Supermarket and Ramayana Lestari Sentosa, promoted private-label brands in the early 1990s as a way of regaining profitability. Today, many of the hypermarkets in the country continue to do so, including French retailer Carrefour. The most common products for private labels are basic household goods: tissue paper, cleaning products and cooking oil, among others. Some hypermarkets also sell private-label electronic appliances and apparel.[9]

Fiercely competitive retail environment in CEE and Turkey

The global financial crisis has hit the CEE region hard and the operating environment for retailers is made even tougher by the number of multinationals present. Tesco (UK), Ahold (Netherlands), Auchan (France), Carrefour (France), Metro (Germany), and discounters Lidl (Germany) and Aldi (Germany) are all well established regionally as food anchors in malls or as hubs of smaller centres.

Tesco has a powerful regional presence and recently opened its first department store, My Liberec, in the Czech Republic. It is also market leader in Hungary as of 2008, according to Nielsen, a market-research company. Ahold, which was brought to its knees by over-expansion several years ago, retains the CEE region and the Baltics as power bases. Metro and Carrefour complete the quartet of European retailers with strong presences here. Yet there is further room to expand. According to Gfk Polonia, a market research firm, only 60% of the Polish population does their shopping in modern retail outlets.

There are strong prospects for discounters to outperform the market, particularly in the Czech Republic, Poland and Slovakia, where they already account for 20% of sales. Aside from Lidl and Aldi, there are strong local discount operators such as Biedronka in Poland (owned by Portuguese retailer Jeronimo Martins), which owns 60% of all the discount stores in the country.[10] Double-digit discounter growth is also expected in Romania and Bulgaria, albeit from a low base.

Europe's biggest potential prize, Russia's grocery market is dominated by home-grown retailers that have expanded rapidly while many international chains procrastinated. X5 Retail Group operates a mix of hypermarkets, supermarkets and hard discount stores and is the market leader. Independent retailers are struggling, and a national network of 50,000 consumer co-operatives known as TsentroSoyuz could unite under a single banner. French group Auchan and Germany's Metro Group are the biggest of the international chains. Germany's REWE is expanding, while both Carrefour and Wal-Mart are in acquisition talks.

Despite Russia still offering huge market opportunity (the top five grocers have a combined share of around 9.5% of Russia's modern grocery distribution, according to Planet Retail, a research company), the market is proving to be challenging for even the most established operator. X5 Retail Group posted a loss for the first quarter of 2009, blaming foreign exchange factors hiking the value of the firm's US$1.1bn syndicated loan. The company is now focusing more sharply on costs and offering an increased range of private-label products. Oleg Vysotsky, managing director of X5's supermarket chain Pyaterochka, says that private-label products will account for 50% of sales by 2014. That is an acceleration of an existing strategy – last year, the company said it would increase private-label sales to 40% of the total by 2012.[11]

In Turkey, the retail sector remains highly fragmented. Traditional retailers still accounted for about 60% of the retail market, compared with about 40% for organised retailers at the end of 2006.[12] More recent data estimates the top-five players have a market share of just under 20%, according to Planet Retail. Among them are three major foreign retailers: Carrefour, Metro and Tesco. Domestic discount chain BIM operates 1,000 stores in Turkey while the larger Migros-Türk is on a growth drive of eight store openings a week since its 2008 acquisition by private equity house BC Partners. Further investment is likely to be curtailed by weak consumer confidence throughout 2009, due to soaring unemployment, a sharp fall in the value of the Turkish lira and domestic credit constraints. As the retail environment starts to improve into 2010, however, consolidation should gather pace, with discounters leading the trend.

Consumer confidence down in Latin America, yet Brazil holds promise

After a five-year period of sustained growth, retail sales in Latin America neared US$1trn in 2008. Nevertheless, companies operating in the region now face a much tougher environment, as income per capita is expected to shrink in most countries. Mexico and Central America, which have been hit the hardest by the financial crisis, look more vulnerable, as do Argentina and Venezuela, where inflation is high (though Argentina's official rate is much lower than Venezuela's and falling). As a result, retail sales in the region are not expected to come back to their pre-crisis level before 2011 at best.

As the economic environment has tightened, Latin American shoppers have responded by trading down market and looking for bargains. Retailers have focused on offering low-price and discounted products. Large retailers have also expanded their portfolios of private-label products. In Brazil, private-label products accounted for 7% of total sales in 2008 and are expected to increase to 9% in 2009, according to the Associação Brasileira de Marcas Próprias, Abmapro.

Foreign multinationals such as Wal-Mart and Carrefour have increased their presence in the past 15 years and will take advantage of opportunities presented by the crisis, although small retailers and the informal sector still typically account for more than half of the market. In October 2008, Mexico's then third largest retailer, Controladora Comercial Mexicana, filed for bankruptcy after suffering huge losses in exchange rate derivatives contracts. The demise of this domestic retail giant has strengthened Wal-Mart's dominant position, and its local unit Wal-Mex vows to expand through aggressive investments in 2009 and price cuts, which may result in narrower margins. Its main competitor is Soriana, which is focusing on improving its services and offering cheaper goods, although it looks more vulnerable than well-capitalised foreign competitors.[13]

Wal-Mart has also taken a leading position in Chile, after buying 73% of local supermarket chain D&S in spring 2009 for US$3.1bn[14]. The market is a competitive one and is expected to contract in 2009, but retail sales should return to growth of over 5% a year by 2010. Wal-Mart, Carrefour, and Casino-owned Pão de Açúcar have also unveiled ambitious investment plans in Brazil for 2009—indeed, Pão de Açúcar has already announced that it has acquired Ponto Frio, the second largest appliances and electronics retailer in the country[15]. The purchase will make Pão de Açúcar the largest retailer in Brazil. Despite the economic conditions, they still believe that the market has huge long-term potential. The retailers are less optimistic about other markets in the region. For example, Carrefour, Wal-Mart and Cencosud have already decided to scale back investment in Argentina. Carrefour has also cut its spending plans in Colombia.

Fashion and apparel

Key findings:

- Asia is the most exciting growth region for apparel retailers, with China and India both expecting double-digit growth in sales.
- The Vietnamese market has potential for apparel, and retailers are taking cautious steps.
- Indonesia holds little promise for apparel in 2009 or 2010.
- The low cost base of the CEE region and Russia is attractive for multinational retailers, yet consumer spending on apparel has shrunk significantly.
- European retailers are making strides in Latin America, even though there is little growth. US players are more cautious.

Large, youthful populations, high interest in fashion and increasing levels of disposable income in emerging markets have attracted numerous multinational apparel chains. As they struggle in Western markets, apparel retailers will be carefully assessing opportunities to enter new countries and capture market share where they already have a presence.

Asia offers exciting growth for fashion

China is the biggest apparel and fashion market in Asia, with domestic clothing sales worth US$33.1bn in 2008. The high-end apparel market is dominated by international brands from France, Germany, Italy, Japan, US, UK and South Korea. The lower end of the country's apparel market, which targets young people and students, is dominated by local Chinese brands. The overall market is forecast to grow to US$37.1bn in 2009 and US$42.9bn in 2010.

India is the region's third largest apparel market after China and Japan, but it is expected to grow at a faster rate than either over the next two years. The country's US$5.8bn clothing market is predicted to rise by 6.3% in 2009 and 4.8% in 2010 in real terms. The key drivers are rapidly-growing disposable income, more shopping malls focused on apparel and increased use of credit cards. There are constraints, however: poor infrastructure and inflexible labour laws prevent even faster growth. Nevertheless, India is attracting foreign investment. The country is a focus for Inditex, the Spanish clothing retailer, which plans to open 25 Zara shops by 2010 in partnership with the Tata Group.[16]

In Vietnam, the deregulation of the country's retail market this year is sparking the interest of foreign brands. The economic crisis has reduced local incomes, but there remains strong demand for apparel from the country's young population: retail sales of clothing are forecast to grow at nearly 15% year-on-year, according to research firm RNCOS. Top-end brands including Dolce & Gabbana, Gucci and Valentino have made inroads among the country's elite, but lower-priced labels such as Giordano, Bossini and Mango enjoy wider acceptance. Japanese retailer Wacoal, which manufactures its clothes in Vietnam, is now also planning to open a store in Ho Chi Minh City in 2009.[17]

With its large, young and increasingly brand-conscious population, Indonesia is an attractive long-term market, although exchange rate factors will come into play over the short term as the rupiah is expected to depreciate against the US dollar. Indonesia's clothing market will barely grow in nominal terms during 2010.

Given their size, China and India will be a particular focus for both foreign and domestic apparel makers. VF Corp and Levi Strauss, for example, endured large shortfalls elsewhere in 2008, but posted significant gains in these two countries. In China, many apparel retailers are pressing ahead with expansion plans: Swedish retailer H&M intends to open five stores, and Gucci plans a new store in Shenzhen.[18] Sports apparel retailer Adidas projects that China will become its second-largest market this year after the US.[19]

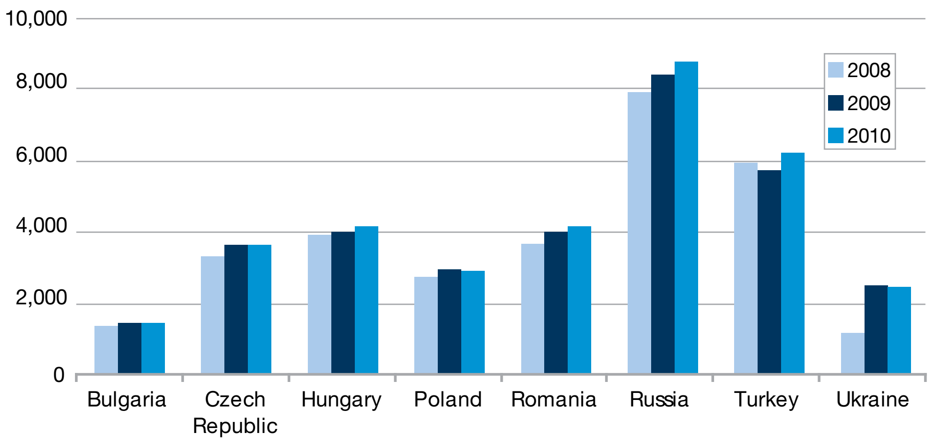
Local Chinese companies are also attempting to gain market share, in part to compensate for a sharp drop in exports. With the encouragement of local governments in China, many apparel producers are shifting from a "make" to a "create" model, whereby they own their own brands. One that has achieved some success is Aimer, China's largest high-end lingerie maker.

Depressed sales outlook in CEE

CEE will be a mixed bag for apparel retailers in 2009 and 2010. Many European apparel retailers are active there, such as Spanish operator Inditex (which owns high-street chain Zara), British chain Topshop, Mango, H&M and Benetton. The forecasts for clothing and footwear spending in CEE, Russia and Turkey project negative or flat growth in many markets in 2009 before a modest rebound in 2010.

Retailers remain largely upbeat. "We are looking to expand from 1,250 to 3,000 stores worldwide, and we view the low cost base of CEE, Russia and Turkey as very attractive for our growth," says Aniko Kostyal, expansion director for Mango. Discount retailers such as UK chains New Look, Primark and Peacocks are also eyeing opportunities. The latter already owns stores in Romania and Ukraine.[20]

Consumer spending on clothing and footwear (US$m)



Source: Economist Intelligence Unit

Russia is still seen as a particularly attractive market for European retailers and, despite the economic slump, real market growth will hover between 4.3% and 6.6% over the next five years. Anecdotal reports from several fashion retailers in the mid and value markets suggest sales per store in Russia are among their best in Europe. UK retailer Marks & Spencer has 17 stores in Russia[21], and department store Debenhams is in franchise talks. Value retailers such as Peacocks are performing increasingly well, with their model considered to be particularly suitable for lower-income consumers outside Moscow and St Petersburg.

Turkey has a flourishing textiles and clothing retail market as it has a strong domestic industry and has also attracted substantial foreign investment, notably from Italian chain Benetton. Rapid mall expansion in cities outside Istanbul had been boosting the sector, although many of these plans are now on hold. The opening of landmark mall Kanyon in Istanbul enabled Harvey Nichols, a high-end UK department store chain, to enter as an anchor store.[22] The market is notable for the number of brands present and also for its ties with the Middle East. Kuwaiti franchise giant Alshaya operates more than ten European and North American retail brands there, including Miss Selfridge, Dorothy Perkins, Next and Topshop.[23] Despite the good demographic profile and appetite for fashion in Turkey, it is not plain sailing for retailers – the market actually shrank in real terms in 2008 and is expected to do so again in 2009 before recovering slowly.

Market fragmentation in Latin America

In Latin America, Argentina and Chile have the most buoyant outlook for the apparel sector, as clothing demand is set to rise by 7% and 13.5% in 2009 respectively in real terms. Growth in Brazil is predicted at 4.6% but is on a slowing trend. Unsurprisingly, Mexico is estimated to have the worst-suffering apparel sector, with clothing demand declining by 3.4% in 2009. This trend is mirrored for footwear demand.

Apparel and fashion retailers operate in a very fragmented market in Latin America, which is mostly dominated by local and traditional brands. A few foreign retailers have made an impact in key markets, such as Brazil and Mexico, and are benefiting from the increasing number of US-style shopping malls in Latin American cities. That said, the disposable income of Latin American consumers will remain squeezed for some time. Pressures to cut costs, so that companies can preserve margins and finance any expansion plans, will intensify.

Foreign brands are hugely popular in Latin America, but they are sold in multi-branded stores rather than proprietary retail chains. Spanish-owned retail chain Inditex is the main exception; it operates 48 Zara stores in Mexico and has more than half this number in Brazil as well as stores in several other countries in the region.

In Brazil, C&A, a Dutch retailer, has emerged as the largest apparel retailing chain, following an aggressive celebrity marketing policy featuring a top Brazilian model. The company has taken the lead over domestic rivals Renner, Riachuelo and Marisa. Nevertheless, its consumer credit arm, Banco ibi, has recently reported an increase in payment arrears, which has prompted a review of its expansion plans. Within the past three years, C&A launched 55 stores in Brazil.[24] In June this year, however, it decided to close its 20 stores in Argentina due to adverse business conditions.[25]

Where European apparel retailers are moderately active in Latin America, US firms such as Gap and Levi Strauss have little direct exposure to the market outside Mexico. JCPenney, a US department store chain, pulled out of Brazil in 2005, after withdrawing from Mexico and Chile.

Fast-food restaurants

Key findings:

- The fast-food sector is proving to be recession-proof in Asia as consumers trade down from fine-dining options, and lower-income consumers continue to be able to afford to eat out.
- There is pressure on fast-food chains to keep costs down and free up funds for opening new stores.
- Russia and Turkey are the focus for international restaurant chains in the CEE region.
- Brazil is a battleground for fast food in Latin America, and McDonald's is in the lead.

The fast-food sector tends to work from a franchise model and, consequently, expansion into emerging markets has been rapid and comparatively low risk in financial terms. Across the board, fast food is performing well despite the global economic downturn as affluent consumers trade down and low income consumers continue to find value. Globally, the BRIC countries, with their large populations, are of particular focus for expansion.

Fast food seems recession-proof in Asia

Developing Asia is home to a youthful population. While the median age in Japan is 44.2 years, in China it is ten years younger at 34.1 years. The demographics skew even younger in India, where the median age is 25.3 years, in Indonesia 27.6 years and in Vietnam 27.4 years. The Asian culture of low-cost street-food, combined with the rise of two-income households and an increasingly frenzied pace of work and school life, provides fertile ground for Western-style fast-food chains. Dominating the market are McDonald's, Kentucky Fried Chicken (KFC), Subway and Starbucks, as well as local brands such as Mongolian hot-pot specialist Little Sheep (a stake in which was recently acquired by Yum! Brands of the US), Yonghe King noodles in China and Jumbo King in India.

The conventional wisdom about fast food is that it is among the last items that get hit in a recession as well-to-do consumers trade down from fine-dining restaurants and middle and lower-income consumers continue to find value in its pricing and convenience. Indeed, McDonald's reported a 4.8% increase in global sales for the second quarter of 2009, with its US revenues up 3.5% and those in Asia, Middle East and Africa rising 4.4%. Earnings per share came to US$0.98.[26] In the same period, Yum! Brands, which operates KFC, Pizza Hut and Taco Bell fast-food restaurants, saw worldwide system sales growth of 3%, including 8% growth in China, prior to foreign currency translation.[27]

Vikram Bakshi, managing director of McDonald's India (North and East Region), told *The Economic Times* in April 2009 that sales in January this year rose an impressive 20% year-on-year. "We are seeing an increase of 14-18% footfalls across our stores system-wide and are hopeful of achieving record-breaking figures this fiscal [year]," the newspaper quoted him as saying. Unnat Varma, marketing director of KFC India, told the daily that the fried-chicken company expects 75% growth in system sales this fiscal year. "I feel that people are more accepting of the middle-price category than fine-dining options," he explained.[28]

The strategies of fast-food companies in Asia remain the same as they have always been: affordable prices, standardised portions and quality, fast and convenient service, focus on hygiene and good locations. They tailor their products to local tastes (such as the deep-fried twisted dough sticks in KFC stores in China, the McAloo tikki burger and Paneer wrap in India), set up centralised commissaries and optimise the supply chain and other processes. Serving sizes look the same as before the recession, but other cost-cutting measures are being put in place. Starbucks, for example, which has nearly 500 stores in China, Hong Kong, Taiwan and Macau, now uses coffee beans from Yunnan province. The local brew is 30-50% cheaper to produce than beans from Latin America and Africa, cutting the company's transportation costs and increasing savings on import tariffs.[29]

Strong growth for restaurants and coffee chains in CEE

Fast-food retailers have penetrated every market in CEE. US giant McDonald's has led the way; Burger King, Pizza Hut and KFC are all well established; and Subway's mushrooming number of stores is reflected across the region. Coffee chains, led by Starbucks, have also achieved notable growth. New store opportunities include high streets and food courts in new malls.

Newly acquired consumer habits seem permanent enough to assume that fast food establishments are well-placed as a cheap offer. McDonald's has earmarked over US$1bn for investment in its European operations this year, with CEE being its primary focus. The company expects to increase its 214 restaurants by 50% in Poland over the next three to five years.[30] New CEE entries include burger chains Carl's Jr and Hardee's, both owned by US-headquartered CKE Restaurants; Burger King has just opened in the Czech Republic; Starbucks in Poland and Costa Coffee are also growing rapidly. In the coffee shop sector, ten chains opened across CEE in 2007.

The 1990 arrival of McDonald's in Russia was symbolic of the decline of Soviet communism. In less than two decades, Russia has become one of the strongest European markets for the fast-food retailer. There are confirmed plans for continued expansion. KFC has partnered with local operator Rostik, which has rebranded all its outlets Rostik-KFC. Other local operators include Russkoye Bistro, Kroshka-Kartoshka and Teremok.

Regionally the strongest domestic food market, Turkey has nonetheless become a major target for fast-food franchise operations. Turkey also has the world's highest per capita bread consumption at 146kg per annum. Inevitably McDonald's was first to arrive, setting up shop in 1985. Expansion of the general retail offer and in particular food courts at new malls around the country have allowed the major brands to establish themselves. Trends associated with "mature" markets such as health food and organic produce are yet to make a significant impact.

McDonald's reigns in Latin America

Latin American consumers love fast food, and the region is often featured among the fastest-growing markets for multinational chains, such as McDonald's and Burger King. Foreign brands are popular although local competition is gaining strength, especially in large countries such as Brazil. The proliferation of shopping centres during the extended consumer boom has allowed for the rapid expansion of fast-food chains. In times of economic crises, consumers still go to the malls but tend to spend less on food, hence the appeal of cheaper fast-food restaurants in shopping centres' so-called food plazas.

In Brazil, the dynamic growth of the food-service sector has been attracting international brands for decades. McDonald's is the largest chain nationwide, and Brazil represents the company's eighth-strongest market. Burger King has been active in Latin America since the 1960s, although it has faced difficulties operating in Brazil. After a failed attempt in 2000, it only launched its first restaurant there in 2004. Across the region, McDonald's has the upper hand over Burger King, its main rival, except for in Mexico and some other parts of Central America.

In Brazil McDonald's has launched a Latin alternative to its world famous "Big Mac" sandwich, with one rather than two bread layers, and no pickles (the conventional Big Mac is still on the menu, however). This alternative is due to be extended to the rest of the region. The healthy meals trend has caught on in Latin America, and the restaurants' offerings reflect this shift. There is a diversified menu that offers chicken meals and wraps, ice creams and coffees. This was also a way to respond to fresh competition from Subway, another US chain that resumed its Brazilian operations in 2003.

Section 2: Consumer products

Consumer-products companies have a longer history in emerging markets than retail companies. Yet the fates of these two sectors are now largely intertwined. The rise of retailers' private-label brands and their ability to discount will undermine consumer-products firms in markets where brand loyalty is weak.

As is to be expected, the FMCG sector is proving to be more resilient to the financial crisis than luxury brands and consumer durables such as cameras and televisions.

Fast moving consumer goods

Key findings:

- FMCG brands are gaining strength in Asia, and multinationals are spending to capture market share.
- However, the demand for lower priced goods, and retailers' aggressive push towards private-label products, are considerable threats to FMCG companies.
- The trend across Asia and Latin America is to penetrate deeper and reach lower income consumers.
- Local products originally made for the export market are increasingly being sold at home in emerging markets, providing additional competition for multinational FMCG firms.
- In CEE and Latin America, the packaged food sector—except chocolate and confectionary—remains immature and fragmented.

The rise of retail presents opportunities and threats, particularly to FMCG companies. Increased retail space presents greater sales opportunities, yet the rise of retailers' private-label brands presents a threat. FMCG companies in emerging markets have avoided a catastrophic decline, particularly at the cheaper end—such as packaged foods, personal care items, beverages and tobacco—but there is real pressure on costs. Their strategy is to move ever deeper into emerging markets to penetrate more rural and low-income populations. They are keeping products cheap and costs down, while investing in marketing and distribution.

FMCG firms spend on marketing in Asia

As their earning power rises, consumers tend to focus more on physical appearance and hygiene, including the cleanliness of their homes. The correlation is seen clearly in Asia, where spending on household goods, cosmetics and toiletries has been on the rise along with the expansion in the ranks of the middle class. In China, the number of households earning the equivalent of US$10,000 a year has soared from 4.4m in 2004 to 20.1m, up 357%. Over the same period, spending on soaps and cleaners more than doubled, from US$8.9m to US$20.9m.[31]

Despite the global recession, the steady expansion of the middle class consumer in China and India is set to continue. Thus, spending on soaps and cleaners in these two large markets will continue to rise, growing 15.1% and 17.1% in 2009, respectively. On the other hand, the ranks of Indonesian households earning US$10,000 a year is expected to shrink from 1.6m in 2008 to 603,000 in 2009, but this is due to the depreciation of the rupiah against the US dollar in 2009. Spending in US dollar terms on soaps and cleaners in Indonesia is expected to stay the same in 2009, indicating an actual increase in sales volume. No comparable household income data is available in Vietnam, but spending on the same FMCG items there is predicted to rise 7.5% this year and another 10.6% in 2010.

This is comforting news for the region's makers of toiletry items and household cleaners, particularly for multinationals such as Unilever, Procter & Gamble, Colgate-Palmolive and L'Oreal, which together dominate Asia's fragmented FMCG markets. It is also good for home-grown companies such as ITC in India, a conglomerate with a significant personal-care portfolio. In the quarter January to March 2009, Procter & Gamble saw organic sales (which exclude the impact of acquisitions, divestitures and foreign exchange) rise 1% on the back of continued strength in Asia, which partially offset middling to weak results in the rest of the world.

The key strategy of FMCG companies in Asia in recent years has been to expand beyond the cities to the countryside, where incomes have also been rising albeit at a slower pace than in the urban areas. Six years ago, Unilever Indonesia agreed to supply its products to 12,000 wholesalers for distribution to 800,000 traditional vendors in the archipelago's villages. It also spent heavily on advertising. In one memorable advertisement, Unilever urged Indonesians to brush with Pepsodent, its toothpaste brand, two times a day, instead of just once as was the practice at the time.

The current crisis is not likely to change this thrust. Indeed, the rural areas may prove a more resilient market for FMCG products, given that the major job losses tend to occur in towns and cities where services and manufacturing industries congregate. Products can be packaged in smaller bottle sizes and sachets to make them more affordable to rural populations, and companies may make wider use of motorcycles as supply vehicles to negotiate rural roads that are too narrow for trucks.

Additionally, domestic FMCG exporters in emerging markets may be tempted to start selling at home as demand slows in the West. Until recently, China's Landy International sold all its crystal soaps, herbal essences, lotions and other bath items to Wal-Mart and other foreign customers. It is now building its own stores in Shanghai and Hangzhou and hopes to sell half of its production in China and the other half abroad.

FMCG under price pressure in CEE

In the same way that changing lifestyles have boosted the soap and cleaning products sector in Asia, CEE is also a fast-growth region for sales of these goods. Poland's cosmetics and drugstore products market, for example, grew by 13% in 2008, according to PMR, a research company. Interestingly, where sales of most products are supposed to rebound sharply in emerging markets in 2010, the slump in sales for soaps and cleaning products will not really hit CEE until 2010.

Sales of soaps and household cleaning products, CEE (%change pa)

Estimates
Forecasts

	2008	2009	2010	2011
Bulgaria	3.0	5.8	-0.3	-0.4
Czech Republic	6.9	10.3	0.2	-0.3
Hungary	3.5	0.9	2.0	2.9
Poland	5.0	8.1	0.0	3.0
Romania	17.2	9.0	3.3	3.7
Russia	12.8	7.5	4.5	6.6
Turkey	1.4	-2.9	7.9	3.9
Ukraine	68.7	-12.2	-5.2	-2.5

Source: Economist Intelligence Unit

In Bulgaria, the Czech Republic and Poland, there is still healthy sales growth in 2009. However, these markets will see an abrupt slowdown in sales in 2010 and, in the former two markets, sales will sink even further into 2011. Ukraine stands out as a market where sales of soaps and cleaning products will come to a screeching halt in 2009. Where there had been 68.7% growth in 2008, the market for these products will shrink by 12.2% this year. Despite the recession, Russia maintains positive growth in these categories.

For food and beverage, brand awareness for the main FMCG labels is strong in CEE. Companies such as Danone (France), Unilever (Anglo-Dutch), Cadbury (UK), Coca-Cola (US) and PepsiCo (US) are well established and have been making many acquisitions to secure market share. The beverage sector has also been booming in CEE. Consumers are increasingly purchasing bottled water, carbonated drinks and juices. The alcoholic beverage industry has also been growing and imported brands dominate the spirits sector in most markets.

In Russia, the packaged food market remains immature and fragmented; there is an emphasis on basic food products. There is, however, a high demand for dairy products, chocolate and confectionary. The Russian confectionary market is the fourth largest globally, although domestic production dominates 90% of the market. The multinationals operating in Russia include Cadbury and US giants Kraft Foods and Mars. Due to the decline of the Russian economy and pressure on local incomes, the short-term trend is towards low-cost packaged goods. According to Romir, a research agency, in January 2009 purchases of groceries and staple goods accounted for 76% of real disposable income in Russia, a similar proportion to that recorded in 1998-1999 and higher than in Thailand, India or Ukraine. Compare that with January 2008 when Russian consumers were spending only 61% of their income on food. Private labels and discounters will almost certainly benefit.

Turkey's packaged food industry is highly fragmented. The top four companies, domestic firm Ulker, Unilever, Nestlé and Eti Gida—also a domestic firm—hold just 16% of the market. Given the large Muslim population, soft drinks are more popular than alcohol. Coca-Cola dominates the market with PepsiCo in second place. Tea drinks are also highly popular. Although alcohol is widely available, consumption is 15% lower than the average for the Organisation for Economic Co-operation and Development, which groups together 30 of the world's richest countries. Tourism may create opportunities for the alcoholic beverage sector to expand. The number of tourists visiting Turkey (in spite of the financial crisis) is set to grow by 30m by 2013.

CEE, Russia and Turkey present large markets for the tobacco industry, although sales are falling in some countries as public health measures take effect. In Poland, sales fell by 3.5% in 2007 and, while they will continue to fall, premium brands will gain market share as the rising numbers of female smokers prefer slim or light cigarettes. Sales are also starting to drop in Turkey, following rising taxation. More than 50% of Turkish men are smokers. The market for tobacco has doubled in Russia over the past decade, and this is one of the largest volume markets for cigarettes in the world along with the US and China.

Lowering prices in Latin America

Latin America has vast potential for FMCG brands, and multinationals have been operating in many of these markets for several decades. Though products in the FMCG sector are less sensitive to the downturn than more expensive durable goods, such as cars or computers, there are signs of slowing expansion. Currency depreciation in several countries has also had a direct impact on balance sheets in dollar terms.

The Brazilian subsidiary of US-headquartered Kimberly-Clark, for instance, depends on imported products to manufacture nappies and other personal hygiene products, and currency depreciation has therefore caused upward pressure on prices, highlighting the need to reduce costs. The Brazilian subsidiary says it already has achieved a 5% cost reduction and managed to avoid price increases while maintaining growth targets[32].

The most severe challenges come from changing patterns in consumer behaviour in times of crisis. Brand loyalty declines, as consumers are attracted by cheaper products, edging out some leading brands. To counter this trend, Danone, a French dairy products company, boosted its marketing budget by 50% in 2009 to support sales of its premium Activia yoghurt[33].

Adapting the sizes of products and bottles is one strategy that companies are pursuing to retain customers. Some manufacturers, such as US personal care firm Johnson & Johnson, are selling larger bottle sizes. Their shampoo for children is now being sold in 400ml or 750 ml bottles instead of the usual, and proportionately more expensive, 200ml. Nestlé has also launched new products with cheaper and more basic packaging in Brazil, which has enabled lower pricing. Kimberly-Clark has also launched cheaper alternatives to its popular deodorants. It has managed to boost sales of that category of products by 10% in Brazil last year.

In vast countries such as Mexico and Brazil, efficient logistics and reliable distribution channels are also a key differentiator. Procter & Gamble now intends to regionalise its output in Brazil in order to reduce freight costs[34]. Meanwhile, deficient distribution recently led General Mills to close its single plant in Brazil in April 2009, which may lead to the extinction of two of its popular brands, Forno de Minas (cheese bread) and Frescarini (pasta).

Luxury goods

Key findings

- Despite the financial crisis, rich Chinese consumers are developing a voracious appetite for luxury goods.
- A depreciating won has bolstered the luxury sector in South Korea as the Japanese flock over to snap up bargains.
- India has huge potential, but regulation prevents rapid expansion.
- CEE and Turkey are immature markets for the luxury sector, and brand awareness does not necessarily equate to sales.
- Luxury brands are badly affected in Russia where tumbling oil prices and the real estate slump have slashed the number of Moscow billionaires by 60%.
- Sales are slowing in Latin America, but luxury firms continue to expand cautiously and focus on long-term brand building.

In the past decade, the luxury sector has been a stand-out global success. The strategy of investing heavily in marketing and diversifying product offerings to include small items and accessories has opened exclusive brands up to the newly rich in emerging markets. This has especially been an Asian phenomenon but has also influenced some of the emerging European markets.

Luxury defies financial crisis in Asia

Global sales of luxury goods are predicted to fall 10-15% in 2009 as consumers tighten their belts and the still-rich refrain from flashy displays of wealth. But this is not the case in many places across Asia. With 15,300 households estimated to have net wealth of over US$1m in 2008, China is a particular target. The ranks of dollar millionaires there are expected to increase to 18,500 households in 2010 and to 24,000 in 2011. By 2015, China is forecast to become the world's top buyer of luxury goods.

For now, Japan, South Korea, Singapore, Hong Kong, Taiwan and the richer economies of Asia account for the bulk of luxury buying in the region. Japan alone accounts for 30% of the world market. South Korea saw a 47.7% increase in the sales of luxury goods between March 2008 and March 2009, but this was because of the steep fall in the value of the won against the dollar and the yen, which attracted bargain hunters from Japan and other neighbouring countries.

Longer term, the growth is clearly in China and, further down the road, India. Coach, the US leather goods manufacturer, recently reported that sales in China rose 30% in the last quarter of 2008, and estimates that by 2010 China will represent 10% of the world's US$25bn luxury handbag and accessories market. Not surprisingly, the company has decided to scale back plans to open new stores in North America, from 40 to 20, and CEO Lew Frankfort announced plans to accelerate growth in China, where the company already has 17 shops, in addition to its eight stores in Hong Kong and two in Macau.

India is attracting new investment too, though it is seen as a longer-term bet. In March, local company DLF Brands announced plans to bring 12-15 top brands, including Donna Karan and Giorgio Armani, to India via 500 stores over the next five years. Because of the financial crisis, DLF will be starting cautiously, building only 40 to 45 stores by 2010, down 25% from the original target, according to *The Times of India*. Foreign luxury retailers are also interested in India but are deterred by duties of up to 60% on luxury imports and high capital requirements required by the government. India is seen as ten to 20 years behind China as a luxury market, with Indonesia and Vietnam even farther behind, although aspirational buying is already evident.

Running for cover in Russia

In CEE, brand awareness for luxury goods has not always translated into sales figures. Europe's central and eastern states, with their burgeoning middle classes, have not embraced luxury retail with the same vigour as ultra-wealthy Muscovites. As a result the major global brands have focused instead on Russia, China, Japan and Asia. Recent news that luxury Polish clothing and cosmetics chain Galeria Centrum has filed for bankruptcy, with sales down 20%, suggest that was wise. The one exception is robust performance from the factory outlet sector. In CEE these off-price retail parks are a relatively new concept, in which mid- to top-tier designer brands sell end-of-season lines.

In emerging Europe, the jewel for luxury brands was Russia and Moscow in particular (80% of Russia's luxury market by sales), yet news that Swedish low-cost fashion retailer H&M is eyeing the very store closed by design doyen Alexander McQueen neatly epitomises luxury's perilous state. With the number of billionaires down from 74 to 27 in a year, a host of designer stores have closed in Moscow and prospects look gloomy until oil prices recover. Similarly, Russia's largest luxury retail group and owner of emporium TSUM has admitted it expects flat sales in 2009. However, some of the biggest global names continue to expand. CHANEL and Louis Vuitton both plan additional openings in Millionniki cities (Russia's regional cities with populations of one million or more), and Harvey Nichols is scouting for a store site in Moscow as real estate prices plummet.

The arrival of Harvey Nichols as an anchor to Istanbul's most prestigious shopping centre, Kanyon, suggests that Turkey is embracing the luxury sector, but in reality its consumer base is similar to that in CEE. High brand awareness does not necessarily equate to sales figures. However some specialists, such as Swiss watchmaker Rotap, have backed the market's potential. More broadly, investment has been overshadowed by the significant opportunities in the neighbouring Gulf countries.

A slowdown, but no crash in Latin America

The Latin American market for luxury goods expanded in 2008 and will continue to do so in 2009, albeit at a slower pace. Last year, sales were estimated to have reached US$25bn, a 10% increase over the previous year, according to MCF Consulting, a São Paulo-based luxury brand consultancy. "Latin America has never been a priority for luxury brands in global terms. But paradoxically, the current crisis and the fragility of the international market may open a new avenue of opportunities in Latin America," says Carlos Ferreirinha, president of MCF, suggesting that Latin America may emerge as an alternative to the traditional focus markets of Japan and Russia for luxury brands.

Historically, Buenos Aires was the regional centre for the luxury industry. But this changed during the 1990s, even before Argentina's devastating economic crisis. More recently, Mexico and Brazil account for some 60% of the regional market, but long-term prospects for Brazil are brighter, says Davide Marcovitch, president of Moët Hennessy (part of the LVMH group) for Latin America, Canada, the Middle East and Africa. The Mexican luxury resort industry, which depends on foreign tourists, was expected to be hard-hit even before the recent swine flu outbreak.

Sales of luxury products in Brazil expanded by 12.5% in 2008, to US$6bn, according to MCF, but the slowdown will bring more moderate growth of 8% in 2009 (less than half the 17% experienced in 2007). After Brazil, Mexico and Argentina (where there have recently been new launches and openings), Colombia and Venezuela are the focus of luxury brand companies, as well as Panama, which has registered strong growth in response to its friendly import regulations. Best-selling articles across the region are fashion and leather goods, accessories, perfumes and, especially in Chile, cars, according to MCF.

Nevertheless, Mr Marcovitch says that brand building and prestige may be more important than actual sales in Latin American territory. "Wealthy South Americans would rather shop in Avenue Montaigne [in Paris] than in Rua Haddock Lobo [in São Paulo]. It is not only a matter of money." Hence, LVMH—which is opening its sixth store in Brazil this year—has focused its marketing strategy on the quality of its products rather than lifestyle values. Mr Marcovitch also emphasises the importance of personal relations in Latin America, well beyond mere public relations.

LVMH has been operating in Latin America for over 30 years with its wines and spirits and over 20 years with leather and other goods. The company also owns all of its outlets. "Luxury retailers would rather have direct operations, but operating costs are higher in Latin America than in other parts of the world," says Mr Ferreirinha, president of MCF. Retail space in Brazil is twice as expensive as the rest of Latin America. Some partnerships with local operators have failed in Brazil, such as Burberry, Kenzo and Ralph Lauren, while PPR (France) took four years to launch its Gucci store in São Paulo in late 2008.

Consumer durables and electronics

Key findings:

- Consumers in Asia continue to spend on electronics, particularly on TVs and computers.
- Though some companies are foundering, most are cautiously optimistic about Asia's prospects.
- Online retail is still very much in its infancy but has most potential in China.
- The market for consumer electronics is depressed in CEE, Russia and, to some extent, Turkey. Household electronics and audio-visual equipment are selling in lower volumes in 2009 than in 2008, although there is still growth in PCs and TVs.
- The same trend is true in Latin America. Household audio-visual equipment is set to see a double-digit decline in Brazil across 2009. Computer sales will hold their ground.

As expensive one-off purchases, sales of white goods, audio-visual equipment, televisions, cameras, personal computers and mobile phones are more likely to suffer as a result of the economic downturn. There are few plans for further international expansion within the sectors, although Asia is the one bright spot where sales are holding up.

Asia defies trend

Already the world's largest manufacturer of consumer electronics, Asia is also emerging as one of the biggest buyers of computers, colour TVs, DVD players and mobile phones. Spending on household audio and video equipment in China reached US$1.9bn in 2003. In 2008, the figure topped US$7.9bn, up 316%. From US$809m five years ago, Indian purchases jumped 123% to US$1.8bn in 2008. In the same period, demand in Vietnam climbed 144% to US$127m.

Despite the financial crisis, steady growth in demand is forecast in 2009 and 2010. Between mobile phones, computers and other entertainment devices, consumer electronics are a high priority for most Asians. Government support for the Internet and the growth in phone and computer applications are helping drive demand. The end of analogue broadcasting, scheduled in many countries in 2011, is also expected to boost buying of high-definition TVs and new-generation video players and recorders.

Indonesia is one of the few Asian countries in which a decline in some electronics sales is expected in 2009. Some 5m TV sets were sold in 2008, driven in part by an exemption from the luxury sales tax for electronics goods valued at around US$100. Only 3.9m units are expected to be sold this year. But sales of DVD players and personal computers are expected to rise. PC ownership in Indonesia is still low, with just 3.6 computers per 100 people in 2008, compared with 13.9 in Thailand, for example.

Consumer electronics makers and retailers in the region are cautiously optimistic. The higher end of the market is dominated by Japanese and Korean players such as Sony and Samsung, but local companies like BPL in India are also thriving. Still, strong demand at home hasn't been enough to keep some Chinese companies from having difficulties. Following a February 2009 announcement of a US$95m loss in the fourth quarter of 2008, PC maker Lenovo is refocusing on the home market.

Online retail in Asia

The prospects for online sales of consumer electronics in developing Asia may be brightest in China, where nearly 300m people used the Internet last year. About four out of ten shopped. China boasts 108 PCs per 1,000 people, much higher than the 28.8 machines per 1000 in India, where duties and taxes on imported PC parts can equal 40% of the price of the component.

However, even in China, the Internet is a long way from becoming a significant sales channel for consumer electronics. In a February 2009 research report, iResearch Consulting Group noted that online payments grew 181% last year to RMB274.3bn (US$40bn), but online shopping accounted for only 38% of that number. Consumer electronics are just 16% of all items purchased online in China in value terms, according to Analysys International, another consultancy.

Channel conflict may be an obstacle. For example, Chinese PC maker Lenovo has opened an online store on taobao.com. But in February 2009 the company indicated that it would combine direct sales with its existing distribution network in China. Some analysts had wondered whether the online portal would cannibalise sales from Lenovo's current distributors. A shortage of local retailing websites, low levels of credit-card use, security concerns and inadequate infrastructure also hamper e-commerce development.

The biggest challenge may be simply getting more people online. However, Asian subscribership may grow faster than some analysts forecast if the promise of WiMAX (wide-area Internet service) pans out. In India, Tata Communications is in the midst of rolling out a 140-city WiMAX network. Strategy Analytics, a US market research firm, predicts the number of Asian WiMAX subscribers will exceed 27m by 2014, including 14m in the subcontinent.

Korea Telecom has already installed a WiMAX network across South Korea's largest cities, helping the country's Internet penetration top 76%, which is higher than Japan's 73.8%, according to the website data aggregator Internet World Stats. At the other end of the spectrum, Internet penetration is only 7.1% in India, a reminder that there is a long way to go before online shopping becomes a mainstream sales channel in some of the major markets.

Tough-going for electronics retailers in CEE

Demand for electric appliances, household audio and video is generally depressed across CEE, Russia and Turkey. Broadly speaking, the TV and PC markets remain healthier than audio-visual and household electricals. Sales of these items are in line with the general economic environment and therefore most depressed in markets such as Ukraine. Even where sales remain solid, companies operating in this sector will have a challenging time as cost pressures and competition intensifies.

Europe's biggest home electrical and electronics retailers have been quick to expand in the region, with UK-headquartered computer retailer DSG International (DSGi), French electronics firm Kesa and Metro's Media Markt leading the way. DSGi also bought pan-European Internet-only retailer Pixmania, which sells into the region through its country-specific sites. However, the big retailers have had sharply different experiences in these markets.

Until recently a powerhouse in the region, UK-based giant DSGi has admitted to "very weak performance in CEE". It announced that the Hungarian operation, Electro World Hungary, has been sold to EW Electro Retail Ltd for a token consideration of one Euro. Operations in the Czech Republic and Slovakia continue to perform well in their markets, and will remain part of the Group. The business in Poland remains under review.

By contrast, performance at Metro Group's Media Markt and Saturn fascias has been supported by strong growth across CEE. Europe's other big electricals retailer, Kesa, continues slow but steady growth with Datart in the Czech Republic and Slovakia where it owns 32 stores. Russian chain, Eldorado, remains the biggest player in CEE.

In Turkey, the sale of PCs and TVs will continue to grow in 2009, but household electricals and audio-visual equipment sectors will both shrink to pre-2006 levels. However, these sectors are both expected to bounce back in 2010. The downturn is likely to particularly affect local players, as they are already squeezed by the influx of international stores. The market is led by Germany's Media Markt and Saturn. Darty (part of Kesa Turkey) recently opened its first stores outside Istanbul at Izmir and Izmit, bringing its total to nine stores. Another four will open within 2009.

Audio-visual suffers in Latin America

In Latin America, sales of consumer-products electronics, which largely depend on credit, have been especially hard hit by the financial crisis after five consecutive years of strong growth. The boom had witnessed record PC sales in several countries, including Brazil. In 2008, more computers were sold in Brazil than TV sets.

Demand for household audio and video equipment is now expected to remain flat in Brazil during 2009 at US$2.5bn and to dip slightly in 2010 before recovering. The number of computers is also expected to continue to grow, although at a more modest pace.

Mexico and other Central American countries that are dependent on remittances from migrant workers in the US and Spain have suffered even more. In Mexico, this is expected to contribute to a contraction of 8.4% in private consumption in 2009. Electronic goods manufacturers have had to deal with growing security concerns in the border area with the US, especially in the towns of Ciudad Juarez and Tijuana, which host important assembling zones. Sales of household audio and video equipment actually started to fall in 2008 in Mexico and may not return to their 2007 peak of US$3.5bn for several years. Nevertheless, the number of computers should increase over the period, albeit more slowly than in the past.

Samsung is among those that have to cut output due to falling demand. Meanwhile, Japanese-headquartered Panasonic, which has boosted its local output to export through the region, stands out as an exception. In Brazil, the leading home improvement and electronics goods retailer, Casas Bahia, which thrived when there was abundant credit in the market, has since slowed down its expansion. One of its local competitors, Ponto Frio, is to be bought by Pão de Açúcar (pending anti-trust clearance), which will now become Brazil's largest retailer.

Nevertheless, the large computer manufacturers that have invested in Latin America in recent years are there for the long haul. Hewlett Packard, a US computer firm, has strong positions across the region. It has signed a partnership in Brazil with Foxconn to assemble computers in a joint plant. Meanwhile, Japanese giant Sony has started to assemble its flagship Vaio laptop range locally. And Dell, which has had a base in southern Brazil for nearly ten years, has invested US$130m in another plant in the state of São Paulo. It has also abandoned its traditional focus on the corporate market in order to compete in the retail market from the end of 2007.

Kodak (US), Sony and Olympus (Japan) dominate the fast-growing Brazilian market for digital cameras. Apple's ipods and iphones are increasingly popular, although they are still accessible to a minority of consumers across the region.

Sales of mobile phones have soared in Latin America in recent years. Penetration rates are expected to reach 100 mobile subscriptions per 100 inhabitants for the first time in Brazil in 2011. This shows a rapidly increasing penetration rate from 36.4 per 100 inhabitants in 2004. Meanwhile, in Mexico, mobile penetration has risen from 29 per 100 population in 2003 to 68 per 100 in 2008, and the number of mobile-phone subscribers is expected to rise to 90m in 2013 from an estimated 75m in 2008.

Conclusion

Consumer-products and retail companies in emerging markets have drawn lessons from Asia's 1997 financial crisis, not least the importance of a robust balance sheet devoid of foreign-currency debt and a strong cash flow, in order to survive weak consumer demand and the disappearance of credit and to provide the firepower to acquire distressed assets and companies. They have also gone through the trauma of restructuring, mass firing and cost-cutting. In surviving the Asian crisis, many enterprises were arguably better armed going into the global credit crunch that has now mutated into a global recession.

But this current crisis is different and more virulent. The 1997 turmoil was largely confined to the region, with some markets like China and Australia relatively unscathed. Eventually companies were able to export their way back to profitability and source loans and investment from outside the region. This time around, virtually every economy is getting hurt, including the major consumer markets of North America and Europe, as well as most emerging markets. And with the global financial system under stress from the backwash of toxic assets in the US, it has become more difficult for most companies to borrow from banks and raise funds in the capital markets, at home and overseas.

Fortunately for Asia's consumer-products and retail companies, they are in an industry that appears to be more resilient than most, as the Economist Intelligence Unit forecasts indicate. Unlike the 1997 crisis, their saviour this time is not the export markets but the local customer, particularly in China, India, Indonesia and Vietnam, as governments embark on stimulus programmes aimed at boosting domestic consumption. Companies should therefore retool their products to appeal to local tastes. Indeed, in vast countries like China and India, they may need to tailor their wares more finely on a sub-regional basis.

While most of emerging Asia will continue to offer growth, albeit slower growth in the short term, several economies in transition and markets in Latin America will suffer sharp contractions. Russia, always a volatile market, will once again require investors with the dedication and local contacts to ride through this period. In Mexico, companies will have to be prepared to wait for a recovery not only in local markets but also in the vital US market. Strategies will have to remain flexible to cope with this.

In one respect, this recession is the same as all others before it: consumers are uncertain about their economic prospects, so they are gravitating towards discounted items. The company that can bring down prices without sacrificing quality can thus enlarge market share and emerge with brighter prospects when the good times return. Even the affluent are attracted to bargains, as shown by the recent foreign rush for luxury goods in Korea, which were priced in the weak won. The question is how to discount without sacrificing the company's ability to continue operating as a going concern.

The answer is the same as in other economic crises: become leaner and meaner, cut back-office and non-essential costs, squeeze concessions from suppliers, align staffing and compensation to levels appropriate in a recessionary environment, close or relocate underperforming outlets, postpone big-ticket investments. One typical response has gained prominence in this particular crisis, and that is the optimisation of financial processes. Given the difficulty of borrowing and capital-raising, conserving and maximising cash should be a crucial objective. This requires an intensified focus on cash and treasury management, including preserving assets and optimising the receivables and payables cycle.

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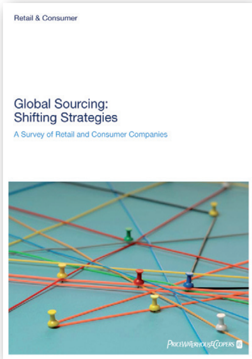

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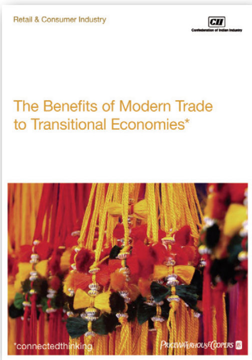

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