

Food for thought

October 2006 - Special Insert 58 - Retail & Consumer Worlds

From São Paulo to Shanghai New consumer dynamics: the impact on modern retailing*

This Food for Thought insert is composed of extracts from the Executive Summary of the 5th edition of PricewaterhouseCoopers' annual regional research project. This on-going thought leadership study has analysed over the years the different and changing investment challenges and opportunities for companies in the retail and consumer sector in transitional economies.

This year, we focus on three main regions in the developing world – Asia, Eastern Europe and South America. We address two major economies for each continent, which include the four BRIC (Brazil, Russia, India and China) countries as well as Argentina and Poland. Therefore, this year's study is at once broader – and deeper.

We are proud to engage once again in the continuing success of our annual study – and to be into our 5th year! The huge potential for investors in the regions covered by the study this year jumps out of the pages of the six country reports, which are available on our website at www.pwc.com/growth. In the meantime, these extracts from the Executive Summary should give you a taste of the range of information and insights provided by our professionals around the world.



Carrie Yu

Foreign Investment Trends

Although China and India are still attracting increased **FDI (Foreign Direct Investment)**, the other countries covered by the report all show a **slight decline** in foreign investment. In Poland, this was particularly marked with foreign investment down by 40% in 2005 compared with 2004. In Brazil, food and beverage represented the most attractive sector for foreign investment.

The general rise in the price of raw materials worldwide and the impact this is having on costs throughout the supply chain is undoubtedly one of the reasons contributing to this general slowdown. Many retail and consumer goods investors are also now into the second or third phases of their development into foreign territories. So, after what has often been the breakneck speed

of the first phase of expansion into foreign markets - to enjoy first-mover advantage - this could be a time for taking stock and revising operational and marketing strategies, before moving on to the next stages of development.

Entry into, or the prospect of entry into **WTO** (World Trade Organisation), is having a beneficial

impact on foreign investors. China has liberalised its rules substantially since entry in 2001. Russia is negotiating entry at the moment. In Hong Kong, a special trade agreement, the CEPA (Closer Economic Partnership Arrangement) will facilitate access to mainland China for companies using Hong Kong as their launching pad.

Key economic growth indicators

Country	GDP growth 2005 (%)	CPI 2005 (%)	Unemployment rate 2005 (%)
China	10.2	1.8	9.0
India	8.5	4.2	8.9
Russia	6.4	12.7	7.6
Poland	3.4	2.1	18.2
Argentina	9.2	9.6	11.6
Brazil	2.3	6.9	9.8
USA	3.5	3.4	5.1
EU 25	1.6	2.1	9.3
World	3.4	3.7	N/A

Source: EIU, July 2006.

An example: the New Opportunities Offered by a Rural Renaissance and Expansion into Tier II and III cities

All countries in the study have in common a major income disparity between the “haves” and the “have-nots”. Rural populations are the poorest, but the massive migration of workers to the biggest cities – for example in Brazil or China – has created an equally massive urban poor. According to the reports from Argentina and India, over 30% of their populations live under the poverty level. It is through their investments which will contribute to improved lifestyles, that retail and consumer companies will be tackling what

C.K. Prahalad, the renowned Indian academic, describes as “**the fortune at the bottom of the pyramid**” (1).

There is an important split between the urban-rural population of the countries covered in the study. Argentina, Brazil and Russia have predominantly urban populations, whereas in China, India and Poland the majority of the population still live in rural areas or small regional towns.

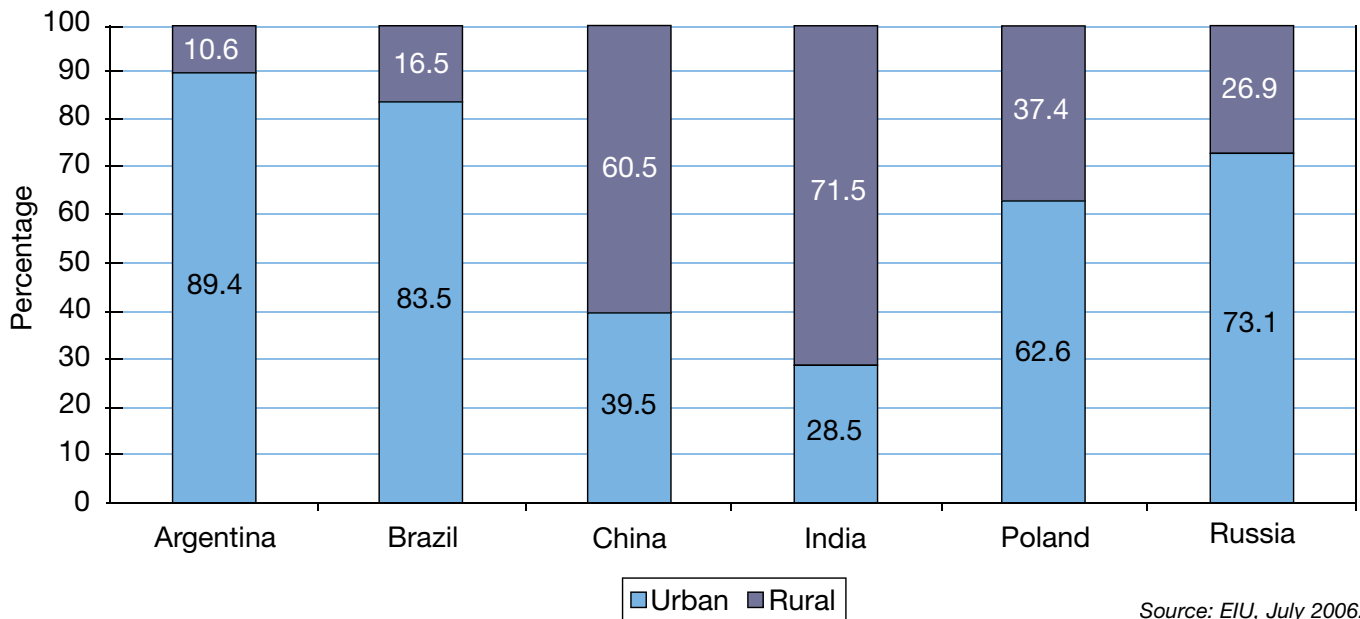
UN (United Nations) figures show that half the world’s population will live in cities in 2007. And one out of three city dwellers – 1 billion people – will be classified as part of the urban poor segment. Indeed, the

(1) - *Financial Times*, August 25, 2006.

rapid urbanisation of populations in transitional economies is creating a substantial problem: assimilation. But it appears that India and China are attempting to come to grips with what can be termed as Asia’s growing **inequality challenge** and contain the too rapid influx of millions to cities which simply cannot guarantee minimal living conditions. Both China and India are addressing income disparities in general and the development of their rural poor populations by encouraging a **rural renaissance** in particular.

In China, the government is giving incentives to develop rural areas by lowering taxes and investing in education and health. In March 2006, the Chinese central government announced a series

Urban versus rural split in percentage of total population in 2004



Source: EIU, July 2006.

of measures to build a “new socialist countryside” over the next five years, including a new rural retail network. Support from local authorities will pave the way for retailers to the hitherto untapped rural market. Encouragement will be given to retailers that take over or cooperate with existing rural stores by means of franchising or voluntary chain operations.

The incomes of Chinese rural populations are increasing through the money sent back to them by their families working in large cities – or when these workers return home. At the same time, Chinese companies are beginning to set up **new factories in under-developed regional areas** in order to benefit from a more stable labour force. For example, businessmen from Wenzhou, an east coast city in China, are starting to build large manufacturing facilities in Chongqing, a fast-growing city some 2,000 km west of Shanghai. If this area takes off, the development could reflect a shift in the country’s economic geography. Instead of workers migrating to big

urban centres, factories will move to where workers live.

By the same token, in India, large software companies such as Satyam Computer Services are decentralising off-shored IT services out of big cities to more distant regions and villages. As **a lack of skilled workers in big cities starts to make itself felt – with a corresponding rise in wages** - it makes sense to decentralise to smaller cities where the new economic prosperity enjoyed by the biggest urban areas has not yet permeated down. The Indian state-run telecom operator, Bharat Sanchar Nigam, has plans to bring 25 million new mobile connections to villages over the next three years. Manoj Kohli, the president of Bharti, India’s leading telecoms carrier says: *“It’s very clear that, of the 700 million living in villages, 400 million can afford a mobile phone, and the other 300 million may be able to three to five years from now”* (2).

(2) - Financial Times, April 24, 2006.

In all the countries covered by the study, foreign and local retail chains are stepping up their investment in Tier II and III cities and less developed regions, as the Tier I cities become saturated.

In India, both Globus and Pantaloon have already begun building a retail presence in Tier III cities before many other retailers have finalised their Tier II operations. In China, the home improvement chain B & Q was encouraged by the government, which contributed financial assistance, to expand into western regions of the country. The **emergence of regional players**, including foreigners, which go immediately for regional development, will be among future development trends. In Argentina, Wal-Mart and Carrefour are both vigorously developing their operations in interior regions of the country.

As a rural renaissance emerges, formats adapted to these less sophisticated populations are being designed. In India, ITC

is experimenting with a rural hypermarket through its “Choupal Sagar” format which combines grain procurement and a storage centre with the mall. The underlying premise of this model is to capitalise on the farmers’ visits to wholesale markets to sell their produce by offering them a range of products and services. Another example is DCM Shriram Consolidates, which is launching “one stop shops” for farmers.

Adapting products, packaging and advertising to rural markets is a strategic requirement. The contrast between the Cartier watches and the Chanel handbags so sought after by the new rich could not be greater when compared with the basic necessities such as toothpaste, detergents or mosquito repellents which are needed by rural populations. The question of product packaging is highly significant in rural areas: the shampoo market took off in India when the product was packaged in individual sachets rather than in bottles which were too expensive. Another example is afforded by Unilever which launched its Lifebuoy soap in India in 2000. The product lost money for about a year, but took off when the company reviewed the product’s quality and perfume and underlined its health and hygiene benefits to children. The price was increased by 20% - and sales increased by 15% per year.

Conclusion of the Executive Summary: Correlation and Contrasts

There is a strong correlation across the countries studied this year as far as **favoured formats** are concerned: hypermarkets at one end of the size spectrum, discounts and convenience stores at the other. Consumer dynamics are also very similar with a growing middle-class, a “new rich” class and an important segment of upwardly mobile young adults. International **brands** are popular in the upper and middle classes, for whom fashion items and consumer electronics function as status symbols. FMCG brands find it more difficult to penetrate certain markets where there is still a preference for local brands in groceries. This underwrites the big potential of **private label** as a solution for the very price conscious grocery shopper.

What jumps out of this study are: the contrasts thrown up by the urban-rural divide, the widening gap between skilled and unskilled workers, and the polarisation of the formats and products needed by highly differentiated consumer segments at each end of the social spectrum.

But, it is now recognised, the retail and consumer sector can do a great deal to accelerate the **improvement of lifestyles** through modernising supply chains,

employing and training workers and selling high quality products in the countries in which they invest. In China and India, tackling the “left-outs” in rural areas opens up new areas of opportunity for business as governments seek to spread the benefits of economic development more equitably.

Other changes, such as the increase in the number of **working women**, the rise in the number of **credit cards** and a potential explosion in **car ownership** are all factors that will be pushing consumption to much higher levels that will greatly favour the retail and consumer goods sector’s expansion.

Who will be the **future winners** in the transitional economies: foreign retail and FMCG companies or locals? The answer is: both. International companies are driving the modernisation of retail and consumer goods development and new concepts, formats and products. Innovation, flexibility and continual adaptation to specific markets are the name of the game. Indeed, global players are becoming increasingly local-minded or “glocal,” as the local players become more westernised in their operational approach. Therefore competition will be increasingly tough. Neither locals nor foreign investors will dominate in the long run. But what is certain is that critical mass is essential for success: BIG will win.

*Carrie Yu
Global Retail & Consumer Leader
carrie.yu@hk.pwc.com*

From São Paulo to Shanghai: Strategic Challenges and Opportunities

Challenges

- Logistics
- Regulations
- Brand loyalty
- The fight for talent

Opportunities

- Retail/distribution concepts involving local populations
- Mergers, acquisitions and partnerships
- Rural renaissance and expansion into Tier II and Tier III cities
- Product innovation

Editorial Team

retail.consumer@fr.pwc.com

Carrie Yu

Global Retail & Consumer Leader
Tel: +852 2289 1386
carrie.yu@hk.pwc.com

Global Retail & Consumer Team

Paris

Anne-Sophie Lacarelle-Gasse

Marketing Senior Manager
Tel: +33 1 56 57 88 30
anne-sophie.lacarelle-gasse@fr.pwc.com

Megan Hofmann

Marketing Co-ordinator
Tel: +33 1 56 57 88 04
megan.hofmann@fr.pwc.com

Hong Kong

Cynara Tan

Regional Marketing Director
Tel: +852 2289 8715
cynara.sl.tan@hk.pwc.com

An International Network

PricewaterhouseCoopers (www.pwc.com) is the world's largest professional services organisation. Drawing on the knowledge and skills of more than 125,000 people in 142 countries, we build relationships by providing services based on quality and integrity.

PricewaterhouseCoopers refers to the network of member firms of PricewaterhouseCoopers International Limited, each of which is a separate and independent legal entity.

Global Industry Programme

Your connection to the marketplace

PricewaterhouseCoopers' Global Industry Programme demonstrates our industry strengths and drives value for our clients. The programme's foundation is a deep understanding of business and industry issues connected with meaningful solutions. Companies leverage PricewaterhouseCoopers' extensive industry resources and knowledge to compete more effectively in their specific marketplaces.

Retail & Consumer Sector Contacts from São Paulo to Shanghai

Global and A7 Retail & Consumer Leader (Hong Kong)

Carrie Yu + 852 2289 1386
carrie.yu@hk.pwc.com

Central & Eastern Europe

George Johnstone + 48 22 523 42 43
george.johnstone@pl.pwc.com

South America

Henrique Luz + 55 11 3674 3601
henrique.luz@br.pwc.com

Argentina

Gabriel Martini + 54 11 4850 4762
gabriel.martini@ar.pwc.com

Brazil

Marcio Vieira +55 11 3674 3950
marcio.vieira@br.pwc.com

China and Hong Kong

Sonny Doo + 86 20 3819 2248
sonny.doo@hk.pwc.com

India

N. V. Sivakumar +91 80 2558 5663
n.v.sivakumar@in.pwc.com

Poland

Katarzyna Witaszewska + 48 22 523 41 82
katarzyna.witaszewska@pl.pwc.com

Russia

Chris Skirrow +7 495 967 6390
chris.skirrow@ru.pwc.com