From the Bottom of the Pyramid to Emerging Middle Classes in Latin America

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EUROMONITOR INTERNATIONAL

FROM THE BOTTOM OF THE PYRAMID (BOP) TO EMERGING MIDDLE CLASSES IN LATIN AMERICA

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The Latin American market was at one time all about the Bottom of the Pyramid (BoP) and the wealthy, but increasingly, the emerging middle classes are the target segment of choice for investors. Economic growth and stability have helped create a vibrant middle class which is growing faster than the still-important BoP. To successfully serve both segments, a detailed knowledge of income, expenditure and demographic trends is key - combined with an understanding of local attitudes and motivations.

INTRODUCTION

Latin America is a consumer market worth US$3,646 billion with a population of 611 million. The region is a similar size to China as a consumer market, but in per capita terms consumer expenditure is far higher in Latin America than in China which makes it an attractive destination for businesses operating in the consumer goods' arena. The region's chief advantages include natural resources, a young population, proximity to the US – the world's largest consumer market – and increasing economic stability. The largest economy in the region is Brazil which accounted for 39% of all Latin American consumer spending in 2013, followed by Mexico (21%); but smaller, fast-growing markets such as Colombia and Peru have been receiving more and more investor attention.

Increased economic stability and low unemployment in Latin America have resulted in rising prosperity for many of the region's inhabitants. Growth has also reduced income inequality – the bête noire of the region – in nine of 13 economies for which we have data, with the largest falls being seen in Bolivia, Brazil, Colombia and Mexico. Nevertheless, income inequality remains one of the chief challenges of the region – with five of the world's ten most unequal countries (in a ranking of 85 globally) in 2013 being found in Latin America. As well as economic growth, government attention to the problem of income inequality has helped drive this improvement, with cash transfer schemes such as Brazil's Bolsa Família and Mexico's Oportunidades key examples.

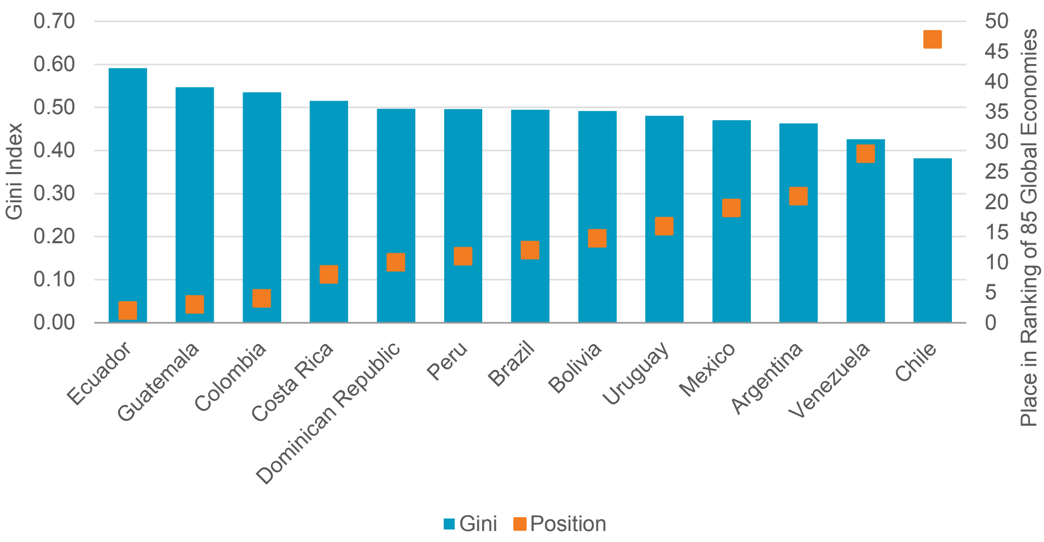
Income inequality has meant that the Bottom of the Pyramid (BoP) has been a key segment in the region for many years, but increasingly, with economic growth and rising prosperity, the emerging middle classes, which are seeing their numbers swell, have become the focus for business in the region.

THE BOTTOM OF THE PYRAMID (BOP)

Who and where are the BoP?

Great strides have been made to reduce income inequality in the region but the BoP remains large with countries from Latin America dominating global inequality rankings. Latin American countries occupy half of the top ten spots in a ranking of the world's major 85 economies. Even Chile, the least unequal large economy in Latin America, comes in at 47th position.

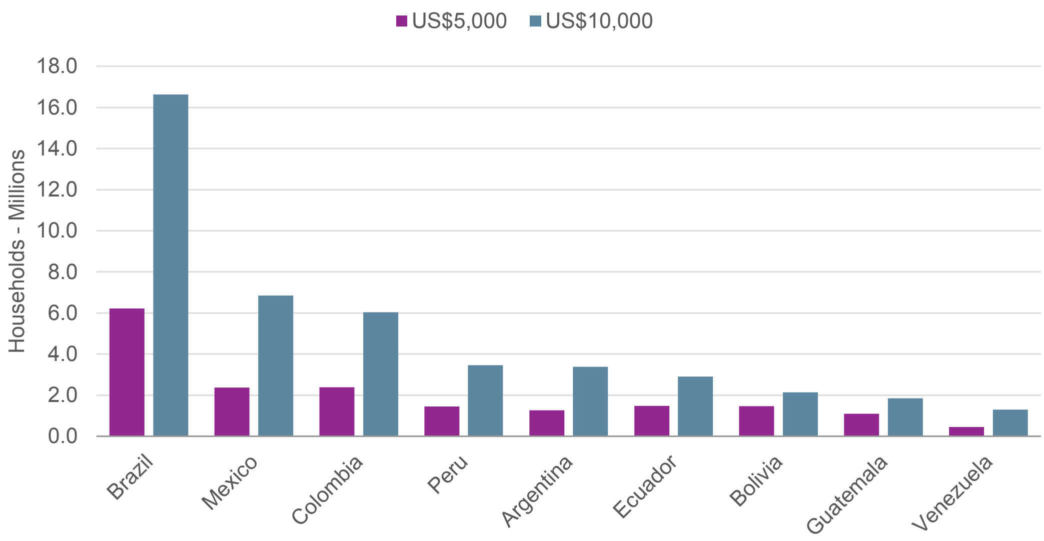
Figure 1: Gini Index in Selected Latin American Economies: 2013



Source: Euromonitor International from national statistics
Note: The gini index is a standard economic measure of income inequality, based on a Lorenz Curve. A society that scores 0 on the Gini index has perfect equality, where every inhabitant has the same income. The higher the number over 0, the higher the inequality, and a score of 1 indicates total inequality, where only one person receives all the income.

In Latin America as a whole there were 171 million households in 2013. Of these, 36.4 million had a disposable income below US$5,000 (roughly equivalent to US$3.80 per household member per day) and 64.1 million an income below US$10,000 (which roughly equates to US$7.60 per household member per day). The former figure is the equivalent of two Spains and the latter figure is equivalent to the total number of households in Indonesia, or half the number of households in the USA. Therefore, taken as a whole, the BoP market remains a sizeable one.

Figure 2: Low-Income Households in Selected Latin American Economies: 2013



Source: Euromonitor International from national statistics
Note: Data are in constant 2012 prices and refer to disposable income

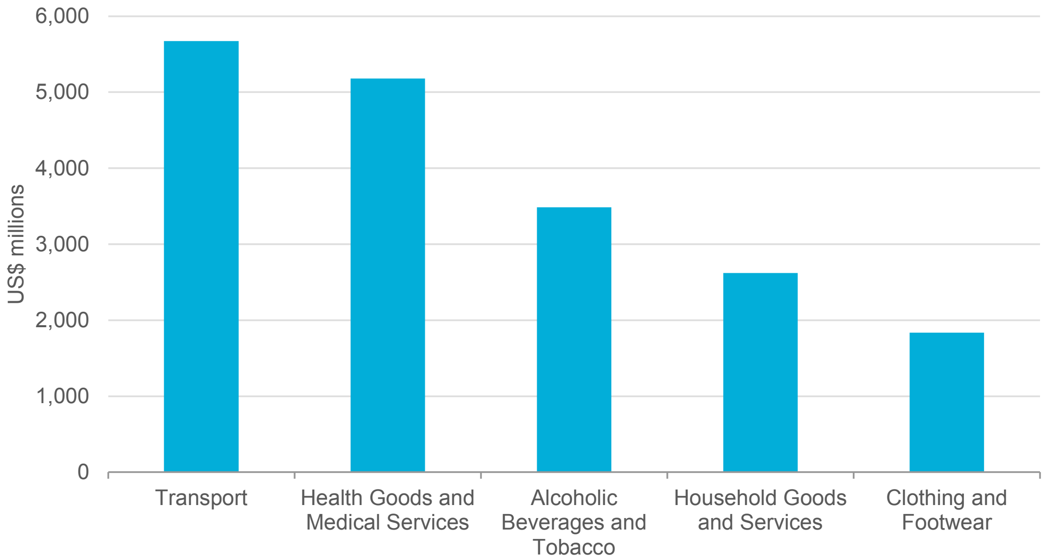
In Brazil alone there are 16.6 million households with an income below US$10,000. These households are concentrated in the north and north-east of the country. Although average household spending is low in these regions – at US$17,758 and US$15,192 per household respectively, the combined market of the north and north-east totalled US$305 billion in 2013. This is a similar level to the entire consumer market of Taiwan or Argentina.

Spending patterns at the BoP

Although individual spending power is (necessarily) limited, this segment taken as a whole represents a valuable opportunity for local and multinational consumer goods companies. In Peru, the lowest earning 10% of households (who have an average disposable income of US$2,077 or less than US$6 per day) had a combined spending power of US$3.3 billion in 2013, almost one quarter of which was spent on non-essentials.

Although their spending averaged US$4,963 per household, the combined spending power of decile 1 households alone in just 13 selected economies in Latin America totalled US$77 billion in 2013. These households do not devote the entirety of their budgets to necessities, although of course essentials do comprise a large proportion of budgets in decile 1 households across the region – on average 63.6% of spending by decile 1 households in the 13 economies in 2013 was devoted to food and non-alcoholic beverages and housing. Nevertheless the combined discretionary spending of decile 1 households totalled US$28.0 billion.

Figure 3: Consumer Expenditure on Selected Categories by Decile 1 Households in Latin America: 2013

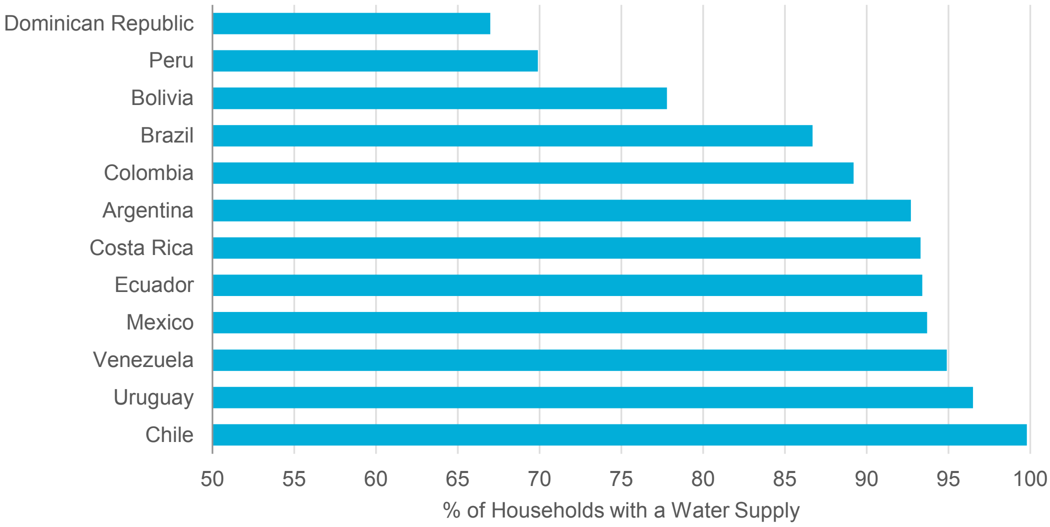


Source: Euromonitor International from national statistics
Note: Deciles are calculated by ranking all of the households in a country by disposable income level, from the lowest-earning to the highest earning. The ranking is then split into 10 equal sized groups of households. Decile 1 refers to the lowest earning 10%. Data refer to 13 economies: Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, Guatemala, Mexico, Peru, Uruguay and Venezuela.

Approaches to targeting the BoP

Despite the size of the market and increased interest in it, this segment remains underserved. Key issues include what has become known as the BoP penalty – the lack of access to essential goods and services, higher prices for goods and services, and/or poor quality of goods and services faced by the poor. (The Market of the Majority: The BOP Opportunity Map of Latin America and the Caribbean; WRI).

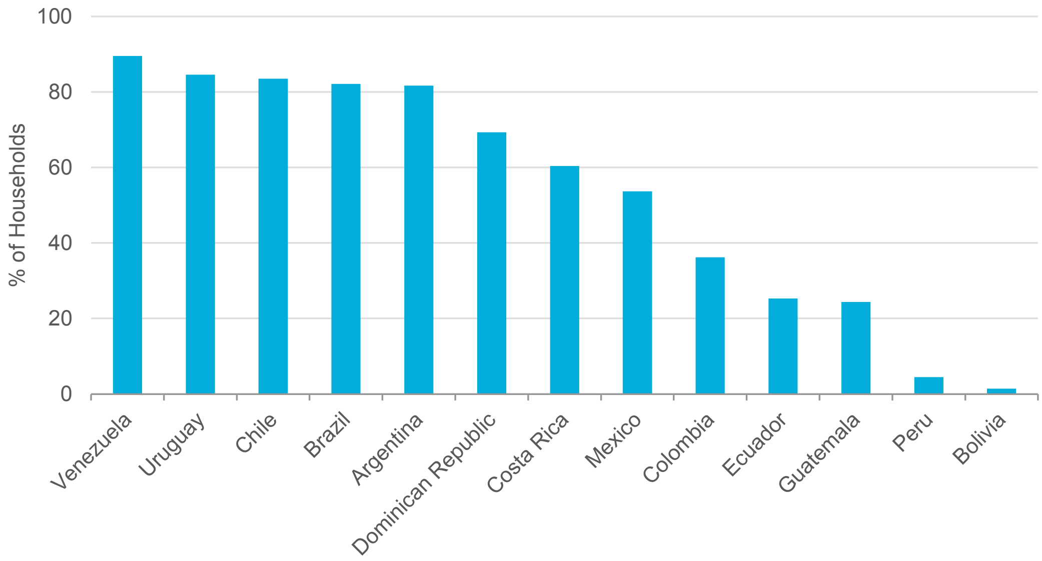
Figure 4: Households with a Water Supply in Selected Latin American Economies: 2013



Source: Euromonitor International from national statistics

In doing business with the poor, companies are required to understand the trade-off poor consumers make between price and quality. It also requires businesses to rethink their business models – strategies cannot be simply imported from advanced economies, or even necessarily from other emerging markets. As well as producing quality goods at a low price, companies usually face distribution difficulties (particularly to remote areas), challenges around building brand awareness or even category awareness (with word of mouth a crucial form of communication) and also problems with infrastructure (for example – if poor households are unlikely to own a refrigerator is it possible to sell chilled goods?)

Figure 5: Decile 1 Households with a Refrigerator in Selected Latin American Economies: 2013



Source: Euromonitor International from national statistics
Note: Deciles are calculated by ranking all of the households in a country by disposable income level, from the lowest-earning to the highest earning. The ranking is then split into 10 equal sized groups of households. Decile 1 refers to the lowest earning 10%

However, economic growth and the corresponding increase in opportunities are being aided by increased access to technology. The ability of companies to produce goods more cost-effectively and to tailor products for specific markets and segments within markets is enabling business to create goods and services that consumers at the BoP both want and can afford.

Case studies in Latin America

Successful companies in Latin America are innovating in order to win BoP consumers. by adapting products and services, changing the business model, constructing unique distribution networks or even creating the market from scratch.

- A well-known example of a company innovating in terms of adapting its business model is Nestlé and its Amazon barge in Brazil –a boat with 100-square metres of supermarket space which travels to 18 small cities and 800,000 potential consumers. As well as supplying consumers, the barge also supplies micro distributors in the area thus extending the company's reach to thousands of BoP households.

- Global Alimentos SAC is the leading breakfast cereal player in Peru with a 58% value share of the market in 2012. It focuses on innovation and offers smaller pack sizes, incorporating Andean cereals into its offer, as well as having an impressive distribution network. This ensures that its products are available throughout the country, even in rural areas, and in traditional sales channels like independent small grocers, in order to reach BoP consumers.

- Éxito, the market-leading supermarket in Colombia, offers store cards to its shoppers. The Éxito Origen credit card can be obtained by cardholders without a banking history or formal income.

- Farmacia Similares, a drug retailer in Mexico with 2,000+ stores, provides access to basic health care for low-income consumers who cannot access public services or pay the usual private fees. Low-cost generic drugs are available and consultations with doctors for a low fee are also available through adjacent medical clinics.

Case studies outside of Latin America

Examples of companies successfully striving to serve BoP markets outside Latin America are also abundant. Particularly in India and increasingly in Sub-Saharan Africa:

- South Africa's Promasidor, through its Cowbell brand, provides milk powder in small portions packaged in sachets. By removing the animal fat from the milk and replacing it with vegetable fat, Cowbell allows for a longer shelf life. These two innovations mean that Cowbell is sold across Africa including in Nigeria, Kenya and Malawi; in countries where households are without refrigeration and suffer from irregular power supplies and in countries where fresh liquid milk is not available.

- In India, Godrej and Boyce launched what has been feted as the world's cheapest refrigerator. It retails for US$69 and was designed to target poor, rural consumers. In a country with 854 million rural inhabitants, this market is huge. The ChotuKool refrigerator looks from the outside like a box, consumes half the electricity of a standard refrigerator, and, importantly in a country which suffers power outages, it also stays cool for hours with no power, due to its superior insulation. It was designed with input from village women and is linked to microfinance organisations which means families can purchase it on credit.

- Unilever's Surf Excel Quick Wash was developed with India in mind – it's a detergent for hand washing laundry and it claims to reduce water consumption and the time taken for rinsing by 50%. Freshwater resources are scarce in India, added to which, in 2012 only 44% of households had a water supply - so a product which uses less water means a lot less collecting of water.

- The brewer, SABMiller brought out Chibuku "Shake Shake" an opaque beer made from maize and sorghum, at half the price of its regular beers to compete with homebrew. The ingredients are tweaked to suit local tastes in different markets and it retails at 40% less than a "normal" beer. Unsurprisingly, it has been hugely successful.

FROM THE BOP TO THE EMERGING MIDDLE CLASSES

Despite the BoP remaining a large segment in Latin America, it is by no means the fastest-growing. Due to economic growth and stability, a vibrant middle class has emerged.

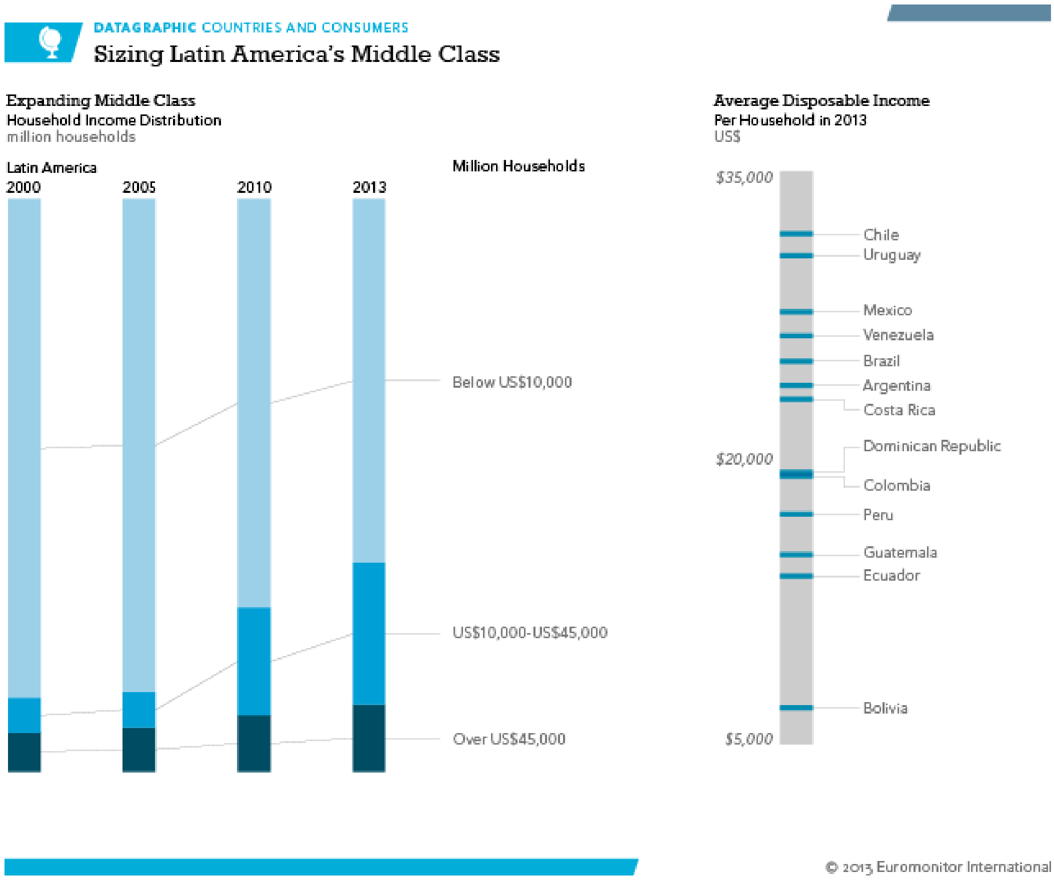
Where are the middle classes?

Strong economic growth does not always go hand-in-hand with the growth of a robust middle class, so it cannot be used as the sole indicator of an attractive market. This is often the case when an economy is reliant on capital-intensive rather than labour-intensive sectors such as mining, the proceeds of which often fail to trickle down to the vast majority of the population. Likewise, this is often the case where economic growth is the result of one-off factors such as a major foreign direct investment (FDI) project or recovery from a war. This explains why São Tomé e Príncipe and South Sudan can feature near the top of the ranking of fast-growing economies in the world whilst suffering from stagnant growth in private consumption (São Tomé e Príncipe), and being mired in instability (South Sudan) and poverty (both).

Looking at the number of households with an income between US$10,000 and US$45,000 – which equates to between 50% and 200% of an average disposable household income in Latin America and provides a rough gauge and a straight-forward way of comparing a vast array of countries - we can see that there are 87 million middle class households in Latin America, and more than 60% of these are in the region's two largest economies – Brazil and Mexico.

On a country-by- country basis, Chile has the largest proportion of households falling into this income band – with almost three-quarters of households earning a disposable income between US$10,000 and US$45,000 in 2013. Chile is also the region's least unequal major economy with a gini index of 0.382 in 2013, comparable to those of most other OECD countries, so in this sense the large vibrant middle class is not a surprise. Chile has benefited from strong economic growth, low unemployment and government policies to eradicate poverty.

Figure 6: Sizing Latin America's Middle Class

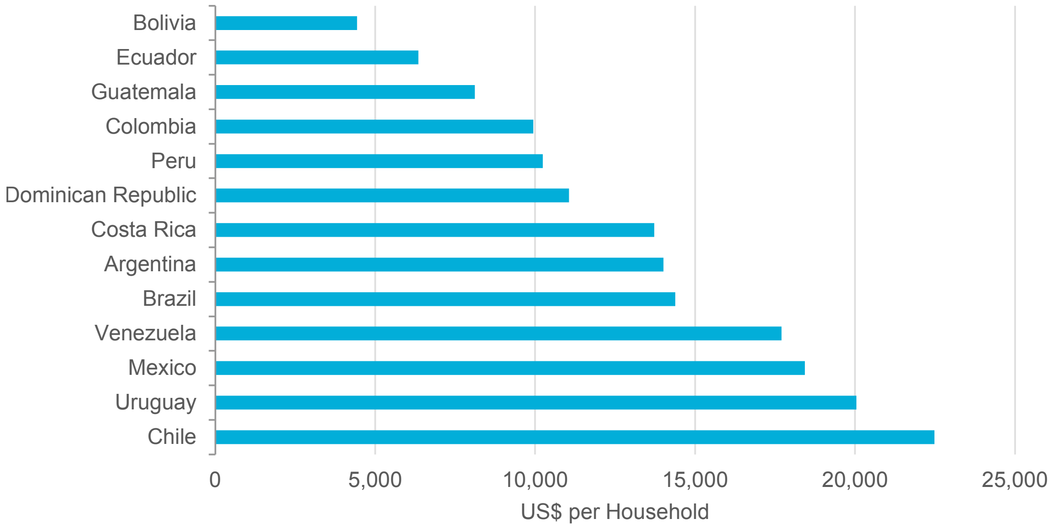


Source: Euromonitor International from national statistics

How much do they earn?

Above we used a broad definition of middle class, in order to compare countries across the region effectively. But the region is home to a wide array of economies with different levels of development. In 2013, per capita GDP at the regional level stood at US$9,854 but ranged from US$97,342 in Bermuda to US$797 in Haiti. Therefore to get a more accurate view of what actually constitutes a middle class income in each of the countries, it is interesting to look at the average income of a decile 5 household.

Figure 7: Average Income of a Decile 5 Household: 2013



Source: Euromonitor International from national statistics
Note: Deciles are calculated by ranking all of the households in a country by disposable income level, from the lowest-earning to the highest earning. The ranking is then split into 10 equal sized groups of households. Decile 5 refers to the lowest earning 10%. Data refer to 13 economies: Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, Guatemala, Mexico, Peru, Uruguay and Venezuela.

Is there a typical middle class household?

Research from the World Bank (Economic Mobility and the Rise of the Latin American Middle Class) has found that many middle class households across the region share numerous similar traits – in terms of their social and demographic make-up. For instance, middle class households across the region are likely to be urban and of smaller than average size. Adult women within the household are more likely than is typical to be in the labour force and household members are likely to be employees working in the formal sector, often in the service industry, with any children in the household in education. However, the same study has found that when it comes to values, attitudes and motivations, differences outweigh similarities and the middle class within each country are more likely to share these traits with the poor in the same country than with the middle class in other countries in the region.

What makes the middle class such an important consumer group?

A middle class income is an indicator of sufficient spending power to consume non-essential goods and for many companies this segment is considered to be their mainstream target consumer.

In emerging markets, some of those entering the middle class will have the ability to spend a decent proportion of their income on non-essentials for the first time, creating significant opportunities for consumer goods companies. For context, since the early days of market growth in the USA, the market leader in 1925 remained the market leader, or in second position, for the rest of the century—true for not only one or two, but for 17 product categories (Atsmon et al. 2012). Gaining first-mover advantage in emerging markets can, therefore, be a winning long-term strategy.

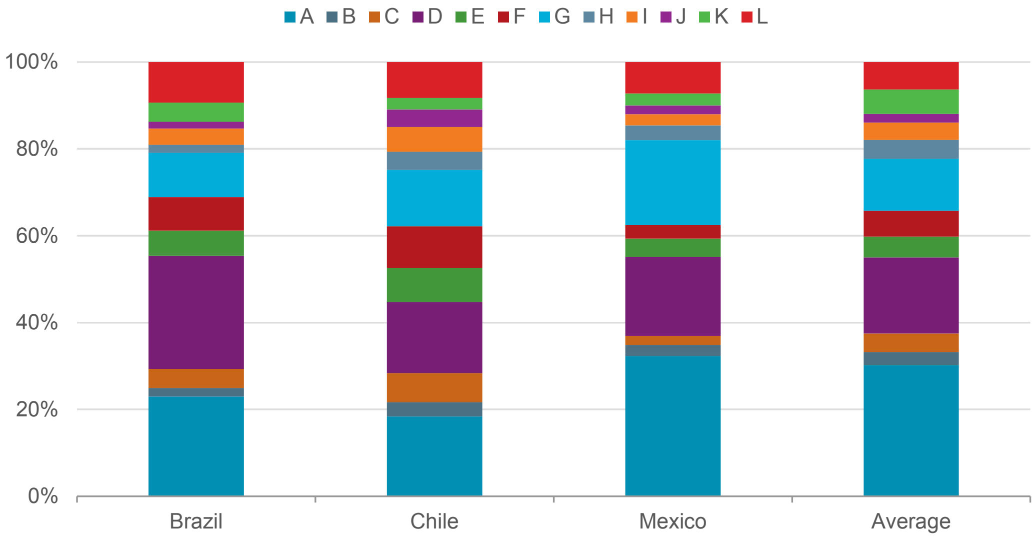
Engaging with these consumers at an early stage is also a great strategy for reaping long-term rewards. These consumers, once won, can be transferred up the value chain—from initial purchases of low-priced items through to purchases of increasingly sophisticated, higher-margin products and services. This is why an effective pricing strategy is crucial for companies to be able to attract middle class consumers with affordable choices, gain their trust, and then eventually be able to target them with more costly, value-added designs.

In economic terms, middle class consumers are important as they can be a major contributor to economic development through spending and future human capital (as they often spend on education). This in turn will help transition countries up the value-added chain and in some cases influence domestic policy. Government revenues in developing countries will benefit from a new class of consumers who have moved from the informal to the formal economy and contribute to taxation. An increase in the middle class, therefore, can have a direct reinforcing effect on economic growth, creating a virtuous circle.

Spending priorities for the middle classes

Looking at the spending priorities of decile 5 households shows that middle class households in Latin America often prioritise health and education. However, the picture is not a uniform one and spending patterns vary considerably from country to country. So for example, whereas a decile 5 household devotes 10.1% of its budget to health goods and medical services in Argentina, the proportion is just 3.1% in Mexico. A decile 5 household in Chile devotes 4.1% of its budget to education, whereas in Guatemala the proportion is just 0.4%.

Figure 8: Spending by Category by Decile 5 Households in Selected Economies: 2013



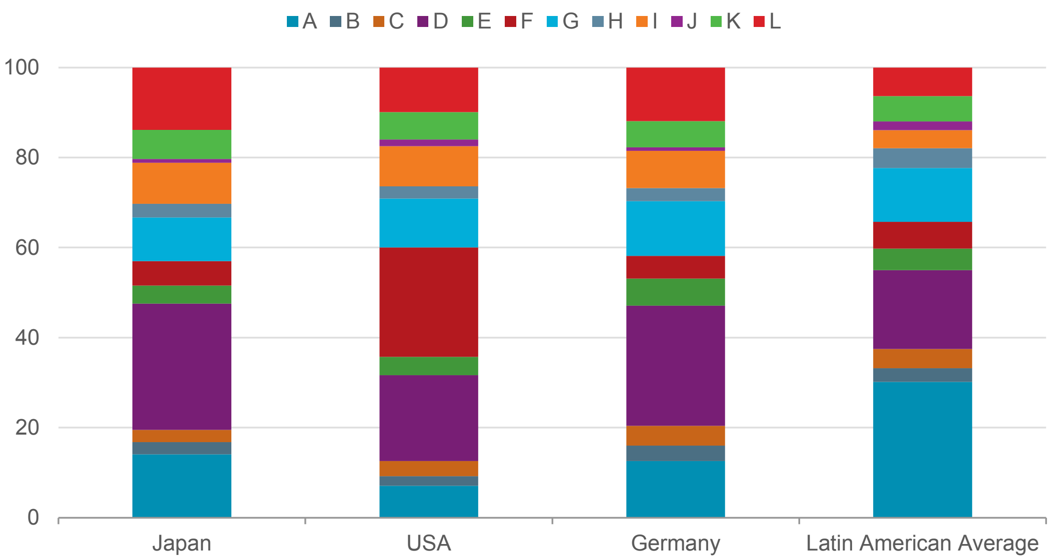
Source: Euromonitor International from national statistical offices/OECD
Note: A: Food and non-alcoholic beverages; B: Alcoholic beverages and tobacco; C: Clothing and footwear; D: Housing; E: Household goods and services; F: Health goods and medical services; G: Transport; H: Communications; I: Leisure and recreation; J: Education; K: Hotels and catering; L: Miscellaneous goods and services. "Average" refers to a simple average of 13 large Latin American economies.

This focus can be seen in growth forecasts in all but one of the countries for which we have data with spending on education outpacing overall spending growth between 2013 and 2020. The same is true of spending on health. Looking at spending on necessities (housing and food and non-alcoholic beverages) versus discretionary spending, the picture is the same. Discretionary spending will outpace spending on necessities in all but one of the 13 economies. The outlier in all three of these examples is Guatemala. Guatemala has a small middle class by regional and global standards. The average household income was US$14,991 in 2013, but 50% of households had an income below US$7,500. The Guatemalan middle class holds considerably lower purchasing power than its equivalents in Brazil or Argentina, and is typically unable to afford branded goods or to spend freely on discretionary items.
The countries which are expected to see the largest increase in discretionary spending, compared to spending on necessities are Argentina, Peru and the Dominican Republic. These three combined will see an increase in discretionary spending of US$139,278 million in 2012 prices between 2013 and 2020.

A second sphere of attention for the middle class is the home, and this was apparent from Euromonitor International's Middle Class Home survey of 2013. The specifics of this home focus vary from market to market, encompassing renovations, interior design and household goods but also a focus on home purchasing, There is a strong preference for materially improving the home before spending on other, more experience-based leisure categories. Part of the explanation for this trend is found in demographics – emerging markets have younger age profiles than their developed counterparts. For instance the median age of population in 2013 in Latin America was 28.4 years, compared to 37.8 in North America and 40.2 in Western Europe. This means that the population in Latin America are more likely to be setting up home for the first time, getting married for the first time or having children, all of which often involve spending on the home. This is borne out in our Middle Class Home survey, which found that in Colombia 19.8% of respondents had moved more than three times in the past five years; the figures were similarly high for Brazil (16.0%) and Mexico (15.9%). As a benchmark, in the USA it was 15.8%, Germany 9.9% and in Japan it was even lower – just 5.2% of respondents had moved home in the past five years.

We have found similar patterns in emerging markets across the world, which can be in sharp contrast to trends in advanced economies where "experiences" are much more important for middle income earners. For instance in the USA, 8.9% of spending of a decile 5 household is devoted to leisure and 6.1% to hotels and catering, in Latin America the average is 4.0% and 5.7% respectively.

Figure 9: Spending by Category by Decile 5 Households in Selected Advanced Economies: 2013

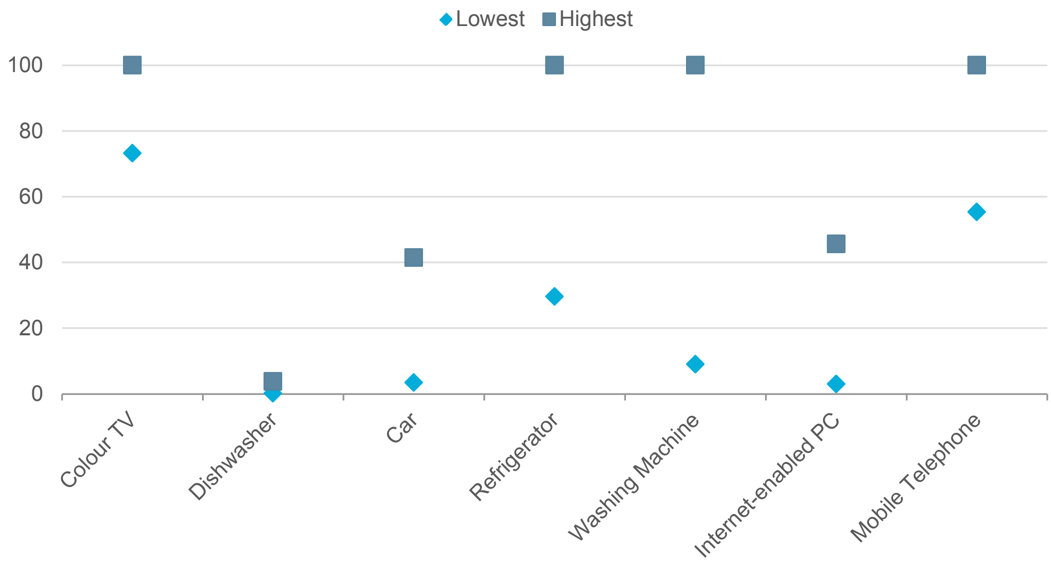


Source: Euromonitor International from national statistical offices/OECD
Note: A: Food and non-alcoholic beverages; B: Alcoholic beverages and tobacco; C: Clothing and footwear; D: Housing; E: Household goods and services; F: Health goods and medical services; G: Transport; H: Communications; I: Leisure and recreation; J: Education; K: Hotels and catering; L: Miscellaneous goods and services. "Average" refers to a simple average of 13 large Latin American economies.

Are the middle classes in Latin America well-off?

It would be wrong to assume that the middle classes in Latin America are well-off. Many have escaped poverty fairly recently and are still reliant on relatively low-incomes, as well as being without many of the durable goods that the middle classes in advanced economies take for granted. For example, although colour TV penetration amongst decile 5 households approaches 100% in some countries in the region (Costa Rica for example), it is below 80% in Bolivia and Peru. Passenger car ownership peaks at 41.5% in Mexico but is less than half this rate in Bolivia, Colombia, Costa Rica, Dominican Republic, Ecuador, Guatemala, Peru and Venezuela; whilst dishwashers are rare across the region, with the highest penetration in 2013 (3.8%) found in Chile.

Figure 10: Possession of Selected Durable Goods in Decile 5 Households in Latin America: 2013



Source: Euromonitor International from national statistics/International Telecommunications Union (ITU)
Note: Data refer to a ranking of 13 economies in the region

APPROACHES TO TARGETING THE MIDDLE CLASS

To successfully cater to the middle classes across Latin America and beyond, companies face some of the same challenges that are present at the BoP. Products and services must be tailored to local tastes, brand awareness may be lacking – especially amongst those who have the ability to spend on discretionary items for the first time – and consumers may be hard to reach logistically and also because word of mouth recommendations carry so much weight amongst this consumer segment. However, at the individual and household level, budgets are set (comparatively) higher, access to credit is easier and the quality/price trade-off is not quite so acute. Middle class consumers are also often urban, making it more likely that modern retail formats exist in their localities alongside traditional retailing. These consumers are interested in convenience and are increasingly willing and able to pay for it – companies that offer good customer service, a wide choice of products and consistent quality standards can expect to be popular in a region suffering from inadequate public services and crumbling infrastructure.

Case studies in Latin America

- OXXO, a Mexican chain with stores across Latin America, combines foodservice and retailing; and trades on a positioning of proximity, flexible hours and a wide range of products and services that serve their customers' daily needs. Oxxo has won market share by focusing on providing convenience to its consumers. This is important as middle class families are more likely to have both male and female members in the labour force.

- Similarly to the low-income segment, the emerging middle class at the lower end of the income spectrum still has difficulty accessing credit. Casas Bahia, a retailer in the home furnishings, appliance and consumer electronics sectors in Brazil, is a well-known example of a company overcoming this by offering credit and payment plans through monthly instalments focusing on making products affordable rather than cheap. It targets both lower-income middle classes and low-income consumers.

- Diageo has a marketing strategy to target the emerging middle classes in Latin America. One of their methods in doing this is to create locally produced variants of their big name products – for example Gordon's Parchita (passion fruit-flavoured vodka). This is domestically-produced in Venezuela, allowing the company to keep prices down and is aimed at young adults in the cocktail market.

- Casa & Ideas, a home décor retailer in Chile, offers a wide range of products and attractive designs at affordable prices for upper and middle segments of the population. One of its concepts is to foster an air of exclusivity by offering limited editions. Stores have a modern ambience which attracts young urbanites.

Case studies outside of Latin America

Examples of companies successfully tapping into this market in emerging markets outside of Latin America:

- Samsung has a "Built for Africa" range of products including a smartphone with dual-sim capability so that users can switch networks in order to find the best signal; and refrigerators that are designed to keep working even if electricity cuts out for several hours.

- Mondēlez International has tailored its Oreos product offerings to suit local markets by introducing new flavours to suit its consumers' taste buds; eg green tea ice cream flavour and mango and orange flavour in the Chinese market. It is these tactics that have helped Oreo to become the brand leader in sweet biscuits in China, accounting for 15.4% of a US$3.6 billion market in 2012.

- Spanish fashion retailer Zara tends to sell the same clothing lines in similar-looking stores across markets, yet varies its pricing substantially across the markets in which it operates. Pricing across most European markets is fairly similar, but in emerging markets products are generally positioned at a far higher price – despite lower average incomes. This change in pricing strategy is a deliberate attempt to position the company higher in the apparel retail market.

CONCLUSION

Between 2013 and 2020 the number of households in Latin America earning between US$10,000 and US$45,000 is expected to grow by 18%. In 2020, there are also expected to be more than 35 million households with an income below US$5,000 (at 2012 prices).

There are profits to be made whether targeting consumers at the Bottom of the Pyramid or the middle classes in Latin America. Households at the BoP have, by definition, only low purchasing power, but taken as a whole the market remains considerable. The middle class, with its willingness and financial wherewithal to spend, is a key consumer segment for many companies. This group, many of whose members have the ability to spend freely for the first time in their lives, offers huge opportunities for companies who are able to capitalise on its emergence.

At the BoP, companies must understand the price/quality trade off that consumers must make every day. For those in the middle, businesses must understand spending priorities, habits and motivations. For both groups, products and services must be tailored to local tastes, brand awareness must be built, and reaching consumers may be a challenge – logistically and also because word of mouth recommendations carry so much weight.

What is true across both segments is that business must create appropriate products at the right price. A one-size-fits-all approach will not work – a middle class income in Guatemala is quite different to a middle class income in Chile. Knowledge of economic, demographic, spending and income trends is vital, but also, importantly, knowledge of lifestyles, habits and mind-sets is equally essential. This knowledge must be in-depth: there is no such thing as an average BoP or middle class consumer in Latin America or in emerging markets globally. In other words, there are no shortcuts to be made in deciding how to best reach and inspire such consumers.

ENDNOTE

This white paper relied on the results of its Middle Class Home survey of 6,600 online consumers ranging in age from 15 to 65+ and living in 16 major markets in 2013: Australia, Brazil, China, Colombia, France, Germany, India, Indonesia, Japan, Mexico, Russia, Spain, Thailand, Turkey, United Kingdom, and the USA.

Download an Extract of the Survey Results

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Sarah heads the Passport: Counties & Consumers team, managing a team of economic and consumer trends analysts based around the world. In her role, Sarah focuses on translating economic and consumer trends information into useful insight and advises client companies on how these trends have a real-life impact on their businesses. Sarah was instrumental in designing our market-leading programme of income research and has played a lead role in developing Euromonitor International's macroeconomic and consumer trend content with a special interest in issues around sustainability, emerging markets and the post-recessionary consumer landscape.

Sarah has an undergraduate degree in European Studies and a postgraduate qualification in International Commerce. She joined Euromonitor International in 1999 as a Project Coordinator and has more than fourteen years' experience of socio-economic research.

ABOUT EUROMONITOR

Established in 1972, Euromonitor International is the world leader in strategy research for consumer markets. Comprehensive international coverage and leading edge innovation make our products an essential resource for companies locally and worldwide.

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