Inside the Minds and Pockets of Latin American Consumers

How Consumers Build Price Perception and its Impact on Retailers.

Executive Summary

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McKinsey&Company

Retail price perception – Inside the minds and pockets of Latin American consumers

Executive summary

After the consolidation of the ´90s, achieving organic growth and attractive returns on investment have become a major challenge for formal players in Latin America. In a region marked by socio-economic characteristics that lead to, among other things, a lower penetration of modern retail formats especially in lower income segments, pricing is of course a crucial component of a retailer's value proposition. In that context, understanding how consumers think, and especially how they build their price perception, becomes ever more critical. Pricing is of course not only extremely important to consumers in their choice of store, but changes in the pricing lever can be directly and immediately reflected in the bottom line. Making the right decisions on price investment has therefore tremendous potential for retailers.

Price is not only important – it is also complex. There are a series of issues that need to be addressed. How do consumers come to perceive a retailer as expensive or inexpensive? What is the relative importance of the main drivers? What is the role of promotions in driving value perception? Do all consumers think alike? Are all markets the same? With questions like these in mind, The Coca-Cola Retailing Research Council – Latin America commissioned McKinsey & Company, a leading international consulting firm, to try to understand how price perception is built within the region, and its implications for retailers.

With the help of ACNielsen, a specialized marketing research firm, a major quantitative survey with 3,000 consumer interviews was conducted in five of the largest metropolitan areas in the region: São Paulo, Buenos Aires, Mexico D. F., Santiago and Bogotá. In addition, comparative data from ACNielsen's database for retailers who account for about 85% of the market in the areas studied were analyzed and complemented by several in-depth interviews with key executives of the most important retailers in the region.

The findings have been summarized in four main areas:

- **Latin America: diversity of consumers, and not just in the depth of their pockets**. We identify and describe five main consumer segments across Latin America. Not only consumers from these segments behave clearly different, but also the presence of these segments varies widely across markets.
- **The few key levers that matter in building price perception – and the one that doesn't**. Reference price and range architecture explain the bulk of price perception but promotions are a relatively weak lever. We see that consumers base their price comparisons on relatively few products.
- **Consumers (mostly) getting it right in their search for value**. In general consumers know value when they see it, but promotions can significantly obscure their ability to spot inexpensive retailers, and there are some differences by consumer segment.
- **Retailers have an opportunity to get it right more often in their search for a better price proposition**. Retailers pursue a true diversity of pricing and promotional strategies with some perhaps unintended results for the type of consumer they attract. In this context, it is clear that some get more credit for value from consumers than others. More than this, the collective behavior of retailers in some markets tend to affect the overall size of some specific segments.

This is the first time that this type of research has been conducted across Latin America and findings from this effort question some of the industry's more traditional beliefs, and have concrete implications for individual retailers and the industry as a whole. The purpose of this study was to look broadly across all of Latin America, and retailers need to take these findings and apply them to their specific situation. There are clearly many questions for further study, but we hope that our findings shed some light on this rich and complex topic.

Background to the consumer research

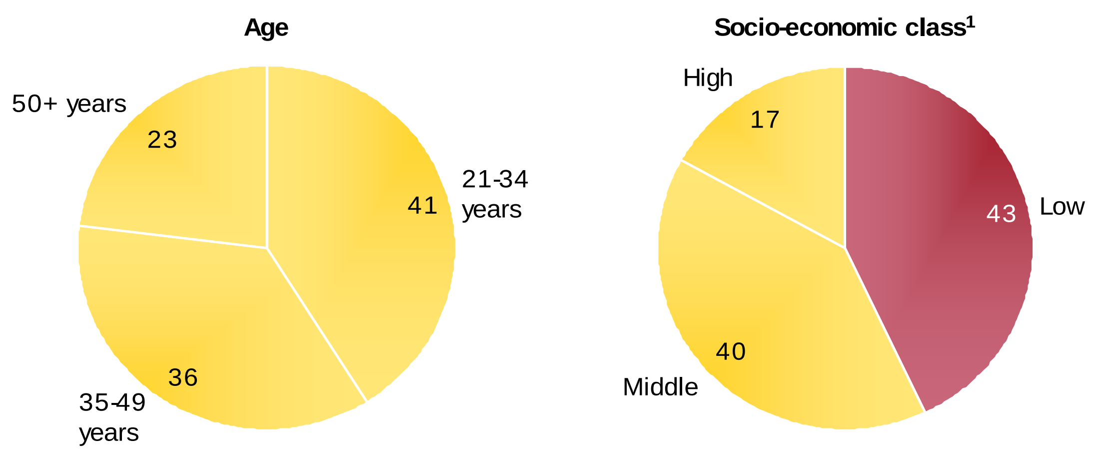
Over the course of two months, more than 3,000 consumers were surveyed in the most important metropolitan region of five different countries: São Paulo in Brazil, Mexico D. F. in Mexico, Buenos Aires in Argentina, Santiago in Chile and Bogotá, in Colombia. The sample size, ranging between 600 and 700 respondents per region, was chosen to yield significant statistical results for a cross-country segmentation. The respondents were selected at random from ACNielsen's database, and were screened to be representative of the universe of shoppers who visit at least one modern format store regularly.

The questionnaire, consisting of 35 multiple-choice questions, was tailored to reflect the peculiarities of each region (such as the list of relevant retailers, items bought most frequently, prices of local goods, etc). It was refined with the help of a series of focus groups, pilot-tested and fine-tuned to the final version. To avoid any interference or bias, customers were not interviewed in stores. Rather, they were surveyed at home by one of ACNielsen's research staff. Each consumer was assigned a weighting factor so that the sample matched the socio-economic composition of the overall population in each region (see Chart 1).

Chart 1 – Age and socio-economic breakdown of sample

Breakdown of age and socio-economic class

100%=2,818 respondents



[1]Based on ACNielsen socio-economic classification for each market
Source: Consumer survey

In order to be manageable, the survey was confined to only the five metropolitan areas in each country, but many results can, with proper care, be extrapolated to all Latin American shoppers.

Key findings from the study

1. Latin America: diversity of consumers and not just in the depth of their pockets

Based on the extensive market research conducted, we were able to identify five different consumer segments across Latin America, each of them with quite distinctive shopping behaviors and habits. These segments are:

- Avid bargain hunters: The most price sensitive of all, these consumers invest a lot of time in shopping and are willing to visit multiple stores for the best deals. They are also the consumers that compare prices the most – almost 60% of respondents compare prices always or very often. They are typically of lower income, and among them we find a disproportionate number of males and older consumers (50 years or older). Their spending on groceries is the lowest amongst all segments, around 14% less than average. They are the least loyal consumers and they are inclined towards shopping in discounters, but rely less on modern formats in general. Finding good deals has more value for them than saving time, as illustrated by a quotation from one consumer in this segment: "Comparing prices is a part of my daily routine. The moment I pass a store I memorize the prices of several items so that I know where to shop later."

- High-income bargain hunters: These consumers are also quite price sensitive, and are willing to visit multiple stores to find the best deals. Typically of medium and high income, they spend about 15% more on groceries than the average consumer. They rely more on modern format stores, particularly supermarkets and hypermarkets. They therefore tend to compare prices in a more limited list of retailers, which is not the case of avid bargain hunters. In general there is no consistent path of loyalty within this segment across markets – in some markets they are relatively more loyal, in others they are not.

- Frustrated shoppers on a budget: Typically low and middle income, these consumers invest little time in shopping and hence seem not care about it. In reality, they are frustrated by their inability to afford many of the typical items found in a store, and this explains their dislike of shopping. They spend about 7% less than average on groceries and make less use of modern format stores. When they do use modern formats, they show no preference between them, and tend to spread their shopping across discounters, supermarkets and hypermarkets.

- Range seekers on a budget: Traditionally careful consumers, who want to bring home the best quality products, but find themselves constrained by a tight budget. They are typically young, low-income mothers, who live in large households of six or more. Their spending on groceries is about 4% lower than average, as is their reliance on modern format stores. Hypermarkets are the format they tend to prefer. They are less loyal on average than other segments, but they tend to make one big stock-up trip a month.

- Quality seekers and time savers: With the deepest pockets of any segment, translated into monthly grocery spending almost 20% higher than average, these consumers are willing to pay a premium to save time and to have access to higher quality products. Mostly of high and medium incomes, they are the most loyal customers, tend to favor modern format stores (mostly supermarkets and hypermarkets) and have small families. Their time is extremely valuable, as one consumer explains: "I don't have time to go around shopping for promotions." As expected, consumers in this segment don't compare prices as much as other consumers – only 25% of respondents compare prices always or very often.

These segments were derived from a combination of socio-economic characteristics and attitudes (see Box 1 for the detailed methodology used). It is important to note that even though income level was an important factor considered for the segmentation, it was not the main determinant of whether a consumer belonged to one segment or another. For Latin Americans, income level alone tends to be a poor predictor of shopping habits. Put differently, from a retailer's perspective, consumers in the segments described above are much more similar to each other than those belonging to the same income bracket. It is only within the same segments that consumers tend to have comparable shopping habits, preference of format, level of price sensitivity, frequency of price comparison and so on.

Box 1: Consumer survey and the two-stage segmentation methodology

How we did it – Market segmentation

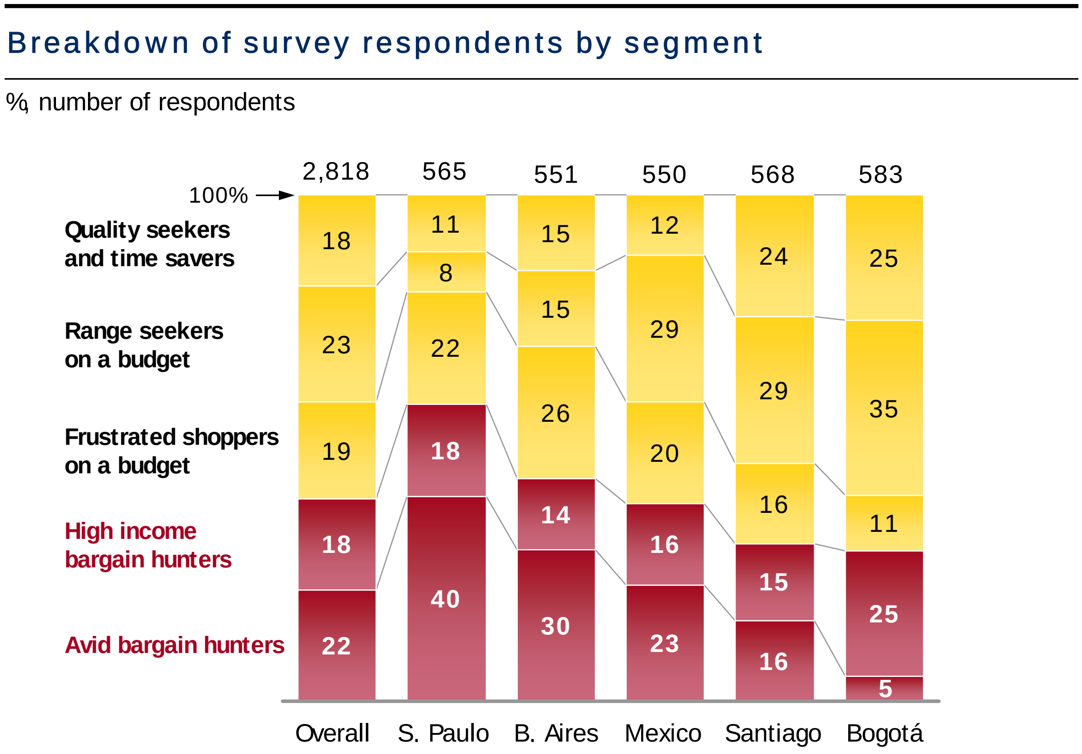
The market was segmented using a two-stage K-means clustering methodology, which combines both socio-economic/demographic and attitudinal statements. Contrary to more traditional methods, that use either attitudes or demographic data and hence do not yield the most actionable results, this approach provides the right blend of these two dimensions. (Traditional methods either produce consumers with quite similar behaviors but very different demographics, making them very hard to identify; or segments with comparable socio-economics but distinct behaviors, which are easier to identify but difficult to target with distinctive value propositions.) As a result, this segmentation methodology generated market clusters of consumers with similar behaviors and demographics, so that they can be identified and targeted using levers common to each segment.

In order to accomplish that, about 20 statistically significant scenarios were built and tested for robustness, leading to the 4 most robust scenarios. These scenarios were than analyzed in much more detail, considering the key buying factors, demographics and several behavioral elements (e.g. average monthly spend, format of main store, number of trips per month, average basket size, etc). One scenario was finally selected, containing 5 main segments. A little less than 10% of the consumers surveyed had to be taken out of the analysis, since they did not were not sufficiently similar to any of the statistically-generated segments nor collectively shared common characteristics to make them stand as a segment on their own. In the end, total number of respondents analyzed was 2,818.

Consumers in the same segment behave similarly, even when different regions are considered: avid bargain hunters in São Paulo have similar attitudes and shopping habits to those in Bogotá or Buenos Aires. Of course, this is not to say that every objective characteristic will be exactly equal – one needs to allow for regional circumstances.

Segments are also not equally split across all regions. São Paulo and Buenos Aires, the two most promotional markets, show a higher share of bargain hunters, while in Bogotá and Santiago, quality seekers and time savers are more prevalent than in any other metropolitan area. These differences in the relative sizes of each segment from region to region cause the "average consumer" to vary significantly from one city to another (see Chart 2).

Chart 2 – Segment breakdown by metropolitan area



Source: Consumer survey, team analysis

Segments have differing levels of attractiveness for different retailers, depending on their specific value proposition and business system. As an example, it is challenging for retailers to serve the avid bargain hunter segment profitably, as these consumers are most likely to cherry-pick the good deals. Success requires an ability of the retailer to drive cross-shopping beyond just these offers, understanding overall promotional effectiveness, and of course working with suppliers on funding support. Above all, the implication for retailers is the need to understand their own consumers relative to the market and the best way of serving them.

2. The few key levers that matter in building price perception – and the one that doesn't

Reference price and range architecture explain the bulk of price perception

Discovering what leads a consumer to think a particular retailer is expensive or inexpensive is clearly complicated. In addition to the actual price level, a myriad of other factors could be influential: promotions, TV advertising, media coverage, word-of-mouth, assortment, service level and many more factors which are hard to determine, let alone measure.

To get to grips with this complexity, we identified 11 elements that might explain how price perception is built. These were identified from previous experience with similar research initiatives as well as focus groups conducted in Latin America. We grouped these elements under five main levers: reference price, range architecture, store environment, promotions and communications (see Chart 3).

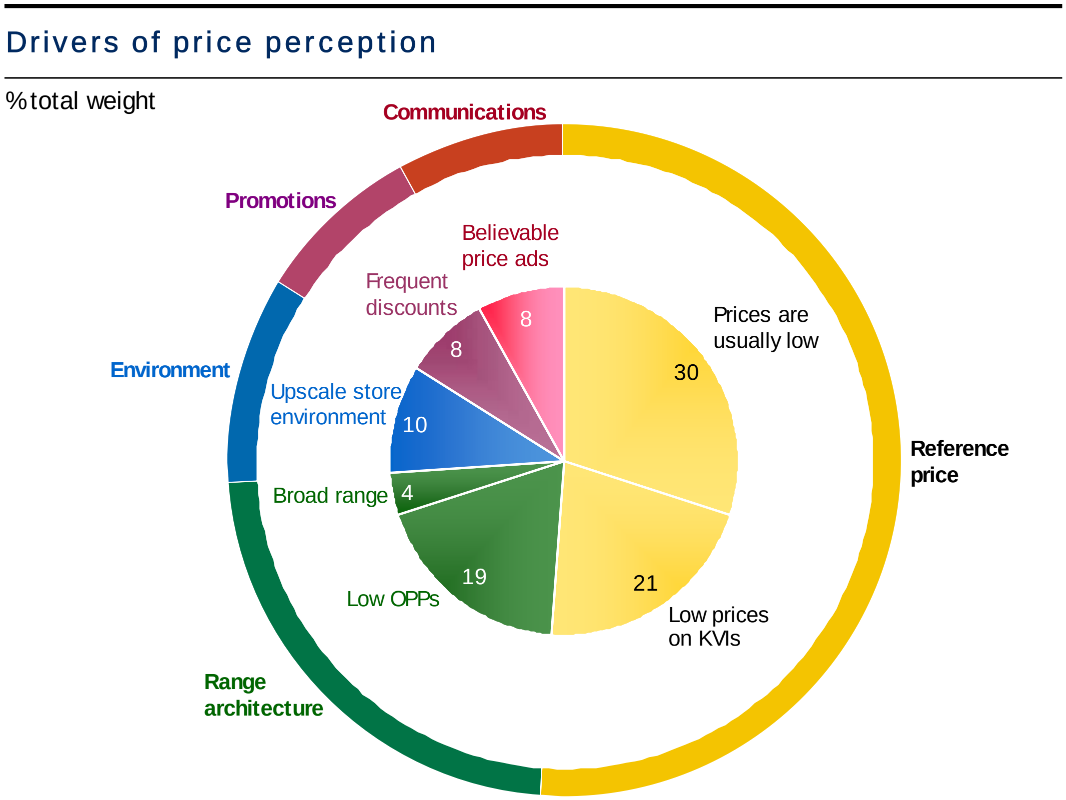
Chart 3 – Five main levers affecting price perception

Price perception lever	Element	Explanation
Reference price	• Prices are usually low • Low prices on KVIs	• Shelf-edge prices are usually low • Prices are low on “known value items” – i.e., familiar items and items bought most often
Range architecture	• Low OPPs • Broad range • Attractive Private label	• Low opening price points – i.e., low price alternatives for everyday basics • Broad range of price and quality levels • Private label with good quality/price ratio
In-store environment	• Upscale store environment • A lot of people shopping	• The store feels smart inside (e.g., fixtures and fittings and overall ambience) • It is frequently full with a lot of people shopping
Promotions	• Frequent discounts • Good promotions	• The store offers frequent deep discounts, typically on well known items • Frequent interesting promotions (e.g., 2x1, wow discounts)
Communications	• Believable low price ads • Pamphlets	• The store publishes clear, accurate information about its pricing in its advertising material • The store distributes advertising pamphlets to households

In order to establish the relative importance of each element, we ran statistical tools against the results of the consumer survey in order to test how a consumer’s agreeing that his or her main store possessed a certain characteristic affected the likelihood of that consumer’s rating the store as inexpensive or very inexpensive. As a result, we could determine to what extent a consumer’s agreement that, for example, the store had a broad range of price and quality levels — a component of the Range Architecture lever — tilted their propensity to say that their store was inexpensive.

A key conclusion from the research was that only two out of the five levers are consistently and broadly relevant (see Chart 4):

Chart 4 – How price perception is built for the overall population



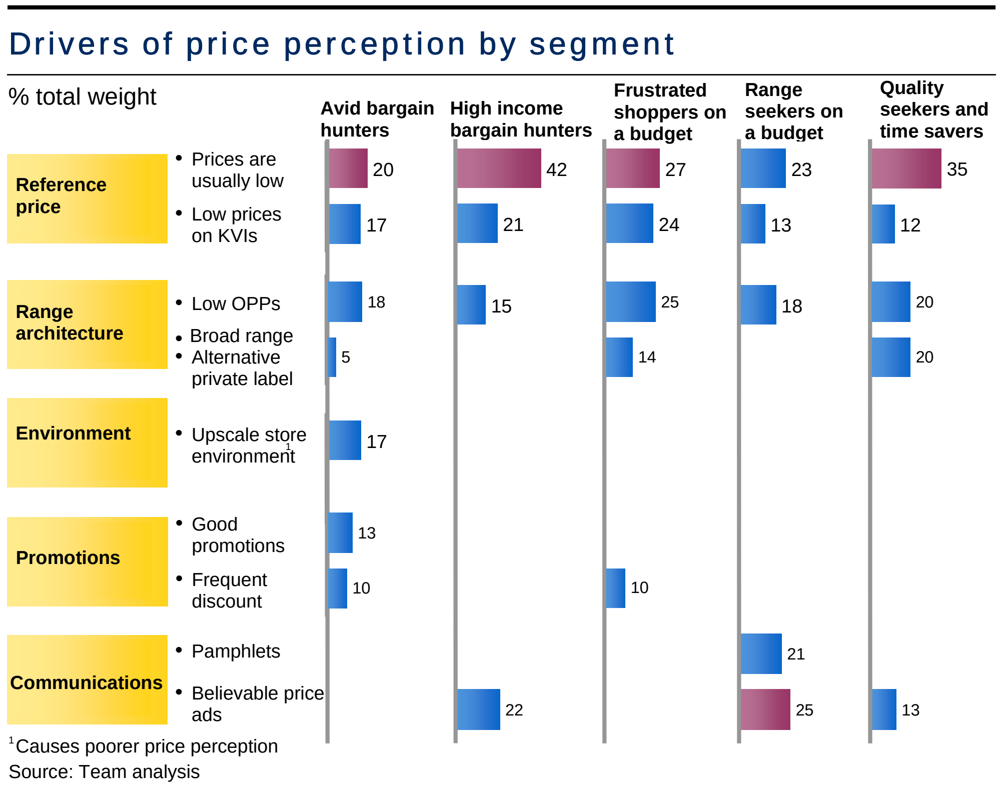
Source: Team analysis

Interestingly, although one might think that many elements would be influential, the research found that only two out of the five levers are consistently and broadly relevant - **reference price** and **range architecture** account for nearly 75% of the price perception

- Reference price. Reference price is by far the most important lever, accounting for as much as 50% of total price perception. This lever has two elements: a broader statement that “prices are usually low” and the other is a more focused one, which states that the shop has “low prices on familiar items and items bought most often.”
- Range architecture. It is the second most important lever, explaining as much as 25% of the way consumers see prices. By far the most important element is “low-priced alternatives for everyday basics”. The other two elements are “a broad range of price and quality levels” and private label.

The relative importance of reference price and range architecture varies by consumer segment. As way of contrast they make up 60% of price perception for avid bargain hunters compared to 90% for frustrated shoppers on a budget (see Chart 5).

Chart 5 – How price perception drivers vary by segment



Different segments have different levers that affect price perception, although the element **prices are usually low** is very significant for most segments (e.g. it represents 27% for frustrated shoppers on a budget), followed by **low prices on known value items** and **low opening price points** (e.g. they represent 24% and 25% respectively for frustrated shoppers on a budget)

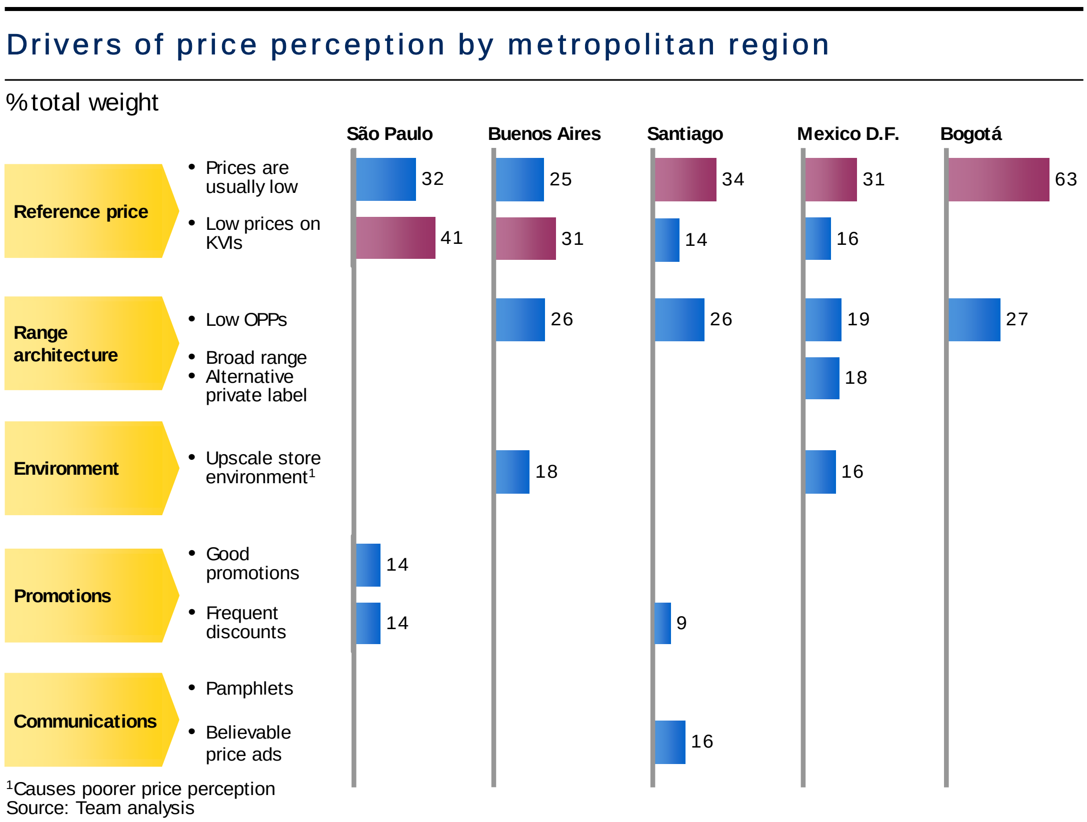
It is important to note however that in addition to these main levers – reference price and range architecture – there are some levers that have particular importance to specific segments. Depending on which set of consumers we consider, **store environment, promotions** and **communications** can all play a (limited) role. More specifically:

- For range seekers on a budget, **believable price ads**, a component of the communications lever, is the most important element, accounting for as much as 25% of their pricing assessment. Overall, this driver is the most effective communications lever, accounting for 8% of price perception for consumers as a whole.
- Avid bargain hunters are the only segment for which **good promotions** and **frequent discounts** are important, together accounting for about 23% of their pricing assessment. Frustrated shoppers on a budget are the only other segment affected by promotional activity, but only to the extent of about 10% of their price perception.

- Consumers in general perceive an **upscale store environment** as a cue for high prices. But the analysis showed that only for avid bargain hunters this perception is statistically relevant, representing about 17% of their price perception.

Finally, it of course should be noted that because of the different importance of specific segments in each market, the results will also vary across countries (see Chart 6)

Chart 6 – How price perception drivers vary by market



Since the relative size of each segment varies by market, it is expected that the average importance of each lever will vary by market as well. The element **prices are usually low**, for instance, represents 63% of the price perception building in Bogotá whereas it represents only 25% in Buenos Aires

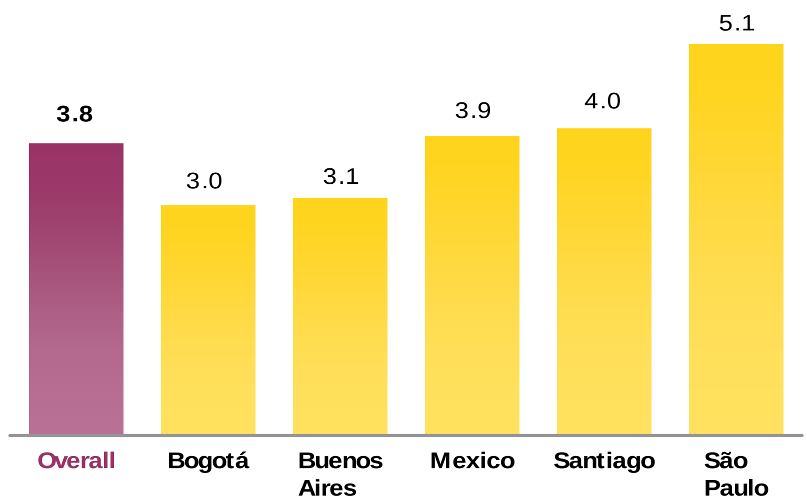
Consumers focus price comparisons on surprisingly few items

Reference prices are clearly critical in building the price perception of consumers. One of the important elements of this lever is pricing on "familiar items and items bought most often". The key question for retailers is to determine which are these items that are so important to consumers i.e. what are the KVIs or Known Value Items?

74% of all consumers in the survey claimed to memorize the prices of only a few items to assess the price level of a store – "When I look at the prices of OMO, I know whether a store is inexpensive or not", says one consumer surveyed. Interestingly, the number of items that these consumers observed was relatively small – less than four on average. This was broadly consistent across countries, ranging from 3 in Bogota to 5 in Sao Paulo (see Chart 7).

Chart 7 – Consumers can memorize the number of only a few KVIs

Number of items consumers memorize to assess the price level of a store



Source: Consumer survey

To illustrate the point, bellow is a short list of the top five KVIs cited by consumers in each market:

Brazil
União sugar 1 kg
Camil rice 5 kg
Lisa soy oil 900 ml
Pilão coffee 500 g
Omo laundry detergent 1 kg

Argentina
Ledesma sugar 1 kg
Serenísima milk 1 l
Domino sugar 1 kg
Natura soy oil 1.5 l
Ala laundry detergent 800 g

Bogota
Oleosoya soy oil
Colgate toothpaste
Flor Huila rice
Roa rice
Ariel laundry detergent

Santiago
Iansa sugar 1 kg
Tucapel rice 1 kg
Chef soy oil 1 l
Belmont soy oil 1 l
Soprole milk 1 l

Mexico D.F.
123 soy oil 1 l
Ariel laundry detergent 1 kg
ACE laundry detergent 1 kg
Suavitel fabric softener
Capullo soy oil 1 l

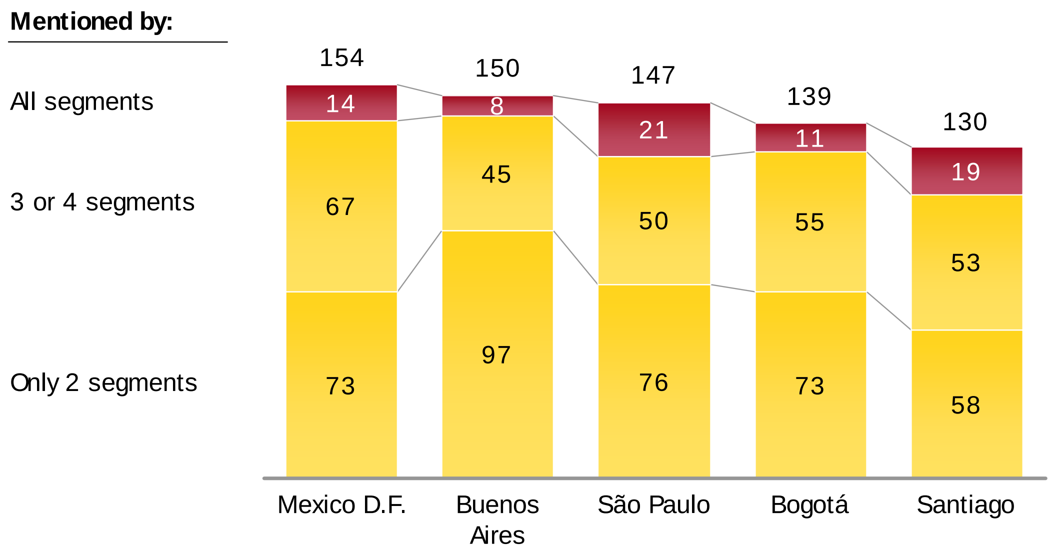
Top 5 KVIs by market

However, because different consumers have different tastes and hence choose different products, they of course base their price comparisons on different products. Looking across all markets, only 10-20 products were mentioned by all segments. Adding up all the items that were mentioned by at least two segments, there are around 130-150 KVIs. (see Chart 8)

Chart 8 – Different consumers identify different KVIs

Different segments, different KVIs

Number of different KVIs mentioned – spontaneous responses



Source: Consumer survey, team analysis

Understanding the correct list of these ultra-KVIs is of course critical for retailers. It is also important to understand the variations by consumer segment and/or region. Deciding the appropriate pricing strategy on these items relative to competitors is a quite different question, but it is highly likely that a retailer who is over-priced on these key items will suffer disproportionately negative consequences in terms of consumer price perceptions.

Note

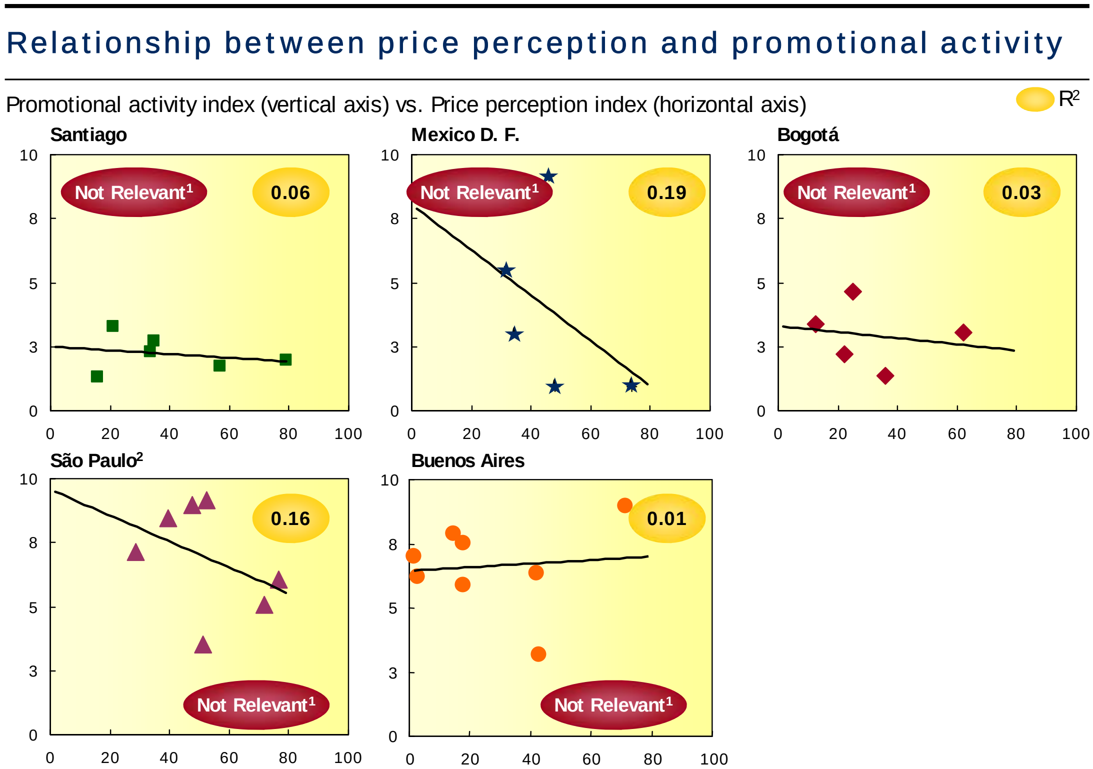
McKinsey experience shows that a typical store will have around 100 items that it can classify as ultra-KVIs, which is consistent with the findings of this study. Even if the sample is significantly increased in order to understand the full range of KVIs, the number of less important KVIs might add a further 500 to 1,500 items, depending on the store format, environment, and other factors, but even when considering a very large and statistically significant sample, this number won't be higher than 2,000.

Promotions are a weak lever to improve price perception

As we have seen in the analysis above based on the consumer survey, promotions are a weak lever in building price perception (a statement that is true for all segments with the possible exception of avid bargain hunters). This finding contradicts the beliefs of many local retailers, who aggressively use the promotional lever, and therefore to substantiate and validate this conclusion, an additional analysis was carried out.

Using ACNielsen-provided data, we were able to calculate actual promotional activity by retailer and compare that with an index of price perception derived from our consumer survey. In all markets there was absolutely no correlation between a retailer's level of promotional activity and its price perception i.e. if a retailers adopts a more promotional stance, it does not necessarily make consumers think it has lower prices – and vice-versa. (see Chart 9). Other factors are much more important.

Chart 9 – Promotional activity does not help explain price perception in any market



[1]T-Stat lower than 2.0
[2]The assessment of the São Paulo market was made without a clear high price player
Source: Consumer survey, team analysis

This conclusion of course does not mean that promotions cannot and do not play an important role in grocery retail in terms of driving traffic to the store, encouraging impulse purchasing, reducing the overall cost of the basket, creating excitement and/or simply obtaining supplier funding. It does argue however that retailers need to focus on other more direct ways to enhance their image of low prices with consumers.

Box 2: Description of the promotional activity index

How we did it – Promotional Activity (Proact) Index

We define promotional activity as price variability – the more changes the price of a product undergoes over time, the more promoted this product can be considered to be. This is irrespective of its average price level – what really matters to us are the "ups" and "downs".

To quantify this level of price variability – or promotional activity, as we will call it henceforth – we analyzed 32 weeks of output from ACNielsen's scanner database, which gathers information on thousands of SKU prices from the most representative retailers in each region. We selected the best selling individual items (about 100) in each of the 30 best selling product categories, so that, with proper aggregation, we could end up with category-level, retailer-level and market-level indices.

The promotional index of a single SKU is given by the following formula:

Proact index = Average of absolute price changes x Number of positive price changes x Number of negative price changes

This formula was designed to capture not only the intensity of the drops or increases in price, but also to set aside what is really promotional (price drops during the promotional period and later jumps back again) from what are continued price decreases or increases due to overall market conditions (such as the continued increase in the price of corn flakes because of a shortage in the farmland supply of corn, or vice-versa). Consequently, the higher the promotional activity for any given SKU, category, retailer or market, the higher the index.

The first term of the formula captures the intensity of the price changes. For the 32-week period, we took the price of the SKU in the first week and computed the percentual difference to the price of the following week, and so on. We discarded the sign of the changes (that is, we considered only their absolute value), summed them all up and took the average, by diving by 32. Therefore, the steeper these changes are, the higher the index turned out to be.

The last two terms of the formula correct for potential sustained downward or upward trends in prices, which do not represent promotional activity. The formula is maximized when the number of positive changes equals the number of negative changes – what truly happens when the product is on promotion: down-up-down-up and so on. Sustained price increases or decreases – which do not represent promotions – cause this multiplication to yield a lower index, achieving the effect we desired.

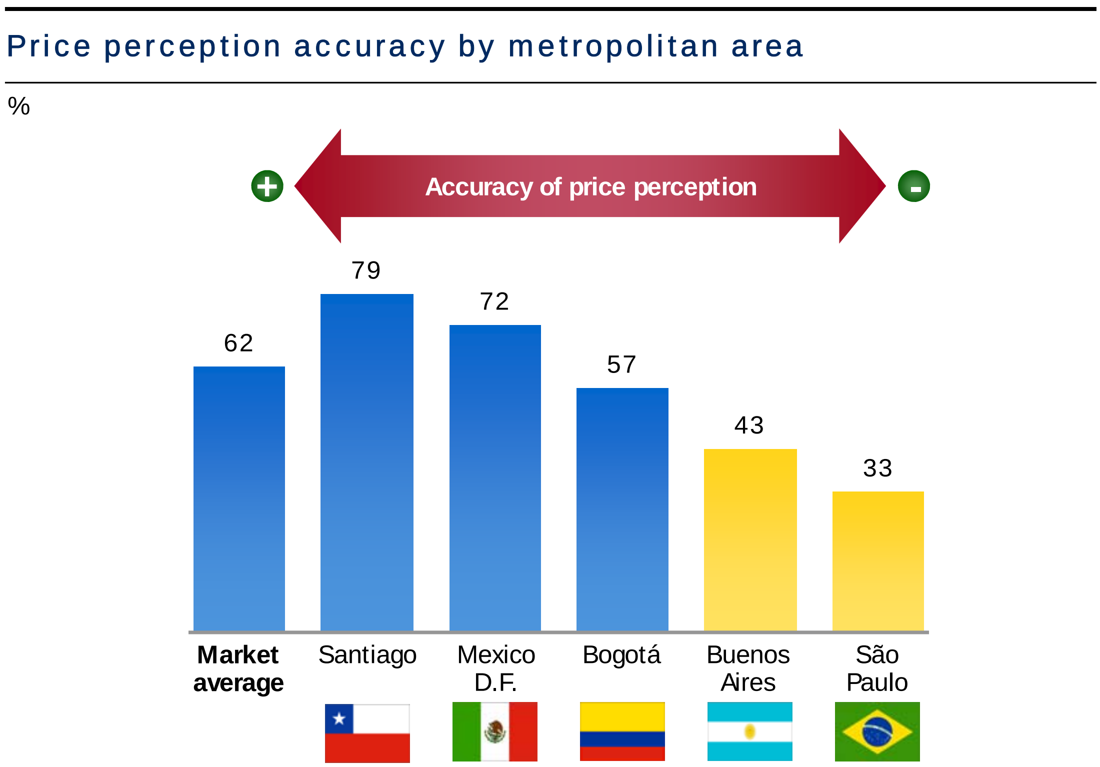
By multiplying the indices of each individual item by its share of sales in each category, we arrived at a category-level index. Following an analogous procedure, we arrived at retailer-level and region-level indices.

3. Consumers (mostly) getting it right in their search for value

Consumers know value when they see it – but promotions obscure the view

In three of the five countries examined, the majority of consumers knew value when they saw it, i.e., when asked to identify who were the least expensive retailers among all those in their portfolio, the majority of consumers in Santiago, Mexico D. F. and Bogotá responded with the names of players that indeed were in the bottom quartile of price reality. This accuracy rate is 79% for Santiago, 72% for Mexico D. F. and 57% for Bogotá. (See chart 10). However, in the two more promotional markets, Buenos Aires and São Paulo, these rates fall to 43% and 37% respectively.

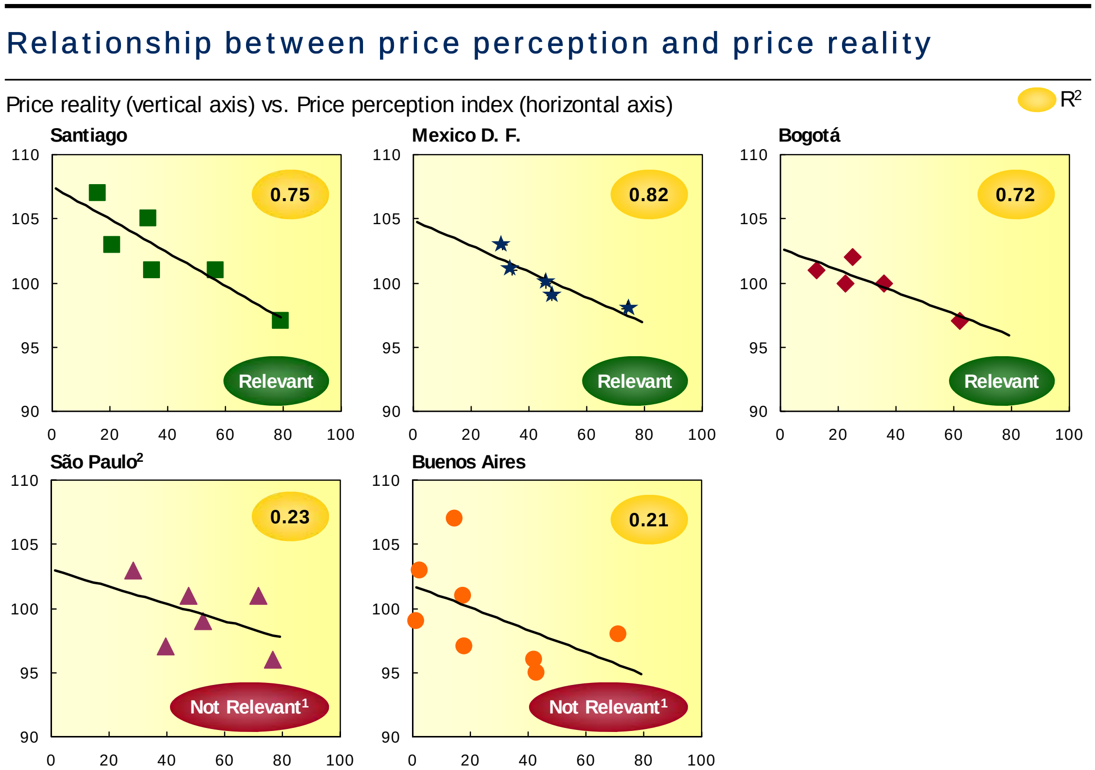
Chart 10 – Accuracy of price perception by region



Source: Team analysis

To understand this finding more fully, we conducted a similar analysis to the one shown earlier on promotions in Chart 9, and examined the relationship between ACNielsen-provided indices of real prices and price perceptions from our consumer survey. The conclusion was identical. In the three less promotional markets, there was a strong statistically significant relationship between price reality and perception, to the extent that almost 80% of the variability in perceived prices is explained by real prices – i.e. consumers were getting it right. However, in the promotional markets of Buenos Aires and São Paulo, there was no correlation – consumers were struggling to get it right in the face of such high promotional activity. As the CEO of one retailer himself put it, “Promotions make noise, not music” (see Chart 11)

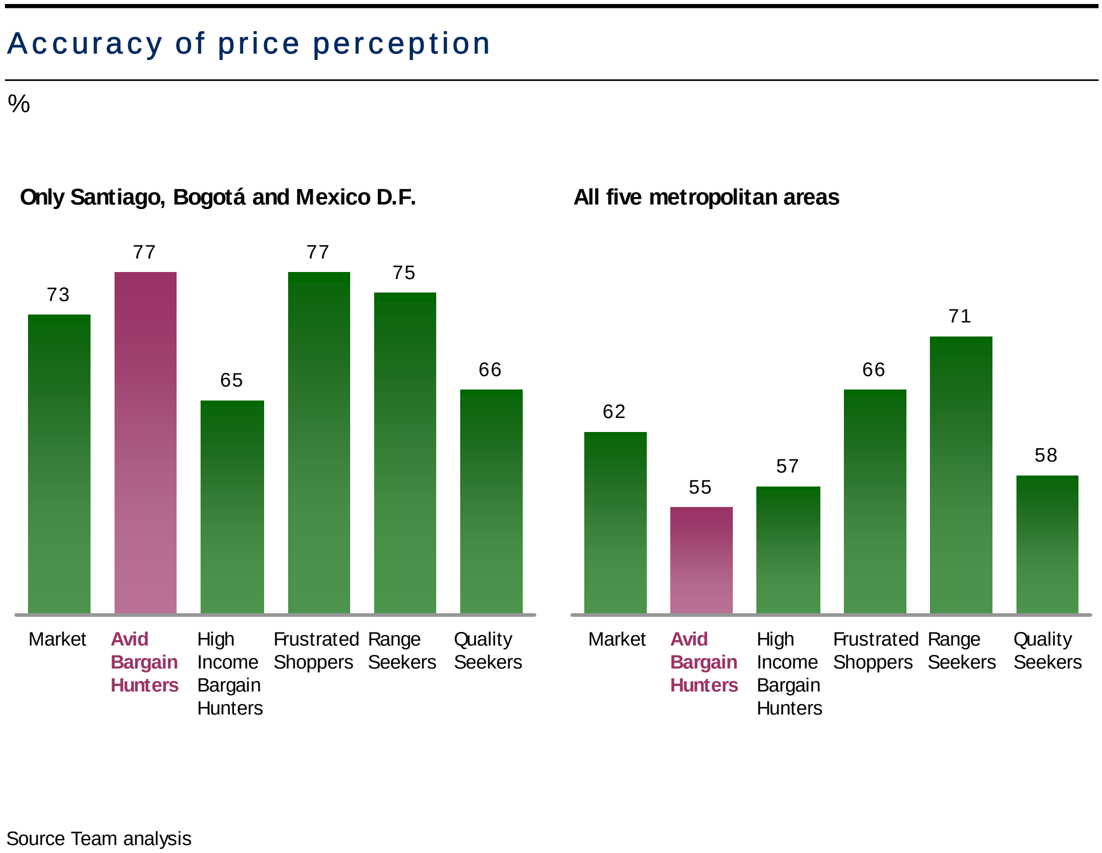
Chart 11 – Price perception equals price reality in some markets



[1]T-Stat lower than 2.0
[2]The assessment of the São Paulo market was made without a clear high price player
Source: Consumer survey, team analysis

Promotions can confuse even the most price sensitive segments, such as the avid bargain hunters. Their relative price assessment performance falls dramatically as we move from less promotional to more promotional markets. When only Santiago, Mexico D. F. and Bogotá are considered, avid bargain hunters are the most precise segment, achieving a 77% price accuracy rate; however, when we include Buenos Aires and São Paulo in the analysis, their accuracy rate falls to 55%, the worst of any segment (see Chart 12).

Chart 12 – Accuracy of price perception by segment



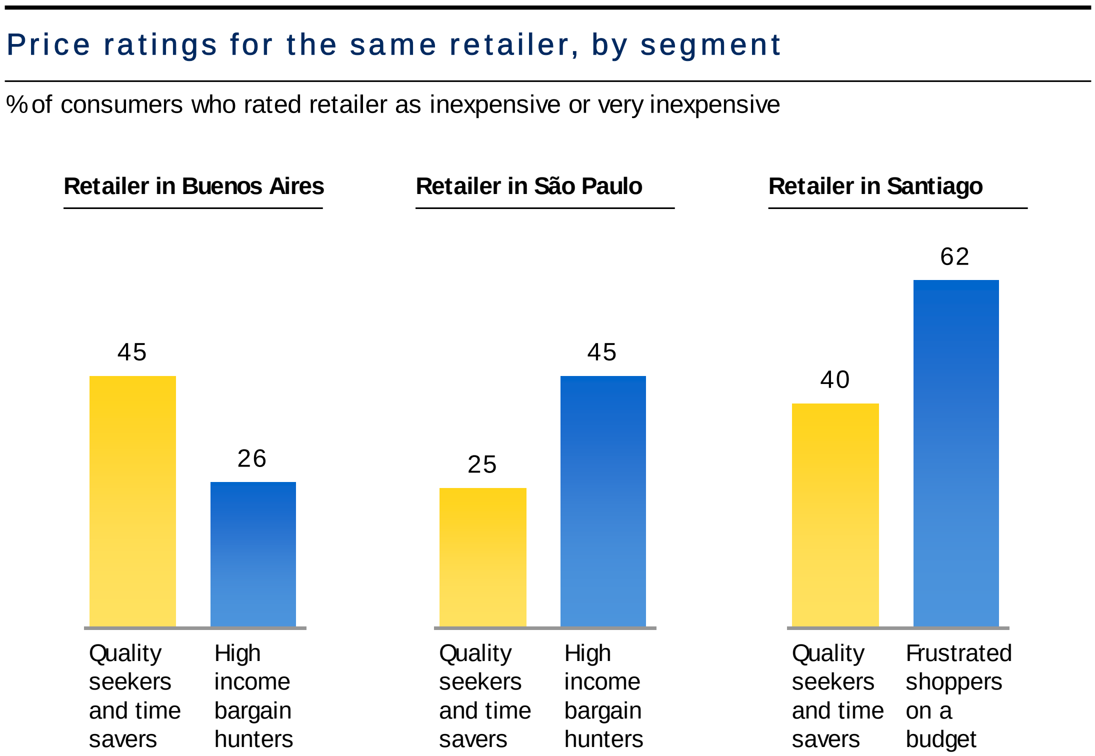
The specific price image of a retailer can vary according to consumer segment

As we concluded above, reference price and range architecture are the two most important levers that drive price perception, but, that there are a number of segment specific differences. Given therefore that different segments have somewhat different drivers of price perception, the price image of a retailer is not completely consistent across all shoppers.

It is clear that because a retailer's performance on the drivers of price perception varies, as does the relative importance of the levers for each segment, different segments will have different opinions about the price image of that retailer. For instance, a retailer with strong promotions will get a better rating from avid bargain hunters than from quality seekers and time savers.

The research discovered several examples of this disparity of price perception across segments: in Buenos Aires, for instance, 45% of quality seekers and time savers gave positive price ratings to one retailer, who managed to earn good perception from only 20% of high-income bargain hunters. For other retailers in São Paulo and Santiago, one can see the opposite situation (see Chart 13).

Chart 13 – Differences in price ratings across segments



Source: Consumer survey, team analysis

The challenge for retailers is of course to understand the specific drivers of its target consumers and tailor its pricing and promotional offer more directly.

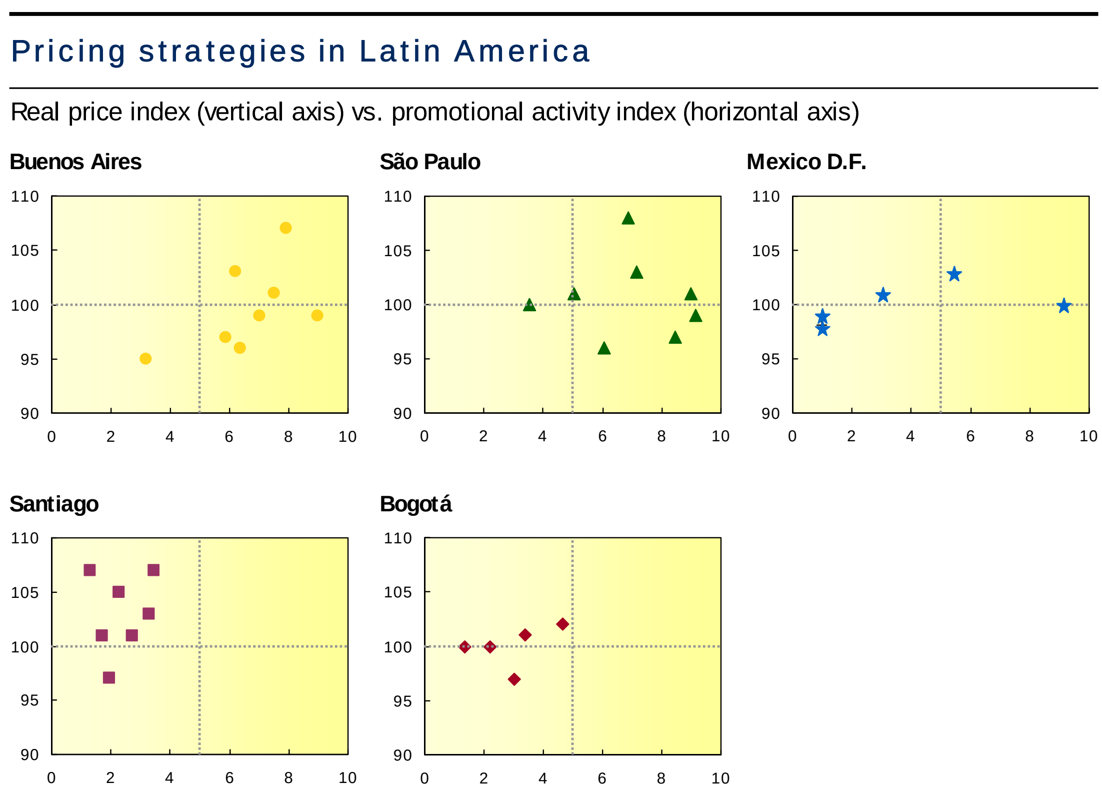
4. Retailers with an opportunity to get it right more often in their search for a better price proposition

Retailers pursue a variety of different price and promotional strategies – but no pure EDLP

Retailers in the region have quite diverse pricing and promotional positions. They have different actual price levels, offer varying levels and types of promotions, as well as focus their price and promotional investment in different categories. The concept of pricing and promotional activity can therefore be thought of as a continuum along which retailers are positioned, with none on the extremes.

All retailers, however, do promote to some extent, and there are certainly no "pure EDLP" players in any market. The level of promotional activity varies by market and in most cases, local market conditions influence the promotional level of **all** retailers. In markets such as Buenos Aires and São Paulo, most players move in lockstep and promote quite intensively. The reverse is true in Bogotá and Santiago, where all retailers have a much lower level of promotional intensity. The exception is Mexico D. F. where retailers are more widely spread over the promotional continuum, although with a narrower band of actual price level differences (see Chart 14).

Chart 14 – Different pricing strategies across the region



Source: ACNielsen, team analysis

As we examine promotional activity by category, it is clear that there are also different patterns of behavior. Contrary to what one might expect, retailers in four out of five markets do not always promote the same categories. In these markets, the correlation between the promotional levels of different retailers by category is quite low, and each retailer tends to promote different categories from their counterparts. This is illustrated by the example of Buenos Aires (see Chart 15). Bogotá is the one exception where retailers act more in lockstep – what one promotes is promoted by all others (see Chart 16). Interestingly, in none of the markets did the extent of promotional activity appear to be driven by the expandability of the category: in both the examples below, note that toilet paper, a truly non-expandable category, is the most and 2nd most promoted category respectively.

Chart 15 – In Buenos Aires, different promotional strategies by category

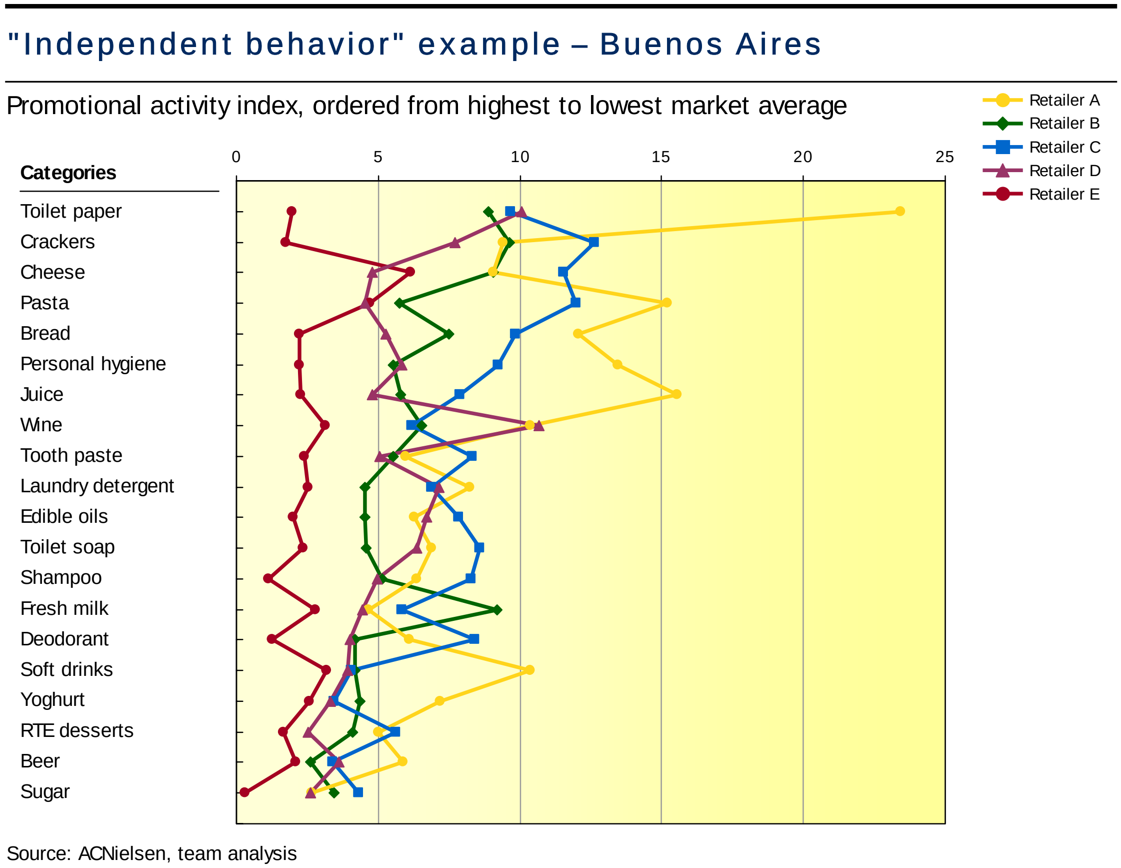
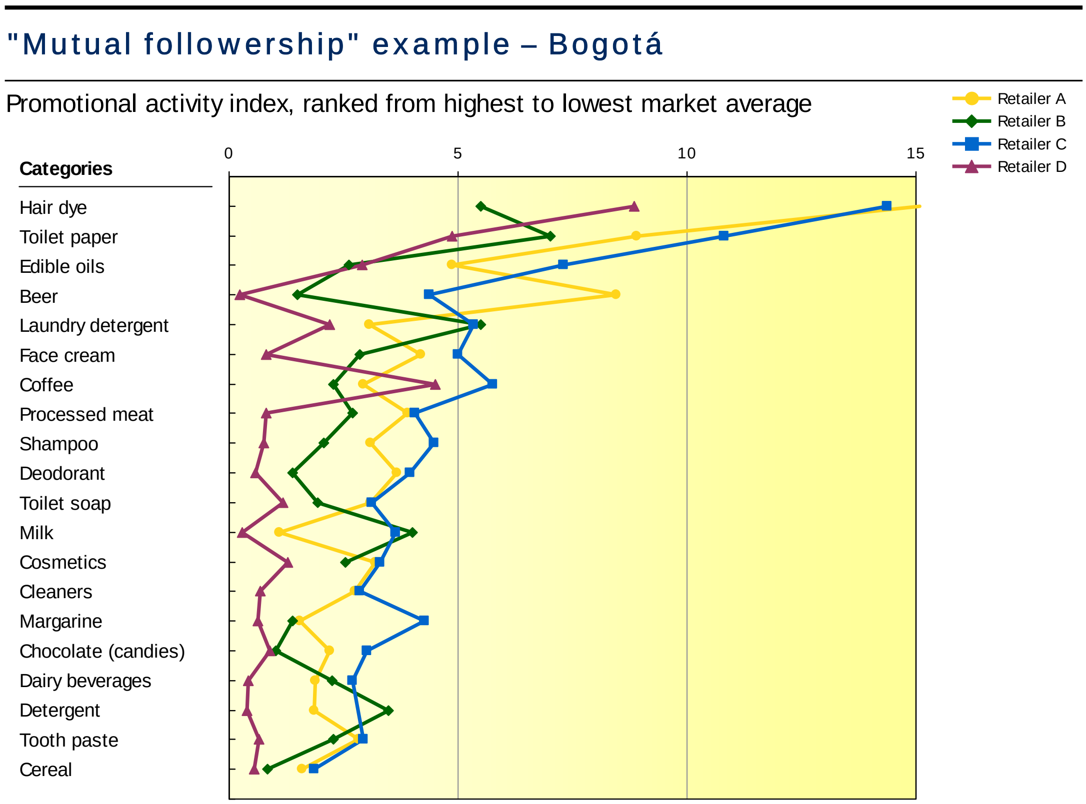


Chart 16 – In Bogotá, retailers follow each other in their promotional strategies



Source: ACNielsen, team analysis

The purpose of this study was not to draw conclusions about whether a particular pricing or promotional strategy is right or wrong. It is for the individual retailer to draw their own conclusions about the effectiveness of their strategy given their business context. However, such a diversity of pricing and promotional strategies does beg the question as to whether they are based on a true understanding of consumer needs or are driven by other market forces. As one retailer put it in reflecting on his own promotional strategy, “I think we have forgotten the consumer”. And remembering the consumer is key in building price perception.

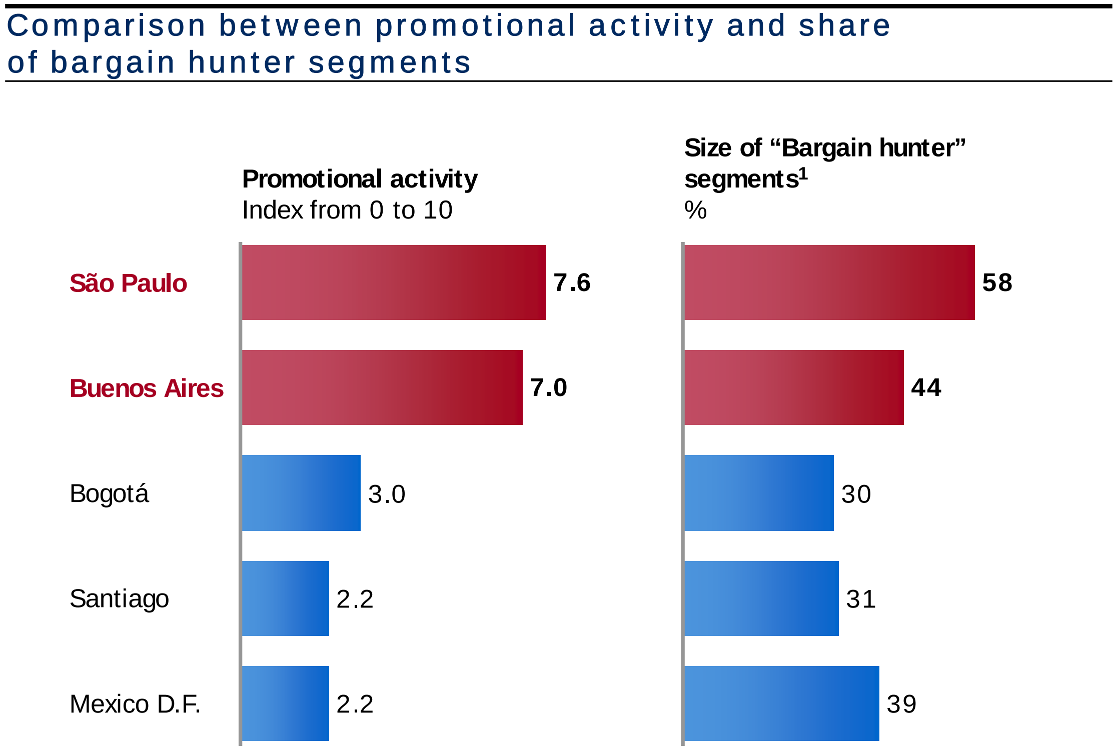
Retailer promotional activity fuels the demand of bargain hunters

As we have described, Latin American consumers have an ample menu of pricing and promotional propositions to choose from: retailers vary significantly in terms of promotional intensity, actual price levels, promoted categories and so forth. This diversity acts as a “selection mechanism”, attracting different sets of consumers to different players. Naturally, retailers end up drawing disproportionately more from the segments for whom their value proposition is most attractive. As an example, in Buenos Aires, the most promotional player has over 80% of its customer base represented by bargain hunters. For other retailers in Buenos Aires, bargain hunters are no more than 50% of their clientele. There are similar such examples in other metropolitan areas.

This finding of course has strong implications for a retailer’s economics because, it is likely that different segments have quite different profitability levels. The ability to effectively design and manage the pricing strategy could generate not only results from the current customer base, but also can shape the future customer base by attracting “better” segments overtime, and therefore improving overall profitability.

What happens to individual retailers also affects entire markets. São Paulo and Buenos Aires, cities in which promotional activity is up to three times more intense than elsewhere, display a disproportionate share of bargain hunters. While these consumers account for an average of 34% of the total customer base in Santiago, Bogotá and Mexico D. F., they make up 44% in Buenos Aires and a striking 58% in São Paulo (see Chart 17).

Chart 17 – Comparison of promotional activity with size of bargain hunter segments



[1]Includes both "Avid bargain hunters" and "High-income bargain hunters"
Source: Consumer survey, ACNielsen, team analysis

This comes as no surprise. Promotions are the "fuel" that power bargain hunters; the more promotions in a given region, the more opportunity for consumers to benefit from bargain hunting and hence the bigger the share of promotion-happy shoppers in the overall customer base. This is an example of the classic "chicken-and-egg" problem – it is hard to say whether promotions created bargain hunters or whether retailers are responding to intrinsic consumer needs – but it is safe to say that, by promoting intensively, retailers nurture this class of shoppers.

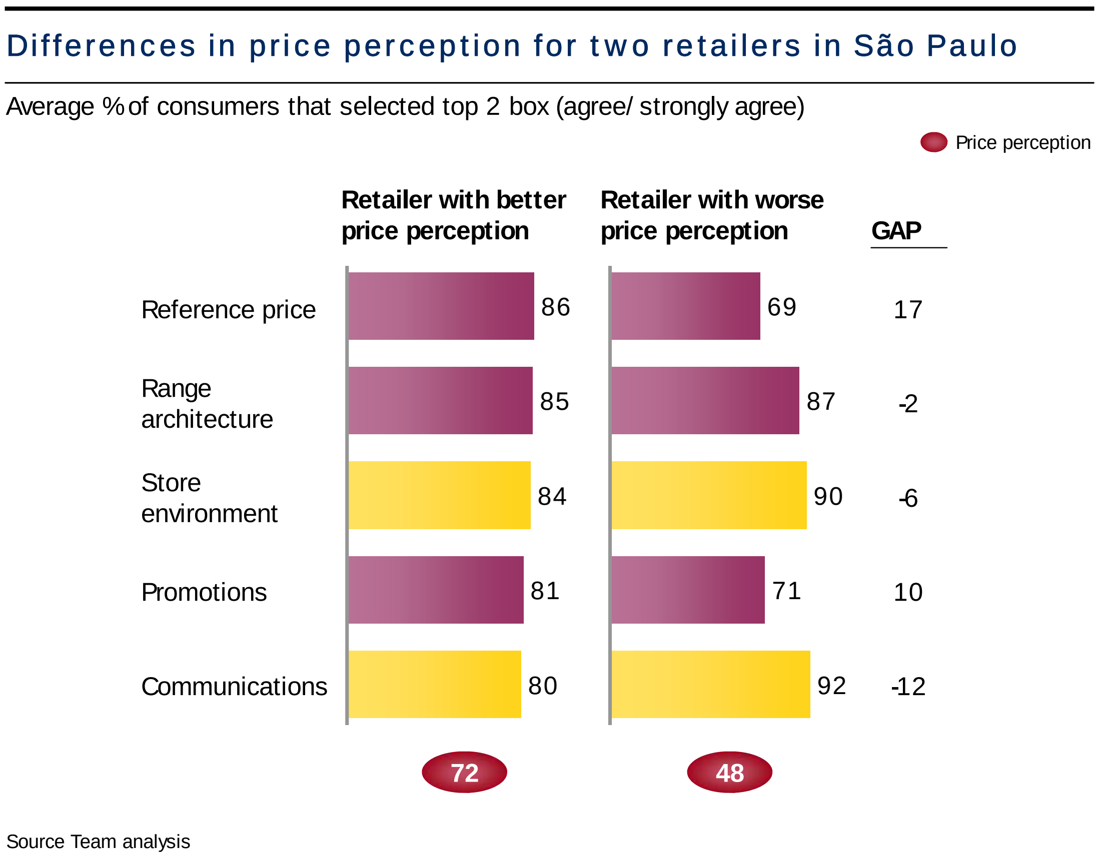
Can this trend be reversed? Could retailers in highly promotional markets reduce their promotional intensity, and therefore reduce their dependence on bargain hunters? Aside from the fact that this may not be a desirable strategy for any individual retailer, the aggressive competitive dynamics in these markets would make this a risky and certainly a longer term strategy. If any individual retailer simply reduced its promotional intensity without a clear improvement in other elements of its value proposition, the temptation of competitors to increase promotions to capture short term share would be very high.

Some retailers get more credit (and others less) than they deserve

We have seen that consumers on average get it right – in general, consumers know value when they see it and the least expensive retailers tend to be the ones that get the better price ratings. However, there are exceptions: instances in which some players end up getting more credit than they deserve as well as cases of retailers whose low real price levels do not yield the favorable price perception one would expect. Understanding this dynamic of course is absolutely critical to retailers – is it possible for a retailer to charge higher than average prices but be perceived as lower than average?

As an illustration, we took two retailers in São Paulo with identical real price levels. One is considered at an overall level to be inexpensive by 72% of its customers while the other one, by only 48%, i.e., significant differences in price perception versus reality. We can see that the biggest single difference among the levers is on reference price, where the retailer with better overall price perception has a 17 percentage point higher ranking. (see chart 18)

Chart 18 – Example of differences in price perception for two retailers in São Paulo



The question of course is why? Does the retailer with better price perception focus price investment on the categories and KVIs that really matter to consumers, or at least its own specific consumers? Is the apparently superior performance on promotions also driving this difference? Either way, it is certainly clear that the retailer with the worse price perception is not getting the credit for the same real prices that it is offering consumers.

Critical to getting more credit for value is understanding the specific needs and drivers of consumers, and then executing against them. Better-than-average performance on the levers that carry the highest weight for the segments that represent the bulk of the customer base can allow a retailer to appear less expensive than it really is. The converse is also true: a retailer can be punished with “unfairly” low ratings if it fails to do well on the drivers that its main consumers most value. At a minimum, one conclusion is clear: retailers must understand if they are getting more or less credit for value than their competitors in order to be able to take the appropriate action.

Defining retailers' management agenda – Transforming knowledge into action

Pricing is a complex topic and understanding what drives consumer price perception is even more so. There were some significant findings from this study, but for the individual retailer the findings may raise as many new questions as they provide new answers. Retailers need to place these findings in the context of their own market and competitive situation as well as their current and future value proposition and target consumers. In that context, there are a series of questions that retailers need to answer:

- What is the most appropriate segmentation of my consumer base? How does it compare with my competitors? To what extent should I be targeting a specific set of consumers, or should I be maintaining a more universal appeal?

- Am I getting sufficient credit for the value that I deliver to my consumers? Are my competitors getting more credit than me? And what are the key drivers that explain the differences?

- Given the importance of reference price and range architecture, am I doing enough on these levers to demonstrate value? In which categories should I focus my price investment to get the most "bang for the buck"?

- What is the right list of known value items? At what level should they be considered (store, region etc)? How should I adapt this list on an ongoing basis?

- Given the weakness of promotions as a tool to enhance price perception, what is the appropriate role for promotions within my value proposition? What are the best categories to promote and what is the right intensity? How can I improve my overall promotional effectiveness?

- How can I use other levers (e.g., communication) to support my overall value proposition? Can I do better at targeting specific segments?

- How can I flex my pricing and promotional strategy by region or store to appeal to different segments of consumers with different needs? What are the operational implications of trying to do this?

Answering these questions (and more) is a challenge for any retailer. No-one said that improving consumer price perception in the Latin American environment of today was easy. However, it is a journey that retailers must undertake in order to be successful. Understanding consumers better is clearly an essential first step of this journey and we hope that this study's attempt to get inside the minds and pockets of Latin American consumers will be helpful in that quest.