

Capturing the hearts of Brazil's luxury consumers

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Brazilians shop differently than other consumers. Here's what you need to know.

Global luxury brands have had their eyes on Brazil for many years. The country has undergone profound – and positive – changes in the past quarter century, transforming itself from a slow-growing debt pariah to a dynamic consumer-based economy. From a GDP of \$1.2 trillion in 1998 (13th globally) to \$2.2 trillion in 2012 (7th globally), and inflation of 5 percent a week to 5 percent a year, Brazil's success story is unquestionable. Although a recent economic slowdown – growth is expected to be less than 1 percent in 2014¹ – has tampered the outlook, it has yet to significantly impact the lives of most Brazilians, as unemployment continues to be low.

Spurred by a burgeoning consumer economy, luxury brands have poured into Brazil. Since 2009, the number of foreign luxury brands in Brazil has more than doubled. Yet those who expected an easy target have likely found themselves disappointed. Although Brazil is still very much a growth market for luxury, challenges remain. Import taxes remain high and Brazilians consume high-end goods differently than in other markets. Understanding the uniqueness of Brazil's luxury consumers is critical to making your investment in the country pay dividends.

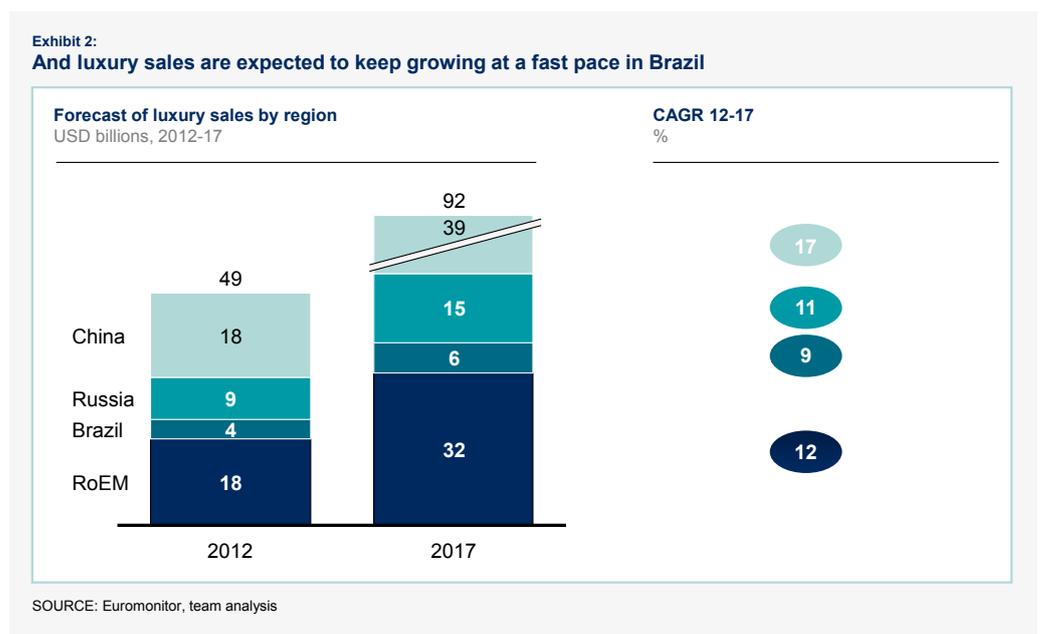
What Brazilian luxury consumers want

Brazil isn't a market that brands can afford to ignore. Emerging markets are driving global luxury consumption growth, with Brazil the third largest contributor, after China and Russia.² (Exhibits 1 and 2) Brazil, in particular, has lots of room for growth. Current luxury penetration is low compared to other countries, with annual 2012 consumer spending on luxury in Brazil \$314, versus \$1,121 in China. Among the three top luxury brands in Brazil there are 0.3 stores for every

¹ BBC Sept 7, 2014 (<http://www.bbc.com/news/business-28757725>)

² Altagamma

million potential luxury consumers (individuals with annual income above \$30K), versus 4 stores in China.³ Part of the reason that Brazil is far from being a mature market is because higher prices make it accessible only to the elite, but that is starting to change. By 2018, Brazil will be among the top 15 luxury goods markets in the world.



The answers for boosting luxury penetration lie in understanding five crucial commonalities among Brazilian luxury consumers.

1) Global and local

Some 80 percent of all Brazil's luxury goods spending takes place abroad while wealthy Brazilians are travelling, mostly to destinations in the U.S. and Europe. Brazilians spend more on luxury in the U.S. than visitors from any other nation. Shifting just a portion of this U.S. spending would have major implications for Brazil's local market. But first brands must think about how Brazilian stores fit into their global strategy, whether they serve primarily as an image showcase or a venue for generating local sales. Having stores serve the latter

³ Goldman Sachs, McKinsey analysis

purpose may involve a different approach to pricing. Brazil's high tax burden forces the cost of luxury products up, constituting the biggest reason for why Brazilians buy high-end goods abroad. (As a secondary reason, 30 percent of Brazilian luxury consumers say they feel they can get a better selection overseas.) Brazil's tax burden is the highest among the BRICs.⁴ After all the taxes are added on, a luxury product costing \$1,000 at the port of entry could wind up with a price tag of \$2,300 for a shopper in São Paulo.

Some brands have responded to this by squeezing their margins, effectively decreasing the attractiveness of purchasing abroad. Today, the price difference for many established brands can be as low as a 50 percent markup, whereas in 2011 products in Brazil were often 3X more expensive. As prices come down, the result is an expansion of the types of consumers who can afford luxury goods.

Also promoting more domestic purchasing is recent legislation that adds an additional fee when using a credit card to buy abroad. In contrast, consumers can buy in Brazil on installment with no interest rate (financing costs are typically already embedded into the price).

2) Immediate consumption

The attitude of Brazilian consumers is: Why wait if I can have it now? Consumers want their products immediately. It's telling to look at the business of luxury cars in Brazil versus the U.S. or Europe. In Brazil dealers must have the car in stock, while in other countries you can maintain and manage a waiting list. If anything, being put on a waiting list in the U.S. serves to enhance the exclusivity and desirability of a car. Not so in Brazil.

The immediacy of demand has implications for a company's business model, since it necessitates a higher level of stock, greater requirements for working capital, and often higher consumer prices to compensate for that. It also means that brands must carefully manage new product launches across countries. If a hit product is launched first in another country, you will likely see it appear in Brazil through gray networks, before you or your official dealer is ready to sell it.

3) Service and convenience

Brazilians have taken the concept of service to the extreme. In the U.S., many companies offer private shopping hours. In Brazil, that's just the beginning. Instead of exclusive store access to a collection, Brazilians have private showings at their house. YSL, for instance, has done product launch events at a client's house, with souvenirs for the invitees. Product demonstration in loco is also very common for luxury brands in Brazil. Customers are able to take products home to test them at no extra cost.

When Brazilians do choose to buy their luxury goods locally one of the reasons they do so is because of a high level of service. It is important for brands to offer not only complementary services like valet parking, refreshments, waiting areas, and home delivery of luxury products, but to also to host prestigious events that will create the sense of an exclusive environment, so that consumers feel like they are part of a rarified club.

4) Personalization

Brazilian consumers are particularly responsive to the feeling that a product is being made just for them, whether it's the inclusion of a monogram on the product or the development of exclusive designs. This is true at a personal level and also for segments of the population. One clothing company, for instance, has adapted their product line to address the needs and desires of different regions of the country, e.g. a lighter texture of fabric for the hot northeast. It is doing this even though the company has no formal store in the region (a distributor connects consumers with product).

⁴ Press search, McKinsey analysis

5) Credit at all costs

Brazilian shoppers of all socioeconomic classes are accustomed to payment installments for all sort of different categories, luxury and otherwise. Often people don't do this because they need to, but because they can. Even Brazilian consumers at the high-end, who could afford to pay for an item all at once, expect to be able to pay in monthly (credit card) installments, allowing their money to stay invested and earn more money. The default market structure is now 10 installments with no interest, making credit a part of the business model in Brazil. One consequence of this is that it has made luxury goods accessible to more of the middle class.

It has also forced companies to revisit their business models and forge partnerships with banks. Even brands that won't consider installments as an option in any of its stores around the world have had to adapt to the way Brazilians shop, and thus offering customers credit. Some 70 percent of luxury products sales in Brazil are done with credit card installments.

How to capture the growth

There are important challenges players must overcome to tap into this opportunity. Here are some key elements we see as critical to success:

1) Capture the shifting consumption

We see a gradual shift happening from consumption abroad to local purchasing, and it will be important to respond to this transition. Brands must leverage synergies and communication between their international and local stores to create a full picture of their Brazilian luxury customers and offer shopping wherever he or she wants. Boosting sales in Brazil involves a trade-off between margins and sales. But it remains a market where there is less competition than many other countries, including the U.S., Europe and even areas of Asia.

2) Decide the right footprint for your brand

It's important to determine whether you want to stop at the top three cities, tailoring your offering to the greatest number of high net worth individuals, or to venture into the second tier cities where a larger amount of the growth will happen. (Exhibit 3) Seventy percent of Brazil's HNWI's consume in Rio de Janeiro, São Paulo and Belo Horizonte. A route-to-market strategy must consider the balance of sales. How will you reach all potential consumers, both in terms of marketing and distribution? How important is it to have control over your distribution, versus the less capital-intensive arrangement of working with distributors? Direct ownership affords brands the ability to squeeze margins in order to gain consumers, yet it requires a higher level of investment. Not all emerging markets are the same and it is important to customize strategy accordingly.

Exhibit 3:
Consumption is shifting patterns inside Brazil



3) Actively manage the aspirations of the consumers without alienating core, high net worth consumers

The democratization of luxury goods is essential for appealing to new and different consumers. In Brazil, more than half of the population is now part of the consumer class. Armani, for instance, has created a large pool of brands that can be affordable for a wide range of consumers. Yet the extended brand portfolio does not cannibalize its premium brand, Giorgio Armani. BMW saw an expansion opportunity through other segments, such as auto toys, clothing and leather goods. This strategy allows the brand to reach many different consumers, as prices range from \$20 to \$250.



Despite the slowdown of the Brazilian economy, the heavy tax burdens and increased competition in the luxury space, it is critical for companies to crack the code in Brazil, as the country continues to be one of the most important markets for future growth. This requires that brands engage with their customers both globally and locally, have the right route-to-market and pricing strategy in place, and design an effective spending model. As usual, the toughest situations are the ones that can unlock the biggest benefits.

<http://mckinseyonmarketingandsales.com/focus/consumer-and-shopper-insights>

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