

# Selling to ‘mom-and-pop’ stores in emerging markets

*Traditional shops and the companies that serve them are finding life harder and harder. For the suppliers, segmented execution is the answer.*

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**One indelible image of Latin America** is the independent “mom-and-pop” shop: ubiquitous retailers that range from street stands and kiosks peddling soft drinks and snacks to corner stores selling groceries—roughly a million such businesses in Brazil, more than 800,000 in Mexico, and 400,000 in Colombia, for example. Despite the inevitable consolidation as large modern retailers (such as Carrefour, 7-Eleven, and Wal-Mart Stores) grow, mom and pops will represent a significant share of retail sales in Latin America and many other emerging markets for quite some time.

Traditionally, large packaged-goods companies have earned healthy margins by selling directly to mom and pops. Small shopkeepers, who have only limited negotiating leverage, often provide favorable or even exclusive distribution deals in return for support such as coolers, shelves, and merchandising services. In this environment major Latin American (and some multinational) packaged-goods companies have enough scale and standardized service to fend off smaller competitors and earn favorable returns.

But it’s becoming more difficult for consumer goods companies to earn easy profits from mom and pops. The appeal of serving them has attracted an

**Article at a glance**

*Pressure from modern chains is depressing sales and margins for “mom-and-pop” shops in Latin America and other emerging markets.*

*Life is therefore getting harder for the consumer goods companies that supply small shops.*

*To maintain profitable relationships with traditional shops, consumer goods makers must carefully segment the diverse mom and pops they serve and then tailor their promotions, displays, discounts, incentives, and sales and distribution approaches accordingly.*

*The sales force plays a crucial role by surveying consumers and shopkeepers, negotiating packages of incentives, and tracking performance.*

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increasing number of consumer goods companies and brands, thus increasing the competition for their limited shelf space and cash. Meanwhile, major retailers are moving in, driving down the sales and margins of the mom and pops. Falling volumes, in turn, raise the cost of selling to and servicing them.

Packaged-goods companies seeking to maintain profitable relationships with traditional stores and to outmaneuver competitors in this hard-to-serve channel must embrace a reality that most have long ignored: mom and pops are incredibly diverse, and the same consumers frequent different ones throughout the week on different occasions, even though these shops are close to one another and may stock the same items. A beer shopper with-

out a refrigerator might go to the corner grocery store to pick up a large bottle for home consumption, split a six-pack with friends after work at a shop that has a pool table, and share a case with teammates following soccer practice at a third store with outdoor seating. A packaged-goods company can therefore have a substantial market share in one shop while underperforming in a similar place right down the street.

A few leading packaged-goods companies have begun making sense of this diversity by segmenting outlets the same way sophisticated marketers segment consumers. These companies develop a rich understanding of the occasions when different people are likely to shop at specific shops, of what most appeals to these men and women when they do shop, and what offers make different shop owners loyal to suppliers. This understanding, in turn, allows companies to decide which shops merit investment and how to tailor cost-effective promotions, displays, discounts, incentives, and sales and distribution approaches in ways that will boost sales and reward shopkeepers financially.

The sales force plays a crucial role in this more discerning approach. Salespeople observe outlets and survey consumers and shopkeepers, besides negotiating packages of incentives with owners and tracking how well they keep their end of the bargain—how much they charge, what displays and promotions they use, and how much shelf space they give different products. Since the typical salesperson is responsible for as many as 300 outlets, he or she needs a lot of support. Well-structured training, performance-management, and incentive systems help ensure consistent execution, and handheld wireless devices can help salespeople to feed headquarters information about the outlets and to receive recommended tactics in return.

Applying state-of-the-art tools to the problems of serving traditional retail shops has yielded dramatic results for packaged-goods companies in Latin America, other emerging markets (including Africa, Asia, and Eastern Europe), and even those parts of Western Europe and North America where retailing is highly fragmented. Brewers, carbonated-beverage makers, confectioners, snack producers, tobacco companies, juice makers, and producers of personal-care goods have all enjoyed significant revenue, margin, and cost benefits by moving away from prevailing “one-size-fits-all” strategies for serving mom and pops.

### **Pressure from two sides**

Traditional retailers in Latin America account for one-quarter to one-half of all grocery sales and hold dominant positions in some categories and markets: mom and pops, for example, sell about 95 percent of the beer consumed in Colombia and control more than 80 percent of carbonated-beverage sales in Mexico. The sheer number of these outlets often increases even as major retailers expand. The number of traditional shops in Mexico, for example, has risen by more than 25 percent over the past five years.

Several factors explain the resiliency of the mom and pops. For starters, most are located in the same neighborhoods or even blocks as their target consumers, who often don't own cars. Furthermore, the smaller scale of mom and pops means that they can serve areas with low population densities or limited purchasing power, where modern retailers aren't economically viable. In addition, some traditional retailers are informal: they avoid paying taxes, and in certain countries, particularly Brazil, that reduces their costs enough for them to charge prices similar to or even lower than those of modern stores. (For more on informality in Brazil, see “How big retailers can serve Brazil's mass-market shoppers,” in the

current issue.) What's more, since traditional shop owners normally live in the same neighborhoods as their customers, who are often their close friends, they can extend credit with no collateral and little risk of default, further binding consumers to their shops. Finally, tradition also plays a role. In the words of a large Mexican retailer's CEO, "Mexicans have been going to the *mercado* and *tianguis*<sup>1</sup> since the Aztecs. It is in our way of life."

Over the years, many large packaged-goods companies have formed cozy, profitable relationships with the mom and pops (Exhibit 1). The prevailing formula involves dividing a country into broad geographic zones—examples in Ecuador, for instance, would be Quito, Guayaquil, the coast, and the Andes. In each region's mom and pops, a packaged-goods supplier generally employs the same promotions, communications tactics, and displays. To protect volumes and keep the largest traditional outlets happy, consumer goods companies often provide them with long-lived assets (such as coolers and tables), as well as product displays, posters, and promotional materials.

Now the game is changing. Major retailers are on the march in Latin America: they account for roughly three-quarters of all grocery sales in Brazil and Chile and about half in Mexico, where there are more than 7,600 modern convenience stores; Wal-Mart alone boasts annual sales of more than \$15 billion in the region and has consistently increased its revenues at annual rates in the high single digits. Modern and traditional retailers have already collided in large urban markets. As these become saturated, large retailers are venturing into smaller cities, poorer neighborhoods, and rural areas, where mom and pops predominate. The result, everywhere, is similar: their revenues and profitability are down. Sales per traditional outlet have also been falling—by 3 percent a year in Mexico, for instance.

Just as traditional retailers are coming under pressure, more packaged-goods companies are trying to win their business, in part because modern retailers are tough customers. Traditional shopkeepers, with their limited shelf space, are therefore in a stronger position when they negotiate with suppliers. (It is easiest to cut favorable deals with regional manufacturers of discount brands.) To complicate matters further for large packaged-goods companies, distribution costs are rising as "drop sizes" (such as the number of soda cases delivered to a shop each week) fall. Even powerful global brands like Coca-Cola, whose bottlers have in recent years lost share to discount brands among traditional retailers in Ecuador and Peru, are feeling the effects.

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<sup>1</sup> Public and open-air markets, respectively.

## EXHIBIT I

**A profitable relationship**Latin American packaged-goods companies, EBITDA<sup>1</sup> as % of sales, by type of outlet

Product category	Traditional retailer (mom-and-pop store)	Large modern grocery store
A	22.4	11.9
B	19.4	10.0
C	18.0	14.0
D	17.9	-11.2

<sup>1</sup>Earnings before interest, taxes, depreciation, and amortization.**Embracing the diversity of mom and pops**

Fortunately for packaged-goods companies, there is an alternative to the prevailing one-size-fits-all strategies for dealing with mom and pops. It involves developing a better understanding of the characteristics of these shops and of the marketing techniques that move consumers to buy from different ones at different times, tailoring bundles of incentives that create value for shop owners who work toward mutually agreed-upon goals, and rethinking sales and service to make them more cost effective. This approach works equally well with formal and informal mom and pops.

Pulling off a more differentiated strategy requires careful coordination. First, the central marketing organization conducts core analyses of consumer needs and consumption occasions. The sales organization's trade-marketing group then uses the general consumer analysis to create a segmentation scheme for outlets. Once that is done, the trade-marketing group helps salespeople to categorize the shops in their territories. The salespeople, in turn, deliver a tailored bundle of brands, products, prices, margins, merchandising, and services to each segment of shops the company targets. Finally, the trade-marketing group creates detailed outlet-level performance reports for the salespeople (and, in some cases, for third parties such as distributors or merchandisers) and rewards them by how well they execute the segment strategy.

A wide range of consumer goods companies have begun following this approach:

- A brewer whose sales had been flat enjoyed a 10 percent jump in the volumes sold at traditional shops after it had segmented and targeted them more carefully.

- A carbonated-beverage company recently boosted its market share at mom-and-pop stores by nine percentage points, largely at the expense of discount brands that had previously been raising their share. Another beverage company spent 20 percent less on distribution while improving its market share among traditional shops by relying more on telephone sales and batching deliveries for outlets that, according to a new segmentation scheme, require less high-touch service.
- A tobacco company categorized the universe of traditional outlets. For each segment, it designed strategies based on the demographic profile of consumers who frequented that kind of shop. This improved segmentation led the company to increase its brand-building investments in a small number of strategic shops while simultaneously reducing its sales, distribution, and merchandising (or “route-to-market”) costs by 12 percent for the mom-and-pop channel as a whole.

#### Understanding and segmenting outlets

To categorize thousands of outlets, packaged-goods companies must borrow from the tool kit of sophisticated marketers around the world who analyze “need states” representing the intersection of what consumers want and how they want it.<sup>2</sup> Need-state segmentation is generally applied to consumers, not stores. Packaged-goods companies in Latin America, for example, sometimes conduct such analyses in major urban areas, where large retailers serving a great diversity of consumers make a store-specific approach unnecessary. It is sufficient to understand, say, that “people consume brand X when they wish to relax with friends over several inexpensive beers and don’t want too many calories.”

But a consumer-level understanding isn’t enough when customers frequent a number of shops regularly and shop-specific characteristics influence each purchase decision. In this environment, packaged-goods companies need to evaluate what consumers want when they go to a particular type of shop and how they want to have it presented to them (Exhibit 2).

One soft-drink company built on its overall consumer segmentation approach by drilling down to an outlet-specific one: it had its trade-marketing group, working with a few salespeople and an outside research firm, administer one-on-one quantitative surveys in a representative sample of its retailers. Their analysis highlighted a number of distinct channel segments, including shops where people go for quick breaks during the workday, stores with pool tables where friends meet, outlets where

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<sup>2</sup>Stephen J. Carlotti Jr., Mary Ellen Coe, and Jesko Perrey, “Making brand portfolios work,” *The McKinsey Quarterly*, 2004 Number 4, pp. 24–35.

## EXHIBIT 2

**What do they want?**

Share of volume sold in given outlet segment (sample illustration), %

■ Primary need state

Consumer need state	Outlet segment			
	Convenience	Activities, eg, game of pool	Place to take a break	Space to hear music
Socializing	20	56	5	20
Craving excitement	18	8	12	48
Gathering after sports	15	11	28	8
Everyday routine	22	13	45	11
Pick up and go	25	12	10	13

men congregate after sports practice for refreshments, places where local residents gather to celebrate and listen to music, and shops where people pick up food and beverages they will consume as soon as they arrive home. Once the general outlet segmentation was established, the trade-marketing organization distilled five questions that salespeople could ask consumers and shopkeepers to categorize the thousands of shops the company served.

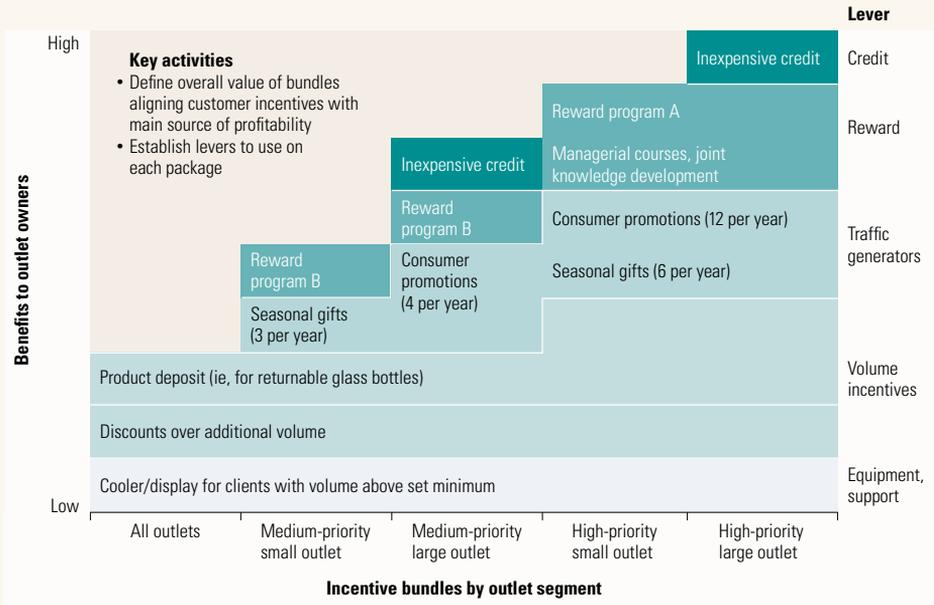
After a company completes an outlet segmentation based on consumption occasions and need states, it can tailor an approach for each type of shop. In those where consumers make quick purchases and convenience is important, for example, one brewer gave shopkeepers vertical coolers intended to entice people to buy beer on their way out. A nonalcoholic-beverage company supplied returnable glass bottles that are more affordable than disposables for stores where low-income consumers make small daily purchases. The same company found that for outlets frequented by young consumers on weekends after they play soccer, it is critical to have outdoor tables (prominently depicting the company's brand) where players can cool down following games. The company and shopkeepers also cosponsored small neighborhood soccer tournaments to cement, in the minds of consumers, the link between these shops and time spent socializing with other players after games while drinking the company's brand of soft drink.

**Creating value for store owners**

Deciding what will appeal to consumers in each outlet is only part of the puzzle. Packaged-goods companies also need to develop bundles of benefits that will help shop owners prosper in today's competitive retail environment (Exhibit 3). This step is critical because even the best-conceived

EXHIBIT 3

Everyone prospers



consumer strategies need the shopkeepers’ support to succeed. In our experience, cooperation from Latin America’s increasingly stretched mom-and-pop store owners can be ensured only by helping them make more money. Alternative approaches, such as extracting promises of exclusivity in return for a table and cooler, are becoming less effective.

A brewer’s experience highlights the broad range of possible benefits. Some that are extremely valuable to shopkeepers are actually relatively inexpensive. The owners of shops with table seating were extremely interested in branded T-shirts, which save them the expense of buying uniforms for beer servers. The owners of shops where consumers gather to listen to music particularly liked the idea of anniversary parties for their shops, complete with banners and promotional materials. Stores emphasizing low prices on daily purchases valued inexpensive credit and free bottles.

Consider as well the experience of a nonalcoholic-beverage business that asked a segment of Mexico’s mom and pops to use a new company-branded cooler that would require them to spend more on electricity. The company, emphasizing that additional soda sales would compensate them for the cost, offered a free case of soda every month in exchange for a commitment to keep the branded coolers connected and well stocked.

In other Latin American countries, the same beverage company found that “management 101” courses and small life insurance policies for shop owners made them more loyal.

Determining what benefits to offer shops requires a company to understand its opportunities to increase sales in each one—something that can be quantified in terms of its outlet-level market share. Obtaining this detailed information falls on the shoulders of salespeople and, in some cases, on outside market research firms. In our experience, shopkeepers are surprisingly forthcoming with information on their volumes, service levels, and margins—perhaps because they hope that openness will boost the odds of obtaining favorable terms of supply.

Having identified the store-level revenue and profit opportunities, companies must tailor their incentive and service packages to ensure positive returns on investment and avoid spiraling costs. For one beverage company, this approach meant not offering rich incentives to all outlets. In fact, its outlet segmentation and competitive assessment suggested that it dealt with three tiers of shops: those meriting large packages worth up to \$5,000 a year, others warranting smaller investments of \$500 or so, and places where opportunities for volume growth were so limited that any investment would be a mistake. In our experience, no more than 5 percent of all outlets typically fall into the high-potential group, and up to half warrant no investment whatsoever.

#### Ensuring cost-effective execution

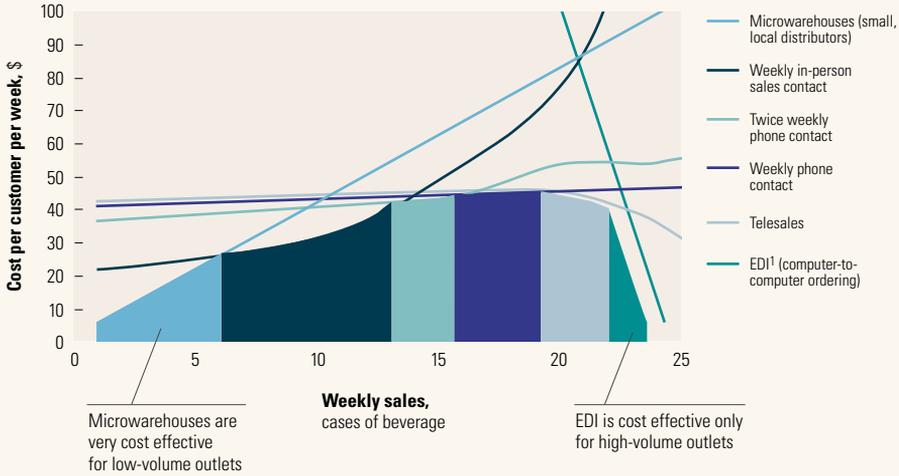
Once packaged-goods companies decide what they want to offer consumers and shop owners and where they want to offer it, the final question is how to execute flawlessly at the point of sale while keeping costs as low as possible. In our experience, packaged-goods companies in Latin America haven't thoroughly assessed the mix and efficiency of their route-to-market techniques. Most companies will probably need a broad range of sales coverage, distribution, and merchandising approaches for the different outlet segments in each geography they serve (Exhibit 4).

To understand what these approaches might look like in practice, consider the experience of another beverage company, which had salespeople visit high-potential shops several times a week to take orders and check in on promotional activities. It also employed merchandising specialists to place products and merchandising materials, as well as clean coolers in these shops. Midtier ones, by contrast, received just a single visit a week from the salespeople and none from the merchandisers. For another group

EXHIBIT 4

**Choose your mix**

Sales and distribution methods by outlet segment, beverage company example



<sup>1</sup>Electronic data interchange.

of outlets, the company created an outbound telesales group that called shopkeepers on predefined days and times to take orders. This tele-sales model reduced the cost to serve some outlets by more than 40 percent, without making sales calls less effective. The company also found that in certain areas independent truck operators could distribute its products and merchandising materials at far lower cost than in-house personnel could.

Efforts to improve the quality and cost-effectiveness of execution don't end when a company gets its mix of sales and service right. It's also important to root out volatility, which often comes in the form of lumpy order sizes and surging deliveries on certain days (such as Fridays), and waste, which is common during delivery runs, when drivers may take circuitous routes or load and unload trucks inefficiently. Companies in industries ranging from automotive assembly to airlines to retail banking have fought volatility and waste for years by using "lean" operational techniques that experience shows to be applicable to serving mom-and-pop shops as well.<sup>3</sup> When a tobacco company conducted a time-and-motion analysis

<sup>3</sup>For more on applications of lean techniques, see Stephen J. Doig, Adam Howard, and Ronald C. Ritter, "The hidden value in airline operations," *The McKinsey Quarterly*, 2003 Number 4, pp. 104-15; and Anthony R. Goland, John Hall, and Devereaux A. Clifford, "First National Toyota," *The McKinsey Quarterly*, 1998 Number 4, pp. 58-68.

of its sales and delivery people and redesigned operating guidelines to cut down on low-value activities, for instance, the cost of each route fell by more than 12 percent, without any decline in the effectiveness of sales or deliveries.

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Maintaining profitable relationships with mom-and-pop shops is more and more challenging. Packaged-goods companies can raise their volumes and margins alike by understanding why consumers shop at different types of stores, what incentives to offer shopkeepers, and how to deliver cost-effective sales and service. *Q*

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