FOOD IN SOUTH AMERICA TO 2010

Executive Summary

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EXECUTIVE SUMMARY

Introduction

In this study we focus on the big-picture issues. Our goal is to help food manufacturers understand the broad trends they will be facing in South America over the next decade and allow them to identify strategies for competing successfully in this new marketplace. Though this study covers a broad range food categories by country and region, it would be virtually impossible to analyze the competitive environment for every category in every country, and we have deliberately avoided this. Instead, we present the forest, not the trees.

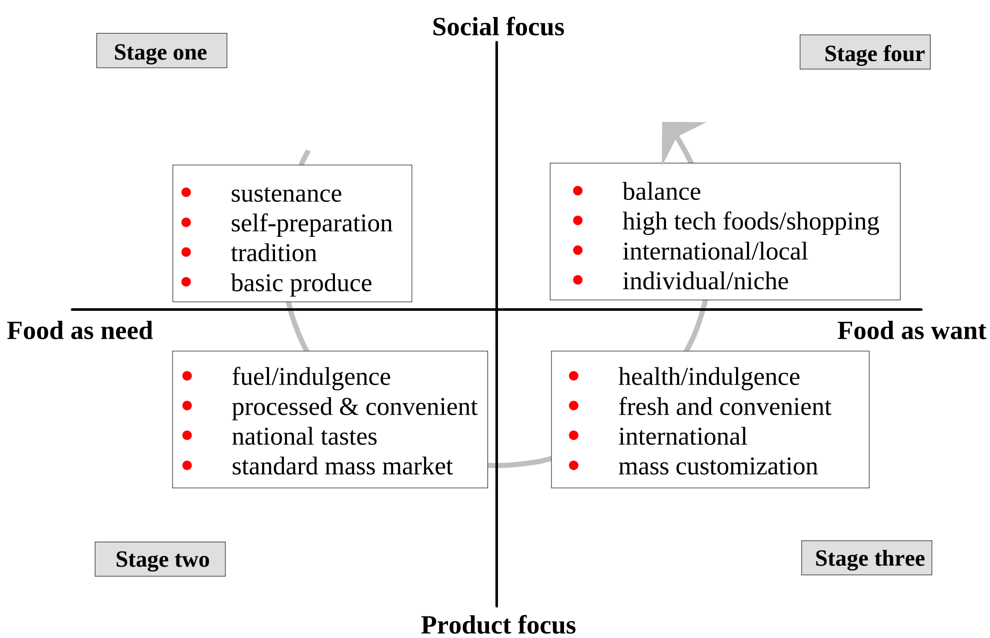
This *Executive summary* is intended to provide a comprehensive view of the findings of this study, highlighting the key changes we see ahead for consumers, food markets, food segments, and distribution, as well as what these changes will mean for food manufacturers. We briefly identify player types, describe the competitive environment today and tomorrow in broad terms, and suggesting imperatives by player type. We strongly recommend reading the entire study, because the *Executive summary* necessarily omits considerable discussion and detail.

We have organized this project into three geographic regions for several reasons. Countries within each region have common features that make generalizations and conclusions easier to develop and absorb. Brazil, for instance, has had a history quite distinct from its South American neighbors, speaks a different language, and represents an enormous market unto itself. The Cosmopolitan countries (Argentina, Chile, & Uruguay) are alike (and different from others) because they share higher incomes and a much more urban environment. Finally, the Andean group countries, though the most heterogenous, still share several key characteristics: lower incomes, larger informal markets, faster growing populations, and generally less diverse economies. All in this group but Paraguay are also members of the Andean Pact. Despite the common features that countries in our regional groupings share, they also clearly have their differences, which we address throughout the study. Please note that we have excluded the Guyanas from this study, as information is limited and inconsistent. Given their small market size, their absence should not detract from the conclusions and recommendations we present. We can provide some basic information on request.

South America in the context of a food market development model

In this study we refer frequently to a "food model" (outlined in detail in Section IV), which helps us to understand the development of these markets. Our years of research has revealed that food markets throughout the world generally follow a specific development pattern, moving through four distinct stages:

Food market stages



- In the first stage a market is rudimentary, goods are basic and consumers seek food for sustenance;
- In the second stage, markets are often controlled and goods mass produced, with only modest levels of added value; consumers in this stage can be quite brand conscious and the industry is often dominated by a few major players (often state-controlled);
- In the third stage, markets become more open and competitive; value is added to goods, and segmentation takes place among both consumers and producers as

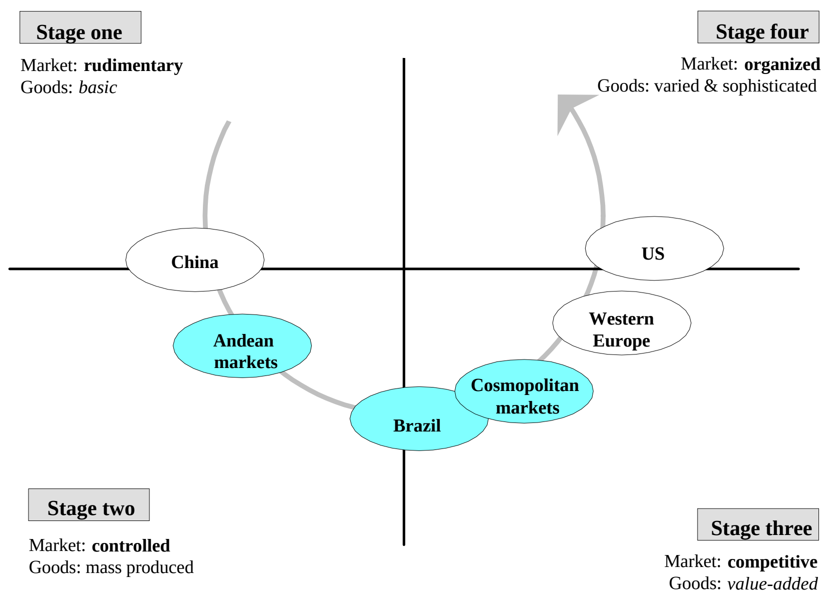
incomes rise and consumers have different desires and abilities to purchase value-added foods;

- By the fourth stage, the market has become organized, comprising varied, value-added goods and there is significant market segmentation; the consumer in such a market is sophisticated and seeks specific goods to fulfil specific needs, hence there is a need for a wide variety of products at different price and quality levels.

Household income levels grow approximately five-fold between each stage and the next. The following can serve as a rough guide: households (and countries, based on average household incomes) enter Stage 2 at $2,500, Stage 3 at $12,500, and Stage 4 at $62,500.

The following graphic shows where the South American food markets fit along this market development path, relative to some other major international markets:

Market positioning in food market cycle, 1998

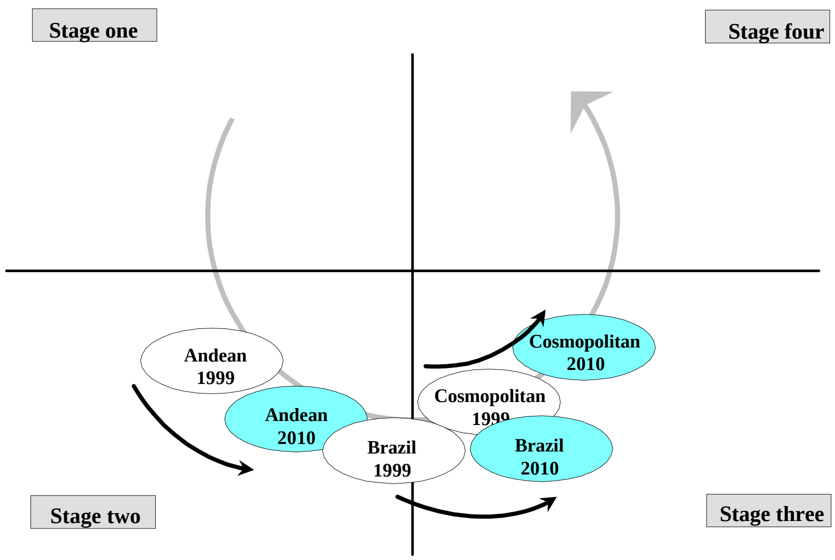


Today, most South American markets have many established brands of mass produced goods. Brazil is currently making the transition into the third stage, where the Cosmopolitan countries can already be found; here, competition between both domestic goods and international foods takes on greater importance; these markets are also beginning to rapidly shift their emphasis towards higher value-added foods.

Andean markets, on the whole, lag behind. Incomes are lower, the room for processed food players is more limited, competition is much less intense. Relatively small numbers of people can afford significant quantities of even mass-produced foods.

The following graphic shows the progress we expect South American regional food markets to make through 2010.

South American regional positioning and movement, 1998-2010



Because South American food markets are developing within Stages 2 and 3, and many consumers will be entering income brackets where they can buy processed products, the continent as a whole should offer excellent sales growth opportunities for most processed ingredients and ready-to-eat foods over the next decade.

- Brazil will offer outstanding growth potential in most processed food categories, though volume demand for high value-added/high "tech" foods is likely to remain low on a per capita basis. Still, the county is so large that the sales potential is significant.
- The Cosmopolitan markets as a group will be moving farther into Stage 3 over the next decade: consumers there will be trading up to higher value-added processed foods. Categories that are particularly promising are convenience products of all kinds, from snacks to prepared meals.

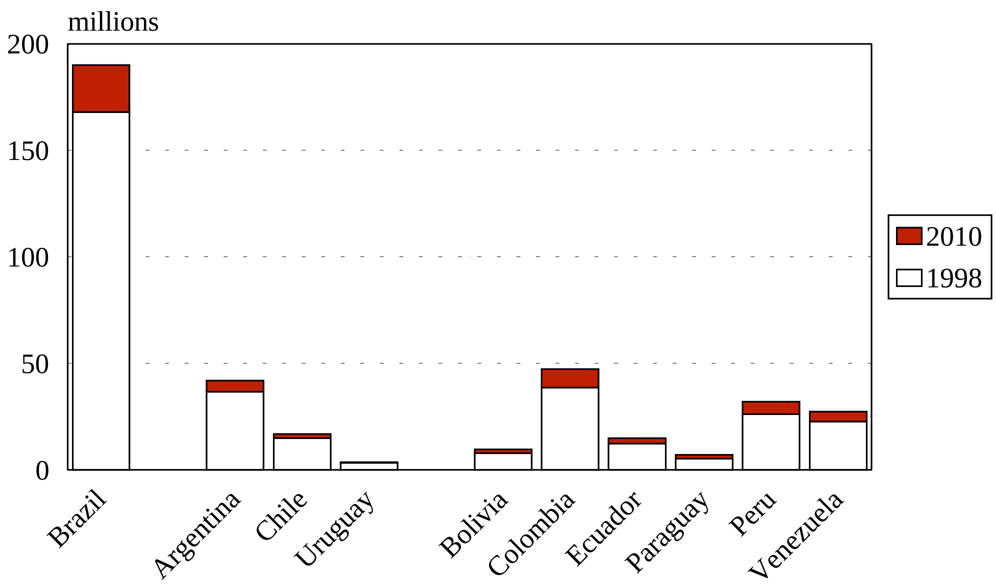
- On the whole, Andean markets will still be progressing through the "mass market" stage (2). Large portions of their populations aren't even processed food consumers yet. This indicates substantial potential for sales increases in basic processed foods.

The changing South American consumer

▸ ***Changing demographics***

Based on projected demographic and income changes in South America, it is clear that most of the growth will be concentrated in relatively few markets.

Population changes in South America, 1998-2010



Source: US Census Bureau

The countries which will add the most people over the next decade are Brazil, Colombia, and Peru. The continent's population is projected to grow by about 50 million people, from 343 million in 1998 to 393 million in 2010. From the food manufacturer's perspective, migration to cities will "intensify" this growth: urban areas should grow by 60 million through 2010.

On a regional basis,

- Brazil will add 26 million urban consumers, to reach 162 million
- Likewise, the Andean region should also add around 26 million, for a total of 111 million; and
- The Cosmopolitan countries will add 8 million, for a total of 56 million urban consumers.

Households in most South American countries will shrink over the next decade. Substantial reductions in household size are projected to take place in Brazil, Chile, and Ecuador. While the number of people per household will decline, there will be strong growth in the total number of households, particularly in Brazil and the Cosmopolitan nations. These two regions will add nearly 15 million new households collectively by 2010. Increases in household size are expected in Bolivia and Venezuela, and the increase in the number of households in the Andean region will be smaller.

Broad household changes in South America to 2010

Region	***HHolds 1997 (millions)***	***HHolds 2010 (millions)***	***Increase (millions)***	***Increase (%)***	***Population increase (%)***
Brazil	52.5	63.6	11.1	21	14
Cosmopolitan	14.5	18.1	3.6	25	17
Andean	22.9	27.1	4.2	18	25

Sources: US Census Bureau, SRC, PROMAR

Finally , the last major demographic change that manufacturers must anticipate is the aging of South America. Though consumers are very young on average, a major demographic transition is taking place:

Children are decreasing as a share of the region's population. Total numbers of children (those under 15) will remain stable around 106 million. In some countries, incoming generations of children are or will be *smaller* than those that preceded them (e.g., Brazil, Chile, and Venezuela). Parents across most income groups will have more money to spend on them, spurring growth in categories such as processed baked goods and dairy products, as well as indulgences such as snacks.

Working age individuals (15-55) will expand their share of the population, and are projected to grow between 15% and 20%, or over 30 million in absolute numbers, to around 230 million by 2010.

Finally, the most dramatic shift will occur in the *retirement-age* population (55+), which will expand by over 40% over the next decade, increasing by 17 million to around 57 million. Brazil will account for over half of this increase, followed by Venezuela and Peru.

- ***Changing incomes***

Income growth in South America to 2010

Country	Total income growth (1998-2010, %)	Per capita income ($)		Per capita income growth
		1998	2010	
Brazil	45	4,800	6,000	25
Argentina	50	8,300	11,000	30
Chile	70	5,400	8,100	50
Uruguay	40	6,200	7,900	25
Bolivia	60	980	1,250	30
Colombia	50	2,280	2,800	25
Ecuador	35	1,600	1,800	15
Paraguay	50	2,020	2,250	10
Peru	70	2,450	3,380	40
Venezuela	35	3,430	3,850	10

Sources: World Bank, US Census Bureau, PROMAR, others.

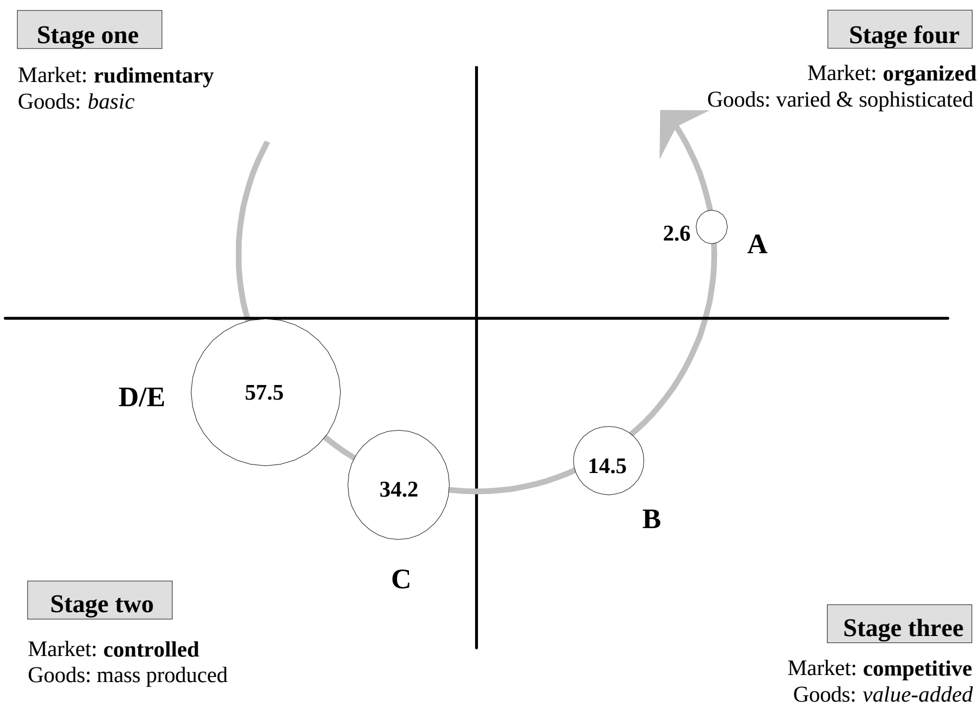
Incomes in the Cosmopolitan countries are considerably higher than elsewhere and they will be among the fastest growing on a per capita basis. Hence these will be prime markets for higher value-added foods.

Andean incomes will also grow fairly rapidly in percentage terms, but much less on a per capita or even absolute basis. Opportunities here will therefore be best for low to moderate value-added food products.

On a per capita basis, Brazil will fall in the middle in terms of income levels and income growth, but the market is so large that the implications of these changes are significant.

Revisiting the model outlined above, it is useful to delve in greater detail into expected changes in income groupings. The following graphic shows the projected size of specific income groups in 2010 (income groups have been combined across all South American markets).

Income group positioning in South America in 2010
(in millions of households)



The lower income group will clearly dominate South American markets, continuing to provide growth potential for even the most basic processed foods. The bulk of South American households, in fact, will only just be moving into "processed food" consumer status. In fact, consumers in the C through E groups will remain in the "mass market" (Stage 2) portion of the food cycle.

The graphic also shows that upper income consumers (A) are as sophisticated as those in the US and Europe, and that even B consumers are fairly "sophisticated" in their food consumption habits. Also, with these broad income groups we should note that overall consumer positioning in the Cosmopolitan region is much farther advanced than in either Brazil or the Andes. Additional detail is available in Section IV.

The following broad changes in income groupings in South America (reflected in the previous graphic) can be expected:

- half a million more A households
- 3 million more B households
- 6-1/2 million more C households
- and almost 9 million more D/E homes

In all, the A, B, and C homes which can afford processed foods on a regular basis should grow from just over 40 million to over 50 million, an increase of 10 million (25%). Almost two-thirds of the growth within this A/B/C group will take place in Brazil, as households multiply there faster than anywhere else (as household formation increases and average household size drops).

▸ ***Changing eating habits***

Basic diet and trends - Brazil

Basic diet	•	Brazil's diet is heavily based on cereals, starches, meals cooked in vegetable oil, and fruit. Common staples include rice, beans, manioc flour, and fruit. Vegetable consumption is low, and the consumption of animal products increases as one moves south within the country.
	•	Consumption of processed foods is reasonably high given the country's income levels, and averages about $350 per capita.
Trends	•	Following the introduction of the Real there was sizeable jump in many food categories, particularly dairy and poultry products, and growth in these categories should remain strong.
	•	Brazil is experiencing strong growth in convenience foods, particularly processed meat and poultry and frozen products.
	•	Among lower income consumers, there has been a measurable shift from staple carbohydrates such as rice and beans to higher protein animal products. Among higher income groups, there has been an increase in sales of health-oriented "diet" and "light" products, as well as a strong interest in gourmet foods.

Basic diet and trends - Cosmopolitan

Basic diet	• Cosmopolitan diets have in common a heavy base in wheat products and potatoes, produce, and animal product consumption (especially in Argentina and Uruguay). Diets for the most part are varied and nutritious. Their cuisines are heavily influenced by their European heritage. • Cosmopolitan diets include modest amounts of processed foods. The abundance of fresh foods has limited the growth of these products to some extent.
Trends	• Rising incomes have been spurring processed food consumption, especially in Chile. Consumers are also trading up to higher value added foods. • The consumption of certain staple foods, such as grain products and starches, has been fairly stagnant or even declining on a per capita basis. As the universe of processed products available to consumers increases, and as their prices drop, this trend is likely to continue. • In all three countries there has been a noticeable increase in the *relative* importance of poultry compared to beef. Beef consumption is still much higher than that of poultry in Argentina and Uruguay, however. • The regional expansion in local agricultural production, driven both by more open international trade, and increased regional competition among processors, has helped increase the volume and quality of local food supplies, thereby fueling increased consumer demand. • Health concerns are growing, as consumers in the Cosmopolitan countries are more educated and aware of the linkages between diet and health. Among the upper income groups, many consumers have begun identifying particular aspects of their diet and their link to health (e.g., cutting down on fat, cholesterol).

Basic diet and trends - Andes

Basic diet	•	Andean diets are most heavily based on locally available fruits, starches, and vegetables (and seafood in some areas).
	•	Domestic food processing industries are much less developed, and incomes are much lower, which means that processed products beyond basic staples (i.e. rice, beans, potatoes, sugar) play only a small role in consumers' diets. These countries also tend to rely heavily on imports of basic processed foods (e.g., canned goods and powdered milk).
Trends	•	On the whole diets have shifted in a subtle fashion up the food chain. Perhaps the most noticeable change across the region has been the expanding role of poultry in the diet.
	•	Increasing regional and international trade is also helping to bring cheaper basic and processed foods to the Andean nations. Trade agreements are multiplying and solidifying in the region: in addition to the Andean Pact, some member countries have individual treaties with Mexico and the Caribbean. Moreover, there are ongoing efforts to link the Andean Pact with Mercosur as well, with the potential of a Free Trade Area of the Americas a more distant possibility. As trade barriers continue to fall, food trade will serve to expand the processed food markets of these countries.

▸ ***Looking ahead - broad areas of dietary change***

In addition to the major changes that can be expected by region, there are some broad trends that will grow in importance across the continent in the years ahead. Some are already important and will become more so, even in the short term; others are less immediate but will nevertheless have a long-term impact.

Near-term

Convenience The strongest "food theme" evident in South America is the growing importance of convenient meal solutions. Increasing urbanization and the continued shift of women to the workplace is serving to constrain the time available for meal preparation. These pressures will be the strongest in the continent's larger urban centers, and for B, C, and D households.

Foods which help speed meal preparation will be very important, particularly to certain household types which will be growing in number: single adults living alone, dual income homes, and working mothers. Products ideally suited to these groups, where affordable, include:

- frozen vegetables
- microwaveable meals
- tomato sauces/pasta
- processed and/or pre-seasoned meat and poultry

Health

South American teenagers, young adults, and adults of A and B households are generally aware of and influenced by international health trends. Food products and eating habits which are seen as compatible with healthy lifestyles are often adopted quickly. Sports drinks have been rapidly adopted, for example, and diet and lowfat products have exhibited strong growth. Health-oriented foods and beverages should continue to grow at above average rates, especially in Brazil and Argentina.

Meal importance

Lunch has been gradually losing its importance, while dinner has grown more important. This has been particularly true in the large urban centers where commutes continue to lengthen, with 9 a.m. to 6 p.m. schedules commonplace. As the underlying factors (urbanization, traffic, etc.) continue, dinner will continue to grow at the expense of lunch.

Longer-term

Shifting regional influences on the diet

Although Europe has traditionally had a strong influence on South American lifestyles and eating habits, this is likely to shift over time, not just to North America but to cross-influences throughout Latin America.

Increasing interaction, spurred by economic agreements and expected integration, are helping to foster cultural interaction and are likely to lead to regional tastes and dishes of the continent being much more influential outside their native countries (e.g., certain Brazilian dishes and flavors becoming more influential in Argentina and vice versa).

This shift will also be influenced by the aging of the population: older consumers are more attuned to Europe, young adults may take some cues from North America, and incoming generations are likely to be much more "South American" in outlook. Over the next decade, the primary effect is likely to be a relative decrease in European influence (relative to others).

"Leapfrogging"

Whereas frozen meal components were an "evolutionary step" in the food markets of North America, many South American consumers, particularly young urban couples, may go directly to frozen, ready-to-heat products instead of components.

Also, 5 to 10 years from now, rather than brave traffic to shop at the newest hypermarket, many A and B consumers will shift to "consumer direct" instead, ordering groceries online. This will require manufacturers to position themselves in virtual stores as well as physical ones, and some of the largest players - e.g., Unilever - have already begun.

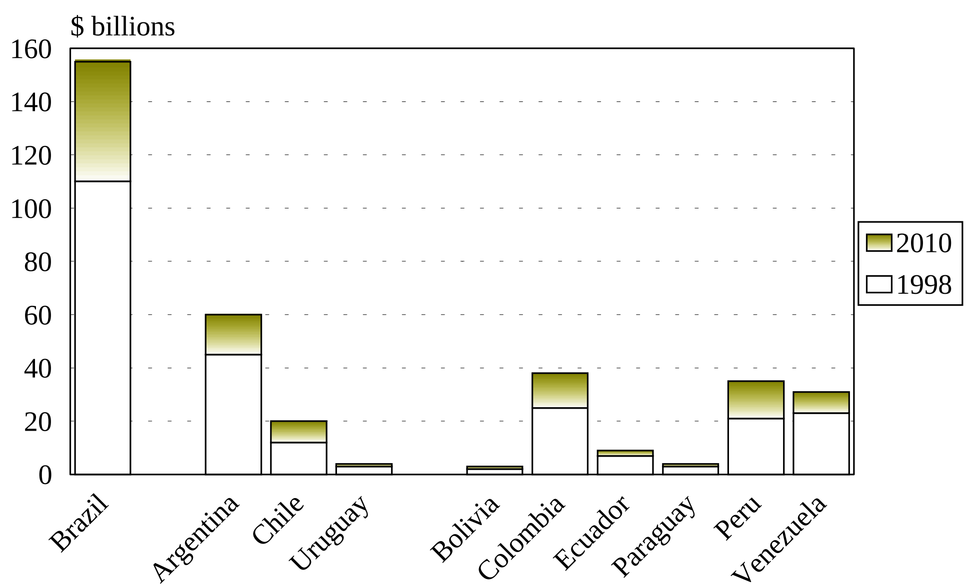
Even C and D consumers are likely to exhibit "leapfrogging" behavior. They are much more likely to be time-pressed than previous generations of C and D consumers, hence convenience for them will take on greater importance, and they are likely to embrace low-cost meal solutions (as phenomenal growth of instant soups in Brazil demonstrates).

South American food markets, segments and distribution

- ***Markets in context***

Building on our assumptions for population and economic growth, we expect the following growth in South America's food markets:

Food sales in South America, 1998-2010



Almost half the continent's growth will take place in Brazil. The other relevant volume growth markets will be Argentina, Peru, and Colombia.

- ***Food segment changes***

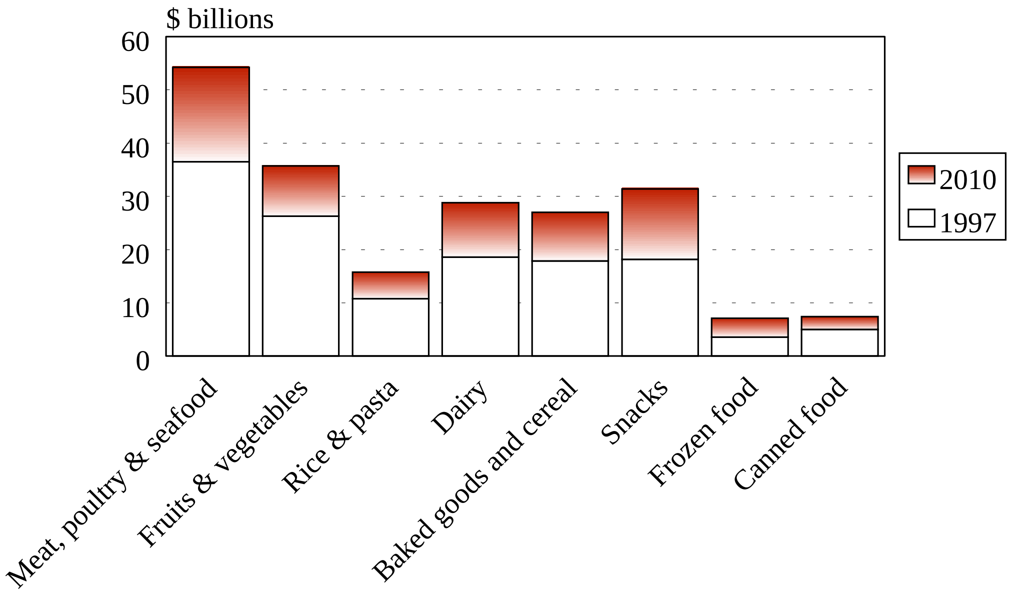
We expect to see virtually all food segments growing over the next ten years (with the rare exception, such "staple foods" like rice or cassava in specific markets as people trade up to processed foods). Food consumption overall and processed food consumption in particular will grow significantly. This is because:

a) average incomes everywhere in South America are fairly low, with many if not most consumers "underconsuming;"

b) populations in all countries are still growing; and

c) consumers generally will be "trading up" to higher value-added foods within categories.

Projected growth by food segment, 1997-2010



Sources: Euromonitor, PROMAR research

The broad changes we expect in each food segment are as follows:

Meat, poultry, & seafood: Sales should grow by $15-$20 billion to around $55 billion, withan emphasis on poultry and on processed products.

Fruits & vegetables: Consumption should grow modestly by about $10 billion from $25 to $35 billion. This growth will reflect a trading up to higher value products, and consumption of a broader variety of products within these categories. Finally, a sizeable share of category sales will move from informal to formal market channels.

Rice and pasta: Sales should grow by about a third to $15 billion. Particularly fast growing segments will be for durum-based pasta products and instant noodles.

Baked goods and breakfast cereals: Consumption should grow by about 50% to $27 billion. For baked goods, there will be a gradual erosion of the fresh daily bread routine, to the benefit of pan bread and processors of other baked goods. Breakfast cereal sales, a tiny fraction of the category total mentioned above, will remain small but grow rapidly. Price points on breakfast cereal are likely to drop substantially over time. There may even be a "leapfrogging" effect to private label in this category as retailers step in to capture what have traditionally been high margins in this subcategory.

Dairy products: Dairy sales should experience similar growth or close to a $10 billion increase in sales, driven by large supply increases in Brazil and surpluses in Argentina. Products are likely to become more and more sophisticated, and will including a variety of nutraceuticals.

Snacks: Sales of confectionery, cookies, and salty snacks in South America should almost double to over $30 billion by 2010. Brazil will represent the lion's share of this market.

Frozen foods: Sales of these foods, currently just $10 per capita, will double over the next decade.

Canned foods: This category will exhibit more modest sales growth than other categories. Population growth and the large numbers of poor consumers, however, along with an expansion in regional production, should increase sales by about 50% to over $7 billion.

- ***Point of sale changes***

Retail development in South America varies widely: it is most advanced in Brazil, Chile, and Argentina, where three-quarters or more of formal retail sales go through organized channels. Retail is less developed in Venezuela and Uruguay (55% and 40%), respectively, and considerably less developed elsewhere on the continent, particularly in the poorer landlocked countries where most sales go through informal channels, let alone through organized retail chains.

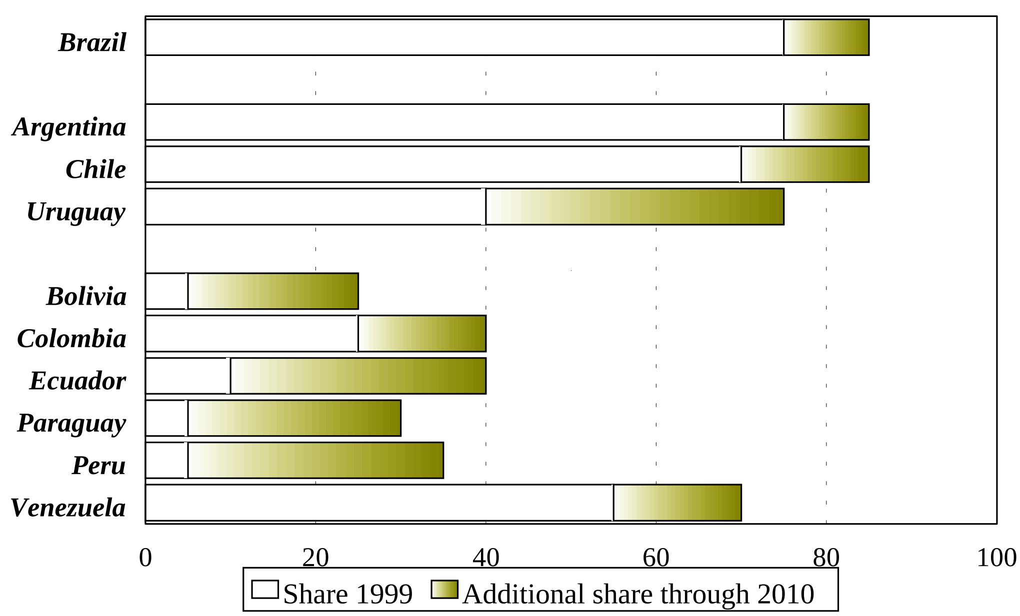
In the past few years, however, there has been significant consolidation in South American retailing, as chains cross borders and as major European and US chains move in to South America and set up or acquire businesses there. Most of the effects of this changed ownership/consolidation "wave" have not yet really been felt, but they will be quite clear in ten years' time, as modern retailing techniques extend throughout the continent.

The increased role of organized retail chains, equipped with modern technology and logistics, is likely to have several major effects over the next decade. First, it will undoubtedly increase retailer pressure on food manufacturers to lower prices and/or develop private label products for them. Moreover, these chains will be able to lower prices to consumers, thereby expanding the consumer base for food manufacturers and distributors, and accelerating the growth of organized retailer sales at the expense of traditional stores.

A near term issue will be an increase in private label. The large, growing, and consolidating South American chains will rapidly introduce private label offerings into their mix. In a rapidly consolidating producer environment as well, there should be plenty of manufacturers drawn to private label production, either by choice or by necessity.

On the horizon - farther down the road, but not so far, will be the spread of home delivery services. This will of course be limited by Internet uptake and telecommunications development, but it will capture a small but noticeable share of upper-income transactions in 2010. Low labor costs in these markets make the business proposition even more compelling in these markets where there is an oversupply of low-wage workers. This will be one of the aspects of "leapfrogging" mentioned earlier.

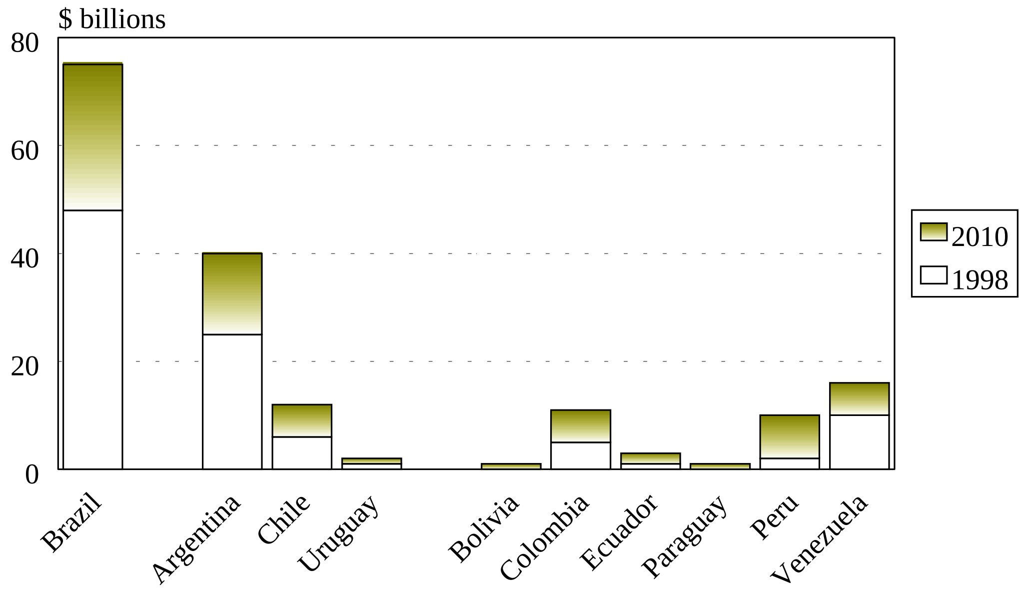
South America: Share of sales through supermarket chains, 1999-2010



Source: PROMAR research

The largest percentage gains by organized retail channels will take place in the Andean countries, but Brazil, Argentina, and Peru will likely account for much of the increase in food sales through organized retail channels. Chile and Colombia will also offer attractive opportunities, which may be relatively easy for some manufacturers to capture (e.g., due to geographic proximity).

Changes in sales totals through supermarkets, 1998-2010



Source: PROMAR research

Foodservice changes

Foodservice in South America remains a largely fragmented market dominated by family-owned businesses. Top international chains have been making inroads in the past few years, especially in Brazil, but for most of the continent, foodservice (other than a cheap locally supplied lunch or subsidized meal) is simply not affordable, and dining out is a rare treat.

Growth in quickservice has been dramatic: in Brazil, where McDonald's had but a hundred stores just a few years ago, the chain is now the country's largest private employer. Brazil should continue to lead the way in foodservice development, with its large markets and franchiser-friendly business environment.

Major changes and food manufacturer implications by region

The broad shifts, some of which have already been outlined, present major changes to which food manufacturers will need to adjust. In the following three tables, for each region we highlight the key changes according to consumer, supply, and distribution issues.

- ***Brazil - major changes***

Consumers

- Buying power in Brazil should grow by approximately 40% in real terms between 1997 and 2010, from $805 billion to over $1.1 trillion; personal income will grow about 25%. Given that Brazil is the continent's largest market, this additional growth potential makes it a vital market for all food processors interested in the region.
- The average Brazilian household will shrink to the point where it will become the smallest in South America. The net result will be a 21% increase in the total number of households.
- Women will continue increasing their formal role in the workforce and in the home. In particular, it is expected that many more households will be headed by women ten years from now.
- The reduction of the use of live-in help will continue to spur demand for processed, pre-packaged, convenience type foods, as well foodservice operations that provide delivery. Also, there is little hope that urban life will get simpler and less hurried in Brazil, so the need for convenient and fast food solutions, both for lunch and dinner, will continue to grow.
- The number of Brazilian retirees will grow by almost 50%. Most of these individuals will be eating nearly all their meals at home. Food manufacturers and marketers need to figure out how to take advantage of this huge group.
- The working-age population will grow by 10%-15%, driven by the increase in young workers in their 20s, which will help drive foodservice sales, particularly fast food. This trend, when coupled with the retirement of older workers (who have typically dined at more traditional outlets) will accelerate the shift toward quickservice restaurants. Also, 10 years from now this "baby boom" will be in its prime period of family formation.
- The absolute number of children is projected to decline slightly. Per child spending is likely to increase, spurring growth in product areas such as breakfast cereals and snacks.

Supply

- Brazilians are open to trying new products. Exporters will find market opportunities where local product equivalents don't exist. But these windows are unlikely to last long, as increasingly sophisticated processors already present in the market will quickly come up with high quality equivalents.
- Quality products that are labor intensive and have low local input costs are ideal products to process in Brazil; meat and poultry products of all type fit this description.
- Market entry will become much costlier with time; players are getting bigger and more sophisticated.

Distribution

- The cost of moving goods in Brazil is likely to drop over the long term, but slowly.
- Retailer consolidation will lead to a further squeeze on supplier margins, as will the use of private label.
- Home delivery remains a niche activity, but targeting consumers that use these services presents an opportunity to get in early on this growing trend and to reach wealthy, young consumers, especially women, who are increasingly pressed for time and hard to reach.
- Foodservice will expand dramatically, particularly restaurant chains and supplying them represents a major opportunity for manufacturers.

▸ ***Cosmopolitan - major changes***

Consumers

- Buying power in the Cosmopolitan countries should grow by approximately 70% in real terms between 1997 and 2010, from $405 billion to about $700 billion. This growth, in both relative and absolute terms, will offer some of the best opportunities on the continent.
- Priority markets for processors should be Argentina, then Chile; these will offer the greatest opportunities not only because of their larger size, but also because of their rapid growth and higher income levels.
- Demographic trends in the region will lead to larger numbers of consumers, increased buying power, and smaller households, which should help spur demand for processed, pre-packaged, convenience type foods, as well as fast food and other organized

foodservice operations. The reduction of live-in help in Chile will make the expansion of these opportunities there particularly strong.

Supply

- In all three countries, the proportion of elderly will increase significantly; packaging should be easy to open and labels easy to read.
- Though the share of retirement age individuals will grow, the share of working age people will remain steady; hence there may well be pressure toward working longer hours to maintain or improve disposable incomes. Add to this worsening traffic congestion, and the result will be much less time for traditional meals during the day. Rather than focus on retail food components, therefore, the greater opportunities will lie in *foodservice components* and *ready-to-eat foods*.
- In principle, Cosmopolitan consumers are open to new products, whether they be premium imported foods or quality private label products, and opportunities for these goods will be significant over the next ten years. For mass standard goods, however, companies which are already established locally with strong brands will have a significant advantage over new market entrants.
- The business climate in the Cosmopolitan countries will offer increasing opportunities for large, efficient branded food processors.
- Exporters of specialty food products should find these markets easier to reach in the future, and a regional approach is likely to be more efficient than a country-by-country one. For international companies with niche products, this could serve as an effective prelude to establishing a production site in the region over the medium- to long-term.
- For processors of mass standard products, entering and competing with established market players will become increasingly difficult and costly.
- The range of well-established domestic food processors in Chile may provide attractive candidates for acquisition or joint venture.

Distribution

- The movement of goods in these countries will become cheaper, particularly 5-10 years from now. This in turn will open additional opportunities for exports of premium foods to these markets; it is also likely to contribute to food industry consolidation, as regional players suffer in competition against larger competitors, and end up being acquired by them. Sectors which are particularly “regional” in nature today (i.e., bakery and dairy) are likely to be broken up in this fashion.

- Growth in larger-format retail outlets, coupled with increasing urbanization (90% of the region’s population will be living in urban areas by 2010) will make it easier for food companies to reach most of the population by concentrating on urban areas.
- Retailer consolidation will likely mean a further squeeze in supplier margins. Their increasing use of private label will be yet another threat to food manufacturers.
- Retail expansion, however, will mean greater chain efficiencies and lower prices and higher volumes of processed foods to the consumer, and a *broadening of the consumer base*. Hence controlling the cost of production will be an important factor for manufacturers.
- However, this larger, easier-to-reach customer base and likely fierce retail competition over the short to medium-term should help offset the strong margin pressure retailers will be able to exert on processors.
- Hypermarkets and supermarkets are able to stock a much broader product selection than many Cosmopolitan consumers are used to. Therefore, the *visual appeal* of products will be increasingly important, both to draw consumer attention and to differentiate products from those of competitors, especially since shoppers will spend much more time in the store, but visit it less often.
- Some companies will find *foodservice* supply a small but rapidly growing niche - local producers will be the primary beneficiaries of this expansion.

‣ *Andes - major changes*

Consumers

- Buying power in the Andean countries should grow by almost 50% in real terms between 1998 and 2010, from $270 billion to about $400 billion. On a per capita basis, growth will be closer to 25%, though, and incomes will remain at the “low” end of the processed foods spectrum.
- Priority markets for processors should be Colombia and Peru, then Venezuela. The first two will offer the greatest opportunities because of their faster growth, young populations, and more open markets; Venezuela is a key market because of its higher income levels, but its competitive environment will be more conducive to well-established market players. Other markets are less relevant except for niche products in

the large cities, or for low-value added (and regionally produced) processed commodities (e.g., vegetable oils).

- Processed food opportunities in the smallest countries will be largely limited to the big cities.
- These countries will remain fairly young, although the working-age and retirement age population brackets are expected to increase substantially at the expense of children. The mix of retirement age/working age/children in the region will shift from approximately 10/56/34 to 12/59/29 through 2010.
- The Andean markets will not be hot prospects for mass standard "health" – positioned products, although niche health foods will likely find a receptive audience. And for these products, exporting to these markets will make more sense than local production.

Supply

- Given the strong likelihood of increased regional trade, the processors most likely to benefit are those which have the largest local markets and can potentially supply smaller nearby markets. Colombia, Peru, and Venezuela are best positioned in this regard, hence acquiring or establishing facilities in these countries will be the best way to supply the region.
- The single best location for higher value-added food processing will be Colombia, since it a) has the largest market in the region, b) can readily supply Ecuador and Venezuela, c) has a strong agricultural base, and d) is well positioned to import raw materials for processing.
- The smaller markets, by contrast, represent much poorer options for investment in facilities, except perhaps through acquisition and development of the best established local brands.

Distribution

- Food distribution costs are likely to remain high in the Andean region, at least over the medium term. It will be the hardest South American region to penetrate, and will have the weakest infrastructure. Reaching consumers will be much easier in the larger metropolitan areas, but these only cover a fraction of the region's population.
- Privatization is likely to lead to significant improvements in the infrastructure in Peru and Bolivia. On the other hand, Paraguay, Equador, and Venezuela are likely to lag behind.

Colombia's fortunes will largely be tied to the status of the internal political situation between the government and rebel groups.

- Manufacturers of low-priced items should consider ways to expand their presence into informal channels. Manufacturers of mass standard and higher priced goods, however, can focus on the growing organized, formal channels.
- As supermarkets expand, food manufacturers exporting niche foods to the region may have increased opportunities as many of these chains begin to import more directly themselves.
- Given the expansion of fast food chains throughout the larger Andean markets, opportunities to supply them on a regional basis should grow over time. Such arrangements must take local concerns into account.

Player types, opportunities, and implications

There are four basic player types in South America's food market today:

- Commodity specialist
- Domestic Branded player
- Transnational
- Global conglomerate.

These player types are generalizations; there are, of course, exceptions. Individual companies reviewing the report should consider their own special circumstances and relative positions within this framework. The next page illustrates the characteristics of these player types.

Food manufacturer player types in South America

Key player types	***Key characteristics***	***Examples of companies active in South America***
Commodity specialist	• Low value added products • Dominate processed commodity industry • Often regional in scope, particularly for highly perishable products such as meat and dairy	*Copersucar* (Braz., sugar) *Leite Paulista* (Braz., dairy) *Mavesa* (Ven., oils, spreads)
Domestic Branded	• Mass standard to premium products • Brands are well known on a regional or national scale • Often specialize in a single sector • Includes many medium-sized companies • Frequently family owned	*Garoto* (Braz., confectionery) *Arisco* (Braz. soups, condiments) *Sadia* (Braz., meats) *Arcor* (Arg., confectionery) *Industrias Alimenticias Noel* (Col., confectionery)
Transnational	• A foreign company which establishes production either through joint venture, acquisition or greenfield operation • Products tend to be at the upper end of standard and mass premium foods • Very strong, internationally known brands • Products often appropriately tailored to local tastes	*Nabisco* (USA) *Quaker* (USA) *Warner Lambert* (USA) *Parmalat* (Italy) *Bunge* (Argentina) *Danone* (France)
Global	• Well-financed company which has operations worldwide • Usually sets up local production in country through acquisition or joint venture • Company tends to be involved in numerous sectors	*Nestlé* (Switzerland) *Unilever* (UK-Holland) *Philip Morris* (USA)

There are five key bases on which food companies compete in South American markets. These are

- Access to finance
- Price
- New product development
- Brand strength
- Access to distribution.

Each player type has a different skill set when it comes to competition. These are shown in the following table (core strengths have dark shading, lesser strengths are shaded lightly). One can see that Globals on the whole have an edge, while Commodity Specialists have the weakest skill set and most precarious competitive position (i.e. one based primarily on low price positioning).

Competitive strengths by player type

Basis	***Commodity specialist***	***Domestic Branded***	***Transnational***	***Global***
Access to finance				
Price				
Product innovation				
Brand importance				
Access to distribution				

- Commodity Specialists' greatest strength is the ability to offer low cost products.
- Domestic Branded companies best understand the consumer and are able to develop effective brands.
- Transnationals have strengths in all areas, although not nearly as much as the Globals.
- Globals are strong all around, particularly with their access to finance and balanced portfolios with powerful brands, both of which give them excellent distribution access.

Over the decade ahead, we expect to see considerable changes: two new player types are likely to emerge, and player types will shift in size, shape and relative clout.

Commodity Specialists:

- A few Commodity Specialists will move up the food chain, seeking to add value to their products, and will become Domestic Branded players. Some of today's most dynamic Commodity Specialists are likely candidates for making this transition.
- Many other Commodity Specialists, unable to compete, will be squeezed from the market or acquired. Those that survive may expand from in-country regional coverage to national reach. The net result will be fewer significant players of this type in 10 years, and those that remain will be larger on average than they are today.

Domestic Branded:

- Domestic Branded players will increase in scale, with a number of them expanding from today's in-country regional stature to a national presence. The largest among them will become *Latin America Specialists* as they try to extend their influence elsewhere on the continent.
- As with Commodity Specialists, many smaller Domestic Branded companies will go out of business (if they cannot adapt to a more competitive environment). Others will be acquired as Transnational and Global companies seek to enter or expand.
- The collective share of market held by Domestic Branded companies in South America will increase, and the large will generally get larger.

Latin America Specialists:

- A new player type, the Latin America Specialist, will emerge as cross-border activity by individual Domestic Branded companies (and possibly some Commodity Specialists) expands in Latin America, primarily across the Argentina/Brazil/Chile and Colombia/Venezuela/Mexico market groups. Large, well-run Mexican companies can also be expected to enter/expand within South America to take advantage of growth opportunities and declining trade barriers.

Transnationals:

- Transnationals will retain their core characteristics in the market. In ten years, however, there are likely to be more of them, and they will be larger. Already, some of yesterday's Transnationals are heading towards global stature: Parmalat and Danone, for instance.
- As their numbers grow, however, they will be squeezed, and their share will shrink as they find themselves in tight competition between the powerful Globals and nimbler Latin America Specialist and Domestic Branded companies.

Global conglomerates:

- Globals, like Transnationals, will stay essentially the same.
- Overall, they will leverage their existing position, powerful portfolios and control over distribution to increase sales as the markets within South America grow.

Internationals:

- A second new player type is likely to emerge in South America over the next decade: Internationals, companies characterized by high value-added premium and niche products. As incomes grow on the continent, Internationals will begin to move in to capitalize on the rising demand for sophisticated, high-end products. International players are likely to set up a greenfield site in order to maintain total control over their products.
- By 2010 the South American market should have several Internationals producing food in-country (e.g., an active Ferrero Rocher, Häagen-Dazs, and probably a few others). Production for this player type will be concentrated in a single or perhaps two key countries, although its products will penetrate the whole region. Major markets such as Brazil and Argentina will be attractive production locations for Internationals.

The bases of competition in 2010 will remain similar to those today; however, the emphasis will change:

Shifts in the bases of competition

Basis of competition	***Facilitates....***	***Basis of competition 1999***	***Basis of competition 2010***
Finance	...production/logistics	• access to finance	• cost efficiency
Product cost	...selling and margin	• low price	• value for money
New products	...capitalizing on new opportunities	• new product development	• holistic innovation
Product and company identification	...consumer loyalty	• brands	• overall relationship with consumers/the trade
Distribution	...reaching consumers	• access to distribution (national)	• access to distribution (national/S. America)

With these new bases of competition, and the changes in player types, come shifting areas of competitive strength. In the future, we expect key and lesser relative strengths as follows (shaded in dark and light, respectively):

Competitive strengths by player type 2010

Basis	***Commodity specialist***	***Domestic Branded***	***Latin America Specialist***	***Transnational***	***Global***	***International***
Cost efficiency						
Value for money						
Holistic innovation						
Relationships						
Distribution						

In tomorrow's competitive environment, each player type will have its own key differentiators and imperatives:

Key differentiators and imperatives by player type 2010

Player type	***Key differentiator***	***Imperatives***
Commodity Specialist	• provide value	• keep up with the consumer • gain scale • efficiency/cost control
Domestic Branded	• brand strength/consumer knowledge • trade relations	• staying ahead of consumers • speed/flexibility • develop national scale+
Latin America Specialist	• Domestic Branded's skills plus scale/efficiency	• gaining consumer acceptance in new markets • seizing acquisition opportunities that can expand scale/presence • leverage distribution with complementary products
Transnational	• No unique competitive advantages vs. other players	• develop/leverage brands • marketing innovation
Global	• distribution • deep pockets • brands	• maintain current advantages • increase flexibility
International	• unique products • innovation	• ensure product integrity • create customer pull to expand distribution • build South American production when demand warrants