

Andres Cadena,  
Patricia Ellen,  
Jaime Morales,  
and Jaana Remes

# Can Latin America reignite growth by connecting with consumers?

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The region needs to build a more diversified and sustainable economic base, focusing on consumers as the pivotal driver of growth both globally and at home.

**With turmoil and recession** in Brazil and Venezuela in the headlines, the rest of the world too often assumes the news from Latin America is uniformly bad. But there are bright spots of momentum from Colombia to Mexico and Peru. Chile is maintaining modest but steady growth, while Argentina, enjoying renewed access to the world's capital markets, is beginning to stage a comeback.

These green shoots are good news, but the region needs a strategy with firm roots that can begin raising living standards for all citizens. To turn this start into sustainable growth, the region needs to take a hard look at the changing global economy and at its homegrown economic challenges.

A great deal of Latin America's momentum over the past decade was built on the world's seemingly limitless appetite for the region's commodities. Today it's a far different picture; not only have once-soaring commodity prices plummeted, but investment is also down across much of the world. China is the harbinger of change, as it attempts to shift to a model of slower but more sustainable growth driven by consumption, services, and innovation. In this new landscape, Latin America cannot afford simply to wait for the next commodities supercycle to restore growth.

The region needs to build a more diversified and sustainable economic base, focusing on consumers as the pivotal driver of growth both globally and at home. It is critical to know which segments will have the purchasing power and the inclination to spend, as well as where they are and what they want to buy.

This is the moment for Latin America to move up the value chain, shifting more of the emphasis from commodity exports to higher-value-added goods and, increasingly, to services. To reignite growth, the region will need to diversify and digitize—and to empower its own consuming class.

## **Who are the global consumers to watch?**

The consumers of the future are overwhelmingly urban. Recent research from the McKinsey Global Institute (MGI) projects that more than 90 percent of global consumption growth over the next 15 years will come from cities. This trend is extraordinarily concentrated: just 32 cities are likely to generate a quarter of the \$23 trillion in urban consumption growth projected through

2030. Two of them—Mexico City and São Paulo—are located in Latin America. In addition to these powerhouses, Buenos Aires, Lima, Santiago, Monterrey, and Bogotá rank among the 100 urban areas that will account for 45 percent of urban consumption growth worldwide.

Companies looking for growth opportunities need to combine a city-level perspective with a focus on the right demographic segments. MGI's research identified five groups as the biggest drivers of future global consumption growth (exhibit):

- **Seniors in advanced economies.** While many companies continue to chase the more glamorous youth market, aging consumers have genuine spending power that has not been appreciated fully. Their ranks are set to swell from 164 million in 2015 to 222 million in 2030. Healthcare is not their only priority; US seniors represent an important segment for the housing, transport, and entertainment industries.
- **China's working-age population.** Between now and 2030, China will add 100 million working-age adults, and their per capita consumption is expected to more than double. By 2030, this group will consist of those born and raised in postreform China—and these consumers are willing to save less and spend more.
- **North America's working-age population.** This is still a large and important market, with millennial consumers replacing retiring baby boomers, but it will be a more challenging one as income inequality deepens. Companies will need to address diverging market segments more effectively, offering attractive goods and services at different price points.
- **China's seniors.** China's aging population will be a testing ground for the types of senior services that emerge for large cohorts of elderly people outside developed economies.
- **Latin America's working-age population.** This medium-size cohort is expected to grow at a moderate rate, with regard to both numbers and incomes. These individuals are projected to contribute more than 5 percent to today's consumption and to projected consumption growth through 2030.

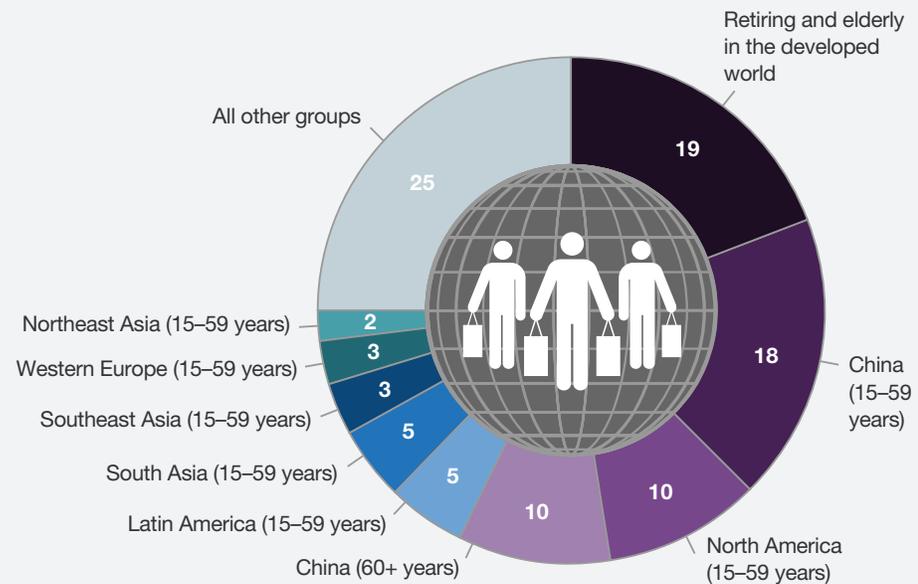
This list shows that Latin American companies have promising markets both abroad and at home. In China, consumers are rapidly developing higher-end and more specialized tastes; Latin American companies will need to move up the value chain along with them, offering more sophisticated goods and services. In North America, the growing senior market needs to be firmly on the radar—and so does the US Hispanic market, which is younger and now numbers more than 55 million strong.

Thanks to digitization, trade is opening up to new places and new players, not just the multinational companies from advanced economies that dominated in the past. Recent MGI research estimates that over the past decade, global flows of goods, services, finance, people, and data have raised world GDP by at least 10 percent, adding \$7.8 trillion in 2014 alone.

## Exhibit

### Nine groups of consumers are set to generate three-quarters of global urban consumption growth from 2015 to 2030.

Share of global urban consumption growth, 2015–30, %



McKinsey&Company | Source: McKinsey Global Institute

Remarkably, data flows accounted for \$2.8 trillion of this value, surpassing the impact of the global goods trade. Latin American companies can overcome constraints in their local markets by connecting digitally with global customers, suppliers, capital, and talent.

#### Empowering the Latin American consumer

Closer to home, the patterns are also changing. Although momentum once stemmed from population growth that simply expanded Latin America's consumer base, almost two-thirds of the region's consumption growth through 2030 will be driven by ramping up per capita spending. The limited income growth of the expanding middle class has been Latin America's greatest challenge, and addressing this issue will unlock its biggest untapped opportunity. The region has made great progress in lifting millions out of extreme poverty; the next step is ensuring that this population becomes a thriving middle class.

In Brazil, the Bolsa Família program cut the poverty rate nearly in half in the decade following its inception. But even this remarkable achievement was not enough to propel these aspiring consumers into real prosperity. Most households experienced only modest income growth

even before the recent recession, while inefficiencies and layers of taxes and tariffs pushed the prices of many consumer goods out of their reach. Mexico, too, has experienced decades of slow income growth. The gap between the modern industrial economy and the traditional economy, which accounts for most of the country's employment, has hampered the development of a strong middle class.

To harness the power of consumption, the public and private sectors will need to join forces in a major push to boost productivity and raise the incomes of those most likely to spend. Governments can set this process in motion by removing the regulatory, structural, and infrastructure barriers that constrain productivity growth, which in turn raises incomes and creates prosperity.<sup>1</sup> One of the strategies for achieving this could be establishing special economic zones with streamlined regulatory structures, exporting infrastructure, and the ability to attract foreign direct investment. Thousands of these zones have been established around the world, but there are relatively few in Latin America.<sup>2</sup>

### How Latin American companies can capitalize on the opportunity

The private sector does not have to wait for governments to act. Productivity ultimately rises or falls with the efforts of individual companies to integrate across regions, reduce costs, and offer more competitive products and prices. Some companies are already leading the way. Chilean retailer Falabella, for example, has gained scale by expanding into multiple store formats and geographic markets across the region, including a recently announced move into Mexico. Others are experimenting with innovative social business models. In Colombia, Empresa Públicas de Medellín is a state-owned utility run as a commercial enterprise by the city of Medellín. It has played an active role in the city's revitalization, contributing a portion of its revenue to city coffers and funding major infrastructure projects—in essence, helping to build its own customer base.<sup>3</sup>

Companies will need to assess how prepared they are to compete for the most diverse consumers in the region's history. This includes reviewing whether they have the right urban footprint and factoring in the growing importance of services. It will also require cultivating the analytics capabilities needed to understand purchasing behavior at a detailed level, then using those insights to tailor products and manage channels and brands targeting specific segments.

Until Latin America's middle class solidifies, companies will have to craft strategies for a highly stratified market. This involves delivering value for money across the board and improving productivity performance to compete on price. Companies need to avoid the mistake of targeting an average consumer when the real pockets of growth remain at the high and low ends of the market. Cinépolis, Mexico's largest chain of movie theaters, for example, concentrates on delivering a luxury entertainment experience to upscale customers.

As noted earlier, the region's working-age consumers (and especially the youth market) will be the prime drivers of growth. We project that annual spending among 30- to 44-year-olds will increase from \$671 billion today to almost \$1.1 trillion by 2030, while consumption among

<sup>1</sup> These issues are discussed in greater detail in the following McKinsey Global Institute Reports: "Brazil's path to inclusive growth," May 2014; "A tale of two Mexicos: Growth and prosperity in a two-speed economy," March 2014; and "Building globally competitive cities: The key to Latin American growth," August 2011, all available on McKinsey.com.

<sup>2</sup> Prosper, "Special economic zones: South America lags behind," blog post by Moises Rendon, Center for Strategic and International Studies, December 18, 2015, csisprosper.com.

<sup>3</sup> Ashoka, "The transformation of Medellín, and the surprising company behind it," *Forbes*, January 27, 2014, forbes.com; and Caroline Merin, Alex Nikolov, and Andrea Vidler, "Local government handbook: How to create an innovative city," Knowledge@Wharton, December 20, 2013, knowledge.wharton.upenn.edu.

45- to 59-year-olds will rise from \$519 billion to \$984 billion. Latin American retirees will also create a robust market for healthcare, housing, transport, and entertainment—in fact, purchasing by people over 75 alone is projected to increase by almost two and a half times over today’s levels. Consumption could post compound annual growth rates of 3 to 5 percent in the region’s biggest cities—Mexico City, São Paulo, Buenos Aires, Lima, and Santiago—through 2030. But it will be important to take a nuanced approach. While most of the region is relatively young, cities in Brazil, Chile, and Cuba will be graying by 2030. Rio de Janeiro’s demographic mix, for example, will resemble that of a Japanese city in the not-too-distant future.

Latin American companies can also create momentum by utilizing and building digital platforms and marketplaces. Smartphone adoption rose from 5 percent of connections in 2010 to 47 percent in 2015, and mobile networks now reach more than 90 percent of the region’s population.<sup>4</sup> Once they are online, Latin Americans are among the world’s most avid users of social networks—a development that gives companies effective ways to reach customers at scale.<sup>5</sup>

Finally, Latin America’s push to integrate more deeply into global markets should start with its neighbors. Connecting the vibrant cities scattered across this vast and diverse region can take many forms: building hard infrastructure, expanding intraregional trade of goods and services, establishing regional business partnerships, encouraging people flows, and linking digital networks. Asia’s close economic integration made it into a manufacturing powerhouse. Now Latin America, with its high-potential consumers, can do the same in a more digital era. □

**Andres Cadena** is a senior partner in McKinsey’s Bogotá office, where **Jaime Morales** is a partner; **Patricia Ellen** is a partner in the Rio de Janeiro office; **Jaana Remes** is a partner at the McKinsey Global Institute and is based in the San Francisco office.

<sup>4</sup> Barbara Arese Lucini and Akanksha Sharma, *Connected society: Digital inclusion in Latin America and the Caribbean*, GSMA, February 23, 2016, gsma.com.

<sup>5</sup> Jacob Poushter, “Smartphone ownership and Internet usage continues to climb in emerging economies,” Pew Research Center, February 22, 2016, pewglobal.org.