Latin America at last lifts its spirits

The fortunes of the Latin American duty free liquor market are naturally linked to the boom-and-bust economic cycles that have characterised this region. The economic woes of recent years, stemming from the Argentinean devaluation crisis, hit duty free liquor sales hard. But Latin America is in recovery, and prospects are brightening.

Key economic and travel indicators have turned for the better in all the major markets of Latin America, but long-term issues of consumer confidence remain.

Pernod Ricard co-managing director Richard Burrows says: "In Central and South America we had a tough year in 2002. Currencies were very volatile. The economies were in very difficult shape. That continued in 2003, but things have started to improve. We saw some growth coming in the second half of the year, particularly in Argentina and Venezuela, though Brazil was flat for us during the year."

"The whole of Latin America is a wait-and-see area," says Richard Ferne, duty free director Americas, Asia and the Middle East at Brown-Forman Beverages Worldwide. "You just get the impression that there is optimism, but nobody is going to go crazy and invest a lot of money yet. There are a couple of countries that look stable, but overall it is still very fragile."

Certainly the market in Argentina, the focus of the last regional crisis, is on the mend. InterBaires (see page 82) also reported a sharp rise in sales last year, up from US$38 million in 2002 to US$49 million in 2003. That was a mightily impressive result given the retailer's well-documented problems in 2002 and early 2003. Similarly London Supply sales rose strongly last year, buoyed by increasing numbers of Chilean travellers whose strong currency put them in spending mode.

The prospects for drinks marketers in the second half of 2003 improved sharply, as the Argentinean economy was resurfacing from its worst-ever recession. Industrial production increased +3.7% in November compared with the previous month, outstripping even the most

Table 1. Latin American duty free sales by category: 1997 vs 2002

Product	Volume 1997	Volume 2002	% share of market 1997	% share of market 2002
Scotch whisky	850	285	60.48	47.54
Flavoured spirits	130	95	9.16	15.67
Tequila	85	70	8.72	11.42
Rum/cane	125	60	7.25	9.67
Vodka	85	45	6.06	7.17
Brandy	100	35	5.95	6.26
Gin/genever	35	14	2.39	2.29
Others	Nil	Nil	Nil	Nil

All figures in thousands of nine-litre cases

Source: Global Drinks Record/International Wine and Spirit Record

Table 2. Top four Scotch whisky brands in Latin American duty free, and share of total liquor market: 1997 vs 2002

Brand	Volume 1997	Volume 2002	% share of market 1997	% share of market 2002
Johnnie Walker	250	110	16.11	15.04
Ballantine's	105	30	6.64	3.83
Chivas Regal	90	30	5.89	4.01
Grant's	70	25	4.71	2.98

All figures in thousands of nine-litre cases

Source: Global Drinks Record/International Wine and Spirit Record optimistic estimates. From bust to boom, Argentina is bouncing back. As Chandon Argentina vice-president marketing Paul Ashworth says: "We had a very good end to 2002, and sales in 2003 were great."

The recovery could not have come soon enough. Devaluation in 2001 had led to large retail price increases, which in turn led to declining volumes. Domestic Scotch consumption slumped from 226,000 nine-litre cases to 87,000 in 2002, and the fall in bottled-in-Scotland (BIS) Scotch shipments was even greater. Not all suppliers passed on the full extent of the devaluation, preferring to absorb the margin hit to maintain their volumes and share of the market. "It is clear that some brands financed the [margin] loss in order to keep market share," says Jorge Grispi, marketing manager of Fratelli Branca, distributor of the William Grant's Scotch whisky range.

Clearly the squeeze on margins in the domestic market has implications for duty free operators. Speaking at last year's ASUTIL (Asociación Sudamericana de Tiendas Libres) conference, held in Cancún, InterBaires CEO Enrique Urioste said: "The image crisis was the main damage to the business. Local prices became cheaper and this affected the sacred asset of duty free." In other words, the consumer price-saving proposition of duty free has been reduced. And duty free margins remain under pressure. Today the retailer is fighting back impressively to restore consumer confidence in that "sacred asset" with a big-budget 'Save, shopping with us' consumer communication campaign targeted at all travellers.

Talking spirits in Latin America

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"Because the prices are related to dollars... we are getting margins squeezed everywhere. Those European companies that haven't changed their prices have lost about -25% margin in the last 18 months. It is a massive problem."
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"In Mexico the outlook for duty free is excellent, thanks to the unfavourable tax reforms. There is now a real saving to be had on super-premium products."
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Brazilian bounceback

The drinks market in Brazil was hit hard by the poor economic conditions and a weak Real. Moreover economic problems in neighbouring countries, such as Argentina and Uruguay, led to a reduction in important beach tourism. With those economies on the mend, tourism is certain to rise.

There was an overstocking problem at Brazil's leading duty free operator Brasif last year. This necessitated a reduction in purchasing for a period while the company reduced its stocks.

Brasif is also increasingly focusing on other product categories and local 'destination' products. New laws introduced in Brazil in late 2002 have permitted locally-made products to be sold in duty free shops for the first time. The outlets now carry a number of local spirits brands, including the big volume cachaca brand Pirassununga 51. These are targeted at departing tourists wanting to take away mementoes of their visits.

Parallels from Paraguay have been hit by the crackdown from Brazilian authorities, but Uruguay fared better and the border towns of Chuy and Rivera largely maintained sales. In another development, many contrabandists are importing Scotch from other re-exporting hubs – such as Miami, Antwerp or Panama – rather than directly from the UK. Consequently Scotch Whisky Association figures for exports to Paraguay are understated (and significantly below *International Wine & Spirit Record*'s shipment figures).

The 1990s saw slow but steady growth in Paraguay, but by 2002 the economy was in serious trouble, partly because of the financial crisis in neighbouring Argentina. A crackdown by Brazilian authorities has resulted in a significant reduction in carry-back activity from Paraguay at the Friendship Bridge with Brazil in Ciudad del Este. In another challenge to operators, low prices in Argentina resulting from devaluation have boosted contraband to Brazil from Clorinda, an Argentinean city 40km away from the Paraguayan capital Asunción. Today the market is stabilising.

Uruguay is traditionally important for Scotch. Consumption there is still eight times larger than that in Argentina, despite a population eight times smaller. The market was hard hit by devaluation in June 2002, but unlike Ciudad del Este in Paraguay, trade with Brazil from the Uruguayan border town of Rivera continues to flourish.

Regional neighbour Chile has been an oasis of relative stability. It was one of the few regional drinks markets to post growth in 2002 and 2003. The stability and economic growth of Chile relative to its neighbours led some drinks companies to re-export spirits to Chile, initially destined for Argentina and Uruguay. With operators eager to reduce regional inventory levels, this led to an unusual increase in shipments to Chile and some fairly low prices. This, and the strong economy, fuelled significant sales volume increases.

Diageo was particularly competitive on price; Johnnie Walker Red, for instance, was selling for as little as US$10 during the crucial Christmas period. But unlike Peru, neither Allied Domecq nor Pernod Ricard entered into a price war with Diageo. Jorge Smith, marketing manager of Comercial FH Engel, which handles the William Grant's and Pernod Ricard portfolios in Chile, says: "Certain brands of Scotch whisky seem to be permanently on sale in the market."

The important duty free savings proposition has been reduced by changes to the excise structure. The excise rates on local and imported products were brought into alignment. Whisky and other imported spirits today pay excise duty of 27% (down from 72%).

Rum is today a real momentum category in Chile. Last year for the first time growth was not led only by the Bacardi brand, with its big Chilean operation, but also by a myriad of other brands from different Caribbean islands and Central America. "The rum category is showing some very healthy growth," says Smith, "but unfortunately most of that growth is coming from very low-priced brands." Another growing category is vodka.

Further north, the socio-political crisis and the general strikes in 2002 and 2003 caused chaos in all economic sectors in Venezuela, including the drinks market. Imports and purchasing power decreased dramatically.

The difficulties had begun as early as February 2002, when the decision was taken to float the local currency, the Bolivar. The move was precipitated by the Argentinean economic crisis and the ensuing regional instability. Import prices, and subsequently retail prices, escalated dramatically, forcing local operators to cut back on imports.

The imposition of currency controls in 2003 imposed big restrictions on the purchasing of US Dollars as a measure to counteract the devaluation of the Venezuelan Bolivar. This made it difficult for operators to restock their inventories; it also led to a big rise in the parallel market. However in December 2003 the government loosened these exchange controls.

Motta Internacional general manager Erasmo Orillac says: "The market went bad because of exchange controls. It affected the whole economy. We are going though some rough times, but slowly our sales have been stabilising." Earlier this year, though, the government devalued the Bolivar by a further 17%.

Venezuela has always been a big consumer of premium Scotch. For a period it was the largest 12yo Scotch market in the world. Chivas Regal, Johnnie Walker Black Label and Buchanan's 12yo dominate. However the currency devaluation hit the imported sector hard in Venezuela, as it did in Argentina. "When a currency devalues you have to increase the shelf price for imported brands," explains Pernod Ricard's Burrows. "And that hits sales. The slowdown in Venezuela was responsible for a -2% reduction on our organic growth rate in the Americas region."

In Colombia, the reduction in excise on liquor at the beginning of 2004 should theoretically damage duty free by reducing the differential between the domestic market and duty free. But in practice it could benefit duty free if it serves to reduce the enormous levels of contraband in the market, which was the government's chief reason for the reduction.

Motta's Orillac says: "It has been a positive development that should strengthen the market. On liquor there is still around a 25% differential between duty free and domestic pricing." He also points out that the pricing comparisons between duty free and the domestic market are less important because there is no arrivals shopping in Bogotá.

Mexico is perhaps the most improved market. Both Dufry and Aeroboutiques, the incumbent operators at the country's airports, have dramatically upgraded the quality of

Table 3. Latin American duty free Scotch whisky by quality: 1997 vs 2002

Quality	Share 1997 (%)	Share 2002 (%)
Ultra premium	1	1
Super premium	2	2
Premium	40	40
Standard	56	55
Low price	1	2
Total	**100**	**100**

Source: Global Drinks Record/International Wine and Spirit Record

duty free retailing in Mexico. Camus regional director Philippe Jamme says: "The business in Mexico is really improving with Aeroboutiques and Weitnauer (Dufry). They have focused more on the brands. They have also refurbished their shops in Mexico City."

Liquor sales in Mexican duty free are expected to benefit from booming tourism to Mexico. Mexico expects an additional two million foreign visitors in 2004, a rise of +11%, according to the Mexican Secretariat of Tourism. The weakness of the Dollar is leading many Americans to holiday in Mexico, where the currency is Dollar denominated, and thus relatively cheaper than Europe.

Mexico has gone from a flat tax by volume basis to a percentage tax based on value. "With the new tax regulations Mexico has killed off all the premium products in favour of less expensive drinks. The government has encouraged Mexicans to trade down from quality premium products to lower-quality products," says Destileria Porfidio CEO Martin Grassl. "In Mexico the outlook for duty free is excellent, thanks to the tax reforms. There is now a real saving to be had on super-premium products."

Tequila has made strong recent gains at the expense of local brandy and Scotch, but price increases due to the agave shortages have hit volumes. As a result, Flor de Cana area manager Gustavo Valdor believes that rum could be well positioned to make strong gains in coming years. "We are growing at a rate of about +20% per annum, and should see some very good numbers in the next couple of years. The rum business in Mexico had a big drop a couple of years ago, but it is bouncing back strongly."

Porfidio's Grassl says: "Mexico has always been a major rum-consuming country, as has most of Central America. I believe rum will be expanding in Mexico over the next couple of years at, the expense of tequila." He believes that tequila is at a big competitive disadvantage compared to other spirits. "Mexico's tequila market is beginning to decline because it is considerably more expensive than imported vodkas, brandies and whiskies. This is because blue agave (the raw material used for tequila production) needs eight to ten years to reach maturity. On the other hand the raw materials used for rum, whisky, vodka and brandy production can be harvested every year. The raw material is also a lot cheaper."

Tequila could be further disadvantaged by a proposed Mexican regulation to stop bulk shipment and require that the spirit be bottled at source. "If the present Mexican laws go through, then much of the market share will be lost to rum," says Grassl.

But Scotch remains the prestige spirit in the region. Orillac says: "It is still a Scotch whisky market, mostly premium Scotch. We see an emerging trend with the new super premium vodkas like Grey Goose and Belvedere. They are attracting some consumers. But it is still largely a Scotch market. Some whisky drinkers are migrating toward the 18yo category with Chivas 18yo, Buchanan's 18yo and Johnnie Walker Gold all doing well."

Allied Domecq has been particularly successful, through its partnership with Dufry, in creating branded destination areas selling duty free exclusive brands, such as Kahlúa and Sauza. Aeroboutiques is also focusing more and more on destination liquor. Says one supplier who prefers to remain anonymous: "70–80% of purchases for foreigners will be good local liquors, particularly if they are brands that they are at ease with. So it makes sense for operators to focus on destination products."

Despite improvements in Mexico, there is still room for progress in the standard of duty free retailing in Latin America. Pernod Ricard Central and South America sales and marketing director Laurent Schun says: "There has not been much change overall [in the standard of retailing in Latin America]. One factor to bear in mind when dealing with some of the larger international retailers is that promotional activity is often decided outside the region, which means greater co-ordination is required."

However Scotch and other European spirits could be undermined by the weakness of the Dollar against the Euro and Sterling, which is making European products more expensive in the region. Jamme of Camus says: "It is a big issue in Latin America because the prices are related to Dollars. So we are getting margins squeezed everywhere. Those European companies that haven't changed their prices have lost about -25% margin in the last 18 months. So it is a massive problem." ■