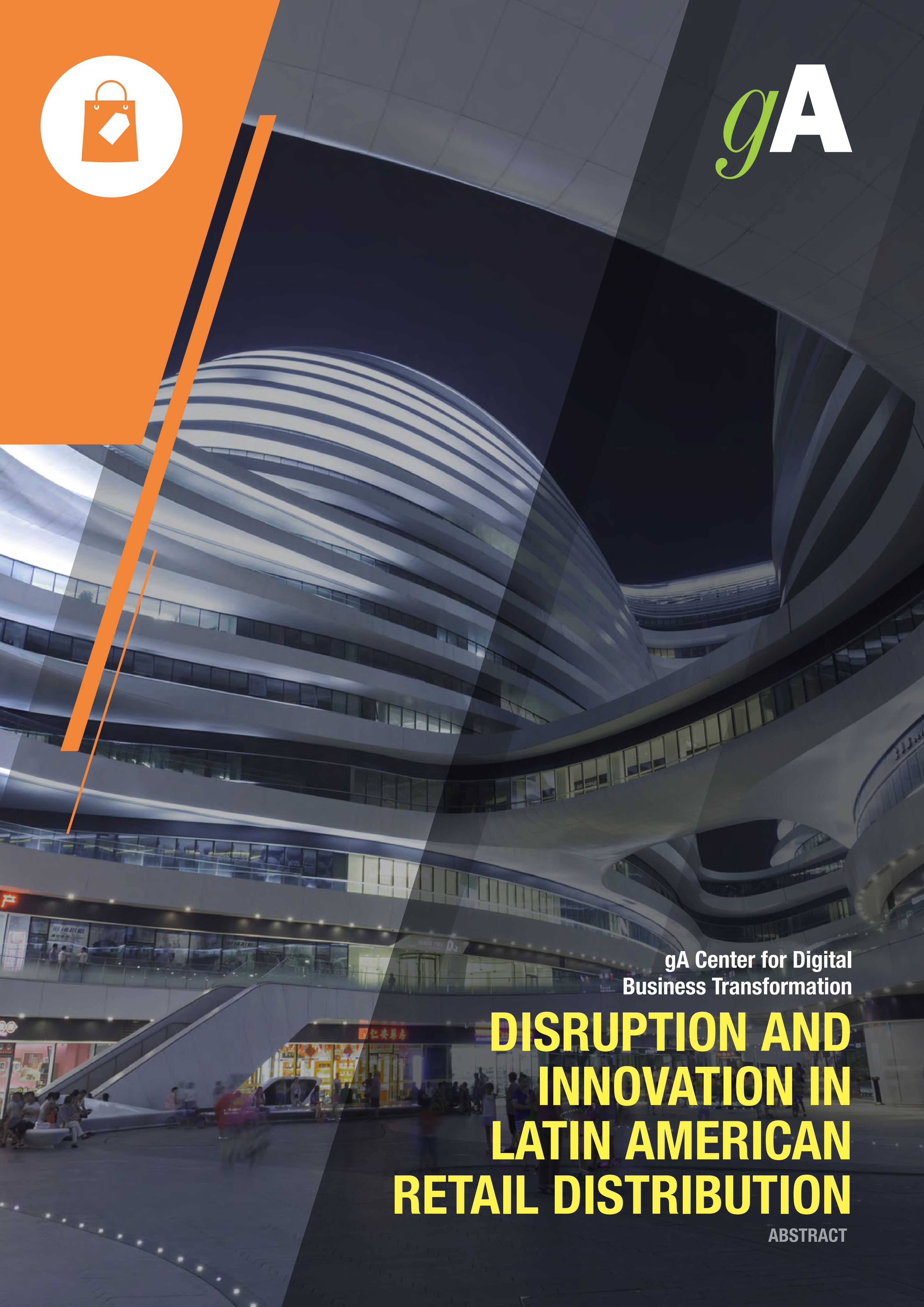

gA Center for Digital Business Transformation

DISRUPTION AND INNOVATION IN LATIN AMERICAN RETAIL DISTRIBUTION

ABSTRACT

"Disruption and Innovation in Latin American Retail Distribution", the first industry-specific report on digital transformation in vertical markets, issued by the gA Center for Digital Business Transformation. It focuses on the Latin American retail distribution industry, analyzing how this sector might evolve as the second wave of digital transformation hits the region, based on the experience of lead markets in tackling digital transformation challenges.

The 27- page study presents the results of the analysis of national industrial census conducted by governments of the region combined with finding from industry surveys. Within this context, the report evaluates how disruptive changes in retailing occur over time in developed countries, and how what has happened in developed countries, including the United States, can be predictive for Latin America.

Key Findings

Taking an historical perspective of retail, the report shows how retail distribution regularly undergoes changes in format, with new formats replacing existing ones. Driving these shifts are factors that impact distribution of goods and the formation of specialized and "generic" channels. These include transfigurations in socio-demographics (rise of the middle class and industrialization); shifts in spatial geography (urbanization and development of suburbs), and deployment of infrastructure (railways, highways, the internet). The report notes that while the format replacement cycles are consistent, the emergence of a new format into the marketplace does not necessarily eliminate the old or existing format. The new format challenges the old by redefining customer expectations. To meet the challenge, prior (or legacy) retail channels need to adapt in order to survive. Those that adapt thrive. Those that do not, disappear.

Tracing the trajectory of e-commerce, a new format driven by the rise of the Internet, the report highlights the bankruptcy of 18 U.S.-based retailers, including Toys R Us, The Limited and Radio Shack. All declared bankruptcy in 2017 when they failed to transition successfully to the new online format. Format transitions create big economic value for innovators, resulting in new players, fast repositioning by those willing to adapt, and rapid failure by those who do not adapt. Examining "why" so many U.S. retailers failed, the report lists breakthrough technologies such as RFID; lack of technology skills and structural barriers such as analogue metrics and the tendency to apply old financial metrics rather than using new models for ROI.

The same format evolution was observed in Latin America driven by different factors than in the U.S. and happening within a more compressed time frame. As the second wave of internet retailing advanced throughout the developed world, e-commerce began taking hold in Latin America as a result of three drivers of retail format change: the emergence of the middle class, a rise in urbanization and the development of broadband internet reaching critical mass in the region. While e-commerce as a percentage of total retail in the region has increased from 0.57% in 2004 to 3.32% in 2016, several hurdles remain in the region's path to e-commerce growth. These include a large underbanked population, lack of efficiency in fulfillment and logistics infrastructure. Taking a global view, even the largest e-commerce countries in Latin America (Argentina, Brazil and Chile) represent a minor share of retail flows compared to the developed world and China.

After establishing that social media and rise of mobile Internet access across Latin America are helping to accelerate format disruption on the demand side, the report looks at the supply side, showing concurrent dynamics that include:

- Emergence of local pure play internet retailers
- Response of local "brick and mortar" players
- Expansion of global internet retailers
- Fragmentation and reintegration of the value chain

Even as the second wave of digital transformation advances in the region, the retail sector lags behind other sectors. Conclusions drawn from the aggregate view of the first wave of digital transformation of Latin America's retail sector paint a picture of a sector still in the process of development, with high adoption of infrastructure but lower digitalization for production processes. The industry is changing, but at a slow pace, and is lagging behind other economic sectors in terms of capital accumulation and adoption of information technology. However, when plans to adopt second wave technologies are factored in, the relative position of retail changes.

To conclude, considering the two waves of digital transformation (first, comprised of adoption of computers, broadband, mobile telecommunications, and the Internet), and second (entailing cloud computing, robotics, IoT, and Artificial Intelligence), the Latin American retail sector depicts a relatively low level of performance in the first wave, and highly embryonic advance for the second wave. The retail sector registers a lower first level digital transformation of the supply chain and operations. The only area where the retail sector appears to be slightly ahead of other economic sectors is distribution.

Moving to the second wave of digital transformation, the Latin American retail sector presents a lower level of technology adoption in every technology, with the exception of robotic systems. While the sector recognizes the high potential of robotics in areas such as warehouse automation, it still lags even in its intention to incorporate big/data and artificial intelligence. The analysis of the second wave digital transformation index among retailers confirms what has been already reviewed in gA's prior research: large retail companies lead the rest of the economy in terms of technology purchasing, but the whole sector indicates a limited assimilation in production processes.

The lessons learned in developed economies are useful in terms of predicting the sector's future evolution. The disruption prevalent at the "tip of the iceberg" will continue permeating down, resulting in a number of exits of those companies that will not be able to adapt to the new business models. This wave, enabled by the low level of sector formalization, will result in more consolidations and exits.

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