MÉXICAN RETAIL TRENDS[1]

By

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México has captured the concentrated attention of the U.S. retail industry during the past years. While the Méxican economy has slowed somewhat in response to the U.S. economy and the world-wide recession, population in Mexico continues to grow at an impressive rate. According to *Banco de México*, during the past five years the retail industry has grown at an average annual rate of 3.29 percent, outperforming the economy which had an average growth of 3.0 percent.

Currently, favorable demographic characteristics and economic indicators prevail. México's population of approximately 85 million persons is projected to grow at an annual rate of 1.84 percent. However, the percentage of the population that live in rural areas is still high compared to that of other developed countries. As an example, the distribution of population is 75 percent urban versus 25 percent rural in the U.S., 78 percent urban and 22 percent rural in Canada and 85 percent urban and 15 percent rural in Germany. According to *I.N.E.G.I.* in 1990 México's population distribution was approximately 69.5 percent urban and 29.5 percent rural. The real population growth combined with the immigration of people from rural to urban areas accounts for the four to six percent annual population growth in selected municipalities within the México City metropolitan area. The development and expansion of urban areas will favor the retail sector due to a more concentrated population.

As a result of the strong population growth rate, (approximately 50 percent of the population are under 20 years of age) new family formations will continue to grow at a rapid rate. Additionally, Mexico has a relatively inexpensive work force of over 34 million persons, with a low unemployment rate of under 3 percent. Fringe benefits required by law, however, are often equivalent to base wages.

While retailers in Mexico generally focus on either the middle upper or upper income markets, it appears that with the expanding economy, there is an emerging middle class. Growth in industry and retailing is expected to increase the demand for middle and lower management. This is expected to expand the middle class, resulting in an even greater impact upon retailing.

Since former President Carlos Salinas de Gorti took office in 1988, government policies have been instrumental in making positive economic improvements in Mexico. These include the privatization of many industries, the elimination of previous trade barriers with other countries, the liberalization of its investment regulations to encourage foreign investment, as well as the recently approved North American Free Trade Agreement (NAFTA). NAFTA, now ratified by the governing bodies of Mexico, the United States and Canada has formed the world's largest free trade market, over 360 million consumers strong and is expected to further the foreign investment in Mexico. The new president is expected to continue the policies of his predecessor. Thus, as the U.S. economy continues to improve, the Mexican economy will also recover and expand.

Retailing represents approximately 23 percent of GDP, making it the largest sector in the Mexican economy. Furthermore, retailing employees over 2,500,000 persons, or about 10 percent of the workforce. Between 1980 and 1992, the number of retail establishments grew from 568,830 to 946,630, or 66.4 percent. Over 94 percent employ less than five people.

México's inflation rate has plummeted from a peak of 159 percent in 1987 to approximately 11 percent in 1993, according to Strategic Planning 93, prepared by the *American Chamber of Commerce of Mexico*. As a result of the stabilization program, deregulation and trade liberalization, *Bank of Mexico* estimates inflation to be seven percent for mid-1994 and declining below five percent for the rest of the decade. In contrast, the United States had an estimated 1993 inflation rate of between 3.2 and 3.4 percent, while Canada's inflation rate ranged between an estimated 2.2 to 2.4 percent. It is expected that continuing government actions will further reduce inflation.

In 1990, the prime rate in Mexico was 36.8 percent. In 1993, the prime rate fell to approximately 28 percent. The much higher interest rate in México is a reflection of inflation related to risk and the lack of available capital.

The attraction to México by U.S. developers and retailers is further enhanced by its state of underdevelopment. The majority of major shopping center development has occurred in or near México City, Guadalajara and Monterrey, due to the country's limited infrastructure. Former government policies of protectionism, coupled with inefficiencies, also stifled development.

While México is quickly attracting U.S. retailers, there are some differences in shopping development.

- Development in México is different than in the U.S. Most of the centers have been developed by their major anchor-department stores and supermarkets. In the past, the exterior of the development was built and segments were sold as condominiums in a piece meal fashion. The interior was built-out as tenants became interested in the various spaces available. Spaces not sold remain unfinished. Real estate development practices required "key money" to be paid to obtain the desired location in the center. Renters, also paid key money, along with a fixed monthly rental rate with annual adjustments for inflation, usually every six months. The amount of key money required is determined by the demand for the space.

- Land costs tend to be quite high in the heart of México's metropolitan areas, typically because these parcels are well located, with good infrastructure and access. Additionally, often a few landowners control large tracts of land, and lease the land rather than sell it. Therefore, there are limited comparable sales to determine the market value, and little incentive for the landowners to sell. Finally, there are a limited number of parcels that offer the infrastructure, access and cost constraints sought by regional mall developers.

- Melaniphy & Associates, Inc. has conducted extensive field research, and has compiled socio-economic data over the last 25 years, in order to overcome the relative scarcity of household and expenditure data in México.

- It is beneficial to have Méxican nationals play a role in major deals. In many cases, who you have on your side has a significant impact on whether or not a development will take place. Joint ventures, however, do serve to spread the inherent risk and provide invaluable access to local knowledge and market perception.

- Sales per square foot of major Méxican retailers is much higher than comparable U.S. retailers.

- The first years rent is usually prepaid and rents are adjusted for inflation at least every six months. Common area charges and also adjusted for inflation. U.S. retailers will not agree to prepaid rent.

- Retailers pay Key Money for the privilege of occupying a retail store space. Key money usually ranges from $800 to $1,200 per square meter.