



CUBA RISING

Cruise ships and planes are visiting the island nation. Is retail next? **by SANDY SMITH**

Boston Consulting Group partner **Marguerite Fitzgerald** has made multiple trips to Cuba over the last few years.

With thousands of 1950s vehicles and crumbling architecture, it might seem that the country is trapped in a time warp, but Fitzgerald sees change.

“When you go there, you see that things are visibly changing,” she says. “When I first went there three years ago, it was impossible to get Internet. Now they have hotspots everywhere and everybody is sitting there with smart-phones. That has had an impact on things like fashion and consumption of popular media.”

The Internet is only one aspect of Cuba’s opening up to the outside world, especially since the United States has moved in the past two years to improve relations with the island nation 90 miles off the coast of Florida.

President Obama and Cuban President Raul Castro announced a “new course” at the end of 2014 intended to end the United States’ economic embargo in place since the height of the Cold War. Mutual embassies reopened in Havana and Washington in 2015, Obama visited Havana this past March and the first flights from the United States to Cuba took off in September. Cruise ships are visiting and

American hotel chains have arrived, managing existing hotels while promising to build new ones.

Is retail the next step for Cuba?

National Retail Federation chairman Kip Tindell, joined by former NRF Chairman Steve Sadove, NRF President and CEO Matthew Shay and others, led U.S. retailers on a fact-finding trip to Cuba in November 2015.

“Where there are consumers, I always see the possibilities for retailers,” says Tindell, founder and chairman of The Container Store. “I do believe that great possibilities can be created and will exist in Cuba, in time, but so do great hurdles.”

HOW BUSINESS GETS DONE

Perhaps one of the greatest hurdles is in how business is currently conducted in Cuba. Most products are sold through government stores, and no marketing or advertising is allowed beyond in-store displays.

In a 2015 report, PricewaterhouseCoopers said “the potential for retail investment is substantial but dependent on government reforms.” Cuba’s three leading retail chains are state-owned and hold the monopoly for selling foreign products because of a 2014



law banning self-employed Cubans and small private enterprises from re-selling imported goods.

Cuban consumers can also purchase from ration-book stores — government-subsidized locations selling staples such as rice, beans and oil. Street vendors and home-based shops make up a small portion of the Cuban retail sector.

Fitzgerald anticipates that opportunities may emerge first for consumer goods companies, a number of which are already distributing there, including U.S.-based Cargill and Tyson Foods and Swiss company Nestlé.

“There are still a lot of things that are slow to change,” she says. “Retail is going to be one of them. It is still centrally controlled and from everything that we’ve heard, there isn’t a desire from the Cuban government to change that in a big way. They’ve been changing it on the margins, allowing small businesses and entrepreneurs to go into that direct-to-consumer [selling]. In terms of big retailers, I generally think the opportunities are limited.”

Retailers must understand that the embargo remains and will require action by Congress to remove. And that’s not the only caution.

“It’s much too early,” says Sadove, the former chairman of Saks Inc. who now runs a consulting and investment firm. “The supply chain needs major changes and the role of government is still evolving, especially in the tourist sector.”

INFRASTRUCTURE CHALLENGES

Even if geopolitical hurdles are resolved, issues remain.

“The logistics for running a retail operation in Cuba appear challenging for any number of reasons, but infrastructure improvement is definitely at the top of the list,” Tindell says.

“On the positive side, if you look at the small mom-and-pop stores, which are what the retailers are, they do have a lot of retail infrastructure like refrigerated displays and electricity,” Fitzgerald says.

She recently took a group of consumer goods manufacturers to Cuba who were experienced in developing markets. “They were pleasantly surprised by how good the in-store experience is. The biggest issue is getting goods to the island and around the island. You don’t have a lot of options in terms of ports.”

The main port, Mariel, has one road in and one road out, which can get clogged, she says. Roads are in generally poor condition and there are not a lot of refrigerated trucks and transports.

“When we were there, the port road had closed down,” she says. “There were fresh goods on the dock that were spoiling because they couldn’t be transported out. It will take investment by the government to overcome this.”

THE CUBAN CONSUMER

Retailers must also consider the Cuban consumer. Fitzgerald recently published a

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The Container Store

three-part white paper series on Cuban opportunities. One explores the Cuban consumer, a difficult task since official statistics are hard to come by. “There’s a large informal economy in Cuba,” she says, “with the money and goods coming from remittances sent from the U.S. to family and friends in Cuba.”

The Council on Foreign Relations put the tally on remittances at \$1.4 billion in 2015; for comparison, the country’s entire economy is estimated to be \$80 billion.

TOURISM: THE FIRST TOE

While issues remain with opening Cuba to foreign retail, the tourism industry is moving full speed ahead.

Boston Consulting Group’s research shows that “demand is great,” says Marguerite Fitzgerald, BCG partner and author of a three-part research series on Cuba. “I was really surprised by how many people, who we’d consider part of the target market, are actually interested in traveling to Cuba in the relative short term, in the next two to

three years. There is demand.”

BCG’s research anticipates that within the next decade, a million Americans will visit Cuba each year. “You’re not starting from scratch,” she says. “You have about 300,000 traveling there now. While Cuba is still a bit of the unknown, people want to travel

there before the Americans get in and things change.”

But they likely will find a disconnect. “They will expect to find a lot of the things that you’d find in resorts that you might get in the Dominican Republic or Mexico,” Fitzgerald says.

“It doesn’t really exist. Even the fantastic hotels in Varadero don’t feel like the fantastic hotels you get in the Caribbean. It’s going to take a while to meet the demand and a while for the level of quality and service to meet the expectations of the American traveler.”

“There is a small but growing segment of the population ... who have more disposable income than the rest of the population,” she says. “They also still have access to the heavily subsidized goods and services provided by the government.”

Even so, they “are still spending it on basics,” Fitzgerald says. “If you go into these stores where you use your ration books, you

have a choice of rice, oil, beans and not a lot else. If you want to buy something [besides] that, you have to rely on your own income.”

The PwC report says purchasing power will “expand noticeably as the economy moves away from its socialist base. Private-sector employment is set to gradually increase, and growing levels of remittances, thanks to improving relations with the U.S., should further raise demand for consumer goods, many of which are undersupplied and in insufficient variety.”

Some brands already have strong levels of recognition: Adidas is the highest-ranked apparel company, with 55 percent of Cuban consumers recognizing the brand. Former President Fidel Castro, who established the Communist state in a 1959 overthrow and held on to power until he handed the reins over to his brother in 2008, frequently appeared in public wearing an Adidas track suit.

“As Cubans get more exposure to the outside world, there will definitely be more brand awareness,” Fitzgerald says. “It’s going to be in these aspirational categories around fashion and electronics where you’re already seeing brand awareness.”

Blu, a U.S.-based smartphone manufacturer with high brand awareness in the country, does not directly distribute in Cuba, but “they’ve managed to build awareness on the island,” she says.

Asian brands like Haier and Samsung join European brands like Lacoste and Nokia as being somewhat entrenched. “Europeans and Asians are already there and doing business,” Fitzgerald says. “They have for many years invested in their brand in an environment that really doesn’t have marketing like we know it in the Western world.”

As relations thaw with the United States, it has opened up other opportunities for non-U.S. companies. It “has taken some of the fear out of doing business with Cuba,” Fitzgerald says. “There was always a risk when Cuba was on the state sponsor of terrorism list that the U.S. would not do business with a company that was doing business in Cuba. That threat has gone away.”

Sadove believes European retailers have a bit of a head start as Cuba continues to open up. “You do see some European retailers there, some of the designer brands,” he says. “You will see boutiques of upper-middle-tier brands



that are European-based. You're just starting to see the explosion of cruise ships.

"You've got to have things that will be catering to the masses of tourists that will come in," he says. "If you are a retailer linking in with tourism, that's where you will see the opportunities."

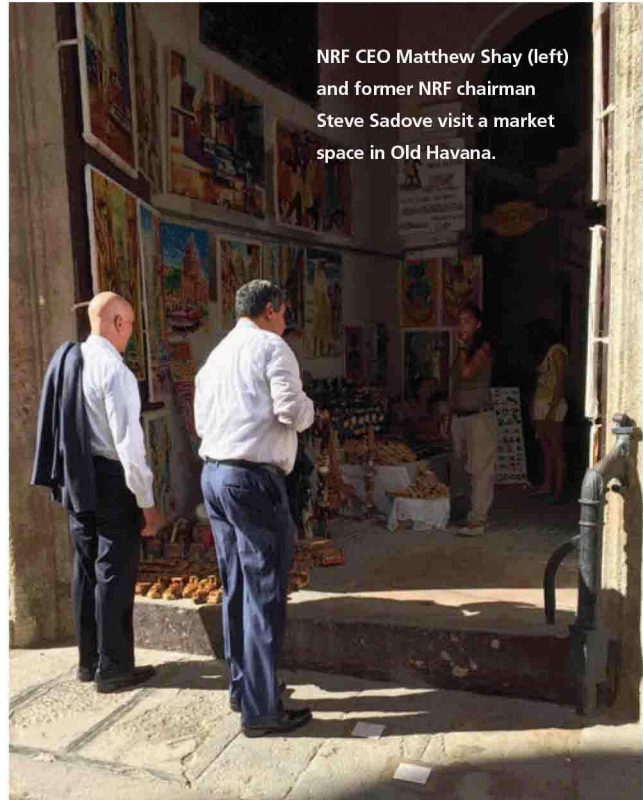
INTO THE UNKNOWN

The Castro brothers have run Cuba for nearly 60 years. Raul Castro has promised to step down in 2018; the presumed successor, First Vice President Miguel Díaz-Canal, has kept a low profile and many of his policy preferences aren't known, according to PwC.

Political leadership aside, Cuba offers a steep learning curve for retailers.

"In some ways it's an upside-down economy," Sadove says.

"Doctors and lawyers are making very little while cab drivers and entrepreneurs are making a lot of money. The



NRF CEO Matthew Shay (left) and former NRF chairman Steve Sadove visit a market space in Old Havana.

Brand Awareness Rising for Non-Basic Goods

As Cuba becomes more connected to the outside world, a number of products are increasing in brand recognition.

<i>Electronics</i>	<i>Apparel</i>	<i>Mobile Phones</i>
Haier – 57%	Adidas – 55%	Alcatel – 47%
LG – 44%	Nike – 32%	Samsung – 41%
Sony – 27%	Puma – 25%	Nokia – 36%
Daytron – 20%	Lacoste – 13%	Blu – 28%
Panasonic – 11%	Zara – 13%	LG – 27%

Source: Boston Consulting Group

opportunity for this to be a vibrant economy as capitalism spreads, as the markets open ... reminds me of China 25-30 years ago. Much of the economy was state-controlled, and you were just able to see the budding of capitalism. It's where Vietnam was early on. It has the potential to explode like those did."

Tindell anticipates that agriculture is "probably going to be the first to see the benefit, on both sides, with the lifting of the embargo.

And I also see great opportunity for food-oriented retail. That could actually be the biggest opportunity of the generation, but it's still a ways off."

"I would tell retailers to watch it closely," Sadove says. "If you have products that are in those areas that are where the spending is going to be taking place, [Havana is] going to potentially be one of the great tourist destination cities in that region of the world. It's only 90 miles from Florida with beautiful beaches. The architecture is phenomenal."

Tindell suggests retailers visit, and not just for the scenery. "Have the conversations. Take your team. Listen, learn and then understand the challenges, opportunities and resources it will take in order to enter this market. This is a long-term proposition, but the day will come ... just not sooner as opposed to later. But I am optimistic about the potential for Cubans to enjoy the benefit of a robust retail industry that will create jobs, lift the economy and provide opportunity for all Cuban citizens." **STORES**

Sandy Smith grew up working in her family's grocery store, where the only handheld was a pricemarker with labels.